

# THE ROAD TO GROWTH

A MEDIUM-TERM  
REFORM STRATEGY  
FOR PORTUGAL



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## A MEDIUM-TERM REFORM STRATEGY FOR PORTUGAL





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# PREFACE

# БЕЛЕВЦЕ

With this document the Government presents its ongoing reforms towards sustainable growth and its commitments towards sound public accounts.

We embrace our ambitious medium-term strategy with confidence and credibility. Facing many hardships and showing great determination, Portugal was able to surpass one of the toughest crises in recent memory.

We have successfully completed a demanding adjustment programme, correcting long-standing imbalances and reforming our economy, though much remains to be done. And we did it against strong headwinds from the global economy and financial markets.

Tough times pass, but tough countries last. Portugal persevered.

The path has been far from painless. When we started this process, our economy was marked by a number of weaknesses that placed our public debt in a path towards unsustainability. And the strict conditions imposed by official funding led to a difficult but necessary adjustment in order to regain full market access.

The Portuguese people have experienced numerous sacrifices and fully deserve a more prosperous and stable future.

This creates a solemn duty for this and future Governments: to do all that is in our power to ensure that history does not repeat itself. We need to make sure that future generations are spared from the recurring pattern of postponed reforms and debt accumulation, which then lead to adjustments under duress.

And we should strive towards an equitable, balanced and dynamic economy, with sustainable job creation, with excellence and innovation at its core, matched by a true safety net in the form of a fair and efficient welfare state.

The institutional and economic reforms carried out in the last three years are breaking this vicious cycle and creating a more equitable economy.

We are a different country today – we have stronger institutions, our economy is more competitive and our public sector is more sustainable.

Still, much remains to be done. Reform is a constant task; fiscal discipline a daily responsibility.

And we have new ideas on which to build a more prosperous future.

Portugal's integration in Europe has been for many years a success story of rapid growth and rising welfare. However, in recent times this trend was interrupted by a decade of economic stagnation. Nevertheless, after a severe crisis and a tough adjustment, Portugal is finally back to growth.

The challenge today is to ensure that this new phase of growth rests on stronger and more sustainable foundations that safeguard all the hard work and progress achieved by the Portuguese people. The work already carried out and the ongoing reforms give us the confidence that this is being achieved.

In this document we present our ambitious roadmap for growth, inviting everyone to contribute and engage with its goals.

Pedro Passos Coelho  
*Prime Minister of Portugal*

# INTRODUCTION

Portugal exited the EU/IMF adjustment programme on May 17 2014. During these last three years, much was achieved through the effort and determination of the Portuguese people. But there is still work to be done.

Under the commitments of the single currency, Portugal has to continue a process of budgetary consolidation and reduce its public debt. And though Portugal is back to growth, it is necessary to maintain the current strong reform momentum in order to sustain the recovery and boost competitiveness.

In this document the Government lays out its main commitments and the reform strategy going forward. It complements the recently presented Fiscal Strategy Document, the roadmap for the reform of the public sector (*A Better State*), and the government platform.

The document is organized in the following manner: the first section discusses what was done in the last three years to correct imbalances in the Portuguese economy, and thus build a stronger foundation for growth.

Sections two, three and four outline the reform agenda for the coming years, which will be anchored in three policy areas: 1) reforms to boost competitiveness; 2) reforms to promote employment creation and human capital; 3) reforms to streamline the public sector.

The fifth section will recap the main policy actions envisaged for the coming months and the sixth and final section will summarize the ongoing fiscal commitments.

**BUILDING STRONG  
FOUNDATIONS  
FOR GROWTH**

FOR GROWTH

FOUNDATIONS

BUILDING STRONG

## RUN-UP TO THE CRISIS

Portugal is a success story of European Integration. Within the European Free Trade Association (1960) and then the European Union (1986), Portugal underwent an extraordinarily fast process of economic convergence with the core of Europe. With it came rising levels of prosperity and social welfare.

More recently, the successful adoption of the Euro was a major collective achievement of the Portuguese people and its institutions and a major positive step towards its future.

But like other countries, Portugal had some difficulties adapting to the new reality, as shown by a widespread misallocation of capital and the accumulation of several macroeconomic imbalances. The result was a “lost decade” of economic stagnation.

The Portuguese economy and its institutions had little time to adapt to the abrupt fall in the interest rate after joining the Euro. High levels of expenditure and a weak regulatory environment meant that the influx of capital was allocated mostly to protected non-tradable sectors with low return for society. This happened directly, through excessive public expenditure or indirectly, through regulatory failures. Since

2000, public expenditure grew consistently above GDP growth.

With low interest rates and often-irresponsible policies, public and private debt increased rapidly and approached unsustainable levels. Several years of twin deficits (in the public accounts and current account) and problems of competitiveness weakened Portugal’s financial standing. More importantly, these high levels of debt masked longstanding weaknesses in the economy and removed incentives for much needed economic reforms.

Low interest rates also led to an excessive channelling of debt to household consumption and imports and thus to the already mentioned deep imbalance in the current account.

The European debt crisis accelerated the inevitable encounter with economic reality. In May 2011 Portugal signed up an adjustment programme, which required the correction of macro imbalances and was regarded as an opportunity to implement much needed reforms.

After four decades of fast economic growth and one decade of economic stagnation, the challenge was to get back to growth. Portugal’s response has been effective.

## THE ADJUSTMENT PROGRAMME

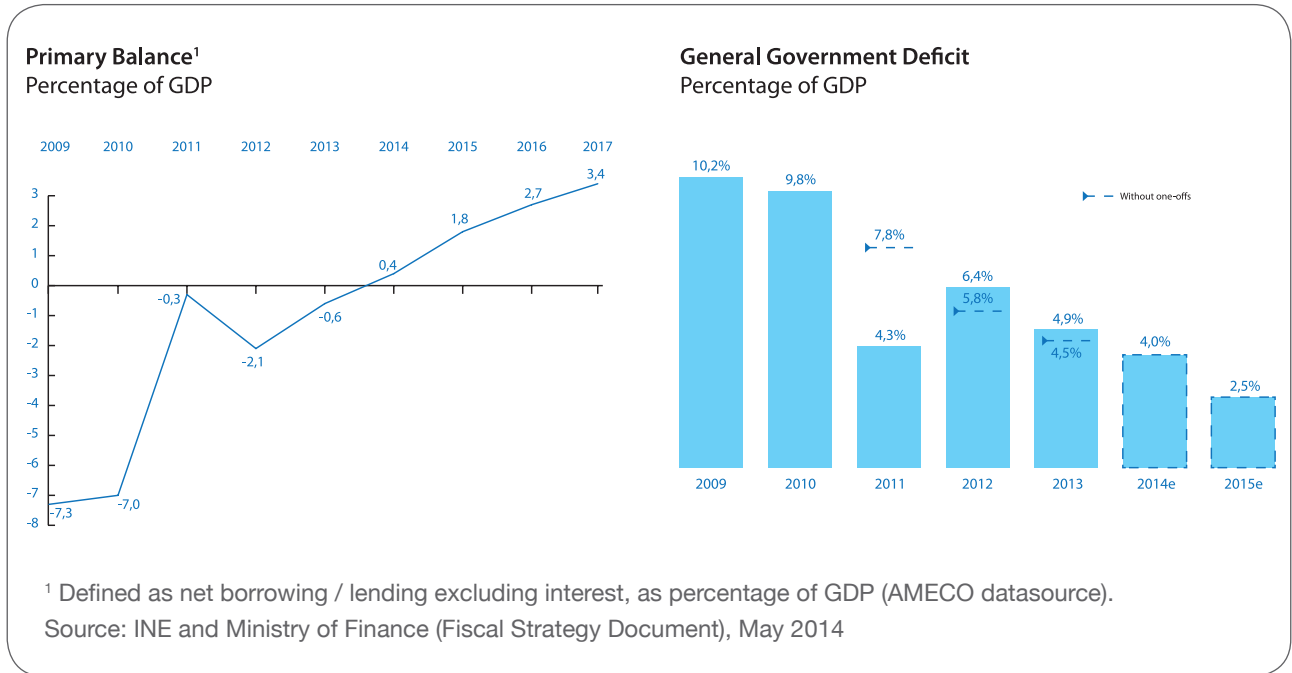
The Programme negotiated with the European Union and the International Monetary Fund was anchored on three major areas: ensuring budgetary consolidation; stabilizing the financial sector; and implementing structural reforms

to boost growth and competitiveness. An overarching feature of the programme was an emphasis on institutional reforms to sustain the gains achieved during the programme.

*Budgetary Consolidation*

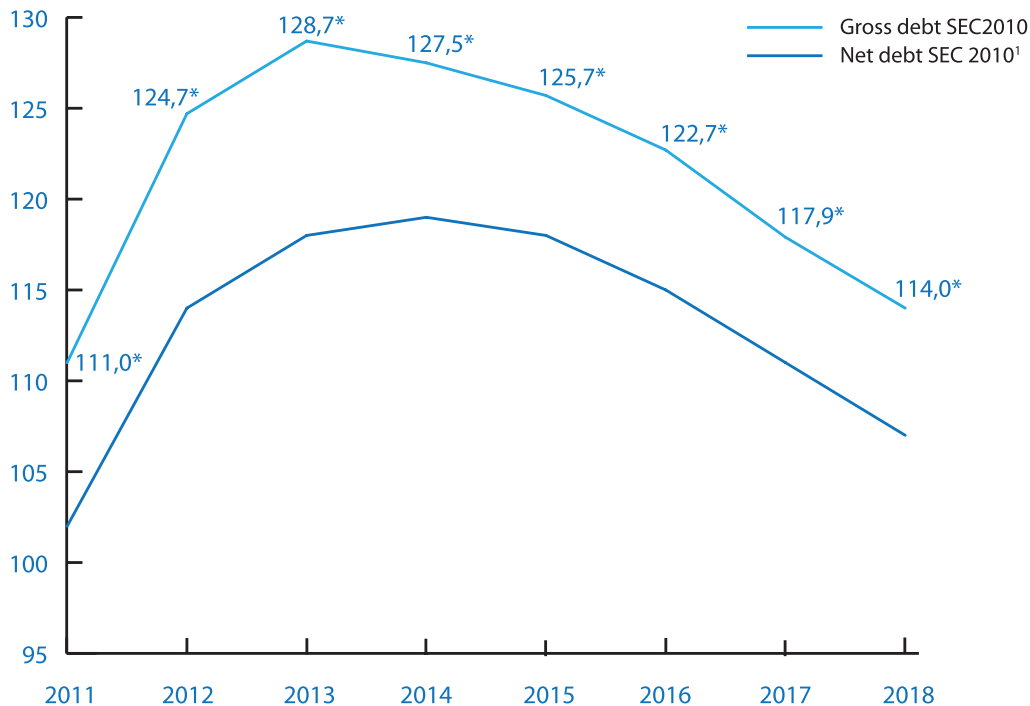
In 2010 the deficit stood at 9.8%. In the second year of the programme, 2012, Portugal was able to reach a positive

structural primary balance. For 2014, Portugal is on track to reach the 4% deficit target and produce the first primary surplus since 1997.



This was achieved through a number of painful but necessary choices involving the reduction of public expenditure and revenue increases. In designing the main measures, the Government was always careful to protect the most vulnerable segments of the population and ensure their strong progressivity. Overall adjustment between 2011 and 2014 involved 26.5 billion Euros in consolidation measures. Of these, around 55% come from expenditure reduction measures and the remaining from revenue increases. Today, Portugal’s public sector, and thus its Welfare State, is more sustainable. This is confirmed by the various debt sustainability analysis carried out under the programme.

**General Government Gross Debt and net debt  
(excluding deposits at Central Administration)  
As percentage of GDP**



<sup>1</sup> Debt excluding deposits at Central Administration.

\* Estimates from the Ministry of Finance for the debt profile under ESA 2010 (published in the Fiscal Strategy Document). Debt-to-GDP ratio to be accounted with ESA2010 from September onwards.

Source: Ministry of Finance, May 2014; Fiscal Strategy Document; IGCP 12th review estimates for net debt.

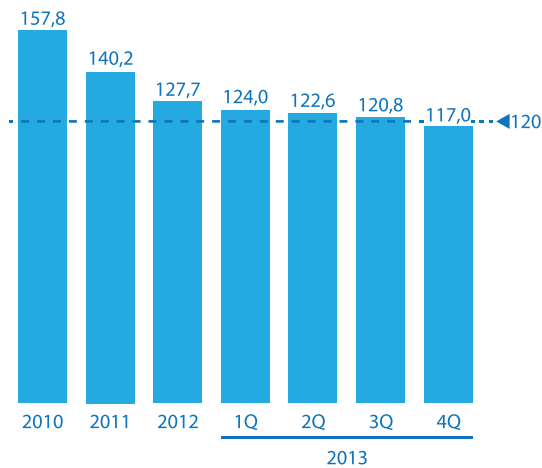
### *Stabilizing the financial sector*

The banking sector was under stress in the run-up to the crisis with high leverage ratios and stretched capital requirements. Measures in this area, implemented in conjunction with the Bank of Portugal, aimed at reinforcing regulation and supervision, recapitalizing the sector to comply with the new EU prudential ratios, and revising the corporate insolvency and debt-restructuring framework.

The four largest Portuguese banks were required to increase their capital to a minimum core tier ratio of 10% under

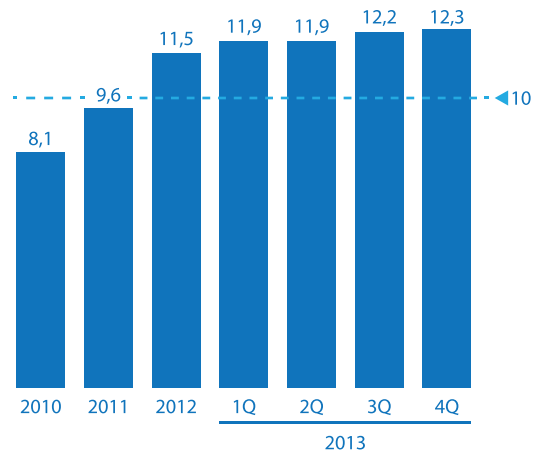
the new requirements, reached this goal and are now comfortably at levels higher than 12%. This was done through market operations and through the partial use of the recapitalization fund envisaged under the Assistance Programme. Average banking sector loan-to-deposit ratios, which in 2010 stood at the very high level of almost 160%, decreased to 120% in 2013.

### Loans-to-deposits ratio Percentage



An orderly deleveraging process is taking place, visible in the reduction of the loans-to-deposits ratio, already below the reference of 120%

### Core Tier 1 Ratio, Portuguese Banking System Percentage



The core tier 1 ratio is well above the minimum of 10% set by the Bank of Portugal since 2012

Source: Bank of Portugal, March 2014

The Portuguese banking sector is today in better shape to meet the financing requirements of the economy while acting within a more robust and vigilant regulatory environment. During the crisis, deposits grew steadily reflecting trust in the banking sector and the rising savings rate of Portuguese families, from less than 6% in 2008 to 13.5% by 3Q 2013.

#### *Structural reforms to boost competitiveness*

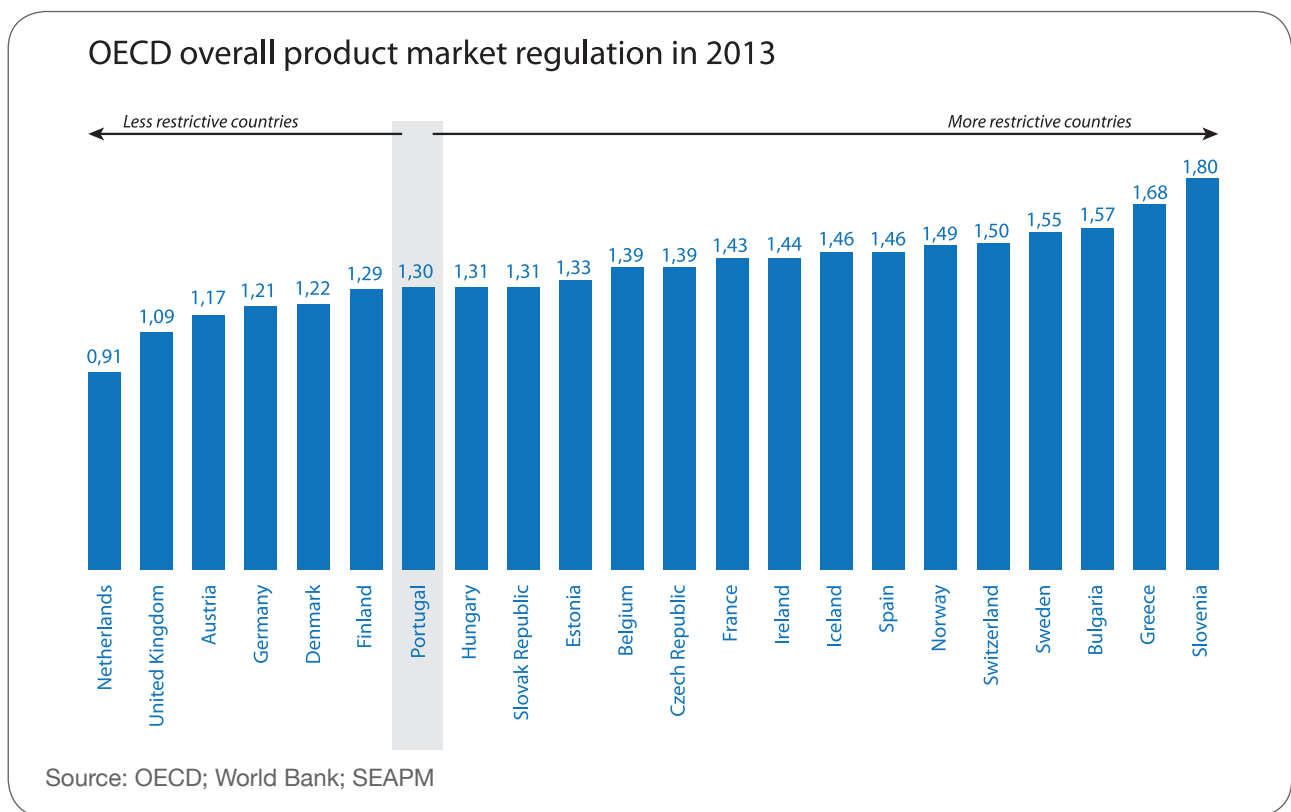
In the context of the programme memorandum alone, the Government implemented over 450 major measures. It represents an average of 3 measures per week. Many other reforms were implemented beyond the programme. From labour to product market reforms and from measures to improve the business

environment to major steps to open the economy, few areas remained untouched during the last three years. Some measures are already producing a positive impact in the economy and others will bring results over time.

A reform programme requires feedback mechanisms and key performance indicators to evaluate whether it is working as intended. The Government is committed to develop an assessment framework that measures the impact of structural reforms until the end of the year. The Government will also propose a methodology to identify key policy priorities for structural reform. With the work carried out, the ongoing reforms and the continued initiatives to support sustainable growth, Portugal has the ambition to become one of the most dynamic and attractive business environments in Europe.

This ambition is within reach and results are already visible, as demonstrated by independent analysis by the OECD recognizing Portugal as a leading reformer in the last three years. The revision of the labour code significantly reduced excessive rigidity in Portugal’s labour market and addressed its marked segmentation, leading to a considerable improvement in the OECD’s Employment Protection Legislation index. Portugal moved from

an index value regarding individual and collective dismissals of 3.5 in 2008 to 2.7 in 2013, lower than the value of Germany, Belgium and France. In terms of product market reforms, according to the OECD’s Product Market Regulation index, Portugal is now the fifth least restrictive economy of the Euro Area, seventh within the European Union. Portugal was the second country with greater progress in this indicator between 2008 and 2013.



Ongoing reforms and upcoming initiatives, some of them presented in this document, suggest that Portugal will continue to progress on this front. Thus, the ambition to become one of the most attractive investment destinations in Europe is within reach and is further reinforced by the rapidly rising educational levels of our work force and privileged links to various

important markets in America and Africa, namely with Lusophone countries.

*Institutional reform: the sustainability of the adjustment*

A major feature of the Portuguese adjustment programme was an emphasis

on institutional reforms to improve budgetary and fiscal processes. Portugal exits the programme with more robust institutions and thus less likely to fall again into the trap of fiscal imbalances.

Reforms in this area were deep and comprehensive. The Fiscal Compact was transposed to the internal legal framework through the approval in Parliament of the Budgetary Framework Law with the votes of the two parties in government and of the main opposition party (meaning nearly 90% of the members of parliament). This means that the path towards balanced accounts and the policies to sustain the equilibrium have today a stronger standing, both legally and politically.

The reform in the budgetary process introduced a medium-term budgetary framework with binding expenditure ceilings, assessment of fiscal risks, stronger fiscal rules as well as targets that are fully aligned with European requirements. Local and Regional Financing Laws were revised to better control transfers from central government and increase accountability and transparency of expenditure.

The government approved a new commitments law and transposed the late payments directive in order to eliminate a long-standing problem of accumulation of arrears. The governance model and monitoring systems for State Owned Enterprises and Public Private Partnerships were also upgraded. On the revenue side, a number of reforms to tackle tax evasion and fraud are now in place and yielding results. Portugal set up an independent Fiscal Council in 2011 to assess public accounts in a rigorous and transparent

manner, including their consistency with existing commitments.

Work on this front will continue in the coming months but results achieved so far mean that it is now harder to deviate from normal budget execution, that public accounts are more predictable and transparent, and that fiscal commitments have a stronger standing under the law.

# MAINTAINING THE REFORM MOMENTUM

WOMEN  
THE BELOW  
MAINTAINING

- FOSTERING COMPETITIVENESS
- PROMOTING HUMAN CAPITAL AND EMPLOYMENT
- STREAMLINING THE PUBLIC SECTOR

# FOSTERING COMPETITIVENESS

## WHY IT MATTERS

As Portugal exits the programme, the key reform goal is to sustain and enhance competitiveness gains obtained thus far. These were obtained against strong headwinds from the global economy and with a historically high Euro. Prior to the crisis, exports represented less than 30% of GDP. In 2013 they already represented over 40% of GDP. The goal is to reach a target of at least 52% of GDP by 2020 and then continue to raise this share in the long run. If the reform momentum is sustained this is achievable as there is still ample

room for growth in the market share of Portugal's exports.

Though the essence of a competitive economy comes from the ability and creativity of its firms and workers, governments can boost competitiveness through targeted reforms and adequate public policies, by removing unwarranted restrictions and by ensuring a competitive level-playing field. In all efforts, it is important to bear in mind that truly sustainable and welfare-enhancing competitiveness comes from productivity gains, not from an economic model based on low wages.

### *Prospects for Productivity Growth*

“Among the 28 Member States, there are only 3 countries (Denmark, Spain, and Portugal) which have managed to have a Total Factor Productivity growth rate over the period 2008-2013 which was higher than in the pre-crisis period, but only Spain and Portugal are forecast to sustain this good performance in 2014 and 2015”. European Economic Forecast (Winter 2014), European Commission.

### *The Reform Agenda*

Fostering competitiveness requires concurrent work on a number of policy areas.

First, a strong REGULATORY FRAMEWORK is crucial to foster competition, and thus productivity growth and innovation. Tackling excessive rents and ensuring fair prices in network industries remains important.

Second, a sound BUSINESS ENVIRONMENT requires the elimination of excessive restrictions and bureaucratic barriers to economic activity, ensuring that entry and exit costs are kept as low as

possible in every economic sector.

Third, an effective and efficient JUDICIAL SYSTEM gives companies and workers the confidence to engage in economic exchanges and expand activity.

Fourth, the state has to ensure that the INVESTMENT ENVIRONMENT is aligned with the objective of fostering competitiveness.

Fifth, the country's PUBLIC INFRASTRUCTURE needs to be aligned with the needs of a tradable economy and serve as an enabler of growth, not as a burden to public accounts.

## I. REGULATORY FRAMEWORK

In the last three years there was a major improvement of the regulatory architecture in Portugal, essential to boost competition and open the economy. After approving a new Competition Law, a new National Regulators' Framework and a new specialized Competition Court, the government will continue reinforcing the regulatory environment to create a true level playing field. This is critical to ensure that prices in network industries (which affect final prices of the tradable sector) are fair and that excessive rents are eliminated. The government has a track record of successful negotiations with key network industries and stands ready to engage in new initiatives towards these goals.

### *Regulators*

With the new framework law in place, the government is now carrying out the necessary adaptations in the bylaws of each regulator – the Competition Authority and the various sector regulators. The aim is to reinforce the independence and effectiveness of regulators while increasing their accountability. After this process, regulatory authorities will have greater financial resources and autonomy and more extended powers. Most by-laws of the sector regulators are now in the legislative pipeline and are expected to be in force by end-September 2014.

### *Energy*

Energy is a major input in most economic goods, meaning that its price affects the overall competitiveness of the economy. For many years prices did not reflect the rising production costs or the public subsidies to encourage investment in renewable energy. They also excluded subsidies for increasing production and capacity, as well other political costs. Thus, like in other countries, a large tariff debt was accumulated which has been creating pressures on energy prices, hindering the competitiveness of Portuguese firms. The government will continue implementing the various measures already defined to eliminate the tariff debt by 2020. The government approved two different packages of measures, negotiated with producers, which tackle economic rents and were deemed sufficient to eliminate tariff debt by 2020, while stabilizing real price increases at around 1.5 to 2% per year. The first package of measures was worth 2.1 billion Euros in reductions while the second was worth 1.4 billion Euros. The special levy on the energy sector implemented in 2014 will also apply in 2015, meaning an accumulated impact of around 300 million Euros, of which at least 100 million Euros will contribute to further reduce the tariff debt. In the coming months, the government will continue to carefully monitor the evolution of the tariff debt maintaining the goal of eliminating it by 2020 while minimizing price increases. The Government is also launching a new set of measures with the objective of ensuring industry competitiveness and social inclusiveness. A new electricity social tariff will reduce

by 34% the price for 500,000 consumers; fuel retailers will have to further disclose information on the composition of the fuel sold; a reference price for bottled gas will be settled; and gas agreements of TransGas will be corrected to reflect a balance of benefits for the National Natural Gas System.

The energy sector also represents a major opportunity for the development of new projects, businesses and jobs, for example, on renewable energy, sustainable cities, energy efficiency, and smart grids. Portugal offers a unique investment environment in the renewable energy industry, where it is already a major player. Portugal will continue to urge European institutions to adopt a 4-targets comprehensive *EU Climate and Energy policy framework for 2030*, including binding targets on greenhouse gas reductions, renewable energy, energy efficiency and electricity and gas minimum interconnections. The Government will also develop an ambitious set of *Energy Financial and Market-based Mechanisms*, boosted by the new EU structural Funds, to promote greater energy efficiency and the use of electric vehicles.

### *Telecom*

The telecommunications sector also has an important role in a competitive economy. The capital-intensive nature of the sector and other barriers to entry tend to limit competition. Thus, a well-functioning regulatory framework is important to ensure that the sector is an enabler rather than a

barrier to the overall competitiveness of the economy.

Portugal is well above the EU average concerning broadband coverage in almost all technologies. According to the most recent data available, NGA<sup>1</sup> coverage is of about 78% of total households. Broadband take-up has been increasing together with the proliferation of multiple-play services. In 2012, following the multi-band auction for the assignment of new spectrum frequencies, 4G/LTE services were introduced in the market. Prices of communications have been decreasing and are below the OECD average for almost all services.

During the adjustment programme a revised regulatory framework for telecoms was introduced. This reduced barriers to entry for new operators and cross-border communication services and strengthened the role of the independent regulator. A new tender process to designate the Universal Service Provider(s) was launched, in compliance with EU law requirements, and completed by the end of 2013. One of the services – directory and full-service inquiry – did not attract any bids, and thus was placed under a temporary contract with the former incumbent, following a new simplified awarding procedure. In the coming months, the government and the independent regulator will assess the need to continue providing this service and if deemed necessary, will redraft the terms of the tender to make it more attractive. Decisive action has been taken to lower mobile termination rates by 80%, which came down from a price of 6.5 cents per minute to a price of 1.27 cents per

<sup>1</sup> Next Generation Access, meaning very high-speed Internet access (3G and 4G).

minute in 3 years (beginning 2010 to end 2012), making Portugal one of the most competitive EU countries in this indicator. Fixed termination rates were also reduced. The regulator will continue to monitor the sector to assess if further measures are required.

## II. BUSINESS ENVIRONMENT

Portugal has the ambition to become one of the most attractive investment environments in Europe. Dozens of initiatives were taken during the adjustment programme, some of them building on important work carried out by previous governments. According to the latest OECD Product Market Regulation assessment, Portugal is already one of the least restrictive economies in Europe. Licensing requirements were eliminated or simplified, administrative burdens were streamlined, and services and access to professions were liberalized. But there is still work to be done.

### *Licensing & Administrative Burden*

Regulations and licences are key instruments to guarantee that businesses, in the pursuit of their legitimate goals, respect the general interest and public safety. However well intentioned, modern States tend to accumulate a number of excessive administrative burdens over time. It is thus important to develop a capacity to monitor, change or eliminate these administrative burdens as needed. The government launched two major

initiatives in this context. The first is an inventory of the most burdensome restrictions affecting businesses. The goal is to deal with the *stock* of regulations developed in the last decades. When the process is completed, the government will be able to make an individualized assessment and decide, for each regulation, either to eliminate it or to simplify it and thus make it less costly. The second initiative is the creation of a “one in, one out” rule, similar to the one successfully implemented in the United Kingdom. The goal is to control the *flow* of new regulations. This has already been approved in the Council of Ministers and is expected to be fully operational by the end of August 2014. Under the new rule, a department proposing a new regulation generating costs to businesses is under an obligation to eliminate one or more regulations of equivalent cost.

Another major new initiative for the coming months will encourage the principle of *digital first* in public administration and the migration of most interactions between citizens and public services to online platforms. Portugal already has a very high percentage of public services available online, which make interactions more efficient. Yet, the rate of use is still low due to the fact that a large proportion of the population still struggles to use these digital services. The new initiative focuses on this bottleneck through a plan to set up over 1,000 Assisted Digital Access Points in municipal and public buildings all over Portugal. These will be digital workstations where citizens and businesses can interact and solve a number of issues with the help of dedicated staff. These and other initiatives will generate a more efficient and

timely interaction between citizens and firms and the State, with lower costs for all. An important feature of this reform agenda is the degree of political consensus around these goals and policies, something that means a stable regulatory environment for the coming period. While in Government, the main opposition party launched some important initiatives in this area and recently voted, along with the parties supporting the current Government, a parliamentary recommendation towards a “national, comprehensive and integrated programme of administrative modernization and simplification”. Our aim is to eliminate at least 1/3 of administrative procedures in the relation between public administration and companies.

In what concerns industrial licensing, an ambitious reform denominated “Responsible Industrial System” was launched, reducing the administrative burden for industrial investors who wish to obtain their license. In addition, the Government is committed to simplifying the process of initiating an economic activity, namely by extending the scope of action for which a simple communication procedure is required, and by optimizing the “Point of Single Contact”, to deal with all business formalities.

The Government also launched the “Zero Licensing” programme, an online procedure that simplifies the establishment of small retail businesses by eliminating licensing requirements, permits, validations, certifications and registers, an initiative recently awarded with the European Prize for Innovation in Public Administration.

A process is also underway to continue the promotion of investment in the agricultural, agro-industry, and forestry sectors. These

are demonstrating already a strong export dynamic, relevant value-added, and job creation.

### *Spatial Planning*

The recent adoption of the new Framework Law for Land, Territorial and Urban Planning represents a major structural reform to simplify and speed up the planning system. For the first time Portugal will have all the relevant regulations in a single legal document. The planning system will be incorporated in Local Plans, which in the future will be the only binding instrument that individuals and developers have to abide to. It is intended to refocus the State’s role in the planning process and strengthen supervision. Financial instruments in this context have been re-defined in order to avoid an irrational increase of urban perimeters and promote the sustainability and the economic and financial soundness of planning options and fostering urban renewal.

In the coming months the Government will review the legal regimes of the Territorial Management Instruments (RJIGT) and the Legal Regime for Urbanism and Building (RJUE), in order to reflect the main changes decided in the Framework Law and align it with the new Industrial Licensing regime. Taking into account the probable high impact of climate change in Portugal, it is also vital to develop a Framework Programme for Coast Protection. The Government reactivated the coastal management action plan and will invest around 300 million Euros to increase the resilience and the competitiveness of the coastal area.

### *Services directive*

Services account for around 2/3 of the Portuguese economy. Initiatives to liberalize and simplify procedures within the services sector are crucial to boost productivity and thus competitiveness. Portugal is well ahead of the curve in the transposition of the Services Directive, the initiative of the European Commission to create a true internal market of services within the European Union. During the adjustment programme, the government approved almost 70 diplomas adapting service-specific legislation. This means that nowadays virtually all major services benefit from a more favourable business environment, one with less bureaucracy, less barriers to entry and reduced regulatory costs.

In line with these initiatives, the government recently reviewed the whole regulatory framework for commerce, services and restaurant activities, simplifying the access to these businesses by combining in a single diploma several existing documents while eliminating most associated fees. In the near future the government will build on this work. Because the services directive is now mostly transposed, it is now essential to carefully monitor its effectiveness in the real economy and fine tune as needed.

### *Tourism*

Portugal's tourism sector represents around 14% of the country's exports. In order to maintain this positive momentum, the current levels of growth of tourists and revenues have to be

sustained. This can only be achieved through an increase in competitiveness in the sector. For this goal, the Government is following a three-pronged strategy: less regulation, better access to financing and a structural revision of our destination's marketing. This strategy will enable a diversification of the target markets and a more effective response to those markets' demand. For these changes to occur, the investment environment also needs to meet the financing needs of players in the market.

### *Access to professions*

The government carried out a number of measures to deregulate professions and eliminate excessive restrictions imposed by professional bodies. Although these associations have an important regulatory mandate, guaranteeing the quality of service and ethical standards, they can also create excessive restrictions and barriers to entry. The new framework law approved in 2013 sets up more reasonable requirements and regulations regarding 18 important professional services in the economy (such as medical doctors, lawyers and engineers). Reduced internship periods and fewer examinations are among the changes introduced in order to lower the barriers to access these professions. Although the foundation for this change is now in place, in the coming months the government still has to adapt each of the associations' by-laws to the new framework. A number of steps were already taken, including the preparation of draft laws and a number of bilateral negotiations between the government and

each professional body. The process will be completed by end-2014.

### III. JUDICIAL SYSTEM

The judiciary was identified early on as an obstacle to growth in Portugal and was thus a major focus of reform in recent years. A well-functioning and competitive economy requires an efficient judicial system. In Portugal the average time to judge a case in court was above the average of comparable countries. Among the reasons for this were the formalistic nature of legal procedures and out-dated court management practices.

With the new code of civil procedure, now in place, judges have more extended powers to advance cases and are more accountable for delays in the process. A new court organization system rationalized the court network, created new specialized courts and reorganized the internal functioning of courts, relieving judges of administrative tasks so that they can focus on judging cases.

Reforms in the judicial system take time to produce their full effects, as they require significant shifts in cultural practices. But the essential package of reforms is now in place and was actually the first chapter of the adjustment programme to be completed ahead of schedule during the programme. Now the goal is to identify a more complete set of quantitative indicators to assess the impact of reforms and introduce changes as needed. The most important recent reforms requiring careful monitoring are: code of civil procedure; enforcement cases (typically a major source of delays); out-of-

court mechanisms; courts of peace; and insolvency code. Apart from this careful monitoring, the government will proceed with a number of new initiatives, some of which are detailed below.

#### *New Code of Administrative Procedure*

The Code of Administrative Procedure regulates relations between public administration and citizens and firms. As it stood, the code was a constraint to economic activity, mainly due to the time it took to reach decisions.

With the new code, the government is creating the so-called “procedural conferences” that convene around the same table the various public agencies involved in a given case. The idea is to expedite the process of finding a speedy solution to the case. The new code also foresees the possibility of digital communication between parties. The approval process is ongoing and is expected to be completed until the end of the year.

#### *Implementation of the Judiciary Organization Plan*

The goal is to rationalize the court network and increase the efficiency and accountability of the judicial system. The plan has been submitted and the challenge for the coming months is its effective implementation. A total of 20 courthouses will be discontinued and new specialized courts will be established. Courts will have a new management structure supported by a set of key performance indicators to assess the efficiency of procedures.

### *Information Systems in the Judiciary*

The government is preparing terms of reference for a major overhaul of the information systems used in courts. The international public tender will be presented by November 2014. Also in this area, the Government is creating a new digital registry system and will, at the end of the year, develop the new Justice Website, a centralized resource to securely share information among the various judicial bodies.

## **IV. INVESTMENT CLIMATE**

The ongoing recovery of the Portuguese economy requires investment in productive sectors, mainly to support the rising share of exports in Portugal's GDP. Investment should sustain gains in competitiveness. For many years, protected non-tradable sectors, some of them characterized by excessive rents, absorbed the lion's share of investment, including foreign direct investment. There was a widespread misallocation of capital, also helped by rising public expenditure and large public works projects.

Though the main driver of investment decisions is the private sector, the Government can have a limited role in addressing market failures, removing distortions and creating the right incentives. Financial fragmentation is also an issue for Portuguese companies, one with impact on competitiveness. Thus, the Government has been vocal on the issue of the Banking Union, working with European partners to accelerate its implementation.

Public intervention in the investment environment has to be disciplined and should refuse the temptation to pick winners among sectors and companies. Rather, the attitude should be neutral and focus on giving the same opportunities for all. Market discipline and a competitive environment, typically present in the most tradable sectors, should be a key feature in public programmes.

In order to monitor and promote the efficiency and speed of investment programmes, the government established: the "Strategy Council for Open Economy" (CEIE), where the main business organizations debated structural reforms with cabinet members; the "Coordinating Council for Economic Affairs and Investment"; and the "Permanent Committee of the Investor".

### *Reform of Corporate Income Tax*

In 2013 the government presented a plan to reduce corporate income rate, simplify procedures and create better incentives for investment. The rate will gradually decrease from the starting point of 25% to 23% already in 2014, aiming to reach 17% by 2018. Starting this year a central new feature of the reform is already in place: Small and Medium Enterprises (SMEs) will be able to benefit from a reduced rate of 17% for the first 15 thousand Euros of taxable income. To reduce compliance costs, the government created a simplified regime for enterprises with revenues up to 200 thousand Euros and total assets under 500 thousand Euros. Furthermore, the tax loss carry-forward period was extended from 5 to 12 years, thus

favouring investment decisions. Foreign shareholders holding positions that exceed 5% will benefit from a very competitive tax exemption system. Finally, there is a favourable amortization scheme for goodwill, in order to facilitate mergers and acquisitions, and a tax credit, which can amount to 20% of tax collection. A similar effort is underway in what concerns the Personal Income Tax, with the appointment of a dedicated committee.

Within the CIT reform the Government revised the international tax policy strategy, including an upgrade in the network of double taxation treaties. This is an essential tool in the strategy to attract foreign investment. Since May 2011, 26 new DTT entered into force, were signed or their negotiation process was concluded. The commitment is to double the number of DTT in force (50 as of May 2011) until the end of this legislature, to bring regulatory stability to investors and strengthen the new cycle of economic growth.

#### *Facilitating access to finance*

The Government has several instruments currently under implementation to ensure increased access to finance, given the persistently high financing costs for Portuguese companies. To this purpose, several credit lines are being launched, amounting to a total of around 5 billion Euros. Portuguese companies have already used about 2 billion Euros, with remaining 2.5 billion still available and 0.5 billion under implementation (*Caixa Capitalização*). In parallel, the Government set new mechanisms to foster entrepreneurship, with targeted credit lines of around 100

million Euros. Finally, three private equity funds under a new public programme called *Revitalizar* are aimed at investing in the restructuring of Portuguese companies. The initial public funding was of 220 million Euros, further complemented by private funds from financial institutions.

#### *Financial Framework 2014-2020*

Under the new wave of European Structural and Investment Funds, the amount of funding available through leverage-based financial instruments for SMEs will double the funds of the previous round (2007-2013). This is particularly relevant in a country where credit conditions remain tight. The Partnership Agreement setting up the new architecture for fund allocation was presented to the European Commission in January 2014 and will be made operational throughout the year and produce a likely significant impact up to 2020 and beyond.

#### *Development Financial Institution*

The Government recently launched the process to establish a development financial institution with the aim of centralizing and streamlining the disbursement and management of EU structural funds, of a reimbursable type, supporting SMEs during the upcoming 2014-2020 period. The objectives of the institution are the following: support public policies that promote growth and employment in alignment with the EU2020 Strategy; act as a wholesale financial institution for public financial instruments to steer private investment

towards the tradable sector; develop technical work on financial public models at the service of competitiveness and internationalization; and aim to address the SMEs funding market deficiencies, namely regarding the capitalization level and the funding of long term production activity, undertaking thereof an important anti cyclic function. The financial institution is expected to be operational in the coming months.

### *Dealing with Corporate Debt*

Portuguese corporate indebtedness is very high when compared to other Eurozone countries. Several ministries and the Bank of Portugal are tackling this issue, creating new control mechanisms and fine-tuning existing ones to accelerate restructuring processes and foster agreements with creditors.

The “Corporate Debt Restructuring Strategic Plan” that is being finalized can be divided in four main areas: development of an early warning system by the Bank of Portugal, to be in force this year, giving Portuguese authorities increased control and enhanced surveillance on potentially at risk companies; recapitalization of non-financial corporates and creation of financing lines to viable enterprises undergoing a restructuring process; facilitation of standardized out-of-court workouts for SMEs and inter-creditor agreements regarding debt restructuring of larger firms; finally, the Government is considering improvements in the restructuring framework.

### *Green growth*

Selective investments in the green economy, eco-efficiency, clean technologies and the efficient use of natural resources (energy, biodiversity, water, oceans, agriculture and forestry) are essential for the protection of natural resources and the promotion of welfare and intergenerational equity. Investing in the green economy is also an opportunity to boost economic growth and job creation and reduce the external debt generated by imports of raw materials and fossil fuel energy.

Portugal has the infrastructures, natural resources and entrepreneurial capacity to compete at the global scale in the area of the green economy. The Government will adopt a long-term *National Green Growth Roadmap*, identifying 2020 and 2030 targets and will implement the *Green Taxation Reform* (based on the current work of the joint committee set up by the Ministry of Environment and Energy and the Ministry of Finance).

### *National Ocean Strategy 2013-2020*

Portugal possesses vast maritime resources, which constitute an exceptional opportunity for economic growth. Accordingly, the Government recently adopted the National Ocean Strategy 2013-2020. The aim is realizing the economic potential of this sector, as well as protecting natural resources and advancing scientific knowledge. One of its most ambitious goals is to increase the sector’s contribution to the GDP by 50% until 2020 (currently, it represents around 2% of Portuguese GDP). This is to be achieved through the

creation of a more favourable business environment in the sector, which in turn will foster employment. Portugal was a pioneer in creating the recently approved maritime spatial planning and management framework law, which allows the creation of a simple, predictable and stable environment for private investors in the Ocean. The national strategy also integrates European priorities for the sector such as blue energy, aquaculture, and cruise ship tourism and blue biotechnology. In order to successfully implement the strategy, the Government will launch an international road show in June 2014 to attract foreign investors.

#### *Other Initiatives*

The Government introduced the *Golden Residence Permit Programme*, available to investors meeting one of the following requirements: a capital transfer with a value equal to or above 1 million Euros; creation of at least 10 job posts; or the acquisition of real estate with a value equal to or above 500 thousand Euros. The recent successful reform in the rental market is also expected to bring much needed dynamism to this sector, facilitate labour mobility and boost investment opportunities, namely in urban renovation. Additionally the Government is committed to carry out intense external promotion and take full advantage of Portugal's external network – embassies, consulates, AICEP Portugal Global (Portugal's specialized investment agency) and Tourism of Portugal – promoting several *roadshows* to attract investment worldwide. Up to date, this initiative has attracted about 500 million Euros of foreign direct investment in Portugal.

## V. PUBLIC INFRASTRUCTURE

An adequate public infrastructure can be a key contributor to a dynamic economy. An extensive transport network enables complex value chains and multiplies business opportunities; and if efficient, reduces economic costs, fostering overall competitiveness. In recent decades, Portugal engaged in major infrastructure investments, reaching a level of oversupply. This resulted in a considerable burden to the budget and, especially, to public debt. In recent years, a major process of restructuring in transport (State Owed Enterprises) brought down costs and increased revenues. This work needs to continue in the coming years, since the level of debt in these companies is still high.

Portugal today has an adequate infrastructure and needs to focus not on large projects but on marginal improvements and on investments that directly benefit the tradable sector. Railways and ports are a clear area where successful public policies can reduce costs to exporters and facilitate trade.

#### *Strategic Plan for Transports & Infrastructure*

The government recently approved the Strategic Plan for Transports and Infrastructure (2014-2020). This document also integrates the recently published conclusions of the IEVA (High Added Value Infrastructures) Working Group, which produced a list of the most critical public investments. New investments will have

to clearly contribute to competitiveness namely by reducing transaction costs for the export sector. The new plan starts from a more favourable financial position due to an intense effort of reducing costs and increasing revenues carried out during the adjustment programme. Although the legacy of heavy levels of debt is still present, transport SOEs are now, as a whole, operationally balanced.

Portugal's peripheral geographic situation means that it is important to upgrade connections with the core of Europe under the EU supported Trans-European Networks. That is why, within infrastructure investments, the Government will pay special attention to the transport sector (rail, maritime ports, road and airports), and mainly to railway networks, which will represent 43% of the total investment and 75% of investment coming directly from the State budget. Next are maritime ports, crucial for the competitiveness of the export sector. Because the road network is already extensive, investment in this area will be limited and circumscribed to local road networks.

### *Ports*

The ports sector is of particular importance for an economy increasingly geared towards the tradable sectors. The Government implemented a number of policies to reduce prices and make the sector more efficient. The main objective is to reduce port charges by about 25% when compared to 2010 prices. This can make Portuguese exports cheaper and thus more competitive. First, the regulatory framework was upgraded, strengthening its autonomy

and capacity. Second, a new port work law was adopted in 2013, giving more flexibility in the management of human resources. Third, the Government gradually reduced the "TUP Carga" (tariff for port use) and then finally eliminated it in 2014, freezing other types of port tariffs. Going forward the Government will continue pursuing this policy of price reduction, chiefly through a new initiative to re-negotiate port concessions. This will be the main focus of work for the coming months. A negotiation commission was set up in April 2014 and is engaging with the port concessionaires seeking better conditions for exporters.

### *Water sector*

The large investments made over the last two decades led to major progress in the water sector in Portugal, with the country being equipped with a vast water supply infrastructure and wastewater treatment systems (reaching, respectively, 95% and 81% of population in 2011). Portugal has a leading position in this sector, particularly due to its technological know-how and strong human resources. For example, Lisbon was recently considered one of the top 10 world cities in terms of minimizing water losses in water distribution networks. Following these important transformations, the Government remains focused on fostering sustainability in this sector. A new strategy for the coming years (PENSAAR 2020) is under development and involves a major shift from infrastructure construction to asset management. Its main goal will be developing the quality of asset and resource management, thus increasing the quality of service. The Government

intends to promote the reorganization and restructuring of the water services sector through the aggregation of sixteen multi-municipal systems in three new larger systems, and further promote vertical integration of municipal systems.

### *Completion of Privatizations Programme*

The privatization agenda was one of the most successful facets of the adjustment programme, with revenues largely exceeding the initial target of €5.5Bn. Nevertheless, the Government continues to consider the sale of TAP Portugal (national airline company) and CP Carga (a cargo railway company), as long as there are market opportunities and the sale fulfils the requirements set in the agenda. Meanwhile, the Government initiated the public tender process for EGF, the main urban waste management operator in Portugal, and is concluding the process of concessions of public transportation services in Lisbon and Oporto.

# PROMOTING HUMAN CAPITAL AND EMPLOYMENT

## WHY IT MATTERS

Sustained growth and welfare depends on an equitable diffusion of knowledge across society. The ambition of every government should be the creation of better educational opportunities to develop the human potential of its citizens and thus to increase the human capital standards of its nation.

This comes from a well-functioning labour market and a successful education system. This balanced growth requires the development of sound vocational education and professional training (VET) systems, promoting apprenticeship training, and a more intense internationalization of the higher education and research institutions.

Historically, Portugal has lagged behind in terms of educational indicators, for example in the percentage of people completing secondary and tertiary education. This has had negative consequences for productivity growth. However, in recent years there has been a rapid catch up not only in terms of access to education or early school leaving (early school leaving rate decreased from 44.2% in 2001 to 19.2% in 2013 – Eurostat) but also on qualitative indicators. Portugal is one of the countries with steeper improvement in educational attainment as measured by the OECD PISA project. Likewise, the percentage of workers between 30 and 34 years with a higher education degree almost tripled since 2001.

This is encouraging in terms of the skills and capabilities of the younger

generation of workers and of those about to join the labour force. However, a large part of current workers have relatively low educational levels. This should be addressed with public policies that boost professional training and lifelong learning while simultaneously targeting specific requirements of enterprises.

The tougher part of the recent economic crisis was the rapid rise in unemployment. The unemployment rate had been rising since the early 2000s, but the recent period was marked by a steep increase, reaching a peak of 17.7% in the first quarter of 2013. Though fortunately the rate has been going down since then, to 15.1% in the first quarter of 2014, it still stands at a very high level. Youth unemployment and long term unemployment are the harshest face of this reality, to the people themselves and their families, but also for the long-term economic prospects of the country.

### *The Reform Agenda*

Promoting employment opportunities and the development of human capital requires a stronger inter-connection between the education system and the labour market. Going forward the Government will carefully monitor recent reforms in the LABOUR MARKET to assess if they are having the intended impact, and fine-tune accordingly.

Another area of continued focus will be the area of ACTIVE LABOUR MARKET POLICIES, where the aim is to increase employment opportunities, in particular for

the younger population and the long term unemployed; provide a better matching between labour demand and supply; and ensure an adequate vocational education and training system.

In terms of EDUCATION in general, the government is upgrading the monitoring of educational quality and increasing the autonomy of schools, a process that will be intensified in the coming period; reinforcing the links between schools and businesses, especially based on apprenticeship schemes. Simultaneously, early school leaving will continue to be tackled and investments in higher education will be better linked to employability rates.

## I. LABOUR MARKET

Portugal's labour market was characterized by a significant segmentation between workers with permanent contracts, with considerable rigidities, and workers with temporary contracts, of a precarious nature. Apart from the equity issue, this state of affairs is detrimental for growth because both extremes can hinder productivity, the first due to the lack of flexibility and mobility and the second due to reduced incentives for professional development. An excessively rigid labour market is also negative for employment creation and to the capacity of firms to weather economic crises.

Recent reforms, carried out under a tripartite agreement signed by all employers' associations and a major confederation of unions, were a major step in the right direction. Various changes in working time arrangements, in collective bargaining and other areas of the labour

market were introduced in these last months, along with more transparent set of conditions for individual dismissals. After a crisis, employment creation tends to lag economic growth. However, in 2013, employment creation picked up as soon as growth started, suggesting that labour reforms could be already playing a positive role, by giving firms the confidence to proceed with new hires.

Going forward, the main focus will be the development of key performance indicators to assess the impact of labour market institutions. Additionally, the evolution of labour market segmentation will be continuously assessed and taken as a fundamental issue in restoring employment growth and ensure fairness among all employees.

### *Further reforms in the labour market*

The Government will actively discuss with social partners the topic of collective bargaining. Both collective and firm-level agreements need to be stimulated to guarantee the competitiveness of the different sectors. Reaching consensus among all stakeholders will be very important for the continuous stabilization of the labour market, continuous decrease of unemployment, continued growth of employment levels and alignment of wage developments with productivity developments. In setting the minimum wage, the Government will take into account developments in productivity and consult with social partners.

The extension rules for collective agreements may be adjusted in order to take into account the representativeness of

micro, small and medium-sized enterprises in the main sectors. Meanwhile, the survival of collective agreements may be shortened so as to foster dialogue between labour unions and enterprises regarding working conditions.

## II. ACTIVE LABOUR MARKET POLICIES

Policies in this area were comprehensive and involved a number of new initiatives to encourage employment as well as significant reforms in the institutional framework of the public employment service, improving their capabilities in matching labour demand and supply. In terms of financing, the various initiatives benefited from the available EU funds directed at tackling youth unemployment. Still in this context, the government is engaged with the OECD in a comprehensive skills assessment to identify skills gaps and adequate responses.

### *Youth job creation initiatives*

The government devoted a lot of attention to the problem of youth unemployment. Under the *Impulso Jovem* initiative, aligned with the EU-led youth guarantee programme, over 106 thousand young people have already benefited from a number of schemes: traineeships; hiring support; entrepreneurship initiatives and vocational training programmes. The government is aware that despite the efforts developed, there is still a wide margin for continuous progression. In

this context, the National Programme for implementation of EU-led Youth Guarantee is already in place, with more than 75 thousand young people in the programme. Until 2015 it is expected that around 378 thousand people will benefit from educational, training and integration initiatives.

### *Public Employment Service*

A new “programme for re-launching the public employment service” was implemented. The public employment service is now developing the capacity to assess the employability of the recently unemployed in order to evaluate risks of long-term unemployment. This will be complemented with a meeting with a “career manager” that will assist in the development of a personalized career plan and then follow-up over time.

The public employment service continues to increase its network of partners in order to provide more jobs offers, enhance the placement of unemployed in the labour market, improve the quality of vocational training, promote entrepreneurship and increase self-employment. The measures implemented so far are already contributing to the increase in the successful matching of job offers to applicants. The remaining ones will be implemented in the coming months.

### *Labour Activation*

The new active labour market programmes have been showing considerable results and should thus continue in the near term. The first relevant programme is *Vida Ativa*,

which ensures an activation response to the unemployed within 3 months after their registration at the public employment service. Through this programme, the unemployed can maintain the requirement of active job search but simultaneously improve their employability profile through modular training courses and on-the-job training. This programme covered over 250 thousand people at the end of March 2014. The *Estágios Emprego* traineeship programme offers a 12-month internship and covered over 40 thousand people in 2013, a 72% increase over 2012. The employment rate 9 months after conclusion of the programme is around 67%. Yet another scheme repays a variable percentage of the employer's social contribution for new hires mainly between 18 and 30 years old and for those over 45 years old. Around 13 thousand people were hired through this programme. This support scheme may be cumulated with another financial support, *Estímulo 2013*, which grants a subsidy equivalent to 50% of the salary and currently covers about 30 thousand new hires. These initiatives will continue in the near future, as they contribute to the development of relevant professional skills and thus to the continuous and sustainable reduction in unemployment.

### III. EDUCATION

The Portuguese educational system is rapidly converging to levels of quality of many of the most advanced countries, as underlined for example by the OECD PISA tests. The challenge in the last two decades was to broaden the access to all

levels of education, diminish the worrying early school leaving rates, and increase the quality of the vocational education and training systems.

Though the system is today better suited to the needs of the country and is more sustainable, there is still work to do in the coming period. The early school leaving rates need additional efforts to continue dropping, vocational education needs to be further developed, the number of people with a tertiary education diploma should continue to rise and, above all, the standards and quality of general education should be continuously improved.

#### *Basic and Secondary Education (Elementary, Middle, and Secondary)*

A new information system to manage, plan and evaluate the educational system is already in use, serving as a monitoring tool to generate real time performance indicators from schools. In addition, the government carried out a major revision of curricula, learning targets and teacher training programmes. The main goals are: achieving a better structured and more demanding curriculum; raising the level of academic performance; and better adapting the educational offer to the needs of modern society.

The Government is also working to improve the quality of teaching. On the one hand, the curriculum at university level has been revamped and an admission test for teachers will be launched. On the other hand, measures for updating current teachers' curriculum and further improving recurrent training are also under development.

The external evaluation of schools has also been overhauled around three pillars: academic and social outcomes; provision of educational services; and leadership and management of resources. A process of continuous increase in school's autonomy is in place. The Ministry of Education and Science signed more than 200 trust agreements up to now, well above the 150 set as a target for the adjustment programme. These schools have increased flexibility for setting up their academic offer, managing curricula and allocating people's time. The agreements include the definition of key indicators to be assessed on a regular basis and early results are encouraging. It is clearly an area to further develop in the coming months.

#### *Improving vocational education and training (VET)*

The strong development of vocational education and training, namely with dual education programmes, has been a major priority of this Government. This has been crucial to fight the traditionally high dropout rate and to better match the educational system with the needs of the real economy. Under the National System of Qualifications, a number of measures were implemented or are under implementation. Vocational programmes at the upper secondary level (10<sup>th</sup> to 12<sup>th</sup> school year) are recognized under this system. In the near future, the Government will promote new Professional Schools in close partnership with local, regional and national companies. The idea is to involve industry in the education effort and also to link curricula to the concrete needs of the

manufacturing and service sectors. Finally, the Government is developing a new network of Centres for Qualifications and Vocational Education (CQEP), with links both to public employment service and to local schools so as to help young students in making the right personal educational choice (also with the support of vocational orientation services) or better guiding adults in their educational options. Another major upcoming project is the definition of a methodological guide for lifelong learning. The idea is to define about 80 professions with strong economic relevance and adapt the lifelong education offer to the needs of these professions, always in connection with employment centres and the private sector.

#### *Higher Education & Research*

Portugal's tertiary education has also been showing rising levels of quality in recent years. The number of young persons (30 to 34 years old) with a higher education diploma has increased from 11.3% in 2000 to 29.2% in 2013 (Eurostat). Currently, the government is focused in rationalizing the educational offer, assessing its relevance and quality and increasing the internationalization of the sector.

The government is currently launching a new type of tertiary educational offer, namely a shorter diploma lasting two academic years with a vocational nature (business orientated) and with strong links to regional business needs. Until 2020 it is expected that 35,000 will attain this degree. With its internationalization strategy the government hopes to increase the number of foreign students in Portugal.

In what concerns the research & development agenda, new initiatives were launched to improve the quality of the national R&D system. In parallel, innovation and knowledge transfer to the productive sector will continue being encouraged. Examples of these initiatives are the following: *FCT-Investigator* program, offering renewable 5-years employment contracts to the most internationally competitive PhD holders; *FCT-Doctoral Programs*, aiming at high-quality doctoral education, fostering national and international consortia of Universities and R&D centres and of universities with enterprises; *National Roadmap for Research Infrastructures*, a multi-year plan with infrastructure investment priorities; finally, the *Programme for Knowledge and Technological Transfer*, seeks to accelerate the convergence between the research capabilities of Portugal and peer countries, through the joint development of PhD programmes by universities and companies, and post-doctoral fellowships within firms.

# STREAMLINING THE PUBLIC SECTOR

## WHY IT MATTERS

Developing public policies that boost competitiveness and promote human capital and employment is critical for growth. But prior conditions are needed: an efficient and effective public administration, capable of designing and implementing such policies; and a sustainable State, with balanced public accounts and a culture of accountability in the use of public resources.

In Portugal there is a broad consensus around the many achievements of the welfare state. In recent decades the improvement in social, health and educational indicators has been staggering. However, recognizing those accomplishments should not lead to complacency. There is much to improve in the way the public sector is organized and managed. An ambitious reform of the State should ask if the same or fewer resources could lead to better outcomes. It should question if the State is primarily an obstacle or an enabler of growth. A successful reform programme needs to promote organizational efficiency and human resource development, leading to a more efficient and less bureaucratic state. But it also needs to bring public expenditure to sustainable levels on a permanent basis, and thus open the possibility of lower taxation levels. A reform of the public sector needs a strong focus on daily incremental progress but always bearing in mind the higher goals of fostering equity

within a society and between generations. All past governments launched important initiatives to improve the efficiency of the State. It is an area where a broad political consensus is particularly important to ensure that long-term reforms are implemented. The Government decided to attribute great priority to the reform of the State and already implemented dozens of measures in this area. Recently, it presented the “Better State” reform roadmap, which will be under implementation in the coming months, and was developed in consultation with political parties and social partners.

### *The Reform Agenda*

Reforming the public sector is among the most complex tasks a Government can undertake. The “Better State” Roadmap<sup>2</sup> presents the framework of the reform agenda going forward, to be developed seeking a broad consensus. Much was already done prior to the presentation of the roadmap, but action in this area will accelerate in the coming period. Going forward, work will proceed on several fronts.

To ensure the long-term sustainability of the current budgetary consolidation, and avoid falling again into the trap of fiscal imbalances, the Government will seek an even stronger political and legal environment around the goals of FISCAL SUSTAINABILITY.

<sup>2</sup> Available at <http://www.portugal.gov.pt/media/1415676/20140508%20vpm%20um%20estado%20melhor.pdf>

This will also entail a concrete focus on the reforms of SOCIAL SECURITY, the largest component of public expenditure. The reform is essential to ensure the sustainability of the system and inter-generational equity.

The HEALTH SECTOR, one of the main functions of the State, is also undergoing a major reform effort that started in 2012, namely in the hospital network and pharmaceutical area. Although the topic was developed in the previous section, Education is another important pillar of the “Better State” roadmap, with an emphasis on the topics of autonomy and school choice in public education.

Finally, the organization and working arrangement in PUBLIC ADMINISTRATION requires extensive work going forwards, building on various measures already carried out, and seeking a more efficient State, responsive to the needs of its citizens.

## I. FISCAL SUSTAINABILITY

During the last three years the Government implemented a comprehensive agenda of public financial management measures to reinforce the budgetary process in Portugal. Portugal is now one of the few countries with a totally independent fiscal council that assesses public accounts. More importantly, the Fiscal Compact was transposed to the internal legal framework through the revision of the Budgetary Framework Law, also with favourable votes in parliament of the main opposition party. This is reassuring for the remaining path towards

fiscal balance and for the need to sustain that equilibrium over time.

### *Budgetary Strategy*

For many years, public expenditure grew consistently above GDP growth. Furthermore the current level of taxation is very high and affects economic activity. The Government believes that in a medium to long-term horizon, budgetary consolidation should continue to be focused on expenditure reduction. Additionally, the Government proposes that once fiscal balance is reached, with sustainable primary balances, expenditure should continue on a controlled or downward path in order to allow for a lower tax burden. A broad political agreement with the main opposition party towards a public expenditure ceiling and a commitment to primary balances should be envisaged for the coming period. Implementing the ongoing reform of the State will bring efficiency to public administration and thus contribute towards this goal.

## II. SOCIAL SECURITY & SOCIAL TRANSFERS

Social benefits represent the largest component of expenditure, including pensions, unemployment benefits, and social transfers. Both demographic developments and economic circumstances are strong pressures to the rise of this expenditure in the future. Reforms in this area are essential to make the system more sustainable, efficient and fair. There is also scope for improving the

operational efficiency in the application of funds and reduce fraud.

### *Pensions*

Demographic developments, a low growth environment, and the design of Portugal's pension structure are all placing undue stress on the system. The government took a number of important decisions in the context of the adjustment programme to reduce spending and rebalance the system. Problems of sustainability have to be decisively addressed as they pose risks to the fiscal standing of the country and affect inter-generational equity.

One of these reforms seeks the convergence between the two systems – private and public – in order to generate a more sustainable and fair model. It should lead to a unique and harmonised regime, replacing the two systems with their different deficits and calculation formulas. As presented in the Fiscal Strategy Document the Government will implement a durable solution to the design of the pension system, always in consultation with the main stakeholders. Additionally, as part of the Reform the State, the Government is analysing an upper cap on contributions and future pensions above a given level of income, maintaining the contributions on the public system below that level. With this move, together with the recent increase of the retirement age to 66 years old (complemented with a sustainability factor linked with life expectancy), the government is fostering the long-term sustainability and equity of the Portuguese system.

### *Social Transfers*

The government will present a study regarding the possibility of capping the accumulation of non-contributory social subsidies and benefits to replace working income to work-age people. This proposal would follow the model introduced in the UK of a “benefits cap”. Today there is limited information on the accumulation of benefits due to lack of communication between central and local and regional levels of government. This may create inequitable situations where a recipient can receive a total amount of transfers that is much larger than that of a worker earning average wage. This reform will produce better quantitative information about social transfers in general and lead to a more efficient and equitable welfare transfer system. It also aims to bring savings to the state budget. An early proposal towards a “benefits cap” is expected for 2015. Other measures will be studied and presented in this context.

## **III. HEALTH SECTOR**

The Portuguese people benefited from major improvements in their health standards in recent decades. Life expectancy increased rapidly and there was particular progress in child health. Since 1990, per capita expenditure in health increased five times, an average yearly increase of 19%. At the end of 2010 public expenditure in health was 6.8% of GDP. Furthermore, the system was generating a significant value in arrears, mainly of pharmaceuticals, which stood at 2 billion Euros in the same year. This

rapid rise comes mainly from innovation in health, but also from system inefficiency and an aging population. Health indicators have been improving consistently but with adequate reforms they can continue to improve within a more sustainable system. In this context, in the months ahead, reforms will focus on improving efficiency and transparency of the system, namely through the continuous implementation of hospital reform, pharmaceutical policy reform and streamlining of public expenditure in pharmaceuticals, with the view to ensure a long term sustainability of the National Health Service. The system needs a greater focus on the citizen's needs. A number of measures will reinforce patient's access to primary care and there is a clear goal of achieving universal coverage by a general practitioner. The main challenge is to accomplish all these objectives and simultaneously ensure access, quality and safety of the health services.

### *Hospital Reform*

The goal is to create more efficient hospitals, with better management practices and better accountability. The implementation of a system of patient electronic medical records is one of the main structural measures within the hospital reform. A new benchmark system was implemented in order to compare performance differentials across the network and produce key monthly indicators. Also, patients are contributing to the accountability and transparency of the system by receiving an invoice with the price of the service but also, for information

purposes, the real cost of providing that service.

The reform will continue to be executed by the effective implementation of the strategic plan by each unit, the reinforcement of central acquisition and shared services, the publication and use of clinical guidelines for medical prescription and other measures in order to improve the efficiency of the system.

### *Pharmaceuticals Policy*

During the adjustment programme the measures related with the pharmaceuticals policy were one of the most demanding and structural measures for the health sector. The challenge was to ensure that its implementation would not affect the access and costs supported by patients. A number of measures to promote the use of generics were implemented: implementation of the International Non-Proprietary Name (INN) prescription; revision of the existing reference-pricing system based on international prices; and the agreement with the pharmaceutical industry to cap annual public expenditure in pharmaceuticals (at 1% of GDP as reference). In the context of the 2015 Budget, the Government will introduce a new measure to ensure that the expenditure ceiling is respected. Additionally, the Ministry of Health will continue to implement structural measures in this sector, namely the conclusion of the national pharmaceuticals formulary and the process of medical device registry and coding.

### *Research and Innovation in Health*

The Government is actively involving academia, industry and health service providers in a joint effort to make the best use of knowledge and technology. The goal is to create a positive environment for innovation, improving standards of applied research, boost competitiveness in health related industries and promote the internationalisation of the health sector.

## IV. PUBLIC ADMINISTRATION

Reforms in the way public administration is organized and managed are critical. Modern States are increasingly complex and require a more streamlined organizational structure. The types of skills and services required by the public are evolving at a fast pace and so are the demands of accountability, transparency and sustainability. Thus, Governments have to reflect constantly on the organization of the public sector.

### *Wage bill*

Throughout the program, the number of public sector workers was significantly reduced through a disciplined control of new hires, and other targeted programmes. The total decrease in the work force over the last three years was around 8%. Together with the policies affecting wages, this decrease means that the wage bill of the civil service is now more sustainable. Recent decisions included changes in public sector working arrangements,

including a convergence to the 40-hour workweek in the private sector, and increased flexibility and mobility in human resource management. A revision of the wage scales and supplements is also underway, sustained by an independent study comparing salary practices in the public and private sectors. Decisions on this front will be presented in time to be included in the 2015 Budget.

The goal is a reduced but more efficient structure. To improve the quality of services, measures should aim at increasing the pool of qualified workers and upgrade opportunities for professional training and lifelong learning. This is essential to meet the complexities of modern public management. Further reductions in the number of workers will be achieved mainly through a policy of restraint in admissions, always below replacement level, and through mutual agreement programmes.

### *Local administration*

A new Local Financing Law was enacted in 2013 with the goals of strengthening fiscal sustainability and increasing transparency and accountability at the local level. The Government is now setting up the Municipal Resolution Fund to provide financial assistance to distressed municipalities and supervise fiscal adjustment programmes. The Government will submit to Parliament by June 2014 a draft legislation regulating the Fund's procedures and instruments.

To improve efficiency, the Government is also committed to foster the decentralization of state intervention in

specific areas. This will be particularly relevant in the provision of social services such as education, health care and social assistance. To ensure a successful policy, the Government is currently launching pilot projects of decentralization of services to a limited number of municipalities. An assessment of overlaps between central and local public services and the *Aproximar* programme will produce concrete proposals of reorganization and rationalization by mid-2014. Social, demographic and technological trends, as well as fiscal constraints, suggest a greater need to reorganize the territorial network of public services.

The Government is also committed to increase transparency and accountability at the local government's level. A nationwide Local Government (Municipal) Transparency Website is being set up. It will have over 100 indicators of administrative and financial management (human resources, procurement, revenues breakdown, municipal expenditures, and debt), fiscal decisions, economic indicators and municipal services. Finally, the Government will launch in the coming months a new programme to train human resources working for local governments. It will be focused on improving the level of service to the local entrepreneurial community.

### *Structural and organizational reform*

Early in its term, the Government launched PREMAC, an initiative to eliminate redundant public administration structures and services and reduce leadership positions. Soon, it will launch PREMAC II, a

new round of assessment and elimination of unnecessary public structures. Furthermore there will be a focus on the development of shared services in the central administration, with concrete proposals until the end of the year, to be implemented throughout 2015. Additionally, a programme tackling Information Technology Systems in the public sector will support these restructuring efforts. The goal is to generate significant savings already in the context of the 2015 budget within a dedicated programme. This plan is structured along 25 key measures destined to optimize spending and will entail, among others: centralization of the IT functions in each ministry, in order to gain significant economies in scale and scope; consolidation of the various data-centres that exist across the Public Administration (over 6,000) in a limited number per ministry; adoption of free or open source software solutions, among other initiatives. An important institutional development was the establishment of the Inter-ministerial Network for Administrative Modernization (RIMA), which will coordinate at central level the reform of regulatory burdens, control of bureaucracy, regulatory impact assessment and simplification of administrative procedures. This Network is composed of focal points in each ministry, playing a pivotal role in the implementation of reforms in every Government department, facilitating information sharing and the development of internal benchmarks.

# KEY UPCOMING POLICIES

POLICIES  
KEY UPCOMING

Non-exhaustive list of initiatives.

<b>Boosting competitiveness</b>	<b>Date</b>
Finalize by-laws of sector regulators, in line with the new framework law, including the National Competition Authority	Q4-2014
Implement package of €3.4bn of measures to eliminate the tariff debt by 2020 as well as a new package of measure in order to stabilize energy prices	Ongoing
Application of the “one-in, one-out rule” and other regulatory impact assessment mechanisms, approved by the Council of Ministers	Q4-2014
Review the legal regime of the Spatial Planning Instruments (RJIGT) and the legal regime for Urbanism and Building (RJUE)	Q2 - 2014
Adapt each of the professional associations’ by-laws to the new framework law for regulated professions	Q3-2014
Introduce the new Code of Administrative Procedure	Up to 2015
Implement the new judiciary map	Q4-2014
Launch and monitor affective use of the National Guarantee Service to SMEs	Ongoing
Continue defined programmes to facilitate access to finance	Ongoing
Make operational the Development Financial Institution	Q4-2014
Finalize and implement creditor early warning system of Bank of Portugal	Q3-2014
Proceed with amendments to SIREVE, to foster out-of-court debt restructuring agreements	Q4-2014
Adoption of the National Green Growth Roadmap and of the Green Taxation Reform	Q3-2014
Implement the Strategic Plan for Transports & Infrastructure	Ongoing
Proceed with the negotiation of Ports concessions, with a view to increase competitiveness	Q2-2014
Implement the restructuring of the water services sector	Ongoing - 2015

<b><i>Promoting Human Capital &amp; Employment</i></b>	<b><i>Date</i></b>
Monitor labour market reforms performed and fine-tune accordingly, namely the recent change to the labour code	Ongoing
Proceed with the promotion of collective bargaining to stimulate social dialogue	Ongoing
Proceed with a skills assessment study from OECD	Q4-2014
Proceed with Youth job creation initiatives	Ongoing
Further foster trust agreement with schools	Ongoing
Continue efforts to improve vocational education and training	Ongoing
Present and implement National Roadmap for Research Infrastructures	Q3-2014
<b><i>Streamlining the Public Sector</i></b>	<b><i>Date</i></b>
Implement measures to ensure sustainability of the pensions' system	Q4-2014
Plan and present a new model to consolidate non-contributory social transfers	2015
Proceed with the hospital reform, including the hospital network reform	Ongoing
Launch PREMAC II	To be detailed
Further promote the launch of shared services and entities	Q4-2014 and 2015
Implement the Interministerial Network for Administrative Modernization	Q3-2014
Continue "Programa Aproximar" at a local and regional level, producing and implementing concrete proposals of reorganization and rationalization	Q4-2014
Launch and implement PGERRTIC - plan for the restructuring and modernization of IT government systems	Q1-2015
Adopt the Government Digital Strategy (with ongoing improvements up to 2020)	Up to 2015
Proceed with effective implementation of the new wage scale and wage supplements scale	Q4-2014

# FISCAL COMMITMENTS

COMMITMENTS

FISCAL

Sustainable growth goes hand in hand with balanced public finances. The Portuguese Government is strongly committed to achieve and maintain a balanced budget, as well as gradually decrease the level of general government debt.

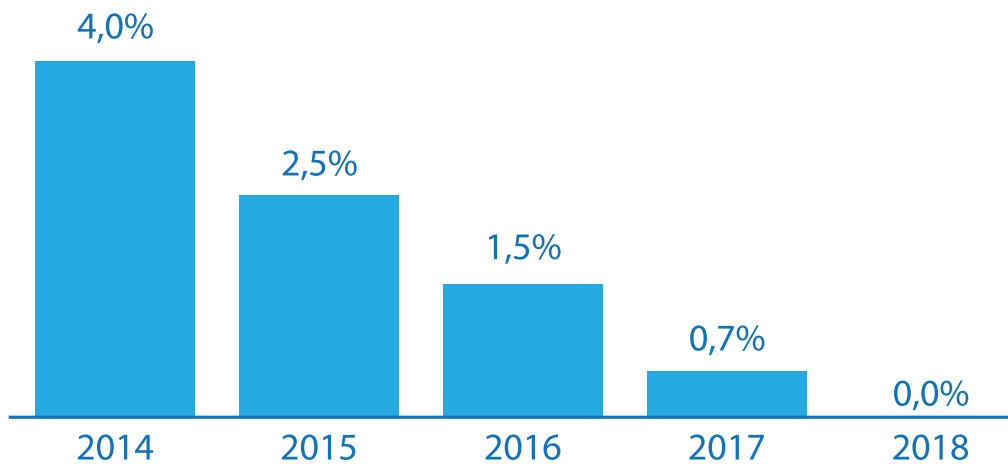
We consider that compliance with both the Stability and Growth Pact and the Fiscal Compact are critical instruments for sustainable growth in our country and in the European Union as a whole.

*Stability and Growth Pact*

According to the Stability and Growth Pact, member States must avoid excessive

government deficits, ensuring balanced and sustainable public accounts. The Pact establishes upper limits for the general government deficit (3% of GDP) and for the public debt ratio (60% of GDP). Portugal is on its way to comply with the requirements of the Pact regarding the general government deficit. The government remains committed to achieve a deficit of 2.5% of GDP in 2015, in line with the Council Recommendation with a view to bringing an end to the situation of excessive government deficit in Portugal. This commitment has been reaffirmed in the context of the Economic Adjustment Programme.

**General Government deficit 2014-2018**  
Percentage of GDP.

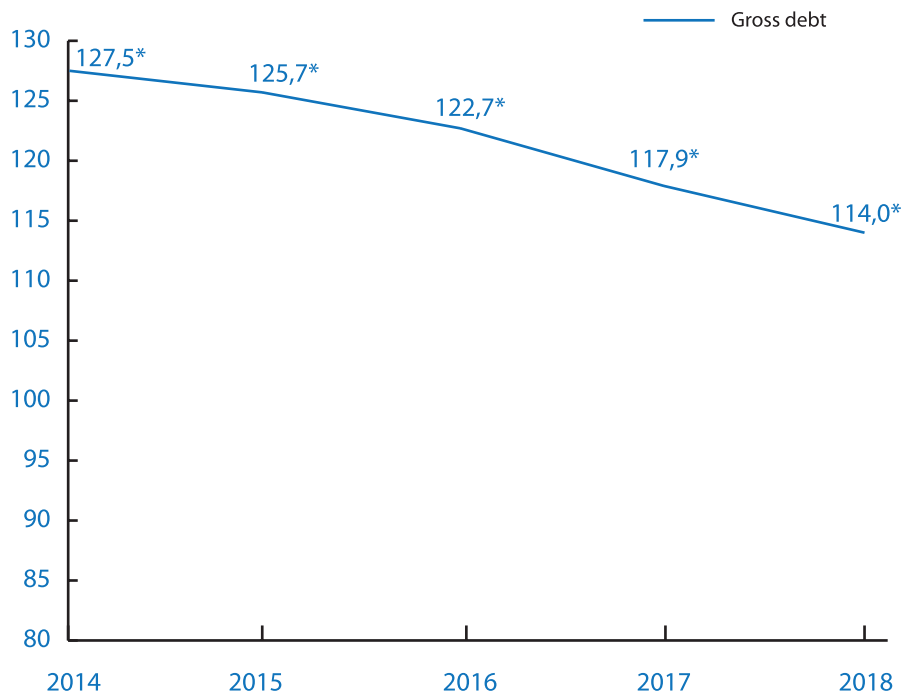


Source: Ministry of Finance, April 2014 – Fiscal Strategy Document.

In turn, general government debt as a percentage of GDP is expected to decrease from 2014 onwards. Nevertheless, it should be restated that net debt is expected to

remain around 120% of GDP by end-2014, reflecting accumulated cash buffer.

**General government debt evolution 2014-2020**  
Percentage of GDP.



\* Estimates from the Ministry of Finance for the debt profile under ESA 2010 (published in the Fiscal Strategy Document)

Debt-to-GDP ratio to be accounted with ESA2010 from September onwards.

Source: Ministry of Finance, April 2014 – Fiscal Strategy Document.

### *Fiscal Compact*

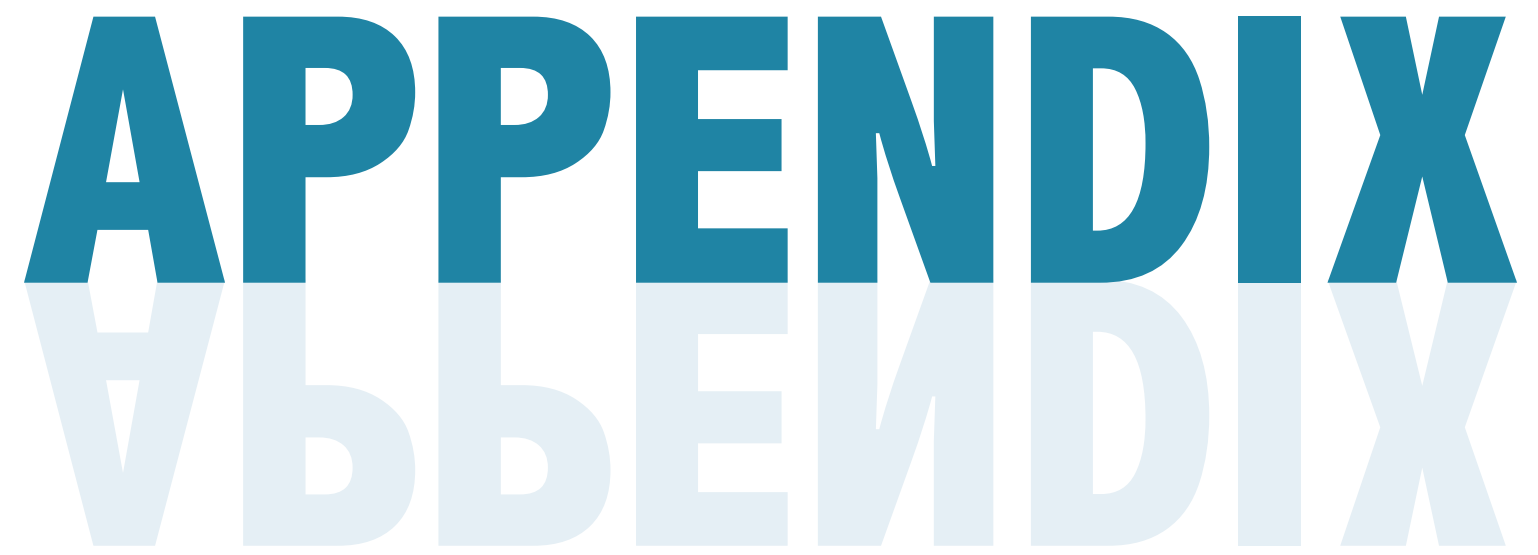
According to the Fiscal Compact, EU countries should ensure a medium-term balanced position of public accounts. For Portugal, this means achieving a structural balance of at least -0.5% of GDP. Portugal is expected to reach this medium-term objective in 2017.

In terms of public debt, whenever the limit of 60% of GDP is exceeded, the excess value should be reduced at an average rate of 1/20 per annum, with this average being calculated on a 3-year period.

In Portugal, the principles of the Fiscal Compact were transposed to the national

legal framework through the revised Budgetary Framework Law, which was approved in Parliament with a broad majority, including the main opposition party.

# APPENDIX



## Appendix I

Highlights of the Structural Agenda implemented during the Adjustment Programme
<ul style="list-style-type: none"> <li>Major revision of the labour code which reduced excessive rigidities, reduced severance payments, increased working time flexibility, altered conditions for individual dismissal, among other changes;</li> </ul>
<ul style="list-style-type: none"> <li>New assessment system to evaluate the impact of educational policies;</li> </ul>
<ul style="list-style-type: none"> <li>New framework for trust agreements with public schools, to increase autonomy;</li> </ul>
<ul style="list-style-type: none"> <li>Action Plan on vocational education and new dual training system, in partnership with major companies;</li> </ul>
<ul style="list-style-type: none"> <li>Liberalization of electricity and gas markets through the elimination of regulated tariffs;</li> </ul>
<ul style="list-style-type: none"> <li>In the energy sector, negotiated measures of 3.4bn to eliminate tariff debt while aiming to minimize the price increases to families and companies;</li> </ul>
<ul style="list-style-type: none"> <li>Transposition of the services directive through the elimination of restrictions in the legal regimes of 67 specific services, thus facilitating market entry and competition;</li> </ul>
<ul style="list-style-type: none"> <li>Development of the point of single contact, a multi-lingual electronic platform to go through all the formalities of setting up a business or request a license;</li> </ul>
<ul style="list-style-type: none"> <li>New urban lease law converging rights of owners and tenants to generate more dynamism in the rental market and thus promote labour mobility and reduce mortgages over time;</li> </ul>
<ul style="list-style-type: none"> <li>Adoption of a new framework law for regulated professions and transposition of the professional qualifications directive, eliminating excessive restrictions and facilitating access to professions;</li> </ul>
<ul style="list-style-type: none"> <li>New law on arbitration, adopting best international practices, to facilitate out-of-court settlements;</li> </ul>
<ul style="list-style-type: none"> <li>Definition of the new Judiciary Map, to rationalize the network of courts and its management, which involves closing several court-houses, creation of specialized courts, definition of transparent performance indicators and new courts personnel management plan;</li> </ul>
<ul style="list-style-type: none"> <li>New Code of Civil Procedure to increase the speed and effectiveness of the judicial system, giving judges the capacity to resist the use of formalisms to delay proceedings;</li> </ul>
<ul style="list-style-type: none"> <li>Targeted measures to tackle the very high court backlog, which substantially increased the civil enforcement cases' resolution rate, from below 100% to almost 200%;</li> </ul>
<ul style="list-style-type: none"> <li>New framework law for enforcement agents and definition of quarterly targets for closing enforcement cases, a major bottleneck in the judicial system;</li> </ul>
<ul style="list-style-type: none"> <li>New insolvency code, to simplify procedures and facilitate negotiations with creditors;</li> </ul>
<ul style="list-style-type: none"> <li>New Competition Law, new Specialized Courts on Competition and Intellectual Property, and a new Framework Law for Regulators, to enhance the competition framework and create a true level playing field for companies.</li> </ul>
<ul style="list-style-type: none"> <li>Reduction and elimination of a number of regulations and licensing requirements, shifting most requirement from an ex ante authorization to an ex post verification, thus reducing costs and bureaucracy.</li> </ul>

## Appendix II

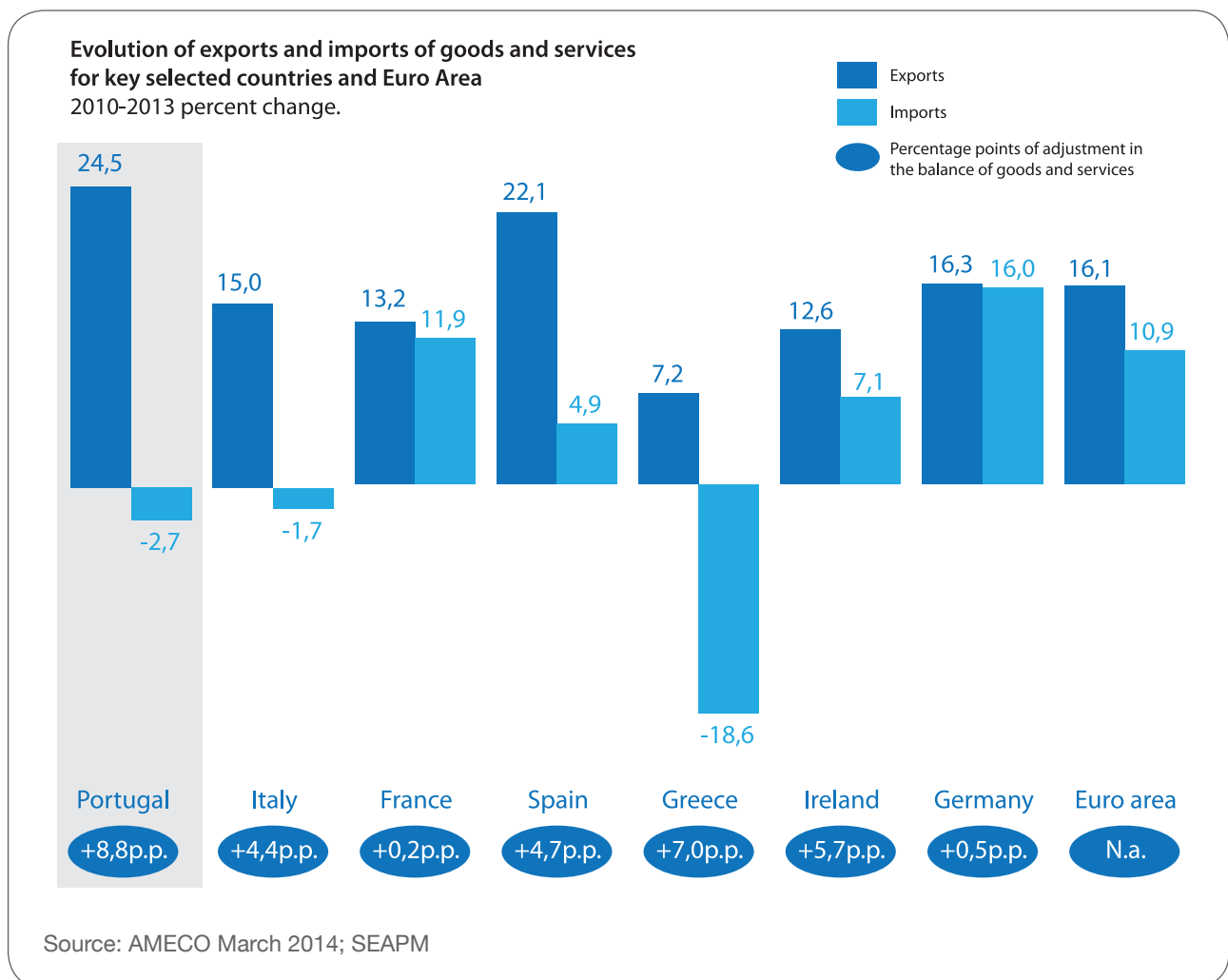
### *Correction of the external imbalance*

A major problem of the Portuguese economy in the run-up to the crisis was a long-standing and recurrent annual deficit in the current account, hovering at around 10% in recent years. This produced a rapid growth of external debt. Each year, imports and other sources of financial outflows were substantially larger than exports and other types of financial inflows. A deficit of 10% of GDP in a given year meant that each year something like 17 billion Euros was freshly added to Portugal's foreign liabilities. High internal demand, in large part fuelled by debt, and structural problems of competitiveness lay at the roots of this imbalance.

Early EU/IMF programme projections were pessimistic on Portugal's capacity to close this gap, projecting a deficit still above 2% by 2016. This pessimism was understandable. For countries outside monetary unions, a traditional easy fix was the devaluation of the currency, which automatically increases prices of imports and decreases prices of exports, thus restoring competitiveness albeit in a somewhat artificial and inequitable way. In the context of the monetary union, this was impossible, meaning that Portugal had to restore competitiveness through structural reforms, a harder and slower, though more sustainable process.

In fact the correction of this imbalance was much faster than anticipated. Portugal reached the current account level expected for 2016 already in 2012, four years ahead of schedule. In 2013 Portugal reached a

current account surplus of 0.5% of GDP and for 2014 there is an estimate of a surplus of 0.8% of GDP. This favourable performance came in part from a decrease in internal demand, and thus a reduction in imports; but it came mainly from an increase in exports. A couple of data points place this remarkable development in context: in 2012 the Balance of Goods and Services was positive for the first time since 1952; the growth of exports of goods and services between 2010 and 2013 was above 24%, a growth rate above that of comparable countries such as Spain, Italy, France or Ireland.



Portugal was thus able to demonstrate that within the constraints of the monetary union and through a difficult but necessary internal devaluation, it is possible to restore competitiveness. In four years, Portugal increased the weight of exports of goods and services in the GDP from less than 30% in 2009 to more than 40% now, raised the added value of its products, diversified markets and gained market share. And this was done against headwinds from the depressed demand in the traditional trading partners of Portugal.



With this document the Government presents its ongoing reforms towards sustainable growth and its commitments towards sound public accounts.

We embrace our ambitious medium-term strategy with confidence and credibility. Facing many hardships and showing great determination, Portugal was able to surpass one of the toughest crises in recent memory.

Pedro Passos Coelho  
*Prime Minister of Portugal*