Portugal: Report on the Observance of Standards and Codes—
Fiscal Transparency Module

This Report on the Observance of Standards and Codes on Fiscal Transparency for Portugal was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on November 18, 2003. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Portugal or the Executive Board of the IMF.

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EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in Portugal in relation to the requirements of the IMF Code of Good Practices on Fiscal Transparency based on discussions with the authorities and other organizations, the authorities’ response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF Manual on Fiscal Transparency (http://www.imf.org/external/np/fad/trans/manual/) should be consulted for further explanation of the terms and concepts discussed in this report.

Portugal meets the requirements of the fiscal transparency code in several areas and has been making significant progress in strengthening fiscal management and transparency. The allocation of responsibilities between different levels of government is clearly defined; intergovernmental fiscal relations are based on relatively stable principles; the legal frameworks for taxation, regulation and administrative procedures are complex, but generally observed in practice; the budget process is based on a clear legal framework and relatively open; adequate mechanisms of internal and external control of government operations are in place; and audited accounts of all government entities are prepared and disseminated, albeit with fairly long lags. New budget framework legislation has set the legal basis for ensuring improved consistency of budgeting policies at all levels of government, and has strengthened accounting and reporting requirements for all entities of the general government.

Still, there are several areas where fiscal management and transparency should be strengthened. With the focus of the fiscal accounts being on the general government, there has been a loss of focus on the finances of public institutions outside of the general government, including the finances and operations of state-owned enterprises and the rapidly proliferating public-private partnership arrangements. Also, budget preparation needs further strengthening, in particular with respect to better integrating the medium-term framework for budgetary policy with the annual budget process, and over time, developing a full-fledged medium-term budget. Similarly, improvements are needed to enhance the quality of budget projections and the analysis of fiscal risks, and to strengthen budget execution, reporting, and accounting processes. This needs to go hand in hand with further improvements in the systems of internal and external control.
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ABBREVIATIONS AND ACRONYMS

AC
ACOM National Communication Authority (Autoridade Nacional de Comunicações)
BP Bank of Portugal (Banco de Portugal)
BFL Budget Framework Law (lei de enquadramento orçamental)
BSL Budget Stability Law (lei da estabilidade orçamental)
CGD General Savings Bank (Caixa Geral de Depósitos, SA)
CMVM Securities Market Commission (Comissão do Mercado de Valores Mobiliários)
CPPT Code for Tax Processes and Procedures (Código de Procedimento e de Processo Tributário)
DGAL General Directorate for Local Affairs (Direcção-Geral de Asuntos Locais)
DGEP General Directorate for Studies and Forecasting (Direcção-Geral de Estudos e Previsão)
DGCI General Directorate for Taxes (Direcção-Geral de Impostos)
DGIO General Directorate for the Budget (Direcção-Geral do Orçamento)
DGT General Directorate of the Treasury (Direcção-Geral do Tesouro)
DR Department for Planning (Departamento de Prospectiva e Planeamento)
DPP Official Journal of the Republic (Diário da República)
EDP Excessive Deficit Procedure of the European Union
EMU European Monetary Union
ESA95 European System of Accounts (1995)
EU European Union
EUROSTAT Statistical Agency of the European Union
FAD Fiscal Affairs Department
FBM Basic fund
FCM Cohesion fund
FGM General fund
GOP Annual government planning framework document (Grandes Opcões do Plano)
IGCP Public Debt Management Institute (Instituto de Gestão do Crédito Público)
IGF General Inspectorate for Finances (Inspeção-Geral das Finanças)
IGJ General Inspectorate of Games (Inspeção-Geral de Jogos)
IMF International Monetary Fund
INE National Institute of Statistics (Instituto Nacional de Estatística)
IRS/IRC Personal and corporate income taxes
ISP Insurance Supervision Institute (Instituto de Seguros de Portugal)
LGT General Tax Law (Lei Geral Tributária)
MoE Ministry of Economy
MoF Ministry of Finance
Parpública Participações Públicas (SGPS), SA (Public Holding Company)
PGR Attorney General of the Republic (Procuradoria Geral da República)
PIDDAC Central Government Investment and Development Plan (Programa de Investimentos e Despesas de Desenvolvimento da Administração Central)
POCP Official Public Accounting Plan (Plano Oficial de Contabilidade Pública)
PPP Public-private partnership (parcerias público-privadas)
QFAs Quasi-fiscal activities
RGIT General Regime on Tax Infractions (Regime Geral das Infrações Tributárias)
ROSC Report on the Observance of Standards and Codes
SDDS Special Data Dissemination Standard
SGP Stability and Growth Pact
SOE State-owned enterprise
### PORTUGUESE WEBLINKS

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<th>Organization</th>
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<tr>
<td>Attorney General of the Republic</td>
<td><a href="http://www.pgr.pt">http://www.pgr.pt</a></td>
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<td>Bank of Portugal</td>
<td><a href="http://www.bportugal.pt">http://www.bportugal.pt</a></td>
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<tr>
<td>Community Support Framework for Portugal</td>
<td><a href="http://www.qca.pt">http://www.qca.pt</a></td>
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<tr>
<td>Competition Authority</td>
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<td>Constitutional Court</td>
<td><a href="http://www.tribunalconstitucional.pt">http://www.tribunalconstitucional.pt</a></td>
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<tr>
<td>Court of Auditors</td>
<td><a href="http://www.tcontas.pt">http://www.tcontas.pt</a></td>
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<tr>
<td>General Savings Bank (Caixa Geral de Depósitos)</td>
<td><a href="http://www.cgd.pt">http://www.cgd.pt</a></td>
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<td>Insurance Supervision Institute</td>
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<td>Ministry of Economy</td>
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<td>General Inspectorate for Economic Activities</td>
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<td>General Inspectorate for Games</td>
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<td>Department for Planning</td>
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<td>General Directorate of the Budget</td>
<td><a href="http://www.dpp.pt">http://www.dpp.pt</a></td>
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<td>http://www.dgaiec_min-financas.pt</td>
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<td>General Inspectorate of Finances</td>
<td>http://www.igf_min-financas_pt</td>
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<tr>
<td>General Directorate for Nonfinancial Assets</td>
<td><a href="http://www.dgpatr.pt">http://www.dgpatr.pt</a></td>
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<td>General Directorate for Studies &amp; Forecasting</td>
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<td>General Directorate of the Treasury</td>
<td><a href="http://www.dgt.pt">http://www.dgt.pt</a></td>
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<tr>
<td>Public Debt Management Institute</td>
<td><a href="http://www.igcp.pt">http://www.igcp.pt</a></td>
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<td>Ministry of Defense</td>
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<td>National Institute of Statistics</td>
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<tr>
<td>National Assembly of the Portuguese Republic</td>
<td><a href="http://www.parlamento.pt">http://www.parlamento.pt</a></td>
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<tr>
<td>Regulatory Entity for Energy Services</td>
<td><a href="http://www.erne.pt">http://www.erne.pt</a></td>
</tr>
<tr>
<td>Securities Market Commission</td>
<td><a href="http://www.cmvm.pt">http://www.cmvm.pt</a></td>
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A number of portals have a broad range of links to Portuguese government websites, including the Portal to Portugal’s Public Administration (http://www.infocid.pt); the Portal to Portugal’s Government (http://www.governo.gov.pt or http://www.portugal.gov.pt); and the Portal to Portuguese Government web sites (http://www.gksoft.com/govt/en/pt.html).

### Portugal: Basic Data

<table>
<thead>
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<th>Type of government: Parliamentary Republic</th>
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<tr>
<td>Population (2001): 10.4 million</td>
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<tr>
<td>GDP (2002): €128,529 million (est.)</td>
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<tr>
<td>Debt/GDP (end-2002): 58.9 percent (est.)</td>
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I. INTRODUCTION

1. This draft report provides an assessment of fiscal transparency practices in Portugal against the requirements of the IMF Code of Good Practices on Fiscal Transparency. The assessment has two parts. Section II is a description of practice, prepared by the staff of the International Monetary Fund (IMF) on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. Section III provides an IMF staff commentary on fiscal transparency in Portugal.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. The institutional coverage of the general government is defined in line with the 1995 European System of Accounts (ESA95). The general government is divided into the central government, the social security system, and the local governments. The National Institute of Statistics (Instituto Nacional de Estatística, INE) is responsible for compiling general government statistics in lines with ESA95, as established by the 1996 European Union (EU) regulation No. 2223. The Directorate for the Budget (Direcção-Geral do Orçamento, DGO) also compiles general government statistics according to ESA95. In the last several years, INE has produced final general government accounts with a two-year lag, while the DGO has prepared estimates for the current and the previous year.

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1 This report was prepared by an IMF staff team comprising Teresa Ter-Minassian (head), Gerd Schwartz, Helio Tollini (all from the Fiscal Affairs Department (FAD)), Juan-Carlos Lerda (panel expert, FAD), and Luisa Zanforlin (European Department), based on a mission that visited Lisbon during May 20–June 2, 2003. The staff team met with officials from the Ministry of Finance, the Ministry of Health, the Court of Auditors, the National Assembly, the National Institute of Statistics, the Central Bank, the Economic and Social Council, the Institute for Financial Management of Social Security, the Institute for Public Debt Management, the Municipality of Lisbon, and the Commission in Charge of Auditing the 2001 General Government Accounts.

2 The central government comprises integrated government agencies and services (i.e., those without financial and administrative autonomy) and approximately 350 autonomous funds and services, including health-sector institutions (e.g., hospitals) and institutions of higher education. The social security system comprises the public systems for private and public sector employees. The local governments consist of municipalities and boroughs, with several boroughs making up a municipality. There are 308 municipalities (278 are in continental Portugal, 19 in the Azores, and 11 in Madeira) and 4,251 boroughs (4,047 are in continental Portugal, 150 in the Azores, and 54 in Madeira). The Azores and Madeira are autonomous regions. The General Directorate for Local Affairs (Direcção-Geral da Administração Local, DGAL) of the Ministry for Territory and Environment maintains an updated list of all entities that make up the local government sector. Note that the Portuguese definition of the “state” differs from the standard definition of the central government in that it only includes the integrated agencies and services.

3 Accordingly, the general government includes all institutional entities that produce market and non-market goods and services that are primarily financed by mandatory payments and/or whose main function consists of redistributing the nation’s income and wealth. The distinction between market and non-market goods and services is based on whether the share of sales income covering production costs exceeds 50 percent.
3. **The allocation of responsibilities between different levels of government is clearly defined and inter-governmental fiscal relations are based on stable principles.**

The basic principles of intergovernmental fiscal relations are set out in the Portuguese Constitution. The constitution (Articles 225–234) provides to the two autonomous regions (Azores and Madeira) broad legislative and administrative autonomy, including the right to exercise their powers of taxation and use the tax revenue collected or generated there; to adapt the national fiscal system to regional circumstances (which, among others, includes the right to grant tax exemptions); and to approve a regional budget. Similarly, the constitution (Articles 235–265) recognizes local authorities, granting them their own assets and financial resources, and stating that they may have powers to levy taxes in accordance with the circumstances and terms provided by the law. An overview of the system of local government finances is provided in Box 1. The Finance Law of the Autonomous Regions and the Local Finance Law define the taxing powers and revenues allocated to these levels of government, and set out the legislative competencies in the fiscal area. All levels of government have the right to borrow, although these rights have now become subject to the limitations set out in the Budget Stability Law (BSL), an overview of which is provided in Box 2. Article 1 of the BSL, which is an organic law and has higher status than regular legislations or decree legislations, enables the annual state budget law to establish limits on the net increase in indebtedness of the state, the autonomous regions, and the local authorities that is compatible with the targeted general government deficit. The same article states that such limits may be lower than those set out in the separate financial laws applicable to each level of government.

4. **Government activities are clearly distinguished from the activities of state-owned enterprises (SOEs), both in the financial and non-financial sectors.** Most SOEs have been transformed into joint-stock companies, and are subject to the same rules and regulations that govern the private joint-stock companies. The state directly participates in the various joint-stock companies, either as a majority owner or by retaining significant voting rights. The role of SOEs is clearly defined in the law, and they are subjected to common commercial, tax, and labor laws, corporate governance regulations, and competition

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6 This is also Article 84 of the Budget Framework Law (BFL).

7 There are only six SOEs that have not been corporatized as joint-stock companies but as state enterprises: the Portuguese Investment Agency (Agência Portuguesa para o Investimento), the Portuguese Railways (Caminhos de Ferro Portuguese), the Management Agency for Strategic Petroleum Reserves (Entidade Gestadora de Reservas Estratégicas de Produtos Petrolíferos), the Lisbon Metro (Metropolitano de Lisboa), the Portuguese Air-traffic Management Agency (Navegação Aérea de Portugal), and the National Rail Network (Rede Ferroviária Nacional). Still, only two SOEs—the telecommunications company (Portugal Telecom) and the energy company (Electricidade de Portugal)—are listed on the stock exchange, and face more stringent reporting requirements, as required by the Securities Market Commission (Comissão do Mercado de Valores Mobiliários, (CMVM)).
rules. Those SOEs that are required to provide services in largely monopolistic markets (e.g., public transportation) usually face regulated prices that fall short of cost recovery, and in return receive subsidies from the budget, in line with EU directives on state aid to public enterprises. While there is no close centralized monitoring of SOE activities, the EU legal framework regarding the reporting of state aid to state enterprises, as well as a recent ruling by the Statistical Agency of the European Union (EUROSTAT) on the accounting treatment of capital injections to state enterprises in persistent deficit, have helped to clarify the fiscal accounting of such budgetary support. In general, SOEs that provide services at prices below cost recovery levels receive subsidies from the state budget. However, in several cases, privatization proceeds have been used for recapitalization operations. These capital injections allowed the government to reduce current transfers from the budget.8

5. **The size of the state-owned enterprise sector has been reduced with the help of privatization operations that have a clear legislative basis and are carried out transparently.** The general legal basis for privatization is provided by a 1990 framework law,9 which allows for the full privatization of state enterprises, and sets out a number of objectives for privatization, including enhancing competitiveness, strengthening the national entrepreneurial capacity, reducing the weight of the state in the economy, promoting the development of domestic capital markets, and reducing public debt. In the wake of this law, a variety of economic activities was successively opened to private-sector initiative through successive changes in the law on the Delimitation of Economic Sectors, which was revoked in 1997 by a law10 that regulates (as opposed to restricting) private sector initiatives in different economic activities. Privatization operations were carried out using a range of modalities, including public offers, offers to institutional investors, direct sales, direct sales to strategic investors, and public auctions. Up to 60 percent of net privatization proceeds can be used for recapitalization operations with the remainder going largely toward public debt reduction. A general overview of progress with reducing the size of the state is provided in Box 3. Privatization has helped to reduce government equity holdings to levels that are broadly comparable to those in other EU economies. Nevertheless, the government retains majority and minority shareholdings in enterprises that operate in a broad range of economic sectors.

6. **Portugal is in the process of dismantling various restrictions on foreign ownership.** The Portuguese privatization framework has retained restrictions on foreign ownership of enterprises in certain sectors, and, in general, requires prior authorization for

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8 For example, the Lisbon Metro has benefited both from recapitalization operations out of privatization proceeds and from budget subsidies.

9 *Lei Quadro das Privatações*, No. 11/90 of April 5, 1990. A first step toward strengthening the private sector had been carried out in 1982 with a constitutional revision that opened several sectors (e.g., banking, insurance, cement) to private investment. In 1988, Law No. 84/88 of July 20 allowed for transforming public enterprises into stock companies, but required the state to maintain majority control. The first privatization operations of minority share holdings were carried out in 1989 on the basis of this law.

foreign acquisition of more than 10 percent of the shares in companies that are being privatized. In a June 2002 decision, the European Court of Justice viewed this as restricting the free movement of capital within the EU and requested that it be modified. To comply with this ruling, the Council of Ministers adapted, on June 13, 2003, a draft law amending the framework law on privatization and abrogating its subsidiary legislation\(^ {11} \) whereby all restrictions on capital holdings and acquisitions by foreigners will be abolished; the draft legislation is currently before Parliament.

7. **The increased use of public-private partnerships in investment projects has been complicating the distinction between public sector and private sector activities, but the government has recently started to strengthen its control over these arrangements.** Since 1996, and similar to other countries, Portugal has increasingly made use of public-private partnership (parcerias público-privadas (PPP)) arrangements for carrying major investment projects, particularly in the transport sector (e.g., highway construction, bridges), but also in other areas (e.g., health care). Initially, the government exercised little control over these projects, and particularly the potential long-term fiscal risks they implied for government budgets.\(^ {12} \) Already in the BFL (Article 16) the government stipulated that the fiscal incidence of these projects had to be estimated and taken into account in the budgeting process. In 2003, a decree law\(^ {13} \) established general rules and principles to be followed by all public entities at the national level in defining, conceptualizing, preparing, establishing, altering, budgeting, and exercising oversight over PPP projects.\(^ {14} \) The law requires, for example, that the partition of risks between public and private entities be clearly identified in each PPP project, and it establishes rules that have to be followed for doing so. It also provides that all PPP proposals be evaluated by a commission that involves the MoF and the relevant sectoral ministry.

8. **Government regulation of the nonbank private sector is implemented through clear and increasingly open regulatory processes, and in accordance with nondiscriminatory criteria, as mandated by the EU legislative framework.** Private-sector commercial activities are governed by the Portuguese civil code, the commercial code, and the commercial corporations code,\(^ {15} \) and regulated and monitored by a number of public regulatory and supervisory bodies; these are largely organized along sectoral lines.\(^ {16} \) Similar

\(^{11}\) Decree Law No. 380/93 of 1993.

\(^{12}\) Lax administrative controls, accounting, and monitoring, of PPPs prior to the Spring of 2003 resulted in the discovery, after a comprehensive audit, of outstanding government liabilities of more than 10 percent of GDP at end 2002.

\(^{13}\) Decree Law, No. 86/2003 of April 26, 2003.

\(^{14}\) It should be noted that PPPs at the local and regional government levels are not subject to the BFL.

\(^{15}\) Decree Law, No. 262/86 of September 2, 1986 (Código das Sociedades Comerciais).

\(^{16}\) Main regulatory bodies are the Insurance Supervision Institute (Instituto de Seguros de Portugal, (ISP)), the CMVM; the Competition Authority (Autoridade da Concorrência, (AC)); the Regulatory Entity for Energy Services (Entidade Reguladora dos Serviços Energéticos); the National Communication Authority (Autoridade Nacional de Comunicações (ANACOM)); the Regulatory Institute for Water and Waste (Instituto Regulador (continued... )
to other countries, Portugal has generally sought to safeguard the political independence of regulators, but there is no uniform framework for regulatory agencies, and the various regulators operate under different legal arrangements. For example, some regulatory agencies are autonomous funds, while others are general directorates of a ministry, a difference which partly reflects whether or not they cover at least two-third of their expenditures by own-revenues. As a result, the various regulatory agencies enjoy a somewhat different degree of autonomy. There has been a growing trend toward open formal processes before implementing new regulations, or when reviewing existing regulations. Examples are the price-setting mechanism in the electricity sector, or the regulation of the minimum services in telecommunications, which both involve a formal public process of consultation with the relevant economic agents.

9. **The central bank is independent and does not carry out quasi-fiscal activities (QFAs).** Portugal is a member state of the European Monetary Union (EMU) and the Bank of Portugal (BP) forms part of the European System of Central Banks, whose main objective is to maintain price stability within the Euro area. According to its Organic Law, the BP is not allowed to provide overdraft facilities or any other type of credit to the state or to entities that depend on the state, either directly or indirectly. In addition, it may not guarantee any commitments of the state or of the entities that depend on the state, or buy debt instruments issued by these bodies. The BP has ceased to perform banking functions for the national treasury, which now uses the retail banking system for virtually all its transactions. The

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**das Águas e Resíduos;** the National Institute for Railway Transport (**Instituto Nacional do Transporte Ferroviário**); the National Civil Aviation Institute (**Instituto Nacional de Aviação Civil**); and the Institute for the Markets of Public and Private Works and Real Estate (**Instituto dos Mercados de Obras Públicas e Particulares e do Imobiliário**). All these entities have broad legal and regulatory/supervisory functions. The AC, for instance, which was formed only recently by joining two public entities that had overlapping responsibilities, deals with issues involving competition, market power, and mergers and acquisitions. It oversees compliance with competition rules to help ensure an efficient functioning of markets and protect the rights of market participants, and it oversees implementation and compliance with EU competition directives. Similarly, the ISP produces technical rules and cooperates in the drafting of new legislation that governs access to and the pursuit of the insurance and pension fund businesses, monitors operators (insurance companies, brokers, and pension fund managers), and controls compliance with the rules and regulations that govern the sector. Other entities, that are organized as independent services of ministries, also have regulatory functions. These include, for example, the General Inspectorate for Economic Activities (**Inspeção-Geral das Actividades Económicas**), and the General Inspectorate of Games (**Inspeção-Geral de Jogos**) of the Ministry of Economy (MoE).

17 For example, in the case of ANACOM, the head of the agency is appointed by the Council of Ministers for a period of five years. ANACOM reports to the MoE, and is largely financed through industry fees.


19 The General Directorate of the Treasury (DGT) still holds two accounts with the BP—a clearing account (**conta única de liquidação**) with an intra-day credit line, and an account for financial applications (**recursos disponíveis**)—that have maintained daily cash balances near zero in 2002–03. The DGT now holds transaction accounts and carries out payment operations with all major commercial banks that operate in the Portuguese retail market.
balances held in treasury accounts with the banking system are remunerated at an interest rate that is usually based on the overnight interest rate of the European Central Bank.\textsuperscript{20}

10. **The roles of the executive, legislative, and judicial branches are clearly defined in the constitution.** The constitution defines as “organs with supreme authority” the President of the Republic, the Assembly of the Republic, the Government, and the Courts (Article 110), and states that these organs shall be separate and independent (Article 111). Section IV (Articles 101–107) of the Constitution covers the financial and fiscal systems. Article 103 states, among others, that the fiscal system shall be directed toward meeting the financial requirements of the State and other public bodies. Article 104 establishes some main taxes (personal and corporate income taxes (IRS/IRC), property taxes, and consumption taxes). Articles 105–06 are devoted to the state budget and to state budget preparation. In addition to providing general specifications on content and coverage, Article 105 stipulates that the budget be prepared in unitary form “so as to preclude the existence of secret appropriations and funds.” Article 106 stipulates that the draft budget shall be accompanied by a number of reports (e.g., on predicted trends in the principal macroeconomic indicators that have a bearing on the budget) that provide background information so as to enhance the transparency of proposed budget allocations. Also, the Constitution (Article 107) gives to the Court of Auditors (Tribunal das Contas) and to the Assembly of the Republic the right and obligation to review the implementation of the state budget.\textsuperscript{21} It states that, having received the opinion of the Court of Auditors, the Assembly shall scrutinize and approve the General Accounts of the State.

11. **Fiscal management is defined by a clear legal and administrative framework that provides to the government significant discretion in budget execution.** The general legal framework for fiscal management is contained in framework legislation (including the BFL and BSL), the annual budget laws, and the annual budget execution decree.\textsuperscript{22} In general, the framework legislation leaves significant room to the annual budget laws to impose additional restrictions on the year-to-year management of public finances, for example by limiting the rights of the subnational governments to incur debt. The annual budget laws, in turn, provide significant discretion to the MoF for managing flexibly the budget execution within the year. The budget execution decrees define specific norms that govern budget execution within the year, and stipulate that the MoF, through its DGO, is in charge of controlling all expenditures and monitoring budget execution; the DGT of the MoF functions as an agent that carries out all payment transactions related to the state budget.

\textsuperscript{20} There are also deposits (of one or two week maturity) where the reference rate is the Euribor.

\textsuperscript{21} The Court of Auditors is entrusted with reviewing the legality of public expenditure and delivering judgment on the accounts that are submitted to the Court. Its responsibilities cover, in particular, general accounts of the State (including social security system), the accounts of the Autonomous Regions of the Azores and Madeira (Article 214), and the accounts of the local authorities (according to Articles 51 and 52 of Law No. 98/97 of August 26, 1997 (Lei de Organização e Processo do Tribunal de Contas)).

\textsuperscript{22} For 2003, see Decree Law No. 54/2003 of March 28, 2003 on Budget Execution for 2003 (Execução Orçamental para 2003).
12. Mechanisms for the management and coordination of budgeted activities are well defined; reportedly, all extrabudgetary activities have been phased out. The DGO executes and controls the financial policies of the state on the basis of the state budget. More specifically, among others, it coordinates the preparation of the state budget, controls budget execution of all services and entities of the central administration, oversees the centralized recording of all public revenues and expenditures; and coordinates the information and management system for the central government budget. It is also entrusted with developing the public accounting framework and overseeing its application in the public administration. The authorities report that all extrabudgetary activities have been phased out since Portugal joined EMU.

13. Mechanisms for coordination between the budget, the central bank, and public financial institutions are well defined. There are regular close consultations and exchanges of information between the MoF and the BP, but there is no need for day-to-day coordination of fiscal and monetary policies given that Portugal is part of EMU, and that the BP is independent and does not carry out payment operations for the MoF. Like other commercial banks, the MoF uses the large and fully state-owned General Savings Bank (Caixa Geral de Depósitos, CGD) as a treasury payment system agent and for collecting revenues, but, overall, the government maintains an arms-length relationship with the CGD on a day-to-day basis. CGD is a large conglomerate that pursues its own commercial objectives under the supervision of the BP and the ISP. However, the MoF is responsible for giving strategic policy orientations at the CGD’s annual assembly, and taking decisions on capital injections.

14. The legislative bases for taxation, regulation, and administrative procedures are complex but generally observed in practice, and taxpayers’ rights are protected. Article 103 of the Constitution recognizes the right to establish laws to impose taxes, and Article 104 mentions four specific taxes (IRS/IRC, property taxes, and consumption taxes) and their purpose. The main basic tax laws are the General Tax Law (Lei Geral Tributaria), the Code for Tax Processes and Procedures (Código de Procedimento e de Processo Tributário (CPPT)), and the General Regime on Tax Infractions (Regime Geral das Infracções Tributárias), which, among others, set out the general principles and procedures relating to tax assessment, tax exemptions and benefits, tax liabilities, taxpayers’ rights, and the powers of the tax administration. Taxpayers have the right to obtain from tax officials all

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23 Decree Law No. 344/98 of November 6, 1998 establishes the responsibilities of the DGO.

24 At December 31, 2002, the CGD held controlling interests in ten commercial banks, five investment banks, six financial institutions in the area of asset management, six firms devoted to specialized credit, 12 insurance companies, three e-business firms, seven firms in charge of auxiliary services, and two asset management companies. Also, it held minority participations in 23 other financial institutions. The group’s total assets were approximately 50 percent of GDP, whereas the book value of the treasury capital subscription was about 2 percent of GDP in 2002.


relevant information, and receive correct and effective assistance, and there are taxpayer assistance services located in key urban areas, some of which are equipped with special assistance phone lines. Similarly, multi-purpose citizen support shops (lojas do cidadão) also provide one-stop tax information to citizens.\textsuperscript{27} There is, however, significant scope for simplifying the tax system to enhance transparency and strengthen taxpayer compliance, and for reducing delays in the tax administration’s responses to taxpayer inquiries. Legislation to protect taxpayers’ rights is elaborate and comprehensive, and usually observed in practice.\textsuperscript{28}

In the complaint process, administrative procedures generally precede court proceedings, but taxpayers do not need to exhaust their administrative recourse options before seeking recourse in the court system. The operations of the General Directorate for Taxes (Direcção-Geral de Impostos, DGCI) are subject to different supervision and control mechanisms, including through the General Inspectorate for Finances (Inspecção-Geral de Financas, IGF), the Court of Auditors, and the National Assembly.

15. Public servants are subject to various, partially overlapping, codes of behavior that are contained in different laws, and subject to oversight and enforcement by different bodies. The Constitution states that public officials shall perform their functions on the basis of equality of treatment, proportionality, fairness, impartiality, and in good faith (Article 266), and that they shall serve exclusively the public interest (Article 269), while barring the possibility of holding more than one public office, unless expressly permitted by law. The Constitution leaves it to other legislation to determine under what circumstances private activity is incompatible with holding a public office (Article 269). The Administrative Procedures Code\textsuperscript{29} reaffirms these principles and, among others, provides mechanisms for safeguarding impartiality (e.g., by impeding public servants from intervening in administrative processes in which they have a private interest), and indicates disciplinary actions in the case of violations. The Criminal Code\textsuperscript{30} provides for barring public officials from office, and suspending their public functions for crimes committed in office, and, in particular, for punishing deeds or practices of active or passive corruption or of improper appropriation or use of goods and assets. The Disciplinary Statute\textsuperscript{31} contains a range of specific penalties (e.g., prosecution, suspension, compulsive retirement, dismissal) for specific violations of the principles of fairness and impartiality, for unlawful holding of more than one public post, and for unlawful access to or appropriation of assets. The General Regime of Incompatibilities for Public Employees,\textsuperscript{32} not unlike the Constitution, details a

\textsuperscript{27} In addition, all tax legislation is published in the DR, and the website of the DGCI of the MoF contains a broad range of information, including, among others, a searchable database on tax legislation and tax forms.

\textsuperscript{28} See, for example, in the General Tax Law (Lei Geral Tributária, LGT) Articles 8, 9, 11, 12, 59, 60, 64, 67, 68, 75, 76, 95, and 97.

\textsuperscript{29} Decree Law No. 442/91 of November 15, 1991.

\textsuperscript{30} Decree Law No. 400/82 of September 23, 1982

\textsuperscript{31} Decree Law No. 24/84 of January 16, 1984.

\textsuperscript{32} Decree Law No. 413/93 of December 23, 1993.
number of undertakings that are prohibited for public employees (e.g., carrying out private activities that are similar or competing with the public function; seeking benefits from or participating in public contracts or services entered into the employee’s authority; intervening in acts that fall under the competence of the employee). High-ranking public officials (e.g., political appointees) are subject to various specific rules and regulations. These generally prohibit assuming any other type of public, professional, or private function while holding office, and assuming private functions immediately after stepping down from public office. They also require a declaration of no conflicts of interest to be submitted to the Attorney General of the Republic (Procuradoria Geral da República) before entering into office. Similarly, upon taking up office, political appointees are required to present to the Constitutional Court (Tribunal Constitucional), a declaration of income, assets, and social functions exercised previously.

B. Public Availability of Information

16. Various publications that report information on government finances are available from several institutions. These include the MoF, the INE, and other entities in the general government (e.g., the social security institutions). Consolidated information on the general government is available only from the MoF and the INE. An overview of the main documents for fiscal and budgetary reporting is provided in Table 1.

17. The state budget focuses on the central government and the social security system, but it also provides aggregate data on the rest of the general government and the consolidated general government. The state budget documents cover, on a cash basis, the operations of the central government (including its integrated services and its autonomous funds and services) and the social security system. The accounts of the integrated services are presented by economic, functional, and organic classification schemes. Revenue items are broken down by main categories. The budgets for the autonomous funds and services, and the social security system are presented by economic and functional classifications but on a more aggregate basis. The budget of the ministry of defense is presented at a level of detail comparable to those of other ministries. The expenditures of the autonomous funds and services are shown in the accounts of the ministry to which they belong. Expenditures pertaining to the multi-year central government investment and development plan (Programa de Investimentos e Despesas de Desenvolvimento da Administração Central (PIDDAC)),

33 Decree Law No. 196/93 of May 27, 1993 for political appointees; Law No. 64/93 of August 26, 1993 for heads of entities related to national sovereignty, political appointees, and high-ranking political appointees; and Decree Law No. 12/96 of April 18, 1996 for high-ranking leaders of public functions.

34 Stemming from the Law on the Organization, Functioning, and Procedures of the Constitutional Court (Law No. 28/82, of November 15, 1982), the Constitutional Court lists among its nine special responsibilities to process the income and asset declarations of political appointees, and their declarations on incompatibilities and impediments.

35 The PIDDAC includes a six-year rolling expenditure framework including both government-financed and EU-supported investment projects in the context of the Community Support Framework for 2000–06 (Quadro (continued... )
are also grouped by ministry. Projected financial flows with the EU are broken down by type, and transfers to public sector enterprises are presented by sector of economic activity. The state budget documents also include tables with the financing requirement and outstanding debt stock of the state, and aggregate bond issuance plans for the relevant budget year. Projections of general government operations on an ESA95 basis, at an aggregate level and on the basis of an economic classification, were presented for the first time in the 2003 budget document.

18. **Transparency of budget execution is expected to be significantly enhanced by recent legislation strengthening reporting requirements for all sectors of the general government.** Specifically, the BFL (Article 57) provides that, before May 15th of each fiscal year, there should be a parliamentary discussion of the first quarter budget execution for the general government, on the revisions to fiscal targets set out under the Stability and Growth Program, and of the PIDDAC. The government is to submit a report with the relevant information before the parliamentary debate. To facilitate the preparation of these reports, the BFL and the state budget execution decree for 2003 strengthened specific reporting requirements for the various components of the general government. These requirements are expected to be implemented in the course of 2003.

19. **Monthly data on budget execution are published on a cash basis.** These are available on the DGO website, covering the central government (with a 15-day lag), and, since January 2003, the social security administration (with a 45-day lag). Quarterly accounts for the autonomous funds and services and for the local governments are expected to begin being published as of mid-2003, although some of the smaller local authorities may have difficulties complying with the enhanced reporting requirements by that time.

20. **The budget documents present limited information on contingent liabilities.** The budget laws set annual limits on new guarantees granted by the state and other public entities. A detailed list of outstanding guarantees is included in the final accounts of the state for each year. No information is provided on past calls on such guarantees. Little information is available to the National Assembly or the general public on other possible sources of contingent liabilities, in part reflecting the fact that SOEs are not monitored closely by the MoF and that close oversight over PPPs only started recently. However, in the context of the periodic reporting requirements to the Economic Policy Committee/Aging Working Group (EPC/AWG), the MoF has been requested to undertake studies analyzing the sustainability

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36 In line with the Portuguese definition of the “state,” this covers only the integrated agencies and services, and excludes the autonomous funds and services.

37 The largest autonomous funds and services are already submitting monthly reports on budget execution to the DGO, but data for the smaller ones are currently received only on a quarterly basis.

38 This is a special working group that was set up to monitor pension and health care spending medium- and long-term trends in EU countries.
and the fiscal risks of the pension and health system. These studies have been completed and are currently available on the website of the General Directorate for Studies and Forecasting (Direcção-Geral de Estudos e Previsão (DGEP)) of the MoF, although they were not referred to in the state budget documents. The state budget documents also do not discuss contingent liabilities arising from PPP arrangements in large infrastructure projects. The state budget usually contains an allocation of about 1 percent (and up to 1.5 percent) of total expenditures to allow for contingent expenditures. However, this allocation has mostly been used to cover additional wage expenditures arising from the uncertainty of the civil service wage adjustment at the time of the budget approval, and, in some case, to deal with higher-than-projected spending.

21. **The state budget documents provide fairly detailed information on tax expenditures.** In accordance with Article 34 of the BFL, the state budget accounts include estimates of tax expenditures by category, together with estimates of revenue losses, including for the past three years and a forecast for the year to which the state budget refers to. Also, Law No. 26/94, of August 19, 1994 requires that any tax benefits granted to individuals are to be published in the DR.

22. **In contrast, no information is provided on QFAs.** As indicated above, the BP does not carry out QFAs. However, some SOEs, such as those in the transport and communication sectors, are required to provide services at prices that are below cost-recovery that are in line with EU directives on state aid. There is no requirement that budget documents include information on operations of SOEs, beyond budgeted transfers to them. Thus, the budget does not capture QFAs that are not compensated through explicit budget transfers or capital injections to the SOEs.

23. **Accurate and timely information on state debt is published monthly.** These data are compiled on a gross basis and at face value, and include values of debt buybacks and swaps. State budget documents show annual data on gross public debt for the general government following the EU’s excessive deficit procedure (EDP) rules.\(^{39}\) Data for central government debt (i.e., including the autonomous funds and services) are published quarterly on the IMF’s special data dissemination standard (SDDS) website.

24. **Formal commitments for timely publication of a broader coverage of the fiscal data have been made and advance-release calendars are announced and disseminated on the SDDS website.**\(^{40}\) Article 78 of the BFL provides that quarterly information on the operations of the central government and the social security system should be published in the DR with a maximum delay of 45 days. The commitments within the EU legal framework

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\(^{40}\) See the IMF’s Dissemination Standards Bulletin Board at [http://dsbb.imf.org/Applications/web/dsbhome/](http://dsbb.imf.org/Applications/web/dsbhome/).
provide for semi-annual dissemination of general government accounts. The actual date of publication generally meets the pre-announced schedule. The Portuguese government subscribes to the IMF’s SDDS, and the data broadly meet SDDS timeliness standards.

C. Open Budget Preparation, Execution, and Reporting

25. Budgetary policies in Portugal are significantly influenced by macroeconomic objectives and constraints, especially those entailed by participation in EMU and commitment to the Stability and Growth Pact (SGP). Within this framework, the annual allocation of budgetary resources among government functions reflects evolving tax and expenditure policy priorities which are outlined in some detail in the report accompanying the draft budget bill.

26. The annual state budget includes all new tax measures; detailed revenue projections by type of revenue and recipient entity; and expenditure appropriations according to economic, functional, and institutional classifications that are broadly in line with relevant international standards. The state budget documents cover the central government, including its integrated services and its autonomous funds and services, and the social security system. The draft budget proposal is supported by more detailed documentation on the revenue and expenditure projections of each entity in the central government, which is submitted to parliament for information only. The proposal includes specific provisions authorizing the government to shift funds among approved budget lines during its execution.

27. The budget does not include a classification of expenditures by program or activities, except for the capital expenditures included in the PIDDAC and the Law on Military Planning. The PIDDAC, which is financed in part by national budget appropriations and in part by EU transfers, is approved for each ministry, and allows the transfer of funds among individual projects within the same ministry. Over time, the authorities intend to develop a program classification for other expenditures, as well as indicators of performance of spending programs, with a view to promoting increased efficiency in the allocation of budgetary resources.

28. In accordance with requirements of the SGP, the main fiscal indicator is the balance of the general government on a national accounts basis. The targets for the overall balance and for the public debt, for the current and the subsequent three years, are specified in the multi-year Stability and Growth Program presented by the Portuguese

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42 Still, the individual budgets of central government services are established based on an activity structure, with each activity and the human and financial resources allocated to it being identified.
government to the European Commission at the end of each year. At least for the first year, the objectives outlined in the government’s Stability and Growth Program reflect, and are underpinned by, specific limits set in the annual budget law on the increase in the net indebtedness of the various components of the general government. For example, the 2003 budget sets a limit of just under €6 billion on the net financing requirements of the central government, and prohibits any increase in the new indebtedness of the regional and local governments. The budget also sets a separate limit on the net increase in the debt of the central government on account of specified debt assumptions and of regularization operations, and limits on the granting of new government guarantees. While significant autonomy is left to the Public Debt Management Institute (Instituto de Gestão do Crédito Público (IGCP)) within certain performance parameters, specific sublimits are set in the state budget on the issuance of floating debt and of debt denominated in foreign currencies (see Box 6 for details). The state budget documents include projections of the net and gross financing requirements of the state, and of main sources of financing for the budget year.

29. The state budget documents also contain an analysis of recent economic developments, projections for main macroeconomic aggregates, and major underlying assumptions regarding the external environment. Projections for the relevant budget year only are shown for the growth rates of GDP, various aggregate demand components, and changes in the GDP and private consumption deflators, all of which are expressed as a range. These projections have varied in realism over the years, and are not independently vetted, e.g., by a group of outside experts, before being submitted to the National Assembly. Similar projections are included in the annual Stability and Growth Program and submitted to the European Commission. The EcoFin Council then delivers its opinion on the Program based on an assessment prepared by the European Commission. Also, the government is required to seek a (nonbinding) opinion of the Economic and Social Council, a consultative body which includes high-level representatives of the social partners, on the macroeconomic assumptions and other features of the annual government planning framework document (Grandes Opcões do Plano (GOP)) that is presented in the summer of each year, prior to the preparation of the budget and the PIDDAC. Among these documents, only the annual updates to the Stability and Growth Program contain some simulations of alternative scenarios.

43 In contrast, the estimates that have been required under the EDP are presented to the European Commission in February and revised in August.

44 With the exception of indebtedness incurred to finance investments connected to the European Soccer Championship in 2004, which will take place in Portugal.


46 For the GOP for 2003, see the website of the DPP at http://www.dpp.pt/pt/GOP.htm.
30. **There is still only a limited focus on medium-term planning horizons in the budget process, although steps have been taken to address this issue.** Specifically, the Stability and Growth Program for 2003–06 includes medium-term projections for the main categories of revenues and expenditure of the general government based on an economic classification, along with an outline of main policy assumptions underlying these projections. It also includes summary long-term (through 2075) projections for pensions for both the general and the civil service pension schemes on the basis of present policies, which highlight the urgent need for social security reform.\(^{47}\) In the state budget documents, however, medium-term projections are limited to investment spending (the PIDDAC), for which the documents provide a breakdown, by ministries and sectors, of disbursements for a three-year period (the budget year plus the following two years) plus the remaining aggregate amount beyond that period. The state budget documents also include a table, organized by ministries, showing total outstanding contractual obligations of the central government entities that are of a multi-year nature. This information is shown for the same three-year period plus the remaining aggregate amount. Currently projected responsibilities associated with existing public-private partnerships, including notably for highways, are included in this table, but not separately identified as such.

31. **The budget documents contain estimates of the yield (or cost) of new revenue measures for the relevant budget year, but not for subsequent years.** They also include fairly detailed estimates of the cost of existing tax expenditures for the year to which the documents pertain and for the three previous years, broken down by type of tax and of beneficiary. In contrast, little, if any, specific quantification is provided in the budget of the short- as well as the medium-term cost of new spending initiatives, although estimates of such costs are prepared by the relevant ministries as part of their respective proposed budget submissions of the MoF.

32. **The budget execution process is largely based on an even profile of disbursements for most categories of current spending.** In general, services are authorized to commit and disburse up to \(\frac{1}{12}\)th of the budgeted appropriations per month. The budget execution decree requires a specific authorization by the MoF to release budgetary allocations that exceed \(\frac{1}{12}\)th of the overall budget allocation that has been accumulated for each month that has passed by the time the expenditure is to be made.\(^{48}\) To create a cushion for unexpected revenue shortfalls, a percentage of certain categories of nonmandatory spending may be frozen (cativação) at the beginning of the budget year through the decree of budget execution.\(^{49}\) A supplementary budget has to be presented if expenditures exceed the

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\(^{48}\) See Article 4 of the budget execution decree for 2003.

\(^{49}\) Accordingly, the budget law for 2003 (Law No. 32-B/2002 of December 30, 2002) restricts the initial execution (commitment and spending) of various specific budget items to a specific percentage rate of the
budget figures or if the financing requirements go beyond the amount set in the budget due to revenue shortfall and/or expenditure overruns.

33. **Monitoring of the budget execution by the National Assembly has traditionally been limited.** Since the National Assembly does not have a budget office, its intra-year budget oversight has focused on handling supplementary budgets rather than accompanying budget execution and reevaluating budget prospects on an ongoing basis. More recently, however, and as required by the BFL, the government has intensified its reporting to the National Assembly, e.g., by issuing in May 2003, a report on the first-quarter budget execution and review of budget prospects for the year, and through more regular testimonies of senior MoF officials to the Budget Execution Committee of the National Assembly.

34. **The central government has been centralizing its financial operations within the DGT.** As part of efforts to rationalize financial management within the central government, and to minimize borrowing costs, autonomous services and funds (but not the social security system) have been required since 2003 to hold their balances in the DGT, which therefore now functions as a bank to these institutions. Specifically, the DGT maintains accounts in its system for each of these entities, with their revenues and payments credited or debited respectively to these accounts. Communication between the information systems of the autonomous services and funds and those of the DGT takes place through the internet, and the movement of funds related to revenues and expenditures of the state budget and its integrated services is being carried out through the DGT’s information system. The MoF is currently working with the Institute of Informatics to ensure a better integration of the information systems of the various entities in the central government, with a view also to facilitating timely reporting and accounting of the operations of these entities. This integration is expected to be fully operational by 2005.

35. **The system of internal controls was restructured in 1998 with a view to strengthening procedures.** Currently, there are three levels of control: an operational one, which is carried out at the individual organization’s unit level; a sectoral one carried out at the level of the internal audit units of the line ministries; and a strategic one, the coverage of which encompasses the whole administration of the general government. The main entity responsible for strategic control is the IGF, which is a service of the MoF. The head of the IGF is appointed by the prime minister and the minister of finance. Inspections by the IGF range from summary investigations of possible violations (to be concluded within 10 days), to more detailed inquiries into alleged individual wrongdoings, and to more comprehensive audits of the activities of certain government services or autonomous entities, with primary emphasis on financial compliance, although, increasingly, efficiency aspects are also being focused on. The IGF is also the Portuguese counterpart of the EU for internal audit issues, thereby giving the MoF significant discretion in freeing these during the budget year. At the same time, the budget law for 2003 also includes specific budget allocations and items that the government is pre-authorized to shift or alter in the execution of the budget.

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and it is responsible for the certification of the EU funds accounts. Except when there is evidence of criminal activities, in which case the IGF remits the results of its investigation to the appropriate judicial instance, the IGF’s analyses and recommendations are sent to the concerned administrative entity, which is to respond within 60 days. The effectiveness of the follow-up is, however, hampered by the lack of specific penalties for inaction by the concerned administrative entity on the IGF’s recommendations. In addition to its ex-post investigative role, the IGF fulfills a preventive (ex-ante) role through the provision, upon request by different entities of the public administration, of advice on specific issues. The DGO also plays a role in the system of internal controls, focusing either on an ex-ante or ex-post conformity of specific expenditures with legal requirements. Coordination between the various entities involved in internal control activities is supported by a special high-level council, chaired by the head of the IGF. The council sets the strategic directives for the control system, coordinates the annual audit plans, promotes overall coordination with the Court of Auditors, and establishes appropriate standards for the various control activities. Internal control activities at the local level vary widely in quality, and, although the IGF has the right to carry out inspections with regard to compliance with relevant national legislation of local expenditure financed by the state budget or EU transfers, there are reportedly instances of attribution conflicts in this respect.

36. **The public procurement regime in Portugal was amended in 1999 to bring it into full conformity with relevant EU directives.** Detailed information on the regulations for procurement procedures is available at the website of the DGO and the General Directorate for Nonfinancial Assets (Direcção-Geral do Património) of the MoF. Transparency and efficiency in public procurement is being promoted through further development of the electronic system of purchases. Since 1999, the catalogue of goods routinely purchased by the central government is available through the internet, and a full-fledged e-procurement system is being tested in six pilot cases, prior to its expected nationwide implementation in 2004.

37. **The government accounting system is still evolving.** Comprehensive, cash-based accounts are prepared by all entities of the general government. A comprehensive and detailed accrual-based double-entry chart of accounts (with special adaptations for specific subsectors such as the health-care system, the education system, the social security system, and the local authorities) has been prepared, but its adoption within the general government is progressing only gradually, although adoption by the local authorities is reportedly almost completed. The MoF prepares and presents in the state budget documents, summary accrual-basis projections of general government operations for the budget year, including a table that shows in what budget categories the main adjustments from cash to ESA95 basis occur. Portugal is required to send to the European Commission periodic reports on the implementation of its Stability and Growth Program: in the framework of the EDP it reports twice a year its estimates of the outturn for the previous two years, and its updated projections of the general government deficit for the current year on an ESA95 basis. Revisions to such estimates over successive submissions have not been uncommon, and have, in part, been due to methodological changes; an especially large revision was carried out in mid-2002 for 2001 as a result of the work of an especially appointed commission on
public accounts, chaired by the governor of the BP and comprising representatives of the BP, the INE, and the DGO. The BP, for its part, prepares and presents in its annual reports a reconciliation of the ESA95-based general government deficit with the change in the stock of public debt as defined under the EDP.

38. Cash-based reports for some parts of the general government are available relatively quickly. As already indicated in Section B above, cash-based monthly reports on the operations of the state (i.e., excluding the autonomous funds and services) and the social security system, on financing to various subsectors of the general government, and on public debt operations are prepared and published regularly by the MoF, the Social Security Institutions, the BP, and the IGCP, respectively, with relatively short lags.

39. There are still significant lags in reporting final fiscal data, particularly on an accrual basis. The INE prepares and publishes national accounts data of general government operations (ESA95 basis) with a two-year lag. The methodology utilized by INE in the conversion of government accounts data to a national accounts basis is not comprehensively published or documented. The relatively long delay in the publication of national accounts data for the general government reflects the currently significant lags in the preparation of final public accounts for submission to the Court of Auditors. Specifically, the final accounts for the central government for each budget year are sent to the Court of Auditors by the end of the following year. The BFL requires this lag to be reduced to six months, starting with the fiscal accounts for 2003. Local governments are required to submit their respective legislative assemblies their final accounts for each budget year within five months for the end of the fiscal year. The BFL empowers the MoF to request from local governments detailed and timely information enabling it to assess the likelihood of their compliance with the limits on new market indebtedness set out in the budget law. The MoF has developed a new quarterly reporting system for this purpose.

D. Assurances of Integrity

40. While the budget report presents main macroeconomic projections in the form of a range, revenue projections are consistent with the mid-point of the range. In more recent years, significant shortfalls have been recorded in actual revenues, compared with the projections. This has been partly the result of real GDP growth falling below the projected range. Total expenditure outturns have tended to be more closely aligned with budgeted

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51 The Report of this commission is available at the websites of the DGEP and the DGO.

52 More specifically, the monthly bulletin of the DGO contains monthly information for the state sector (with a 15-day lag); since January 2003, the quarterly accounts for the autonomous funds and services (with a 75-day lag); and, since January 2003, the social security system (excluding the system for public-sector employees). Data for the consolidated central government are available on the SDDS website.

53 For example, national accounts for general government transactions in 2001 only became available in August 2003.
levels, although this has often been achieved by recourse to cuts in investment spending, resulting in significant shifts in expenditure composition compared with the initial budgets.

41. **Financial accounting frameworks still differ across government levels and units, contributing to the above-mentioned delays in preparing final accounts for the general government.** The reliance on cash accounting in most of the central government has hindered the timely monitoring and control of arrears in payments to suppliers, especially in the health sector and in public works. This fact, as well as methodological issues of contention between the Portuguese authorities and EUROSTAT, have led to significant revisions of the general government deficit estimates in the EDP notifications of 2002.

42. **There is scope for improving the coverage and timeliness of data on government financing through the banking system and through the issuance of securities, and the reconciliation of budget (above-the-line) and financing (below-the-line) data.** Twice a year the BP prepares summary reconciliations for previous years, and as a check for the forecasts of the general government deficit, for the current year. The most recent of these exercises is published in the Annual Reports of the BP. Some reconciliation between budget and financing data is also carried out within the scope of the EDP.

43. **External auditing is carried out by the Court of Auditors whose independence is inscribed in the constitution and in the law.** The Court of Auditors has jurisdiction and exercises financial control over all sectors of the general government, as well as publicly owned or participated entities and enterprises. In addition to its reports on special-purpose audits, (e.g., the recent reports on the health care system and on public-private partnerships in the highway sector), the Court of Auditors prepares each year a comprehensive report on the finding of its audits of the annual accounts of the state and the social security system. As of mid-2003, the latest available report was from the year 2000, and in it the court recorded significant reservations on these accounts, citing certain accounting irregularities as well as resort to some activities of extrabudgetary nature. The Court of Auditors is independent of the National Assembly, but forwards it reports to the latter. A more systematic follow-up by the National Assembly on the Court’s findings and recommendations would be important in order to promote corrective action by the executive where deficiencies have been identified by the Court of Auditors. To date, evidence of such follow-up appears to be limited. Follow-

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54 These differences relate in particular to the statistical treatment of capital injections into loss-making SOEs, and the calculation of tax revenues on an accrual basis.

55 Accordingly, the Court of Auditors gave a generally unfavorable evaluation of the reliability of fiscal data. In particular, it cited that the changes that had been implemented until then were insufficient to render the revenue data comprehensive, timely, reliable, and consistent. Similarly, it pointed toward practices of “unbudgeting” of expenditures (either by taking on expenditures that were not in the budget or by making budgeted expenditures outside of the budget), and to the fact that the registration of some operations did not conform with existing accounting practices. It concluded that, as a whole, the government documents used in the audit did not represent a true picture of the resulting financial situation. See, “Parecer Sobre a Conta Geral do Estado de 2000,” *Volume I—Conclusões e Recomendações,* Tribunal de Contas (Lisbon, 2002).
up by the judiciary on instances where evidence of crimes has been identified in the Court’s audits is reportedly not systematic.

44. **The INE is given legal assurance of independence in terms of all data it produces and publishes.** The basic stipulations in this regard are contained in Law 61/1989 on the National Statistics System.

III. IMF STAFF COMMENTARY

45. **Portugal meets the requirements of the fiscal transparency code in several areas.** Notably:

- the allocation of responsibilities between different levels of government is clearly defined, and intergovernmental fiscal relations are based on relatively stable principles;

- the legal frameworks for taxation, regulation and administrative procedures are complex, but generally observed in practice, and taxpayer rights are protected;

- the budget process is based on a clear legal framework, and is relatively open;

- adequate mechanisms of internal and external control of government operations are in place; and

- audited accounts of all government entities are prepared and disseminated, albeit with relatively long lags.

46. **Moreover, significant progress has been made recently in strengthening fiscal management and transparency.** In particular:

- The BFL and the BSL have set the legal basis for ensuring improved consistency of budgeting policies at all levels of government, in line with Portugal’s commitments under the SGP. They have also substantially strengthened accounting and reporting requirements for all entities of the general government, an essential precondition for improved reliability and transparency of government accounts.

- The scope for efficient financial management at the central government level has been strengthened through the integration into the state budget of a number of hitherto autonomous services, and through the centralization into the treasury system of the accounts of all central government entities, except the social security institutions.

- Government procurement rules have been brought into conformity with EU standards, and the growing use of electronic means in the procurement process is increasing efficiency and transparency in this area.
The published fiscal information has improved, notably by complementing the information on the central government with information on the social security system, thereby broadening the coverage of the monthly cash accounts.

The steady progress in privatization has continued to reduce the weight of the public sector in the economy, as well as the public debt.

Nevertheless, there remain significant areas of weakness in fiscal management and transparency. In the view of the IMF staff, these will require further corrective efforts on the part of the Portuguese policymakers.

In particular, in the context of the SGP requirements, the coverage of the fiscal accounts has remained confined to the general government, which has contributed to a potentially dangerous loss of focus on the finances of public institutions that are not included in the general government. In this context, the current monitoring by the MoF of the finances and operations of the enterprises that are partially or wholly-state-owned, which may generate significant pressures on the state budget over the medium term, is not sufficiently detailed and systematic. The recent transformation of several public hospitals into wholly state-owned joint-stock companies, while offering an opportunity to improve efficiency and managerial accountability in these institutions, may also create risks for the state budget unless their financial performance is closely monitored, information is transparently disseminated, and early corrective measures are taken if needed. Finally, it is essential to strengthen the ex-ante financial analysis and the monitoring of implementation of the rapidly proliferating public-private partnerships at all levels of government; the recent law on public-private partnerships, when fully implemented, would address these concerns.

To strengthen the monitoring and regular analyses of the performance of the SOEs and of public-private partnerships projects, the IMF staff recommends that the authorities constitute a monitoring unit in the MoF. The work of the unit crucially depends on having stringent reporting requirements in place. The analyses prepared by the unit should be regularly and broadly disseminated to facilitate oversight of the financial and economic performance of the SOEs (including the hospitals) and of the costs and benefits of public-private partnerships by the National Assembly and the society at large. It would also be desirable to include a MoF representative, appointed by the government, among the board members of SOEs. Finally, it would seem highly desirable to broaden the legal reporting requirements of the local authorities (i.e., the municipalities, boroughs, and the two

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56 This has also been emphasized in a recent report of the Court of Auditors. See Tribunal de Contas, “Relatório de Auditoria,” No 14/2003, available at [http://www.tcontas.pt/](http://www.tcontas.pt/).


58 In some countries (e.g., Brazil), monitoring the performance of the state enterprise sector appears to have been facilitated by the systematic appointment of representatives of the MoF to the Board of Directors of the SOEs. Before deciding to go that route, however, potential improvements in monitoring should be weighed against potential downside risks related to governance issues.
autonomous regions) to include the operations of their enterprises and their public-private partnership projects.

50. **Transparency could be further enhanced by streamlining some of the existing legal and institutional framework.** In general, the existing legislative bases for taxation, regulation, and administrative procedures could be streamlined with a view toward reducing their complexity and eliminating overlaps. An example would be the various codes of conduct governing civil servants and the institutional framework overseeing them. Another example would be tax legislation, where simplification and streamlining would help enhance compliance.

51. **Similarly, there are a number of steps that could be taken to strengthen the effectiveness and transparency of the budget preparation process.** These include the following:

- **Better articulate the medium-term framework for budgetary policy outlined in the Stability and Growth Programs with the annual budget process, with a view to developing, over time, a full-fledged medium-term budget.** For this purpose, consideration could be given to implementing the approach recommended by the 2001 Public Expenditure Reform Commission, namely a two-step budget process which in a first phase would set overall spending and deficit ceilings (compulsory for the first year and indicative for the subsequent three), consistent with the latest Stability and Growth Program, as a framework for the preparation, presentation, and parliamentary approval of the next-year budget in the second phase.69 An additional early step that would help strengthen the medium-term focus in the budget process would be to require that all new revenue-reducing or expenditure-increasing proposals include a quantification of their expected cost and financing sources not only for the first year, but also for at least the subsequent three years. It would also be desirable to extend the coverage of the long-term projections for pensions to other aging-related spending, such as health care.

- **Improve the quality of the projections of revenues and mandatory expenditure in the budget, as well as the analysis of fiscal risks.** This could involve:
  - expanding the still limited sensitivity analyses of the macroeconomic scenarios and their implications for the budget;
  - submitting these projections to a transparent scrutiny by outside experts, before they are finalized for inclusion in the proposed budget;
  - providing in the budget document updated, detailed information on outstanding guarantees and a record of past calls of various types of guarantees; and

69 For an overview of the commission’s proposals, see Box 5.
including in the overall contingency reserve of the budget an adequate provision for possible calls of guarantees.

- **To strengthen the evaluation of the budget proposals, and monitor budget execution during the year, it would be desirable to continue to strengthen the technical capacities of the National Assembly.** This could be achieved through the creation of a small budget office staffed by well-qualified employees.

- **Develop and implement an overall budget classification by programs and activities as well as appropriate indicators of performance of these programs.** While individual budgets are already structured according to activities, creating an overall budget classification by programs and activities could prove a complex task, possibly requiring the support of outside experts from countries that have already successfully developed and implemented such classifications.

52. **There also remain areas in which budget execution, reporting, and accounting processes should be strengthened further, including in the following:**

- There is no systematic accounting of arrears for all central government institutions (also reflecting the fact that the verification stage of the expenditure process is not systematically registered), which makes it difficult to convert budget execution data from a cash basis to an accrual basis.

- Information systems used by various entities within the central government are not fully integrated, and the implementation of the new government accounting plan throughout the public administration is uneven, both of which contribute importantly to delays in preparing consolidated government accounts and revising successive estimates of these accounts.

The authorities need to give high priority to correcting these weaknesses as quickly as possible, and also to make full use of their strengthened legal power to enforce reporting requirements by all general government entities, even resorting, if needed, to the application of the sanctions for noncompliance envisaged by the BFL. To improve the reliability of the government accounts, it would also be highly desirable to carry out more systematically and transparently the reconciliation of “above-the-line” and “below-the-line” information. The recent improvement in the cooperation between the MoF, the BP, and the INE in this area is welcome, but it would also be desirable to more systematically and frequently disseminate the results of these reconciliations.

53. **Finally, the internal and external control systems could be strengthened further.** This could take the form of:

- improved coordination of the plans and operations of the various agencies involved in these tasks;
• increased emphasis on the assessment of efficiency (as well as financial compliance) in government operations. This task will, of course, be facilitated by the development of program budgeting and performance indicators for government programs and activities; and

• improved follow-up on the results of internal and external audits. This could include, among others, a requirement for the audited institutions to present specific corrective reform proposals in response to the audit’s recommendations; and more structured requirements for discussion of audit results by the National Assembly. The envisaged shortening of lags in the submission of the annual state accounts to the Court of Auditors should also help make the audit reports more timely and relevant.
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Box 1. Local Government Finances

Portugal’s constitution defines three levels of subnational government: administrative regions, municipalities (municípios), and boroughs (freguesias) that make up the municipalities; only the latter two have been implemented. In addition, there are two autonomous regions—the island groups of Madeira and the Azores. Both the municipalities and the boroughs are referred to as independent entities (autarquias locais); they have their own assets and finances, can establish their own enterprises, and can form associations and metropolitan areas. They have four main financial resources: central government transfers, own revenues, EU funds, and borrowing. The main law governing the finances of the municipalities and boroughs is the 1998 Law on Local Finances, which replaced an earlier law of 1987.

Transfers from the central government. Municipalities receive 30.5 percent and boroughs receive 2.5 percent from the average of state revenues from IRS and IRC, and value-added taxes. These transfers are calculated based on revenue collections in year t-2, adjusted for coefficients relating to inflation, and are distributed to municipalities through three funds: basic fund (FBM) (4.5 percentage points), general fund (FGM) (20.5 percentage points), and cohesion fund (FCM) (5.5 percentage points). The FBM grants the same base amount to all municipalities. The FGM is distributed on the basis of population, population below 15 years of age, area, number of boroughs, and IRS revenue collected in the municipality. The FCM is distributed in two components: one which relates to the own-revenue effort of the municipalities, and one which relates inversely to the level of development. Funds for boroughs are distributed based on population and area, in addition to a fixed share. Taken together, municipalities and boroughs have enjoyed significant real increases in transfer payments in each year since 1995, particularly during 1999–2002, when real growth rates averaged almost 10 percent. In 2001, transfers from the central government amounted to 29 percent of municipal finances (revenues plus net borrowing).

Own revenues. Municipalities are permitted to raise revenues from a number of sources, including real estate taxes, a surcharge of up to 10 percent on the IRC (derrama), and various fees on activities including markets and fairs, rents, hunting, etc. In 2001, own revenue amounted to 42 percent of municipal finances.

Cofinancing funds: Municipalities receive EU grants (from EU structural funds and EU regional development funds), to cofinance investment expenditures. In 2001, cofinancing funds amounted to 17 percent of municipal finances.

Net borrowing: The outstanding debt of municipalities and boroughs has remained below 5 percent of GDP. However, both municipalities and boroughs have access to credit and capital markets, subject to various restrictions, including those that are set out in the Law on Local Finances, and those that may be imposed in the annual state budget laws. Article 84 of the BFL stipulates that the annual state budget law can impose specific indebtedness limits on municipalities, boroughs, and the autonomous regions, and Article 89 of the BFL states that the state budget law allows the government to reduce transfers proportionately, in case the indebtedness limits are violated. The 2003 state budget law, for example, stipulates that the overall net indebtedness of all municipalities is not allowed to increase, except for infrastructure expenditure related to the Euro 2004 soccer championship. In 2001, net borrowing amounted to roughly 11 percent of municipal revenues.

Financial oversight. Municipal and borough financial and asset management are subject to oversight, respectively by the IGF, and the State Inspectorate for Territorial Administration (Inspecção-Geral da Administração do Território). Municipal and borough budget execution is subject to oversight by the Court of Auditors, which has a wide range of responsibilities, including checking legal aspects of budget execution, verifying the budget execution accounts, and evaluating the efficiency of budget execution and overall fiscal management. Municipalities have to submit their accounts to the Court of Auditors by May 15 following the end of the fiscal year.

Provision of information. Municipalities and boroughs are subject to a number of reporting requirements. To enhance overall transparency they have to provide budget information to their respective assemblies, they have to report financial information to the INE, regional coordination bodies, and the DGO (which follows their budget execution and the evolution of their indebtedness throughout the year).

1 In addition, two recent laws establish the conditions for creating new forms of local government organization, including metropolitan areas and inter-municipal associations. The financial operations of all new institutions that are created should be integrated into the accounts of the general government so as to safeguard fiscal transparency. See Law on Metropolitan Areas, No. 10/2003, and Law on Inter-Municipal Communities No. 11/2003, both of May 13, 2003.
Box 2. The 2001 Budget Framework Law and the 2002 Budgetary Stability Law

The 2001 BFL and the 2002 BSL represent important steps for strengthening budgetary processes and procedures. The BFL sets out general and common principles for the budgetary frameworks and accounts of the entities that comprise the general government; establishes rules and procedures on organization and structure, elaboration, presentation, discussion, parliamentary voting, alterations, and execution of the annual state budget law; and establishes rules concerning the organization and structure, elaboration, presentation and parliamentary voting of the final accounts of the central government. Among others, it includes the following:

- A requirement that annual budgets be elaborated in the context of a multi-year macro-economic and financial planning framework geared toward maintaining fiscal sustainability; specific aspects of the framework remain to be defined.
- A definition of the state budget that includes the budgets of all state services and funds—i.e., independent of whether they have or do not have financial autonomy—and the social security system. It does not include the budgets of the autonomous regions, the local governments, or the state enterprises.
- A specification of the state budget cycle, where, generally, the government has to submit to parliament by October 15 the draft budget for the upcoming fiscal year. A vote on the budget is to occur within 45 days after it has been received by parliament, and the state budget has to be published by end-February of the ongoing budget year. During the first two weeks of May of each year, the government has to initiate in parliament a debate on budget execution, and submit to parliament (up to 21 days before the debate) a report that allows evaluating the expenditure policy measures that have been implemented.
- A planned shift toward activity-based budgeting for the state budget, which is to be based (in whole or in part) on specified programs, measures, projects, or actions. More detailed stipulations are to be elaborated in subsequent decree-laws.
- A requirement to implement strengthened reporting and audit mechanisms, whereby, among others, the government has until June 30 to present to the National Assembly the accounts of the state for the previous year. The National Assembly then has until December 31 to approve or reject the accounts.

The BSL—as an organic law—defines further the principle of budget stability, and aims at strengthening coordination between different parts of the general government. Accordingly, public administration bodies are subject to three main principles:

- **Budget stability**, defined as a budget that is balanced or in surplus (based on the ESA95 definition);
- **Reciprocal solidarity**, where all parts of the general government are to contribute proportionally to achieve budget stability. Based on the solidarity principle, the BSL (Article 84) stipulates that the state budget may set specific limits to the net increase in indebtedness of various entities of the administrative public sector. Transfers may be reduced proportionately to any excesses over the established ceilings (Article 89).
- **Budget transparency**, which requires information disclosure among public entities. Administrative bodies that do not meet their disclosure duties may have their budget transfers suspended.

The BSL also alters the management regime of the autonomous funds and services that, in 2000 and 2001, did not generate at least two-thirds of their expenditures from own revenues, requiring their incorporation into the state budget, which provides for greater financial control over their operations. As a result, 43 services and funds lost their autonomous status starting with the 2003 budget year.

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1 The BSL consists of five articles, the first two of which add two more titles to the BFL (that now form part of the BFL), while the remainder changes other laws. See Law No. 91/2001 of 8/20/2001, and Organic Law No. 2/2002 of 8/28/2002, as published in the Diário da República—I Série-A, No. 198 of Aug. 28, 2002.

2 This was recently changed from October 1, which had proven overly tight for budget preparation.

3 Exceptions are the National Health Service, the universities, as well as other services who owe their existence to a constitutional imperative.
Box 3. Progress With Downsizing the Role of the State

Privatization in Portugal started in 1989, a few years after the country joined the European Community. Initially, it was conceived as a reprivatization program that largely focused on enterprises that were nationalized following the 1974 revolution, mainly in the banking and insurance sectors; there was no intention to achieve full restitution to former owners. The program was quickly broadened to include other state enterprises in all sectors of the economy. In general, Portugal has succeeded in privatizing/reprivatizing its more profitable SOEs; it has not yet succeeded in privatizing some chronic loss makers.

Privatization has brought significant financial benefits that have helped to reduce public debt. The 37 privatization operations that were carried out during 1996–2001 totaled gross receipts of €15,919.8 million (about 13 percent of the estimated GDP for 2001), and covered a broad range of economic sectors (e.g., banking, telecommunications, petrochemical, chemical, cement, tobacco, construction, naval construction and repair; agro-industry, steel, paper) and were carried out with different modes (e.g., public offers, offers to institutional investors, direct sales, direct sales to strategic investors, and public auctions). Net privatization proceeds of €12,785 million during 1996–2001 (about 10.4 percent of the estimated GDP for 2001) were largely divided between public debt amortization (60 percent) and the capitalization of other SOEs (33 percent), with the remainder going toward other activities, including the acquisition of shares and lending to state enterprises. At end-2002, the government dissolved the public holding company IPE (Investimentos e Participações Empresariais, SA) which controlled or actively participated in 28 SOEs or funds, of which 11 were privatized while the remainder remains in public hands.

In this context, privatization has helped to reduce the weight of the state enterprise sector in the economy. During 1989–95, the share of state enterprises in the economy was cut by about 50 percent in terms of share of GDP (to 10.9 percent in 1995) and by 40 percent in terms of employment (to 3.9 percent in 1995). By 2000, the share of the state enterprise sector in total value added had dropped to around 5 percent, and its share in permanent employment to 2 percent.

The state enterprise sector is defined by a separate law. Accordingly, the state enterprise sector comprises companies (“state enterprises”) in which the state or other public entities exercise, individually or jointly and directly or indirectly, a dominant influence that results from holding the majority of capital, retaining the majority of voting rights, or having the right to designate a majority of the board members. It also comprises enterprises (“participated enterprises”) in which the state or other public entities, individually or jointly and directly or indirectly, have a permanent participation—i.e., a participation that does not have exclusively financial objectives. Among others, the state retains full ownership of a state-owned holding companies (Parpública, which in turn owns other state enterprises), and some financial enterprises, including the state-owned CGD (which owns three insurance companies). The total number of SOEs has grown recently, since, in the context of the ongoing reform of the health sectors, some 34 public hospitals were transformed into 31 joint-stock companies.

There is no strong centralized ministerial oversight for the state enterprise sector. While, from a legal standpoint, the bulk of public enterprises faces the same oversight framework as the private sector, the special relationship between the state and its enterprise sector has, in many countries, led to a strong centralized oversight by the executive branch of government. While the DGT (as part of the MoF) is the formal holder of all direct participations of the state, which gives it ultimate oversight responsibility as owner, it does not systematically compile and analyze state enterprise data and trends, and does not provide consolidated analytical reports on a regular basis.

The government is committed to continuing the process of privatization, but seeks to retain a public ownership role and/or domestic ownership in some key sectors. In the Stability and Growth Program for 2003–06, the government has committed itself to continuing the privatization program, with emphasis on enterprises operating the sectors of paper, pulp, water, energy, transport, and tourism. At the same time, the authorities seek to maintain a Portuguese ownership role in sectors that are considered strategic, including energy, transportation, natural resources (pulp and paper), water, and radio/television. In some companies in these sectors (including Portugal Telecom, EDP, and GALP), the state has retained and/or intends to retain special voting rights (golden shares) in line with EU regulations.

Box 4. The Corporatization of Hospitals

The government very recently changed the legal status of 34 public hospitals, forming 31 corporatized entities that are fully owned by the state. Like other SOEs they will now have to produce quarterly and annual accounts that are subject to independent external audits, as well as continued surveillance by the Court of Auditors and the IGF. This is expected to improve accountability and monitoring of hospital management and lead to medium-term efficiency gains and cost savings in a sector that has, traditionally, been plagued by expenditure overruns and poor quality of services.

As a result, the corporatized hospitals are no longer part of the general government, but will continue to receive funds from the state budget. These funds, which will be calculated based on the services provided by each hospital, will be recorded in the national accounts as social transfers in kind, and accounted for in the state budget as an acquisition of goods and services. These funds from the state budget will represent the largest part of hospital revenues; they will be calculated for each hospital on the basis of occupancy rates, length of stay of in-patients, number of surgeries performed, the number medical treatments and appointments for out-patients, and other health services rendered. These numbers will be adjusted by a case-mix index, to take into consideration the complexity of the services provided. In addition, and to provide more time for restructuring and enhancing efficiency, some hospitals will continue to receive, for a number of years, a transfer from the state budget that is expected to decrease over time. Budget overruns that result from poor administration would be reflected in a negative profitability of the hospital, with transfers remaining unchanged.

In the context of corporatization, hospitals were recapitalized. To cover existing obligations and ensure that the hospitals had enough working capital to manage effectively their balance sheet, the central administration issued, at the end of 2002, about 1 percent of GDP in new debt. This recapitalization increased government net debt, and future interest payments on this debt will be recorded as interest expenditure. It cannot be excluded that, in addition to continued budgetary funds for the public services they provide, hospitals will need further capital injections.

A new administrative system is expected to strengthen budget management and cost control, to allow better benchmarking for performance evaluation, and to identify differential efficiency levels. The hospitals’ labor force will be covered by private-sector employment contracts. The initial pricing for hospital services has been pre-determined with the help of international consultants, using a sample of comparator hospitals; these prices will continue to be controlled by the government. Since efficiency levels differ widely across hospitals in Portugal, hospitals have been divided in four different efficiency categories that have different benchmark prices. While hospital services have been valued differently depending on the category of the hospital, it is expected that the markup for each category with respect to comparator hospitals in the private sector will be gradually reduced over time.

The implications for fiscal transparency will largely depend on how the state will manage its relationship to the newly corporatized entities. Corporatization of the hospitals is expected to increase managerial control and result in efficiency gains over the medium term. To achieve these efficiency gains, strong government oversight and supervision will be necessary. Fiscal transparency will only be enhanced to the extent that losses and cost slippages are readily recognized, and hospitals are not allowed to run down their capital over time, which would, eventually require another recapitalization operation. The government has set up a working party within the IGF to monitor and take preemptive action to ensure financial soundness and accountability.
Box 5. The Proposals of the Public Expenditure Reform Commission

In early 2001, a specially appointed public expenditure reform commission made 20 recommendations aimed at strengthening the budget execution framework, strengthening control and evaluation of public expenditures, enhancing the organization of public administration, and improving the management of public services. The main recommendations with fiscal transparency implications are as follows:

- Consider adopting an expenditure rule to limit the growth of current expenditures.

- Implement a two-step state budget procedure that is framed within a multi-year macroeconomic context. In January of year N the government publishes its annual stability and growth program for years N to N+3. As Step 1 of the budget cycle for year N+1, in May or June of year N the government would present a rolling multi-year plan that includes a macroeconomic framework for years N+1 to N+4, sets ceilings on deficit and expenditures (total and current primary expenditures) for years n+1 and indicative targets for years N+2 to N+4, and discusses overall fiscal policy objectives. This would be followed by a parliamentary discussion. As Step 2, and as is current practice, the government would present by October of year N, the state budget for year N+1, followed by parliamentary discussion and approval.

- Elaborate a rolling multi-year plan for social security and develop a multi-year plan for the financial assets and liabilities of the public administration. The format and timing of these plans should be synchronized with the state budget cycle and use the same time frame. While expenditure ceilings should be indicated for a four-year period, social security projections should be provided for a ten-year period.

- The macroeconomic projections underlying the state budget should be transparent and subject to external review. In particular, the macroeconomic framework for the multi-year plan should provide information on the main macroeconomic assumptions and the assumptions for the revenue projections for the various levels of government. These should either be submitted to an independent commission or, alternatively, the documents sent to parliament should also include the projections of three independent research institutes.

- Enhance expenditure flexibility. Avoid creating new expenditure obligations and ensure that all new legislative initiatives are accompanied by a clear estimate of their expenditure implications, at least for the current year and the subsequent three years. New initiatives should also be accompanied by proposals for reducing existing expenditure obligations by at least the same amount.

- Strengthen managerial control over various transfers to households. For existing schemes (e.g., housing savings, health care) enhance managerial oversight, and for new schemes provide for a clear schedule for their phasing out.

- Create mechanisms of budgetary coordination between the subsectors of the administrative public sector, including by creating a financial coordination council for all entities of the administrative public sector.

- Strengthen control and oversight over state budget execution. Nominate a financial comptroller for each ministry who oversees budget execution in cooperation with the MoF, provides information (e.g., financial information and data on inputs and benchmarks), and elaborates the accounts of the respective ministry.

- Provide support to strengthening managerial and control functions, among others by reinforcing program budgeting; creating a database for each service that contains the (quantitative) objectives to be attained and allows for permanent oversight over progress toward their achievement; and enforcing reporting mechanisms, including an annual evaluation of performance and achievements versus the stated objectives.
Box 5. The Proposals of the Public Expenditure Reform Commission (Concluded)

- **Strengthen the legal environment for budget execution**, including through a law that clarifies the responsibilities in budget execution (e.g., the responsibilities of managers), and revising the norms on financial responsibilities that are contained in different other laws.

- **Improve oversight for public projects that have private sector financing**, including by creating in the MoF a small unit that oversees the responsibilities and budgetary implications of the new forms of financing of public investment.

- **Improve oversight for the public enterprise sector, and set out a medium-term strategy**. Create a unit (in the MoF) that oversees public enterprises (including their budgets, assets and liabilities, investment plans and needs, and guarantees assumed by the state) and propose a medium-term plan for the sector that includes proposals for restructuring and downsizing the overall sector, and is geared toward enhancing efficiency. For enterprises that are to remain in public hands, the unit should propose measures to enhance efficiency (e.g., by outsourcing), and make proposals for revising the system of prices and tariffs.

- **Implement management based on objectives and outputs in public institutions that produce consumer outputs**, including in health and education. This would involve, among others, setting production objectives and budgets for each institution in cooperation with the respective ministries.

- **Create conditions for efficient management of the public administration**, including by introducing competitive elements (e.g., in health and education), providing comparative information on results achieved.

- **Eliminate special rights and privileges of public sector institutions**. This would involve a broad range of actions, including, for example, leveling state budget social security contributions for civil servants with those of the private sector, rent payments by public institutions for the public space they occupy.

- **Enhance the efficiency of human resource management**, among others, by defining criteria for measuring productivity of state employees, implementing performance evaluations that determine progress within the career stream, enhancing the mobility of government employees, and creating productivity premia.

- **Implementing management audits**, that, among others analyze, on a regular basis, to what extent the management structures of public sector institutions is aligned to their mission, and relating budgetary allocations to the outcome of these audits.

- **Strengthen managerial autonomy of public services**, including in the areas of financial management of human resource management (including contractual arrangements for employees and their salaries, as well as performance bonuses).

- **Accelerate the application of the unified official public sector accounting plan** (*plano oficial de contabilidade pública, (POCP)*), among others, by imposing a calendar for adopting the POCP by different services, and linking the provision of budgetary resources to the adoption of the POCP.

- **Implement independent external audits**, including for the budget execution of different institutions, their financial and other obligations and liabilities, and their assets. The external auditors would need to be selected through a transparent process.

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1 See *Relatório da Estrutura de Coordenação para a Reforma da Despesa Pública*, Ministry of Finance, September 2001. Recommendations that have already been carried out, e.g., implementing the BFL, are not mentioned here. The focus of this overview is on recommendations that have transparency dimensions or implications.
Box 6. Public Debt Management

Since 1997, public debt management operations have been undertaken by the IGCP, an independent agency of the MoF. The IGCP has administrative and financial autonomy, governed by a Board of Directors, comprised by three members nominated directly by the Council of Ministers for a three-year term, which reports directly to the MoF. The IGCP’s income depends on a percentage of the value of the debt stock under management and its staff is covered by the general labor law. The annual financing program is assessed by an advisory body, consisting of the chairman of the IGCP, a member of the board of the BP, and four experts in economic and financial matters. The advisory body also gives an opinion on the annual report. The financial management of IGCP is controlled by an audit committee, which includes a representative of the IGF, and an official chartered accountant.

The framework of operations for the IGCP has evolved over time. The formal framework for the management of public debt was regulated in 1998 by a new public debt law, with guidelines defined by the MoF in 1998 and 2001 regulatory documents. The terms and conditions of the debt management mandate are set out so as to identify which instruments and types of transactions are authorized, to state formally limits for key risk variables, to lay out the composition of the benchmark portfolio, and to set reporting requirements. Each year the National Assembly approves with the budget law an annual limit for net borrowing of the central administration, which includes ceilings on total amounts of short-term debt, the maximum allowed maturity and the maximum exposure to foreign currency risk. The MoF subsequently approves an annual financing program which specifies the funding strategy for the year. Further, the IGCP establishes the specific conditions of debt issues and negotiates and contracts other related financial transactions.

The IGCP coordinates its activities closely with the DGT, where all payments and receiving operations are conducted, and is formally responsible for maintaining a positive balance in the treasury accounts. The settlement of debt flows takes place in these accounts. The management of excess balances falls under the DGT’s responsibilities. The IGCP is responsible for providing to the DGT a forecast of daily debt flows for the following three months, while the DGT provides IGCP a daily forecast of the balances and flows in the treasury accounts for the following two to three months. Quarterly reports on debt management activity are sent to the MoF.

This institutional arrangement appears to have served Portugal well. Portugal is responsible for about two percent of the total Euro-denominated sovereign debt outstanding. There are currently 13 primary dealers, of which ten are nonresidents. The inflow of foreign investors has been significant, and about 80 percent of total Portuguese debt has been turning over outside Portugal. The strategies currently followed by the IGCP have been directed mainly at enhancing the liquidity of the government bond market by controlling the size and maturity of the issues, broadening the investor base in the EU market, and improving the infrastructures of primary and secondary markets. Lately, the strategy has involved issuing mainly at a fixed rate, in benchmark maturities from two to ten years, and conducting buyback and refinancing operations for nonliquid debt. The average issuance amounts have increased but the number of instruments has been reduced. The ultimate objectives of the strategy have been to smooth the amortization profile, achieve a modified duration of around three years, and implement a transparent and predictable borrowing pattern.