EUROPEAN COMMISSION
DIRECTORATE GENERAL ECONOMIC AND FINANCIAL AFFAIRS

The Economic Adjustment Programme for Portugal

Third Review - Winter 2011/2012

ACKNOWLEDGEMENTS

The report was prepared in the Directorate General Economic and Financial Affairs under the direction of Jürgen Kröger, Director and European Commission mission chief to Portugal.

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The report was prepared in liaison with the ECB.

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OUTLINE OF THE REPORT

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EXECUTIVE SUMMARY

A joint EC/ECB/IMF mission met with the Portuguese authorities in Lisbon during 15-27 February to assess compliance with the terms and conditions of the Third Review under the Economic Adjustment Programme. *The objectives of the Programme are to restore sound public finances, improve competitiveness and to put Portugal's economy back on the path of sustainable growth and job creation. This report provides an assessment of compliance and summarises the findings of the mission.*

The contraction of economic activity in 2012 is likely to be more pronounced than foreseen, in spite of a better macro-economic outcome for 2011. *The decline in output in 2011 was less marked than projected, as exports and consumption performed better than foreseen. But economic sentiment worsened markedly in the fourth quarter of 2011, with unemployment rising sharply and business confidence reaching record lows on the back of weakening external trade. As the slowdown in exports is likely to deepen, the outlook for 2012 has deteriorated and GDP is now projected to fall by 3¼ per cent, i.e. ¼ percentage point more than projected in the second review. With the turnaround of the economy somewhat delayed, growth in 2013 will also be more shallow than expected originally. While the external adjustment so far has been remarkably fast, as Portuguese exports are gaining market shares outside the EU while imports are falling strongly, its sustainability is still uncertain. Given the large external debt Portugal has accumulated a substantial further adjustment of a structural nature is required.*

Financing conditions remain tight but risks of a credit crunch are contained. *Bank lending to the non-financial sector has been shrinking since mid-2011, in particular for households and small and medium-sized enterprises. Aggregate data suggest that so far the ongoing deleveraging has been broadly in line with the adjustment of the real economy, but developments need to be kept under close review. Recent monetary policy decisions by the ECB are expected to ease banks' liquidity constraints. Furthermore, the authorities are considering a range of measures to mitigate funding strains for sound companies. Capital requirements at end-2011 were met, but going forward some banks might need to resort to the Bank Solvency Support Facility. Further improvements in the supervisory and regulatory framework are being put in place as planned.*

The Programme's 2011 target for the general government deficit of 5.9 per cent of GDP has been overachieved by resorting to a transfer of banks' pension funds to the state amounting to 3½ per cent of GDP. *Primary expenditure overruns in the first half of 2011 were almost reversed in the second half of the year, but non-recurrent factors kept the deficit 1½ per cent of GDP above target. The pension funds transfer was used to close this gap, lowering the headline deficit to an estimated 4 per cent of GDP. Despite this one-off operation, the structural consolidation in 2011 was large and amounted to 3½ per cent of GDP, when measured as the change in the cyclically-adjusted primary balance net of one-off measures. In December 2011, payment arrears in the general government sector showed for the first time a decline, but performance in the next few months will have to be monitored to confirm that arrears have been brought on a downward trend*

The Programme's 2012 target for the general government of 4.5 per cent of GDP remains valid. *The 2012 budget is ambitious and aims to achieve an additional structural consolidation of 4 per cent of GDP through high-quality measures predominantly on the expenditure side. A supplementary budget that will be adopted in March will leave the 2012 deficit target unchanged. The supplementary budget will incorporate various elements such as the budgetary implications of the pension funds transfer, the agreement with the Autonomous Region of Madeira, the fiscal impact of the deterioration in the economic outlook, lower interest payments and the strategy for the settlement of arrears. The implementation of the 2012 budget is being strengthened through a number of improvements in the Public Financial Management framework, notably the adoption of* *the law on commitment controls, the full implementation of the Budgetary Framework Law at all levels of government and the establishment of an independent Fiscal Council. The Autonomous Region of Madeira is put under tight control through an adjustment programme agreed between the Central Government and the Region. Important steps have been taken to control expenditure and raise the efficiency and cost-effectiveness in the health care sector. To contain fiscal risks, the government needs to strengthen measures to prevent arrears accumulation, complete the reorganisation of tax administration, streamline public administration and press ahead with the restructuring of state-owned enterprises. As the revision of the regional and local finance laws has been postponed, safeguards are needed to ensure budgetary control of these government levels.*

Noticeable progress has been made in the area of structural reforms*. The far-reaching and ambitious reform agenda is on track in the areas of labour market, health care, housing, judiciary and the insolvency and regulatory framework including competition. Also, privatisations so far have been highly successful. In network industries, progress was more mixed. In particular, in the energy sector a comprehensive strategy to eliminate the sector's rising debt by tackling excessive rents remains to be fleshed out. Major reform steps in services and the regulated professions are still outstanding and entail an extension of deadlines.*

Overall, the programme is on track. *The fiscal adjustment in 2011-2012 is remarkable by any standards. The necessary deleveraging of the financial sector is progressing in an orderly manner. Reforms in labour and product markets aimed at raising competitiveness, growth and job creation are advancing and framework conditions for doing business are being improved.*

But important risks and challenges remain. *On the budget side, risks are related to a further increase in unemployment beyond current projections. Also, revised reporting and control mechanisms, notably at the regional and local level, will have to pass their test. In health care, a number of measures need to be put in place rapidly to reach the ambitious cost savings targets. The government also still needs to devise a strategy that combines the settlement of the stock of arrears with incentives to avoid further arrears accumulation. The large debt overhang of state-owned enterprises calls for urgent resolution to avoid spilling over into the government budget. On the structural side, in view of the pressing need to unleash the economy's growth potential policy slippage cannot be afforded. It is crucial that the government ensures that there are no delays in the implementation of the ambitious reforms in labour, product and services markets. Furthermore, regarding labour markets it may be necessary to go beyond currently planned reform steps in specific areas such as the duration of unemployment benefits or the extension mechanism of collective agreements. In network industries, sheltered services and regulated professions, significant efforts will have to be made to eliminate barriers to competition and excessive rents that are stifling economic dynamism. Strong resolve will be necessary to overcome resistance from vested interests.*

Raising the country's attractiveness for foreign investment is a crucial element for the success of the Programme. *To assure the trust of the markets, a close and systematic monitoring is necessary to show that the reforms deliver the intended results. This must be underpinned by a continued strong commitment of the government and broad political and social consensus, together with a clear communication strategy on the benefits and necessity of the reforms.*

The Programme's financing projections remain valid. *The Programme is supported by loans of EUR 52 billion from the European Union and EUR 26 billion from the IMF's Extended Fund Facility. Approval of the conclusion of this review will allow the disbursement of some EUR 15 billion (EUR 9.7 billion by the EU and EUR 5.2 billion by the IMF) in April/May 2012.*

I. INTRODUCTION

1. The report assesses compliance with the conditions of the Third Review of the Portuguese Economic Adjustment Programme (the "Programme"). The assessment is based on the findings of a joint European Commission (EC)/European Central Bank (ECB)/International Monetary Fund (IMF) staff mission to Lisbon from 15 to 27 February 2012.[1] In accordance with the Council Implementing Decision amending Implementing Decision 2011/344/EU on granting EU financial assistance to Portugal[2], the mission assessed compliance with the conditionality associated with the fourth disbursement and progress towards the key objectives of the Programme of sound public finances, restoring competitiveness and putting Portugal's economy back on the path of sustainable growth and job creation. It also revised the specific policy conditionality while keeping unchanged its main objectives.

2. The Economic Adjustment Programme was agreed by the Ecofin Council on 17 May 2011 and by the IMF Executive Board on 20 May. The Programme, which covers the period 2011-2014, entails an external financing by the European Union, the euro-area Member States and the IMF of up to EUR 78 billion, for possible fiscal financing needs and support to the banking system. One third will be financed by the European Union under the European Financial Stabilisation Mechanism (EFSM), another third by the European Financial Stability Facility (EFSF), and the remaining third by the IMF under an Extended Fund Facility. So far, EUR 38.2 billion (of which EUR 25.3 billion by the European Union and EUR 12.9 billion by IMF) has already been disbursed.

3. A successful completion of the Third Review will pave the way for the release of the next loan instalment of around EUR 15 billion, of which EUR 9.7 billion from the EU and SDR 4.4 billion (about EUR 5.2 billion) from the IMF. This instalment is the largest of the programme and will bring EU and IMF financing to around EUR 53 billion, representing more than two thirds of total available financial assistance.

4. Several elements lend support to continued optimism on a successful Programme implementation:

- The Portuguese government remains committed to the implementation of the adjustment programme. Legislation passes smoothly through the Parliament, and the main opposition party continues to support the Programme targets. Despite the often difficult measures and rising unemployment associated with the crisis, social cohesion in Portugal so far appears to hold. This bodes well also for raising the attractiveness of the country for investment and tourism.

- The cooperation between the three lender institutions and the Portuguese authorities is good. The missions are well-organised from the Portuguese side and run smoothly and regular exchanges between the missions ensure that monitoring of reform progress takes place in continuous time. Resident offices of the EC and the IMF have been established in Lisbon to facilitate the flow of information.

- While the scope of the reform programme is inevitably testing the authorities' administrative resources, technical assistance is being provided in crucial areas, such as public finance management, tax administration and judicial reform. The recently established Support Group of the European Commission will help identify specific needs

[1] The cut-off date for the macro-economic and fiscal projections of this report is 28 February 2012.
[2] OJ L 269 of 14.10.2011

in this regard and organise further technical assistance in co-operation with EU Member States.

- Significant actions are taking place beyond the Memorandum of Understanding (MoU), which complement the reforms within the Programme.

    - The government has reached an agreement with social partners on labour market reform which envisages action in a number of areas beyond MoU requirements.

    - Agriculture and rural development remains outside the MoU. Early government considerations for the upcoming revisions of the Rural Development Programme are promising. Swift action in this important area has a great potential for raising productivity as the sector runs a net trade deficit of 2 per cent of GDP while its share in overall employment is close to 11 per cent.

    - A reprogramming of European Regional and Social Funds is underway to make better use of the available transfers. The increase of the EU co-financing rate should contribute to a front-loaded disbursement of funds to Portugal.

5. A number of deadline postponements in the current review are not necessarily a sign of non-compliance by the Portuguese authorities. When negotiating the original MoU in May of last year, a relatively large cluster of deadlines were set to be fulfilled by the end of the year. Most were met by Portuguese authorities, but a number of deadlines turned out to be over-optimistic for one or several reasons, be this (i) an underestimation of the challenges to be tackled, (ii) capacity constraints as overlapping demands have been addressed to the same services; or (iii) the need to deal with unforeseen events, such as the Madeira programme, or the EU fiscal regulatory framework which absorbed additional administrative resources. While these explanations do not hold in all cases as will be discussed below, the mission found no indications of reform fatigue in programme implementation.

II. ECONOMIC DEVELOPMENTS AND OUTLOOK

MACROECONOMIC OUTLOOK

6. The decline in economic activity in 2011 was less pronounced than expected, mainly due to strong export dynamics. Real GDP is estimated to have declined by 1.5 per cent in 2011, which is 0.7 percentage points better than the initial Programme projection. The main reason besides stronger exports is that the contraction in public and private consumption was less sharp than foreseen. The significant reduction of the current account deficit in 2011 by about 3 per cent of GDP suggests that the external rebalancing of the economy is underway. Portugal's export performance has become more broadly based, with increasing export market shares outside the EU partly compensating for the deceleration of exports to the EU. However, part of the external adjustment is due to a strong decline in imports, in line with the fall in domestic demand. It remains to be seen to what extent the ongoing adjustment will be sustained once domestic demand grows again. In view of the high external debt Portugal has accumulated over the last decade a large and persistent adjustment is still needed.

7. The contraction of economic activity has intensified in the last quarter of 2011. Business and consumer confidence indicators reached record lows in Q4-2011. The decline in industrial production accelerated and the sector's outlook remains bleak given that confidence, albeit stabilising at the beginning of 2012, remains very low. Furthermore, declining export growth in the second half of the year suggests that the weakening economic activity in the EU is starting to take its toll. The situation on the labour market worsened more than expected in the fourth quarter, with employment decreasing by 2.4 per cent compared with the previous quarter and the unemployment rate reaching 14.0 per cent, up from 12.6 per cent in the third quarter. Moreover, financing conditions remain tight and, while the risks of an outright "credit crunch" are limited, bank lending to the non-financial sector has been shrinking since mid-2011, in particular for households and small and medium-sized enterprises.

8. The deterioration of the external economic environment continues to weigh on economic activity in 2012. Based on the assumption of a further slowdown of economic activity in Europe in the first half of 2012, Portuguese exports are now expected to increase by only 2 per cent in 2012, implying a downward revision by 1.8 percentage points compared with the Second Review (see Table 1). This will also have some negative second-round effects on private investment, which is now expected to decline by some 12 per cent in 2012. Private consumption expenditure is forecast to contract by an unchanged 6 per cent, as the impact of weaker disposable income and the worsened employment outlook is expected to be absorbed by a further decline in the households' savings rate. Real GDP is now forecast to fall by 3.3 per cent in 2012, which implies a downward revision by 0.3 percentage points compared with the last review. The adjustment of the current account is set to continue in 2012, albeit at a slower pace than in the previous year, with a further strong adjustment in the external balance being partly offset by a still increasing primary income deficit (see Table 5 in Annex 2). The downward revision in the outlook also affects 2013. Although the economy is still expected to regain traction during 2013, annual growth is now projected to be rather weak at 0.3 per cent, almost ½ per cent less than before, as the growth rate will also be dampened by a negative carry-over from 2012. The main driver of growth in 2013 will be an acceleration of exports on the back of a strengthening EU economy and improved cost competitiveness.

Table 1: Projections of main macroeconomic aggregates

	Feb 2012 (3rd review)			Nov 2011 (2nd review)			Difference		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
					year-on-year volume change				
Gross domestic product	**-1.5**	**-3.3**	**0.3**	*-1.6*	*-3.0*	*0.7*	0.1	-0.3	-0.4
Private consumption	**-3.8**	**-5.8**	**-0.9**	*-3.8*	*-5.8*	*-1.1*	0.0	0.0	0.2
Public consumption	**-3.1**	**-2.9**	**-2.6**	*-3.7*	*-4.1*	*-2.4*	0.6	1.2	-0.2
Fixed investment	**-11.3**	**-11.8**	**0.7**	*-11.3*	*-10.3*	*0.6*	0.0	-1.5	0.1
Exports of goods and services	**7.2**	**2.0**	**4.7**	*6.8*	*3.8*	*5.5*	0.4	-1.8	-0.8
Imports of goods and services	**-5.7**	**-6.9**	**1.9**	*-4.8*	*-5.0*	*1.2*	-0.9	-1.9	0.7
					contributions to real GDP growth				
Domestic demand excl. inventories	**-5.4**	**-6.6**	**-0.9**	*-5.5*	*-6.5*	*-1.1*	0.1	-0.1	0.2
Change in inventories	**-0.5**	**-0.1**	**0.2**	*-0.1*	*0.1*	*0.1*	-0.4	-0.2	0.1
Net trade	**4.4**	**3.4**	**1.1**	*3.9*	*3.3*	*1.6*	0.5	0.1	-0.5
Employment (y-o-y change)	**-1.5**	**-2.5**	**0.2**	*-1.0*	*-1.6*	*0.2*	-0.5	-0.9	0.0
Unemployment rate (level)	**12.7**	**14.4**	**13.9**	*12.7*	*13.8*	*13.6*	0.0	0.6	0.3
HICP (y-o-y change)	**3.6**	**3.2**	**1.3**	*3.6*	*3.3*	*1.3*	0.0	-0.1	0.0

Source: European Commission

9. The weak economy should ease price pressure from higher indirect taxation in 2012. Consumer prices increased by 3.6 per cent in 2011, in line with Programme projections. Inflation accelerated in the final quarter of 2011 due to an increase in VAT for natural gas and electricity. Inflation will stay at fairly elevated levels in 2012 following further hikes in indirect taxes in January 2012. On the other hand, rising unemployment should keep wage increases low while the weak domestic demand should put pressure on price mark-ups. These dampening effects are projected to dominate the price dynamics from 2013 onwards when the effects of the tax hikes dissipate.

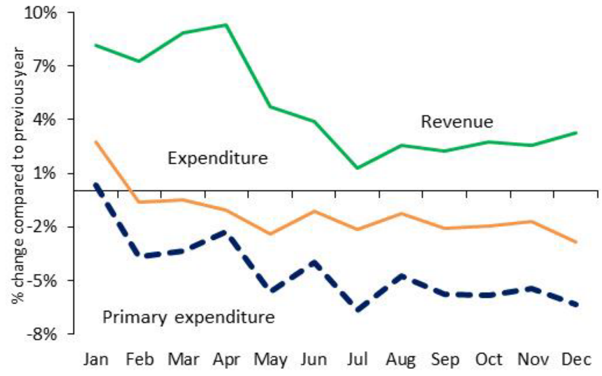
FISCAL DEVELOPMENTS

10. A fiscal gap of 1½ per cent of GDP for achieving the 2011 budget target has been closed by the transfer of banks' pension funds to the public social security system. The 2011 deficit is now estimated at around 4 per cent of GDP compared to a target of 5.9 per cent of GDP, with the banks' pension funds transfer increasing capital revenues by 3½ per cent of GDP on an ESA95 basis. Budgetary execution in 2011 has come under strain with data for the first half of the year showing both expenditure and revenue off target. Additional revenue measures adopted in the summer (a one-off surcharge on personal income taxes and bringing forward the increase in VAT on energy originally planned for 2012), whilst significant, were not sufficient to close the fiscal gap by the end of the year. However, according to the available data in February 2012, the primary expenditure overruns in the first half of 2011, notably in the public wage bill, were almost reversed in the second half of the year, but non-recurrent factors at the level of sales of concessions and real estate, reclassification of capital operations and PPP investment have kept the fiscal gap at 1½ per cent of GDP. The recapitalisation costs of the troubled bank BPN added a further 0.3 per cent of GDP to this fiscal gap on an ESA95 basis.[3]

[3] Transactions related to the banking sector support and restructuring strategy under the programme are excluded from the deficit definition of the TMU.

11. In cash terms, budgetary execution resulted in a falling deficit until end-December 2011.[4] Economic activity fell less than expected in the last quarter of the year, mitigating to some extent the loss of dynamism in tax revenues observed since the summer (see Graph 1). At the same time, expenditure declined in nominal terms from the previous year's level. Given that interest payments increased considerably over the previous year, primary expenditure fell even more sharply than overall expenditure. The fall in primary expenditure is broad-based with cuts in personnel costs and spending on goods and services being the main drivers.

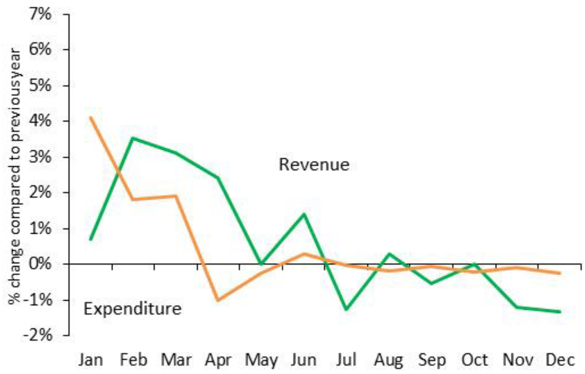
Graph 1: Budgetary outturn for January-December 2011 (Cash data)



Source: Ministry of Finance and Commission services
Note: Includes non-consolidated data for the State, Autonomous Funds and Services and Social Security); Primary expenditure includes data for the State subsector only.

12. The deterioration in the macroeconomic environment and, in particular, the faster-than-expected increase in unemployment is starting to weigh on budgetary execution. Preliminary data suggest a sharp deterioration in labour market conditions starting in the last quarter of 2011 with important consequences for the budget of social security. In cash terms, December 2011 and January 2012 preliminary budgetary execution data showed lower social contribution revenues and higher unemployment benefits (see Graph 2). The projected stronger deterioration in the balance of social security is currently expected to be broadly offset by savings in net interest payments - due to higher interest received from deposits, the removal of the EFSF margin from loans disbursed in May/June and lower interest on EFSF/EFSM loans disbursed afterwards - and higher revenue from the reprogramming of EU structural funds financing.

Graph 2: Budgetary outturn for Social security in January-December 2011 (Cash data)



Source: Ministry of Finance and Commission services
Note: Includes non-consolidated data for Social security,

13. The stock of arrears in general government complied for the first time with the indicative target of non-accumulation.[5] At the end of December, the combined stock of arrears

[4] The universe considered here is somewhat more restricted than the one relevant for the Programme targets as it excludes SOEs for which no detailed high-frequency data on budgetary execution are available.

[5] Arrears are defined as payables/creditors that have remained unpaid for 90 days or more beyond any specified due date (regardless of any contractual grace period). In case no due date is specified, arrears are defined as payables/creditors that have remained unpaid for 90 days or more after the date of the invoice or contract.

for the general government sector and SOEs classified outside the general government has been estimated at about EUR 5½ billion or 3 per cent of GDP. The health sector accounts for almost half of the stock, mostly from incorporated hospitals classified outside the general government sector. Local and regional governments account for another large share (see Table 2). The stock of arrears of central and local government decreased in the second half of the year, while arrears of the general government as a whole complied for the first time with the indicative target of non-accumulation in December. Performance during the next few months will have to be closely monitored to confirm whether this decrease in the stock of arrears is of a persistent nature.

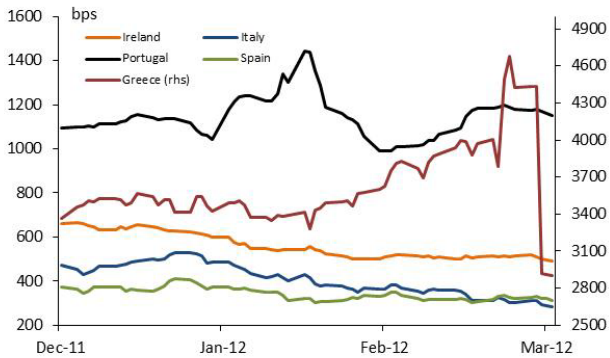
Table 2: Stock of arrears in 2011 (in EUR million)

Subsector of the General Government	(1) Jun	Jul	Aug	Sep	Oct	Nov	(2) Dec	(3)=(2)-(1) ∆ Dec-Jun	% total
Central Government excluding NHS	312	309	274	314	351	325	162	*-151*	3%
NHS classified in General Government	346	407	362	385	421	428	363	*17*	7%
Reclassified entities	58	86	94	99	84	77	67	*8*	1%
Local Government	1,716	1,708	1,717	1,726	1,684	1,661	1,606	*-110*	30%
Regional Government	923	969	972	998	1,080	1,161	1,158	*235*	22%
Total	3,355	3,478	3,419	3,522	3,620	3,651	3,355	*0*	63%
Total Consolidated	3,181	3,283	3,262	3,338	3,433	3,492	3,252	*70*	61%
Other entities outside General Government									
Enterprises excluding NHS	13	11	11	8	10	14	18	*5*	0%
NHS incorporated hospitals	1,718	1,941	1,988	2,047	2,110	2,120	2,055	*337*	39%
p.m.: health sector inside + outside GG	*2,064*	*2,348*	*2,350*	*2,432*	*2,531*	*2,548*	*2,418*	*354*	*45%*
TOTAL	4,912	5,236	5,261	5,393	5,552	5,626	5,325	*413*	
p.m.: percent of GDP	*2.9*	*3.0*	*3.1*	*3.1*	*3.2*	*3.3*	*3.1*		

Source: Ministry of Finance and Commission services
Note: Consolidated data concerns data net of intra-government sector arrears

FINANCIAL MARKETS AND FINANCIAL SECTOR DEVELOPMENTS

Graph 3: 10-year bond yield spreads versus Germany



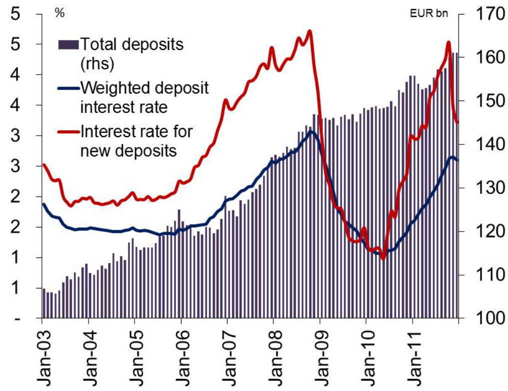
Source: Reuters

14. Portuguese sovereign spreads have come down after a sharp increase in the beginning of the year. Portuguese interest rates failed to retreat after the first ECB's 36-months long-term refinancing operation (LTRO), as downgrades below investment grade have forced many institutional investors to sell Portuguese debt. Also, low turnover coupled with market speculations about a second adjustment programme containing private sector involvement have led to widening yield spreads in early 2012. (Graph 3). At around 13 per cent and 1000 basis points above the Bund, long-term interest rates are around the peaks observed in July 2011.

15. Banks' liquidity situation improved considerably, largely as a result of recent monetary policy decisions of the ECB. With Portuguese banks being virtually shut out of the wholesale funding market since May 2010, their liquidity situation has eased significantly following the ECB's launch of the first 36-month LTRO. Borrowing from the ECB has oscillated between EUR

40 and 50 billion over the past 21 months. The figures for January 2012 read EUR 46.5 billion, equivalent to 9 per cent of total liabilities (Graph 4). The ECB has recently also broadened the range of assets eligible as collateral in refinancing operations. At the same time, Portuguese banks face higher haircuts due to the sovereign downgrades. Currently, there are sizeable unused collateral buffers in the system, but they are very unevenly distributed across banks. This has not changed substantially after the second LTRO by the ECB, because the LTRO mostly substituted for shorter-term ECB financing and banks could already use additional eligible assets in application of the measures decided by the ECB to increase collateral availability.

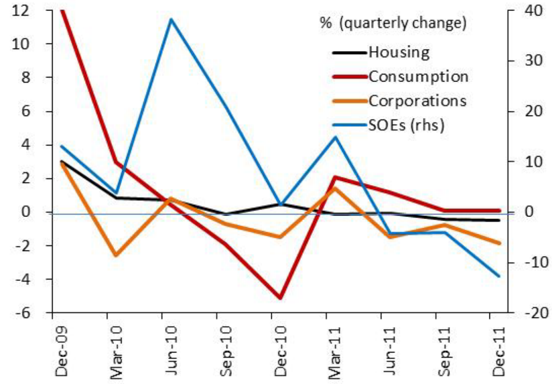
Graph 4: ECB Borrowing and deposit developments



Source: Bank of Portugal, Reuters

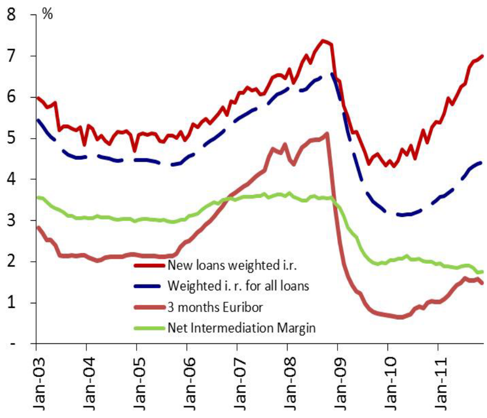
16. Lending to the economy decreases. Against the recessionary economic background and banks' tightening credit standards, loans to the corporate sector have shrunk by 1.8 per cent in Q4 2011. Consumption loans remained flat and mortgages decreased by 0.7 per cent (Graph 5). Banks project further deleveraging in their funding and capital plans. Given the high levels of indebtedness in the public and private sector, this adjustment process is necessary to put the economy on sounder financing. At the same time, to prevent the emergence of financing constraints, Portuguese authorities are working with stakeholders on a proposal aiming at diversifying the financing channels of the corporate sector. As banks adjust their business models, they gradually reduce their high dependence on wholesale liquidity and increase funding from deposits. The attempts to increase the deposit base made interest rates on new deposits soar in 2011. To reduce these unsustainably high deposit rates, the Banco de Portugal introduced in early November restrictions for the remuneration of deposits beyond 300 basis points above the comparable Euribor rate. Since then interest rates for new deposits have dropped significantly (Graph 4). Overall the deposit base has remained stable. As a result of the increased remuneration of deposits also interest rates for new loans went up substantially, as banks protected their intermediation margin (Graph 6).

Graph 5: Sectoral lending developments



Source: Banco de Portugal

Graph 6: Loan interest rates



Source: Banco de Portugal

17. The five largest Portuguese banks recorded a cumulated loss of EUR 1.5 billion in 2011 due to the recessionary environment, the situation in Greece, the impact of the Special on-site Inspections Program (SIP) and the partial transfer of pension funds. Last year's economic contraction translated into growing impairment charges on the deteriorating domestic assets quality (non-performing loans, based on the new definition comparable to that in use in other Member States, amounted to 6.9 per cent in Q3-2011) weighing on the yearly result. Net losses were however driven to unprecedented levels mainly by the one-off impact of the losses on Greek holdings, the outcome of the SIP and the cost resulting from banks' pension funds transfer to the state. The banks' outlook for 2012 remains challenging in view of the deep economic recession. However, the bad 2011 results hide a few bright spots. The deposit base continued to increase throughout the year signalling depositors' confidence in the banking system. Moreover, all but two small banking groups subject to BdP supervision met the 9 per cent Core Tier 1 ratio target set under the Programme for end-2011, including the eight largest banking groups (accounting for 83 per cent of banking system's assets). However, the special on-site inspection and the pension funds transfer lead to additional regulatory capital needs by June 2012. Lastly, the loan-to-deposit ratio dropped to 146 per cent, down from 160 per cent in December 2010.

Table 3: Soundness indicators for the Portuguese banking sector

%	2009Q4	2010QI	2010Q2	2010Q3	2010Q4	2011Q1	2011 Q2	2011 Q3
Return on Equity	6.0	7.3	7.6	7.2	6.8	6.4	4.7	2.5
Gross Income on Assets	2.8	2.5	2.6	2.6	2.6	2.4	2.5	2.5
Cost to Income Ratio	56.8	57.7	57.1	57.2	57.6	59.1	58.1	59.0
Old Non-Performing Loans	3.2	3.4	3.6	3.9	3.2	3.5	4.0	4.8
New Non-Performing Loans	4.8	5.4	5.5	5.8	5.2	5.5	6.2	6.9
Coverage Ratio	59.0	63.2	62.9	60.8	61.5	60.7	57.7	55.3
Capital Adequacy Ratio	11.6	11.4	10.9	11.0	11.1	11.1	11.1	11.1
Core Tier 1 Ratio	7.9	8.0	7.8	8.0	8.1	8.4	8.6	8.5
Loan-to-deposit ratio	161.8	163.7	166.8	158.6	158.1	157.5	149.9	146.4

Source: Banco de Portugal
Note: The Core Tier 1 ratio excludes banks in resolution.

18. The partial transfer of banks' pension funds helped the government to meet its 2011 deficit target but created book losses for banks. The agreement of December 2011 established the terms for the partial transfer of EUR 6 billion (out of EUR 14 billion) of the credit institutions' defined benefit pension plan obligations together with corresponding assets to the Social Security System. The deal envisaged payments in two tranches almost exclusively in cash: EUR 3.2 billion by end-December 2011 and EUR 2.9 billion before July 2012. The deal had to simultaneously achieve a budgetary improvement in ESA 95 terms while being compatible with state aid rules and actuarial fairness both to taxpayers and the banking community. In the short run, banks will be affected by book losses of some EUR 0.3 billion on the income statement and the negative impact on the Core Tier 1 ratio stemming from the full recognition of actuarial losses accumulated over the past years. However, in the long run, the transfer of almost 50 per cent of the pension related assets and liabilities will significantly reduce the volatility of banks' balance sheets linked to these defined benefit plans. The government is considering the use of part of the pension fund assets to take over, subject to strict eligibility rules, credits from the banks (up to EUR 3 billion), while maintaining the contractual obligations of the debtors.

19. Banks will need to raise high-quality Core Tier 1 capital in 2012. As a consequence of the economic recession banks' domestic assets quality is expected to further deteriorate. Moreover, banks need to meet the capital requirements set by the European Banking Authority (EBA) of EUR 6.9 billion at system level, while at the same time ensuring that the deleveraging process remains consistent with the Programme's macroeconomic framework. By June 2012, banks will have to address the capital needs stemming from the special on-site inspections, meet the full capital impact of the pension funds transfer and provide the required capital amount related to EBA's sovereign debt valuation. The focus remains on the extensive use of capital from private sources, mainly from present shareholders, while the state-owned CGD is expected to rely partly on public capital, as a cash injection, to meet its capital shortfall. Nevertheless, private banks could make use of the Bank Solvency Support Facility (BSSF) to cover capital requirements in order to reach Core Tier 1 capital of 9 per cent by June 2012.

III. PROGRAMME IMPLEMENTATION

20. The joint EC/ECB/IMF mission concluded that implementation of the Programme is on track. The 2011 budget target has been achieved, albeit by resorting to a large one-off operation in the form of the banks' pension transfer of nearly EUR 6 billion to the state. However, even so the structural (cyclically adjusted net of one-offs) primary deficit shows an improvement of 3½ per cent of GDP in 2011. Moreover, the 2012 budget is expected to achieve an additional improvement in the structural primary balance of 4 per cent of GDP by means of structural measures, predominantly on the expenditure side. A supplementary budget that will be adopted in March to incorporate various developments such as the implications of the pension funds transfer, the Madeira agreement, the deterioration in the economic outlook, lower interest payments and the strategy for the settlement of arrears, will leave the 2012 deficit target unchanged at 4½ per cent of GDP. The Public Financial Management framework is being strengthened, but the revision of the regional and local finance laws and administrative reforms will not be able to meet the original ambitious deadlines. The Autonomous Region of Madeira is effectively put under tight central control through an internal economic adjustment programme.

21. The adjustment of the banking system is proceeding. Banks have met their capital requirements, but some might need to resort to the Bank Solvency Support Facility. Further improvements in the supervisory and regulatory framework are being put in place.

22. Noticeable progress has been made in the area of structural reforms but deadlines have not always been met. Advances are on track in the labour market, health care, housing, judiciary and the insolvency and regulatory framework including competition. Also, privatisations so far have been highly successful. In network industries, progress was more mixed. In particular, in the energy sector a comprehensive strategy to eliminate the sector's rising debt by tackling excessive rents remains to be fleshed out. Major reform steps in services and the regulated professions are still outstanding and entail an extension of deadlines. An annex to this report provides a detailed list of the measures taken to meet the conditionality for this Third Review.

Table 4: Summary of compliance with policy conditionality for the Third Review

	Status
Fiscal policy	The quarterly quantitative performance criteria on the general government cash balance and debt for Q4-2011 were met. Despite some slippages, the budgetary target of 5.9 per cent of GDP in 2011 was overachieved due to a large one-off transaction, namely the banks' pension funds transfer, which reduced the deficit in national accounts terms to 4 per cent of GDP. The 2012 budget makes up for the slippages in 2011 and contains bold and ambitious structural consolidation measures, the bulk of which are on the expenditure side.
Financial sector	Banks have presented funding plans and capital plans on time. Preliminary results of two parts of the programme of special on-site inspections to validate banks' credit portfolio quality and their calculation of risk-weighted assets were available by mid-October. Final results were presented in December. The third part of the Programme, focusing on stress test methodologies and parameters, was completed in February. The sale of Banco Português de Negócios (BPN) will be finalised by end-March at the latest. The European Commission opened an investigation to check the compatibility of certain aspects of the deal with EU competition and state aid rules.
Fiscal-structural	Public finance management: Implementation of the Budgetary Framework Law is on track, including progress towards medium-term budgeting and the transition to accruals accounting, and the Fiscal Council was established as planned. Stronger

	legislation on commitment control was adopted. Arrears: The government will submit a revised strategy document approved by the Council of Ministers, before the supplementary budget is submitted to Parliament, giving priority to the settlement of arrears caused by the chronic underfunding of the health sector over the past years (about EUR 1.5 billion). Revenue administration: Progress has been made in modernising and merging the tax and customs authorities and implementing the strategic plan to combat tax and customs fraud and evasion for 2012-14. An IMF/EC technical assistance mission on the revision of the regional and local finance laws took place in March. Regional and local finance: The schedule for the revision of the local and regional finance laws was extended. An adjustment programme for Madeira was concluded in January. PPPs: A top tier international accounting firm was contracted in February to complete a detailed study of PPPs. SOEs: A draft law on the legislative authorisation for the reform of the legal regime of the public enterprise sector was presented to EC/ECB/IMF, but its submission to the Parliament is pending. It is accompanied by an explanatory memorandum which sets out the key features of SOE governance. Except for Azores, the restructuring of SOEs at the regional and local level still needs to see progress. Privatisation: The EDP sale was finalised in January. Two bidders for REN were selected in December and the mutual intentions for the sale of stakes to each of them signed in February. Regarding the plans to privatise Parpublica a new deadline was set for April 2012. Public administration reform: The legal basis for organisational changes in the majority of the 150 entities in the central administration has been decided. Provisions are in place for similar measures at regional and local level. A survey on foundations is ongoing on the basis of which an assessment will be made on whether to maintain, reduce or abolish them. The Government submitted to Parliament in February a new legal framework for foundations. Health: A large number of legal instruments were adopted and implemented, including the revision of National Health System fees, lowering of prices for medicines, including generics, reduced pharmacies profit margins, compulsory e-prescription, and better monitoring of prescription behaviour, and of hospital performance.
Reform of goods and services markets	Labour market: The Government and social partners concluded a tripartite agreement, which covers most of the labour market reforms in the MoU. Draft laws to reform the Labour Code were sent to Parliament, which will substantially reduce rigidities by lowering severance pay, redefining fair dismissals, raising working time flexibility, facilitating firm level collective agreements, and lowering unemployment traps. A programme to facilitate new hirings has been put in place. Energy: The important issue of containing the tariff debt through a reduction of excessive rents has not been addressed adequately as the proposed elements for a solution (mainly voluntary renegotiations and reduction in support schemes) appear insufficient. The issue will need to be the revisited in the next review. The transposition of the Third Energy Package to liberalise the electricity and gas sectors is advancing as planned. Telecommunications: The introduction of transparent and non-discriminator access to universal service provision was not observed. Postal: The law transposing the Third Postal Directive was approved by Parliament. Transport/Ports: The separation of port regulatory activity, management and commercial activities has been completed. A draft law for revising port works is under preparation.

	Services and professions: There have been efforts in a number of areas (e.g. the Commission on Regulated Professions has been analysing a significant number of proposals; a draft horizontal legal framework on professional bodies (*Ordens* or *Câmaras*) has been prepared on schedule), but many of the necessary sector-specific amendments to comply with the Services Directive are running behind schedule. Further delays will result from a recent constitutional interpretation that these measures require Parliamentary approval. Proposals to lower entry barriers in the construction and real estate sectors remain unsatisfactory. Progress on the Points of Single Contact is satisfactory but its implementation suffers from delays in the service-sector liberalisation.
Reform of framework conditions	Housing market: A draft decree law for amending the urban rental legislation was submitted to Parliament, which phases out open-ended leases, provides for more flexibility in contract duration and updating of rents, sets incentives for renovation, and provides for extrajudicial procedures, all in line with the MoU's main objectives. Judicial system: Reforms are advancing largely ahead of schedule: backlog clearance is making progress; a roadmap was presented to adjust court districts; the implementation of new arbitration procedures is being completed. Competition framework law: the law proposal has been submitted to Parliament. Public procurement: A revised code is about to be adopted. The public procurement web portal has been improved thereby increasing the transparency of the overall system. New by-laws of the court of auditors to extend its competence have been adopted. Business environment: the "simplex export" programme is well on track, and as a first step to a broader strategy to facilitate access to finance and export markets for companies (in particular for SME's), a report has been submitted describing the existing system. Special rights: the sale of CGD's stake in Galp has been postponed. Report on functioning of National Regulator Authorities: the procedure to appoint the consultant for the study has been launched.
Data submission	Requirements under the Programme have been observed. Work is ongoing to improve further data submission.

FISCAL POLICY

Budgetary execution in 2011

23. The quarterly quantitative performance criteria on the government cash balance and on the stock of government debt for end December 2011 were met. The achievement of the ceiling on the cash balance was possible due to relatively robust revenue growth and nominal spending reductions as described above. Moreover, the indicative target of non-accumulation of arrears by the general government sector was met for the first time in December (see also Table 2 above).

24. The Third Review mission confirmed the fiscal gap of 1½ per cent of GDP for achieving the 2011 budget target and the large one-off transaction of the banks' pension funds transfer of about EUR 6 billion (3.5 per cent of GDP) used to close the gap and overachieve the target. Contrary to the assessment of previous reviews, deviations from the Programme plans had been found to be caused mainly by non-recurrent deficit-increasing factors, namely non-tax revenue underperformance at the level of sales of concessions and real estate, the recording of the debts of a financially-troubled SOE and of a failed PPP agreement both in the remit of the Madeira regional government and the reclassification of the investment of a PPP due to the introduction of tolls. Non-tax revenues, excluding pension funds' transfers, also seem to have been overestimated in the 2011 budget. Additional costs related to the planned sale of troubled bank BPN increased the budgetary shortfall further in ESA 95 terms (see Table 5).

25. Expenditure overruns in the first half of the year were largely reversed in the second half of the year. Consolidation measures on the expenditure side included an average cut of 5 per cent in government wages, reductions in government payroll lists, cuts in social transfers such as unemployment benefits and family allowances, and a freeze of other social outlays, including old-age pensions. Additional measures were targeted at curtailing spending in the health sector, state-owned enterprises (SOEs) and public investment. Consolidation efforts on the revenue side consisted mainly of an additional increase by 2 percentage points of the standard VAT rate as of 1 January 2011. In addition, revenue projections reflect the carry-over effect of tax hikes introduced in mid-2010. The government had reacted to the early signs of budgetary slippages and adopted additional measures. In late June, when the data for the first quarter pointed to a higher-than-expected deficit, a one-time tax surcharge on personal income was introduced. Moreover, the government increased the VAT rate on electricity and natural gas from 6 to 23 per cent, originally planned for 2012, with effect from 1 October 2011.

Table 5 - Estimated 2011 budget shortfall and corrective measures (% of GDP)

		2nd review	3rd review
Budget deviation		**-2.5**	**-2.2**
	Permanent deviations	**-1.5**	**-0.8**
Expenditure			
	Primary expenditure overruns	-0.6	-0.1
	Interest expenditure overruns	-0.1	0.1
	Capital expenditure	-0.3	0.3
	(excl. one-offs and concessions)		
Revenue	Tax revenue	0.0	-0.1
	Current non-tax revenue	-0.4	-0.3
	Capital revenue (excl. pension funds)		-0.5
	Gap created by the pension fund transfer included in the budget	-0.1	-0.1
	One-off deviations	**-1.0**	**-1.5**
	Debt assumptions of SOE and PPP by Madeira gvt	-0.3	-0.3
	Reclassification of PPP investment		-0.2
	Gross costs of selling BPN	-0.3	-0.3
	Sales of real estate	-0.2	-0.2
	Revenue from concessions	-0.2	-0.4
Offsetting measures		**0.5**	**0.5**
of which:	PIT surcharge	0.5	0.5
	VAT increase on energy	0.1	0.1
Total budget shortfall after corrective measures		**-1.9**	**-1.7**
Total budget Shortfall excluding BPN costs		**-1.6**	**-1.3**
Banks' pension funds transfer		1.9	3.5
Net lending (+) / Borrowing (-), excl. the pension transfer		**-7.8**	**-7.5**
Net lending (+) / Borrowing (-), on ESA95 basis		**-5.9**	**-4.0**

(+) represents a balance-increasing impact; (-) a balance-reducing impact

Table 6: Arithmetic of the government deficit: from the deficit in one year to the next

(+) means balance-improving impact; (-) means balance-reducing impact	% of GDP
2010 balance (observed)	**-9.8**
Primary balance drift in 2011	1.8
Change in interest expenditure	-1.0
Dissipation of one-offs and non-recurrent effects from previous year	0.7
New consolidation measures	4.3
2011 balance (estimate)	**-4.0**
Primary balance drift in 2012	-2.0
Change in interest expenditure	-0.7
Dissipation of one-offs and non-recurrent effects from previous year	-3.1
New consolidation measures	5.4
2012 balance (target)	**-4.5**
Primary balance drift in 2013	-0.4
Change in interest expenditure	0.1
Dissipation of one-offs and non-recurrent effects from previous year	-0.4
New consolidation measures	2.2
2013 balance (target)	**-3.0**

Balance in year t equals balance in year t-1 plus nominal primary balance drift in year t, plus the impact of the change in interest expenditure in year t, plus the impact of the dissipation of the one-offs and non-recurrent measures from year t, plus the impact of new consolidation measures in year t.

The Primary Balance Drift includes the change in the balance lev el that would take place without discretionary measures. It includes the impact of economic activ ity on the balance and the structural increase in expenditure in real terms, e.g., the increase in pension expenditure.

26. The pace of deficit reduction in 2011 was supported by a better than expected macroeconomic environment. More favourable developments in economic activity in 2011 added to the impact of the consolidation package put forward with the 2011 budget. Moreover, the dissipation of the net effect of large one-off transactions in 2010 (among the one-off measures increasing the deficit in 2010 were the rescue of two troubled banks (BPN and BPP), while the one-off transfer of the pension funds from the telecommunication company Portugal Telecom (PT) to the government reduced the deficit in 2010) mechanically contributed to the increase of the deficit in 2011 (see Table 6 above). These developments offset the large increase in interest expenditure.

27. A significant part of the slippage in 2011 is of a non-recurrent nature, which will not carry over into 2012. However, the pension funds transfer that compensated for the slippage resulted in a structural increase in future pensions liabilities. Offsetting the medium-term effects of the pension funds transfer will therefore require higher budgetary consolidation efforts. In particular, although decreasing over time, pension expenditure will be significant in coming years and needs to be compensated by additional measures.

Risks to the 2012 budget and the fiscal targets

28. The 2012 budget aims at a government deficit of 4.5 per cent of GDP as set in the Programme and includes new consolidation measures worth 5.4 per cent of GDP when compared with 2011. This is a higher effort than foreseen at the outset of the Programme, due to the need to compensate the worse underlying fiscal position in 2011 and the projected sharper contraction of economic activity. The 2012 budget is ambitious, based on structural measures of high quality (see also Box 1). Expenditure-reducing measures account for most of the effort (mainly wage and pension cuts), with additional contributions coming from revenue-raising measures (mainly higher indirect taxes).

29. The government will submit to Parliament a supplementary budget by end-March, mainly to regularise a number of revenue and expenditure developments that largely offset each other. The main elements to be included in the supplementary budget are:

- the budgetary cost of additional expenditure with pensions in 2012 stemming from the banks pension fund transfer;
- costs related to the Madeira programme;
- adjustments due to the downward revision in the macroeconomic environment and labour market conditions;
- the non-tax revenues from the telecommunication spectrum auction finalised in 2012;
- expenditure savings due to the re-classification of PPPs projects in 2011;
- savings from interest and fees as a result of the transfer of pension funds' assets as well as lower margins and interest on EFSF/EFSM loans;
- the strategy for the settlement of arrears in the health sector; and
- the participation in the European Stability Mechanism (ESM).

The last two items will have no impact on the general government deficit in ESA 95 terms. While the net impact of these items is estimated to be broadly neutral, downside risks to the government balance persist, particularly related to a possible further deterioration in the macroeconomic outlook. At this stage, however, no additional fiscal measures seem to be necessary. Should risks materialise, the government is committed to attain the 2012 fiscal objectives through tight budgetary execution and possible additional savings, for instance, as a result of the reprogramming of EU structural funds financing

30. The authorities reconfirmed the commitments presented at the end of August 2011 in their 4-year fiscal strategy (2012-15) to reduce the deficit to 3 per cent of GDP by 2013. The large consolidation effort in 2012 constitutes a good basis for the achievement of a deficit of 3 per cent by 2013. In addition, measures of some 2 per cent of GDP as envisaged in the original Programme will be taken. To a large extent, they are the continuation and deepening of the consolidation measures already considered for 2012, notably by broadening tax bases and reducing primary expenditure. However, part of the additional effort in 2012 described before is a frontloading of measures originally foreseen for 2013. The details of the fiscal consolidation plans for 2013 and beyond and the adjustments to the medium-term fiscal projections that are needed also as a result of the additional pension expenditure and the downward revision in the macroeconomic outlook will be included in the annual fiscal strategy document to be submitted in compliance with the Stability and Growth Pact requirements by April 2012.

BOX 1: TAX POLICY IN PORTUGAL

Tax policy has significantly improved in Portugal. The tax system reform has focused on measures that will lead to significant base broadening such that the detrimental effect of a higher tax burden is reduced. Prior to these reforms, the Portuguese tax system had been characterised by narrow tax bases in direct and indirect taxation and rather high tax rates. The recent tax measures, while having substantially contributed to fiscal consolidation, have mainly focused on raising higher revenues from those taxes which are considered less detrimental to growth and competitiveness, i.e. consumption taxes (VAT and excise duties) and recurrent taxes on immovable property. Moreover, the significant reduction in tax credits, tax benefits and tax allowances is going to help reduce the previous distortions caused by the tax system, in particular with respect to the bias towards debt financing in housing taxation.

The measures implemented with the 2012 budget follow the above policy line. The main measures on the revenue side in the 2012 budget concern VAT, which amounts to additional revenues of 1.4% of GDP in 2012. Following past increases in the VAT rates, the 2012 budget focused mostly on broadening the tax base by moving goods and services from the reduced and intermediate rates to higher rates (i.e. the intermediate or standard rate). In particular, energy products are now subject to the VAT standard rate. In order to protect vulnerable groups, many essential goods remain subject to the 6% reduced rate and this rate also continues to be applied to goods considered crucial for domestic production, such as wine. Overall, the measures will help to significantly increase VAT efficiency, while there still appears to be room for additional steps. Increases in excise duties on alcohol products, fuels, tobacco, heating diesel, the introduction of a tax on electricity consumption and higher car taxes will also contribute to higher revenues.

Concerning real estate taxation, the focus has also been on broadening the tax base. Starting already from October 2011, tax administration has made significant efforts to put in place an ambitious framework for the valuation of the housing stock. The framework will ensure that by end-2012 the taxable value of all property is close to market value. The 2012 budget increased the minimum and maximum rates of recurrent taxes and provides for an updating of the taxable property values at regular intervals. The next steps will include a shift away from the tax on property transfers towards the recurrent tax.

Regarding direct taxes, reforms focused on base broadening measures following past tax rate increases. For the taxable personal income, many tax credits and tax benefits were significantly reduced and/or will be totally phased out. In particular, this concerns tax credits for health expenses and health insurance premiums as well as tax credits and deductions for housing loans, repayments of capital and rental payments. Moreover, lower ceilings for overall tax credits and tax benefits were introduced for most income tax brackets, thereby abolishing credits and benefits at very high income levels. In corporate taxation, reduced rates were abolished and tax exemptions reduced. However, the tax burden on very high personal incomes and profits was increased temporarily for the fiscal years 2012 and 2013. Taxes on personal capital income and capital gains were also raised.

A higher overall tax burden tends to lead to higher tax evasion and tax fraud, which renders the measures undertaken to improve tax governance and the revenue administration framework even more relevant. The strategic plan to combat tax and customs fraud and evasion for 2012-14 has been completed and the authorities have taken important steps for its implementation. This will play an important role in 2012 given also the less favourable macroeconomic environment.

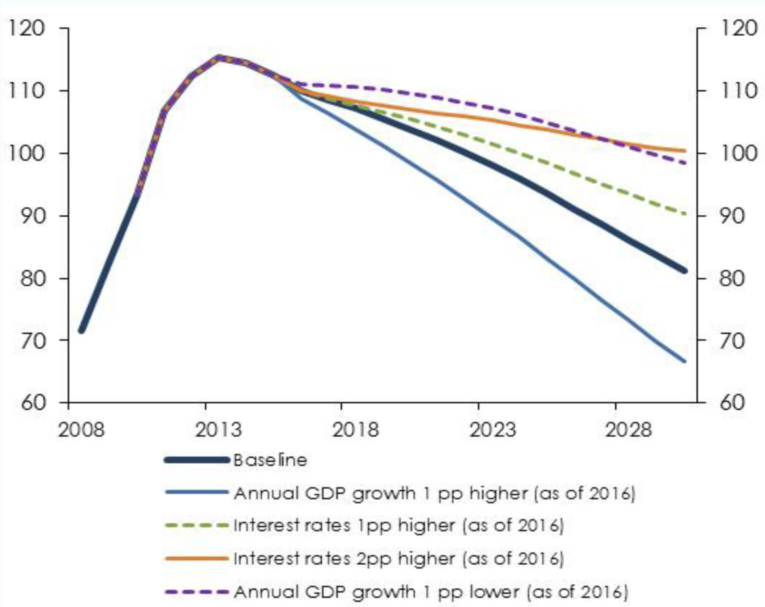
The tax measures in the 2012 budget contribute to improving the tax structure and the overall design of the tax system. This should reduce the negative impact of the overall higher tax burden on the economy. Moreover, the budget included measures in VAT, the area of excise duties and direct taxation which address distributional concerns and help to make the tax system more environmentally friendly.

31. The mission concluded that the improvement in the cyclically-adjusted primary balance, net of one-off measures, amounted to a considerable 3½ per cent of GDP in 2011 and is likely to be even more important in 2012 (about 4 per cent of GDP). The budgetary targets in the Programme for 2012 and 2013 are confirmed at 4.5 per cent and 3 per cent of GDP, as is the commitment to move towards a balanced budget position in the period after the Programme. This path is in line with the Council Recommendations under the ongoing Excessive Deficit Procedure**.** The government is committed to react effectively in the event of slippages occurring during the year.

BOX 2: GOVERNMENT DEBT AND FISCAL SUSTAINABILITY IN PORTUGAL

Under the Programme scenario, government debt is projected to peak at 115 per cent of GDP in 2013 before starting a gradual decline. The baseline long-term calculations shown below incorporate the Programme scenario up to 2015. The precise calculations for these figures are shown in Table 7 in the annex. The turning point is the result of achieving a primary surplus of over 2 per cent of GDP by 2014, combined with a modest GDP growth. After 2015, it is assumed that: (i) the structural primary fiscal balance (i.e., the government balance adjusted for interest payments, one-off and temporary measures and for the effect of the cycle) remains unchanged at a surplus of 3.2 per cent of GDP; (ii) nominal interest rates are 5 per cent; (iii) nominal GDP growth stays close to 4 per cent (2 per cent growth in volume terms plus 2 per cent inflation); (iv) ageing costs are taken into account according to the projections in the forthcoming Commission's 2012 Ageing Report. The new ageing costs projections look much more favourable than previously assumed given the downward revision of the pension expenditure projections. This is mainly due to the pension indexation mechanism, which includes inter alia a demographic factor. With the macroeconomic projection of an average GDP growth rate lower than 2%, lowest pensions are expected to grow only in line with CPI and higher pensions are expected to decrease in real terms; (v) the expected fiscal impact of PPPs costs and bank recapitalisation costs of EUR 12 billion over the Programme period is factored into the analysis.

Graph 7: Macroeconomic risks- growth and interest rates (debt as % of GDP)



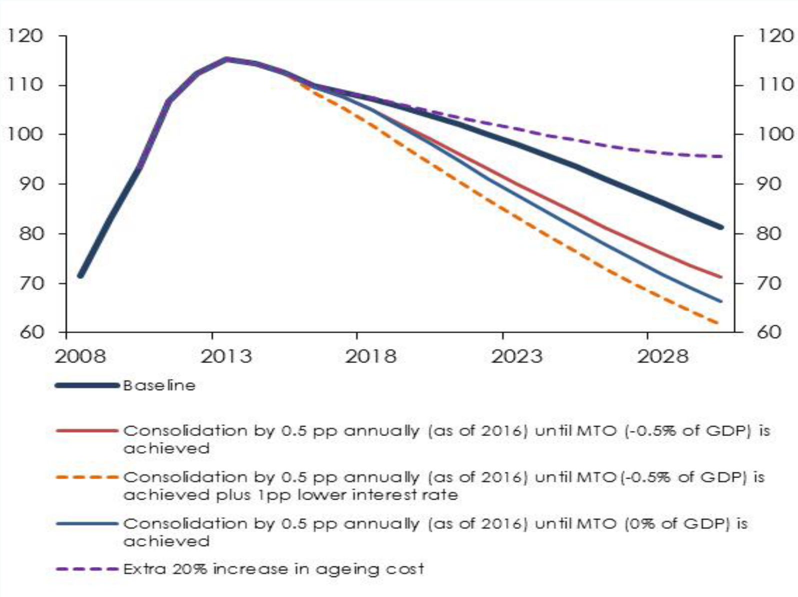
Source: Commission services

Full observance of the Programme plans ensures a gradual decline of the debt ratio over the longer term. However, for a large number of years the debt ratio would remain higher than before the current crisis. The graphs in this box present a sensitivity analysis with respect to macro-economic risks, impact of fiscal consolidation, and of changes in the government perimeter.

The sensitivity to macro-economic assumptions is shown in Graph 7. Variations are shown to changes after the end of the Programme. A lower GDP growth rate or a higher interest rate on new debt by one percentage point would significantly slow down the pace of the debt ratio reduction. However, neither the weaker macroeconomic environment nor higher interest rates would jeopardise the declining debt ratio profile. Upside risks to growth in the medium-term given the significant structural reform measures already undertaken may, conversely, result in visibly lower debt-to-GDP ratios.

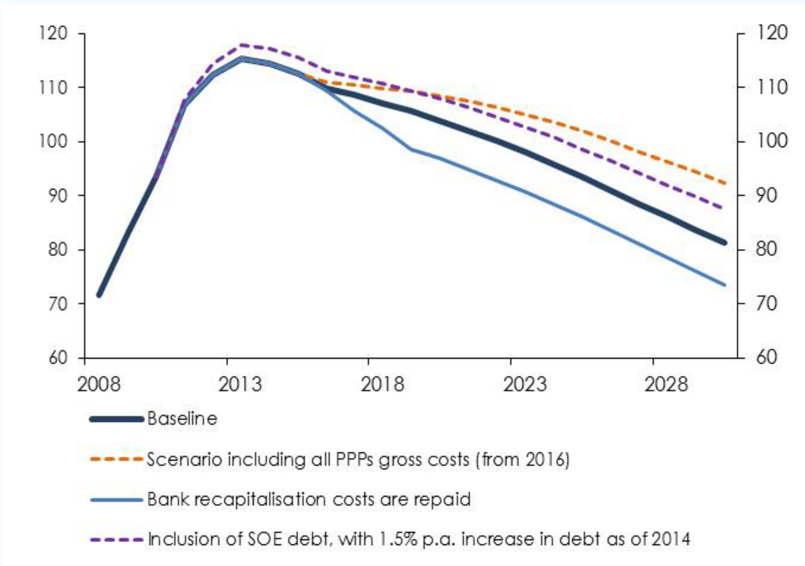
The same is true for continued fiscal consolidation beyond the Programme horizon (Graph 8). Clearly a further consolidation to achieve the Medium Term Objective (MTO) would significantly accelerate the fall in the debt-to-GDP ratio, bringing it well below 100% by 2020. On the other hand, if ageing costs are allowed to rise significantly (simulated as a 20 % increase), the fall in the ratio would be severely curtailed. Instead it would stabilise at a high level in the absence of compensating fiscal consolidation.

Graph 8: Fiscal consolidation and ageing costs (debt as % of GDP)



Source: Commission services

Graph 9: Changes in the government perimeter (SOEs, PPPs, Bank recapitalisation)



Source: Commission services

Finally, as set of simulations consider the impact of changes in the government perimeter (Graph 9). The inclusion of the costs of PPPs in the government debt and of the debt of all state-owned enterprises (SOE) would move the government debt curves up noticeably, especially if further SOE debt increases are not reined in. On the other hand, privatisation and an effective strategy to reduce SOE debt would contain the budgetary risks from SOE activities. By the same token, a quick repayment of the bank recapitalisation funds to the government would quicken the adjustment towards lower debt-to-GDP ratios.

Overall, the debt sustainability analysis reveals that the debt reduction path of the baseline is robust across a wide range of scenarios. Even in a setting which combines a number of adverse shocks, a solid reduction path is attainable if fiscal constraint is maintained after the end of the Programme period.

32. Debt projections point to a stabilisation of the debt ratio by 2013 and a robust fall afterwards. Government debt is estimated to be lower than previously estimated at the end of 2011 (106.8 per cent of GDP) due to lower general government deficit in cash terms than previously assumed by the 2011 target. Debt is now projected to peak at around 115 per cent of GDP in 2013 and gradually decline thereafter. The peak is estimated to be lower than in the second review, mainly due to the government's strategy to pay back bank loans of general government entities in 2012. The declining debt profile seems to be robust against weaker growth prospects. (Box 2)

FISCAL STRUCTURAL REFORMS

Fiscal policy framework

33. The government has adopted legislation aimed at strengthening the budgetary execution process. The law on commitments control has entered into force and the government will implement the system across all sub-sectors of government and SOEs hospitals. The law is expected to be fully implemented in the health sector and the largest local municipalities by the end of the first semester. To this aim, starting with March, the Inspectorate General of Finance (IGF) will carry out inspections following a risk-based approach to verify whether the commitment control system is operational and entities are able to control commitments against the availability of funds in compliance with the law.

34. A proposal to reduce budgetary fragmentation will be submitted by end-June. Following the improvement in budgetary monitoring system through the development of intra-annual targets on a cash basis and monthly assessments of deviations against fiscal targets, the government will present options to reduce budgetary fragmentation at central administration level. Following the creation of budget coordinators at the level of spending ministries, there is a need to strengthen further the position of the Ministry of Finance in the overall budget implementation.

35. Following the inventory on tax expenditures, the authorities are making progress on the annual report on tax expenditures in cooperation with EC and IMF staff. This tax expenditure report will be published each year as part of the budget, in line with international best practices. The report will cover central, regional and local administrations. A first draft of the report will be submitted by Q1-2012.

36. Full implementation of the Budgetary Framework Law at all levels of government is underway. **The Fiscal Council has been established and will be operational by end-March**. The authorities will ensure all the necessary changes to define in detail the proposed characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry-over rules, commitment controls, and appropriate contingency reserves and related access rules. (see also Box 3)

Box 3: Budgetary Framework and Fiscal Decentralisation in Portugal

Portugal has made clear progress in strengthening its budgetary framework and the Budgetary Framework Law approved by the Parliament in 2011 addresses relevant weaknesses of the budgetary process aiming at establishing: i) a multi-annual framework with expenditure and budget rules over the medium-term; ii) requirement for a subsequent correction whenever deviations from the budget balance rule occur; iii) an enlarged scope of application of the law to all entities that are part of general government; iv) programme budgeting and full compliance with intra-annual information requirements applying to all entities; v) a complete accrual accounting system for all entities; and v) an independent Fiscal Council.

Full implementation of the Budgetary Framework Law is challenging, although some requirements were implemented before the end of 2011, **such as the inclusion of all general government entities into the budget, and the creation of the independent Fiscal Council.** Programme budgeting was also introduced with the 2012 Budget consolidating central government appropriations according to ministerial portfolios. The fragmentation of the budgetary process still needs to be further reduced, although with the 2012 budget, budget coordinators have been established in each ministry facilitating the task of the Ministry of Finance in the overall budget design and implementation.

In 2012, the remaining challenges for the implementation of the new budgetary framework relate to:

- The implementation of the detail characteristics of the medium-term budgetary framework in terms of baseline expenditure projections, setting and modifying expenditure ceilings, defining appropriate contingency reserves and related access rules, and limiting by strict rules carry-overs within the medium-term
- The revision of the regional and local finance laws to adapt to the principles and rules in the revised budgetary framework, ensuring Fiscal Council's role in reviewing local and regional governments own revenue projections and multi-annual fiscal plans.

Regional and local governments' legal framework (Local Finance Law 2/2007 of 15 January, and subsequent amendments and Regional Finance Law, Organic Law 1/2007 as amended by Organic Laws 1/2010 and 2/2010 Revenues) details the revenue sharing mechanisms between the state and the local governments and between the state and the regions as well as the fiscal rules regarding indebtedness and targets.

Revenues. About 40 per cent of regional governments' revenues and about 50 per cent of local municipalities' revenues derive from transfers. Regions retain all taxes levied on their territory. Municipalities own revenues include according to the local finance law 2/2007: i) a 5 per cent share in state personal income tax; ii) own taxes (property taxes, surcharge on state corporate income tax, tax on vehicles, fees and fines), and iii) block grants defined as a share of central government revenues from personal and corporate income tax and value added tax as accrued in the year before the last in which the state budget authorising the transfers refers.

Net indebtedness. Local governments are allowed to incur medium- and long- term financial debt to finance investment projects only. Short-term debt is also allowed for cash management purposes and accumulation of arrears is permitted if revenue are lower than forecast. Net indebtedness is capped at 125 per cent of previous year's revenues. For the municipality that exceed the debt ceiling in a given year, the transfers to it from the State are reduced in the subsequent year by the amount of debt in excess of the ceiling. Municipalities with excessive debt are expected to diminish the excessive debt by at least 10 per cent per year. Net indebtedness ceilings for autonomous regional governments are defined annually in the State budget. However, the ceilings must be fixed such that debt service and principal payments do not exceed 25 per cent of the revenues of the regional government (excluding the state transfers). Sanctions are foreseen if non-compliance by means of reducing the transfers from the State in the subsequent year by the amount of debt in excess of the ceiling.

Main weakness: **Weak budget constraint**. Spending at local government level has been increasing at higher pace than at central government level over the last decade, the increase in expenditure after 2007 being due mainly to current expenditure (mostly compensation of employees and intermediate consumption), and not to investment. Such increase in spending is partly due to the institutional framework that links transfers to state revenues with a two-year lag, leading to highly pro-cyclical growth in spending. During downturns, optimistic revenue forecasts also lead to accumulation of arrears. Growing revenues in good times are also inflating the debt limit, while servicing the liabilities incurred becomes difficult during downturns when revenue transfers are declining.

Regional and local finance laws revisions are in the preparation phase: The own-revenue projections and plans for fiscal adjustment to bring expenditure in line with revenues will start to be reviewed by the Fiscal Council. Implementation of fiscal rules for subnational governments is currently being studied as well as early triggers for corrective action. A procedure for an orderly debt restructuring for regional and local governments will be designed and implemented. In the medium-term, the revenue sharing mechanisms are to be revised and a fully-fledged medium-term fiscal framework in line with the central government will be introduced. The revisions also need to be designed in the light of the new EU fiscal framework.

The strategy for the settlement of arrears

37. The government will revise the strategy document for the settlement of arrears before the supplementary budget is submitted to Parliament.[6] The revised strategy document will lay out the prioritisation criteria for paying creditors, as well as governance arrangements to ensure a fair and transparent process across all sectors. The IGF will be responsible for validating the claims. Payments will only be made in connection with arrears that have been validated by IGF and for entities that have changed their commitment system in accordance with the new law. At the same time, the strategy will ensure that local governments will reduce their stock of arrears by 10 per cent as envisaged in the 2012 budget.

38. The government has given priority to the regularisation of arrears caused by the chronic underfunding of the health sector over the past years (about EUR 1.5 billion). The stock of arrears in the health sector amounts to about EUR 2.5 billion, out of which about EUR 1.5 billion can be considered to have been caused by the underfunding of the system through the state budget since 2005. The remaining amount of debt of EUR 1 billion can be seen as the amount of arrears caused by the inefficient management of hospitals and the amortisation of this debt will be carried out progressively based on restructuring plans for the concerned hospitals and from their own resources according to a debt amortisation plan.

Revenue administration

39. The government has significantly strengthened the revenue administration framework. Following the creation of the new *Autoridade Tributária e Aduaneira* (AT), implementing the merger of the tax administration, customs administration and the information technology service (DGITA) in a single entity, central and support functions are currently being merged and progress is being made to reduce the number of branches by 20 per cent in 2012. Moreover, the government is developing a modern tax compliance management framework as an important tool to curb non-compliance. As part of this effort, in 2012, the focus on large taxpayers will be enhanced through the implementation of a full-fledged Large Taxpayer Office (LTO).

40. The strategic plan to combat tax and customs fraud and evasion for 2012-14 has been completed and the authorities have taken important steps for its implementation. Measures to curb non-compliance include criminal sanctions for tax crimes, access and transmission of data on payments transactions to tax authorities, obligation of introducing certified invoicing software for companies with a turnover above EUR 100 000, limitations of cash payments by companies to up to EUR 1000, and focusing attention on high-evasion sectors and taxpayers. E-invoicing mechanisms to facilitate compliance and improve control will be adopted in 2012. In particular, the authorities will finalise the assessment of the net financial impact of the proposed incentive scheme that grants up to 5 per cent rebate, subject to a limit per taxpayer, on VAT paid through electronically transmitted invoices in selected sectors and consult with the EC and IMF before implementing the scheme. Progress has been made with clearing the backlog of tax appeal cases worth above EUR 1 million with the support of the tax court judges.

Regional and local government finances

41. The central government's adjustment programme for the autonomous region of Madeira is ambitious. The government designed this programme similarly to, and in full consistency with the financial programme between the Republic of Portugal and the EC/ECB/IMF. In addition to the programme conditionality, past weaknesses in public finance management in Madeira are being addressed through tight controls, technical support and budget management by the central government (see Box 4). The central government will monitor progress of

[6] Prior action in the Memorandum of Economic and Financial Policies.

implementation on a quarterly basis and present the results in advance of the reviews of the MoU, with a first report due by the end of April 2012**.**

42. The calendar for submitting to Parliament the revision of the regional and local finance laws is postponed to the end of this year. The preparations of the revisions are not yet sufficiently advanced to allow a substantive change of the regional finance law by the end of March and of the local finance law by the end of June (see box). While the deadlines appeared ambitious from the outset, the interference created by the preparation of the Madeira agreement which absorbed substantial administrative capacity make these deadlines now look unrealistic. Furthermore, the revisions also need to be designed in the light of the new EU economic governance framework. Some of the fiscal risks at regional and local levels are also addressed by the new rules on budgetary commitment controls even though the specific modalities of implementation still need to be defined. A working group with representatives from different ministries and external experts as well as a monitoring committee that also includes representatives of regional and local governments has recently taken up their work. An IMF/EC technical assistance mission on these issues took place in mid-March. The revised calendar envisages a draft proposal to be discussed with EC/IMF/ECB by the end of June and the submission to the Parliament before the end of 2012.[7]

Streamlining the public sector

43. The reform of public administration is progressing, but more time is needed for its completion. Important steps have already been initiated to reform the public administration: creation of a database on public sector employment; reduction of management positions and administrative units; stock-taking and restructuring of foundations and associations; shared services on human, financial and IT resources; reorganisation of local government administration; shared services on human, financial and IT resources; less duplication on central and local levels. In addition, the government has put forward proposals which aim at introducing into the public sector several of the new measures of the private sector labour code. While reforms move forward in a wide range of areas, their completion requires more time than foreseen due to capacity constraints of the relevant services.

44. The review took stock of the implementation of the government's strategy on state-owned enterprises (SOEs). To reach the objective of operational balance at the end of 2012 at an aggregate level, the restructuring of public transport SOEs (which in terms of importance constitute a large share of the SOEs sector) is implemented through a new round of transport price increases in February as well as personnel cost reductions in the form of the suspension of the 13th and 14th salary, reduced employment (mainly through early retirement or mutual agreement), streamlining of management positions, and reduction in fringe benefits. A report on the financial situation of SOEs, presented in February, showed that in 2011 the operational expenditure of SOEs already decreased compared with 2010, but the total operational and financial results deteriorated further. A report on progress towards achieving operational balance is due by the end of June. Furthermore, a strategy to deal with the historical debt stock of transport companies totalling about EUR 17 billion will be prepared for the next review. Finally, the government is preparing a decree-law on the governance framework for SOEs which aims at a clearer distinction between commercial and non-commercial SOEs with different implications for their governance. Following an analysis of local government SOEs last autumn, there has been little follow-up in terms of addressing the identified weaknesses.

45. The government is pursuing its privatisation programme. With EUR 3.3 billion of proceeds resulting from the sale of its stakes in the energy company (EDP) and the energy network company (REN), the target of EUR 5 billion through the end of the Programme is likely to be

[7] A Q3 deadline would have faced similar capacity constraints as it overlaps with 2013 budget preparations.

exceeded. The sale of the small remaining stakes in GALP and REN has been delayed until market conditions have improved. The privatisation agenda for 2012 includes the national air carrier (TAP), the airport operator Aeroportos de Portugal (ANA), the cargo handling subsidiary of the railway company (CP Carga), the postal service Correios de Portugal (CTT), as well as the insurance arm of Caixa Geral de Depositos (Caixa Seguros). A strategy for the government's financial holding company (Parpública) will be prepared for the next review, given that its financial position is increasingly affected by the privatisation process as the revenues are mainly flowing to the government for debt amortisation.

46. Work on Public-Private Partnerships (PPPs) proceeds as planned. The government is preparing a decree-law on a legal framework for PPPs which defines the role of the technical unit in the Ministry of Finance, the identification of the economic and fiscal impact, and the scope for its application. An international audit firm was appointed to study the scope for the renegotiation of PPP contracts; the results should become available in June.

Box 4: The Economic Adjustment Programme for the Autonomous Region of Madeira

The government concluded in January a financial arrangement with the Autonomous Region of Madeira (RAM), to restore the region's fiscal situation and contain the fiscal risks that the region has caused on the Portuguese public finances.(1) The arrangement was designed similar to and is consistent with the financial program between the Republic of Portugal and the EC/ECB/IMF. It includes quantified measures for fiscal and structural performance in line with the recommendations set out in the September IMF Technical Assistance mission on RAM's public finance management. An important element of control is the cash and debt management of the regional budget by the central government. The central government will review progress every three months. A report summarising the results of these reviews will be available ahead of each review of the Economic Adjustment Programme for Portugal. The report on the first review of the Madeira programme will be available by the end of April, in good time for the Fourth Review of the MoU.

The total volume of the Madeira programme is EUR1.5 billion (about one quarter of the total debt), available in tranches amounting to EUR 1 billion in 2012, EUR 307 million in 2013, EUR 110 million in 2014 and EUR 83 million in 2015. The repayment of the loan will start in 2016 and last until 2033, with interest rates being those of the central government plus 15 basis points. The majority of conditions replicate those of the Portuguese Programme. Among the most prominent measures are the convergence of income tax rates towards those applied on the continent (already introduced on 1 January), VAT rates of 1 pp. below those of the continent (from 1 April), and a maximum public investment of EUR 150 million per year. The various revenue and expenditure measures should allow reducing the budget deficit to 3.1 per cent of the regional GDP in 2012, 0.8 per cent in 2013 and a surplus in subsequent years. The fiscal consolidation effort is frontloaded, with an estimated impact of 12.6 per cent of GDP in 2012 and 1.7 per cent of GDP in 2013 compared to a no-policy change scenario. The regional public debt-to-GDP ratio (excluding SOEs outside general government) is expected to decline from 81.1 per cent in 2012 to 72.9 per cent in 2015. Some risks may arise from the projection for regional GDP growth for which national growth rates were assumed, even though economic structures and the impact of the measures can be expected to be very different.

(1) http://www.portugal.gov.pt/media/445364/programa_ajustamento_madeira.pdf

Healthcare sector

47. Important steps have been taken to control expenditure, raise the efficiency and cost-effectiveness of the system, and improve equity of financing. Throughout 2011 and especially during the last quarter, a large numbers of regulatory changes were put in motion including the revision, increase and exemptions of National Health System (NHS) fees, the revision of the reference countries for pricing medicines, the reduction in the maximum price of the first generic and the removal of barriers to the entry of generics, changes to the pharmacies' profit margins, the introduction of compulsory e-prescription, the implementation of enhanced/regular monitoring of prescription behaviour and regular feedback to physicians, and the strengthening of centralised procurement. In addition, a large number of guidelines for prescription of medicines and diagnostic have been published and there is improvement in the development of electronic medical records for patients. A number of reports have been published, and hospitals are starting to be compared along a number of indicators which include financial and activity performance. There has been a reduction in costs with contracted services and in operational costs of hospitals.

48. The coming months should be dedicated to further improving and fine-tuning these policies and assessing the impact on cost reduction. It is important to further improve the existing mechanisms for monitoring, assessing and providing feedback regarding physicians' prescription but also hospital revenue and expenditure flows. The potential savings of centralised procurement and tenders must be fully realised. A number of important measures such as the compulsory prescription by substance (INN) and an update of the legislation on pharmacies await implementation. While a number of policies have been taken to reduce the expenditure of the public health system, there are no plans to ensure its independence from public funding. Also, downsizing, concentrating and redefining NHS hospitals has not yet taken full speed. For example, while two new PPP hospitals have opened in the Lisbon region there appear to be no clear plans to downside the existing capacity in this region. Finally, there remains a substantial amount of arrears by NHS hospitals to private providers for which a strategy is yet to be fully defined.

FINANCIAL SECTOR

49. Portugal's banks continue to improve their reserve cushion of high-quality capital, but meeting 2012 recapitalisation needs will be challenging. The higher solvency ratio remains a fundamental dimension of the Programme to help Portuguese credit institutions to weather the extended recession and Europe's prolonged sovereign debt crisis. Banks have applied an array of actions in order to reach the milestone 9 per cent Core Tier 1 ratio in December 2011, such as non-core asset sales, new capital issues and loan book deleveraging. However, the 2012 recapitalisation needs are sizeable in view of Portugal's deep recession and the corresponding worsening of the non-performing loans ratio, the capital requirements stemming from the special on-site inspections, the pension funds transfer and, most importantly, to the EBA capital exercise. It is expected that a few privately-owned banks might have to use the BSSF, as shareholders might not be able to finance such large amounts.

50. Efforts to streamline the state-owned Caixa Geral de Depósitos (CGD) are continuing. The sale of CGD's insurance arm to a final buyer will be undertaken in the course of 2012 and completed in the second half of the year. In order to meet the EBA capital requirements as well as the end-of-year 10% CT1 milestone, CGD will require additional capital which will be provided by the government using its cash buffers.

51. Negotiations on the sale of Banco Português de Negócios (BPN) will be finalised by end-March at the latest. The European Commission opened an investigation to check the compatibility of certain aspects of the deal with EU competition and state aid rules. A decision on this investigation is expected before end-March. Thereafter, CGD's partially state-guaranteed claims will be settled in cash over time. Three special purpose vehicles (SPV) which took over BPN's bad loans in 2010 have failed to recover any significant amounts so far. Given that collateral value wanes over time, this is worrisome. To protect taxpayers' interest the government will prepare with a strategy of how to maximise recoverable value from the assets within the SPVs.

52. The Special on-site Inspection Programme (SIP) is in its last phase. The SIP was initiated in September 2011 and was performed in the eight largest Portuguese banking groups, which represent more than 80% of the Portuguese banking system in terms of total assets. The SIP comprised the valuation of the credit portfolio, the validation of the calculation of credit risk capital requirements and the assessment of parameters and methodologies used by banks in stress-testing exercises, as of 30 June 2011. A Steering Committee, comprising international experts appointed by the EC, ECB and IMF, by three euro area supervisory authorities and by Banco de Portugal, has been set up to monitor the implementation of the programme. The valuation of the credit portfolio was conducted by two independent external accounting firms, which assessed a sample of over 60,000 credit files, covering more than 50% of the individually assessed exposures in the scope of the SIP. This resulted in a total impairment deviation of EUR 838 million, which was partly offset by the allocation of existent impairment buffers (of 242 million euros) already registered in the accounts on 30 June 2011. The validation of the calculation of credit risk capital requirements (which represent about 90% of capital requirements) identified the need to introduce some corrections. The combined impact of the SIP on the banking system's Tier 1 ratio amount to 0.3 per cent, thus decreasing the banking sector's solvency ratio to 8.8 per cent, as of 30 June 2011, but remaining above the minimum 8% required at that date. These results will be subsequently fed into banks' forward-looking stress test models, which have already been assessed under the third and last work stream of the SIP. The latter concluded that, albeit with some difference, almost all banks use appropriate parameters and methodologies in their stress test exercises.

53. The amended recapitalisation law has been published in the Portuguese Official Journal. The purpose of the legislation is to provide temporary public support to viable banks, under strict conditions respecting EU state aid and competition rules committed to a strong protection of taxpayers' interests. Capital injections can henceforth be undertaken in the form of hybrids which convert into equity in case of material short-comings to banks' capitalisation plans or non-voting shares which acquire voting rights if the state's ownership increases beyond 50 per cent. The shares' issue price provides a sizeable discount compared with market-quoted shares and encompasses an incentive for early buy-back. The shares' repurchase price will refer to the issue price plus an accrued remuneration and a fair participation in any market value gains. Incremental increases in the remuneration for the hybrids shall act as an incentive to buy them back from the state as early as feasible.

STRUCTURAL REFORMS

Labour market

54. Labour market reforms are being implemented under a broad social consensus. On 18 January 2012 the Government and social partners concluded a tripartite agreement, which covers most of the labour market reforms in the MoU[8]. The continued maintenance of social peace in Portugal, in spite of the sometimes difficult but necessary reduction in privileges, is an important accomplishment and bodes well for the successful implementation of the Programme. Besides the reform of the labour laws the tri-partite agreement presents a set of measures to enhance employability through ALMPs and through education and vocational training.

55. A draft law to reform the Labour Code sent to Parliament will substantially reduce labour market rigidities. The draft law is in broad compliance with the MoU and is expected to enter into force by July/August 2012. The main elements of the draft law are as follows:

- **Severance pay rules of current employees are aligned with those of new hires**. Following the reduction of severance payments to 20 days per year of work for hires after 1 November 2011, the draft law applies the new severance pay rules to current

[8] The agreement was subscribed by the General Worker's Union (UGT), the Confederation of Portuguese Industry (CIP), the Confederation of Trade and Services of Portugal (CCP), the Confederation of Farmers of Portugal (CAP), the Confederation of Portuguese Tourism (CTP) and the Government. The largest trade union confederation - the General Portuguese Workers' Confederation (CGTP) – has not signed the agreement.

employees, while preserving accrued-to-date rights. The alignment will occur on 1 November 2012, when a level of severance pay in line with the EU average is expected to be put in place. The Government will continue consultations with the social partners to define the exact value of the new level and the design of the fund that will finance part of severance payments.

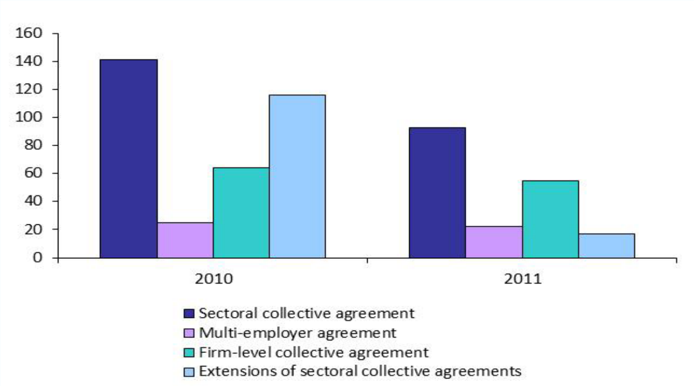
- **Definition of individual fair dismissals is eased**. Individual dismissals based on the extinction of the job on grounds of economic structural or technological reasons will no longer need to obey to a tenure rule when more than one worker is involved. Instead, the employer will need to present an objective reason for the selection of workers. Individual dismissals based on unsuitability of the work will become possible also when no new technologies or other changes to the work place had occurred. The employer has to justify the dismissal based on substantial changes in worker's performance. In both types of dismissals, the employer is no longer obliged to look for a suitable alternative position for the worker within the firm. The Government will carry out an analysis of the impact of these measures on relevant labour market variables by the second quarter of 2013.
- **Working time flexibility is increased**. Overtime pay is reduced by 50 per cent, and the mandatory 15 minute extra time off for each overtime hour worked is abolished. The scope for working time flexibility is increased with a 150-hour bank of hours that can be activated by agreement between employer and employees. Short-time working schemes during industrial crisis are streamlined. The number of working days is increased by cutting four national holidays and by eliminating the possibility for workers accumulating three additional annual leave days based on their record of absences.
- **The possibility for works councils to conclude firm-level collective agreements is enhanced**. The firm-level threshold for unions to delegate to works councils the conclusion of collective agreements was reduced from 500 to 150 workers. Simultaneously, the draft law includes the possibility that sectoral collective agreements contain clauses under which works councils can negotiate at firm level functional and geographical mobility, working time and remuneration. The proposal is in line with the MoU but it is less ambitious than a proposal discussed during the second review mission that would give works councils direct power to conclude collective agreements at firm level if no unions were present at the firm. The Government committed to provide evidence on the implementation of the measure and, if needed, to take further action to ensure that works councils are given the possibility to conclude collective agreements at firm level.

BOX 5: EXTENSION OF COLLECTIVE AGREEMENTS

Sector-level collective agreements are often extended to non-signatory firms in the sector. This practice is common in many European countries. Austria, Belgium, Bulgaria, the Czech Republic, Germany, Estonia, Greece, Spain, Finland, France, Hungary, Lithuania, Luxembourg, Latvia, Netherlands, Poland, Portugal, Slovenia and Slovakia all have extension procedures.

The design of the extension mechanism differs substantially across countries, and an extension usually needs to respect some specific criteria. In several countries extension is granted upon the application of at least one of the two parties. Minimum requirements for sufficient representativeness are established in a number of countries. In most cases the employers' associations that subscribe to the agreement must represent at least 50 per cent of the employees in the sector. In other cases, extensions must be considered as being in the public interest.

In Portugal, until recently most collective agreements were generally extended. This has changed in 2011, with just a few extensions being decreed before May and none since. According to the Labour Code, the authorities may extend collective agreements if this is justified in particular by the social and economic similarity between those who subscribed the agreement and those who will be object of the extension. However, there are no objective criteria for extension, and it is not required that parties need to ask for it. The theoretical possibility of affected individual or institution to ask for exemption is rarely used, which may be related to the fact that no criteria are defined on which to base such a decision.



Source: Ministry of Economy and Employment. DGERT.

Although extensions may play a role in establishing a level playing field, facilitating wage setting coordination or reducing transaction costs, they may pose undue burden on competitiveness of non-affiliated firms. Where productivity differences are large across the sector and regions and collective agreement are not representative, extensions may distort the inter-firm distribution of wages. The responsiveness of wages to shocks is reduced as wages cannot adjust to differences in productivity across firms or geographical areas. In Portugal, the widespread use of the extension mechanism might have contributed to the low cyclicality of wages. Portugal is therefore working on a definition of clear criteria to be followed for extension of collective agreements. The Government is currently collecting data on the representativeness of the social partners. A collective agreement subscribed by employers' associations representing less than 50 per cent of workers in a sector will no longer be extended. Above that threshold a decision on extension will have to take into consideration the implications on competitiveness of firms in the sector. The extent to which the introduction of this rule can contribute to improve the responsiveness of wages to economic conditions will also crucially depend on its effective implementation. Close monitoring of its application and effects will be necessary in the initial phase.

56. The unemployment insurance benefits system is being revised to reduce unemployment traps, while better protecting workers with short contributory careers and self-employed. Two draft-decree laws approved by the Council of Ministers revise the unemployment insurance system to approximate its generosity to the EU average and to enlarge its coverage. A declining profile is introduced with a 10 per cent reduction of benefits amount after six months of unemployment duration and the maximum ceiling is reduced from about three to two and a half times the social support index[9]. The coverage of unemployment benefits is enlarged by reducing the length of the contributory career needed for eligibility from 15 to 12 months and by extending coverage to specific categories of self-employed. These revisions are in line with the MoU. By contrast, the reduction in the maximum duration of unemployment benefits from 38 to 26 months is not in line with the maximum of 18 months agreed in the MoU. In addition, age continues to play a significant role in determining benefits duration. The Government will carry out by the end of the year an analysis on benefit dependency and long-term unemployment with a view to tackling possible deficiencies with the unemployment insurance system

57. Measures are taken to improve activation and other Active Labour Market Policies (ALMP). A hiring incentives programme – Estímulo 2012 - entered into force on 14 February 2012. The measure covers employees registered for more than 6 months with the Public Employment Services (PES). It subsidises 50 per cent of the wage of the employee up to a ceiling equal to the social support index during 6 months. The firms benefiting from the scheme must provide training and offer a contract of at least six months. The Government estimates that more than 56,000 unemployed will benefit from the measure. In addition, the Council of Ministers has recently approved a strategy to reform the PES. The measure is part of an action plan to improve activation and ALMPs. The Government presented a report to take stock of ALMPs, which will be followed up in June by an evaluation of the causality between ALMPs and employability. The results of the study will feed the action plan to improve the effectiveness of activations and ALMPs.

Education

58. The development of a monitoring tool to evaluate education outcomes is progressing as planned. The system is expected to be operational by September 2012. In addition the authorities presented broad action plans on the improvement of quality of secondary education and on the improvement of quality and attractiveness of education and vocational training. Detailed action plans including road maps for implementation will be prepared by March, in line with the MoU.

Housing market

59. A draft Decree Law for amending the urban rental legislation was submitted to the Parliament which paves the way for a more flexible and dynamic rental market. It balances rights and obligations of landlords and tenants, phasing-out within a transitory period of maximum 5-years the old system of open-ended leases signed before the 1990s in which rents were frozen and contracts could not be terminated by landlords. The legislation also provides for more flexibility in the choice of contract duration and updating of rents, sets incentives for renovation of the housing stock and provides a new and fast extrajudicial eviction procedure. The reform is therefore in line with the main objectives of the MoU. However, additional improvements were discussed during the third review such as: (i) further aligning the prior notices for the termination of leases, in particular for open-ended leases; (ii) increasing incentives for renovation works by the landlords; (iii) setting mechanisms to accelerate the transitory period of 5 years through negotiation, lower contract duration and/or compensation; and (iv) progressively treating socially

[9] Social support index is equal to EUR 419.22 per month. The maximum unemployment insurance benefit was reduced from EUR 1257.66 to EUR 1048.05.

vulnerable cases through instruments other than rent control mechanisms. The authorities also need to ensure that the extrajudicial eviction procedure does not take longer than three months.

Judicial system

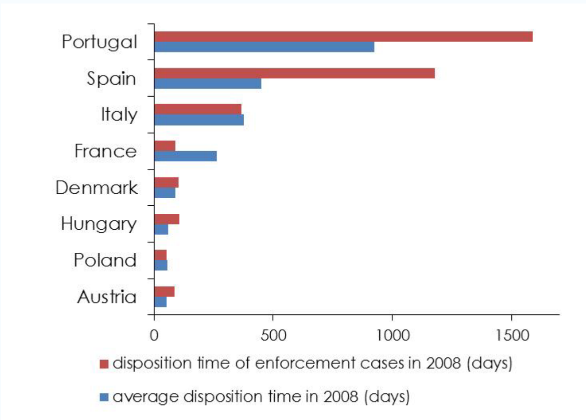
60. Reforms of the judicial system are progressing largely ahead of schedule. Adjustments to the MoU reflect the successful completion of a number of measures or follow-ups from the elaboration of reform plans and road maps. The first 50,000 backlog cases in the courts have been cleared. The target to resolve the case backlog appears well on track with a task force to expedite the backlog resolution set up and quarterly monitoring being put in place, and regulations adopted to ensure the oversight body's full access to the enforcement case files and tighter supervision of enforcement agents. The recently submitted roadmap on judicial reforms identifies quarterly milestones to reduce the number of court districts and close down underutilized courts. Ten court sections have been closed since November 2011. Also the assessment of court management and a new personnel management plan to support judicial specialization and mobility of court officials have both been completed ahead of the deadline of January 2012. The Portuguese government has made significant progress in strengthening alternative dispute resolution (ADR) to facilitate out-of-court settlement. After adoption of a law on arbitration on 4 November 2011, the authorities have taken the necessary legal, administrative and other steps to make arbitration fully operational ahead of the deadline set for February 2012.

61. The organisation of the court system is becoming more efficient. Specialised courts and judges on competition matters and on intellectual property rights are set to become operational. A task force of tax judges has been established to facilitate the resolution of outstanding tax cases. Concerning the review of Code of Civil Procedure, the government has prepared a bold proposal to speed up the judicial process. It is conducting an extensive consultation with stakeholders on these proposals, including through workshops to be held in April with the IMF and EC technical assistance. Concerning small claim cases, data are currently being collected, and a concept note on resolving such cases is being prepared.

BOX 6: IMPROVING THE FUNCTIONING OF THE JUDICIAL SYSTEM IN PORTUGAL

One of the main problems of the Portuguese judicial system is the huge **number of pending cases** before the civil and commercial courts. Portugal currently has about 1.5 million civil and commercial cases pending. The bulk of these (about 1.18 million) are enforcement cases. As required by the Memorandum of Understanding, Portugal has analysed the reasons for the backlog in two studies and has suggested a number of measures to reduce it. It emerges from these studies that this problem has to be tackled by a combination of measures, amongst which the following main aspects should be highlighted:

Council of Europe (CEPEJ — European Commission for the Efficiency of Justice) statistics show that average disposition time in first-instance civil and commercial cases in Portugal is 925 days compared with 53 in Austria and 91 in Denmark (see Chart). Acceleration and simplification of the court procedures for civil and commercial matters imply a **reform of the Code of Civil Procedure**. In this context, at the end of 2011 Portugal submitted a study (together with a legislative proposal) which identified the key areas for improvement, including (a) consolidating legislation for all aspects of enforcement cases before the courts, (b) giving judges further powers to expedite cases, (c) reducing the administrative burden on judges, (d) introducing and enforcing statutory deadlines for court procedures, in particular injunction procedures and debt enforcement and insolvency cases, and (e) establishing a single judge procedure for small claims. Based on this study and taking into account the results of stakeholder consultations (including a conference in April 2012) and comparative law analysis, Portugal will draft amendments to the Code of Civil Procedure by June 2012 and submit them to parliament by September 2012.



As the bulk of these cases are **enforcement cases** (i.e. concern enforcement of judgments or other enforceable titles), one of the main measures focuses on improving the lengthy enforcement system. Again, statistics from the Council of Europe show that the average disposition time in first-instance enforcement cases in Portugal is 1 588 days compared with, for example, 89 in France (Chart). Apart from structural measures to streamline the enforcement procedure (which would require changes to the Code of Civil Procedure, see above), measures will have to be taken to strengthen the legal and institutional framework for enforcement agents in line with international practice. To this end, Portugal has prepared an Action Plan identifying measures to be taken over the next twelve months to achieve the objectives of strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents. This will include an analysis of the feasibility of a fee structure that creates incentives for speedy enforcement. In addition, Portugal will give the oversight body full access to the enforcement case files, including financial data, by 30 June 2012. By mid-May 2012 it will complete the above-mentioned Action Plan with specific measures based on extensive stakeholder consultations and international experience (including a conference in April 2012).

Portugal is also taking targeted measures to reduce the number of pending enforcement cases and set up a task force for this purpose and closed more than 50 000 cases. Approximately 634 000 cases (out of about 1.18 million) are claims not exceeding EUR 3 000, out of which 311 000 do not exceed EUR 1 000. It stands to reason that such **small claims** should be processed and closed expeditiously. For this reason, the Portuguese authorities will collect data on small claim cases pending on 31 December 2011 and prepare a concept note by the end of March 2012 on measures to resolve such cases. Portugal will also finalise an Action Plan to resolve these cases, complete with specific measures and deadlines, by the end of May 2012.

Finally, a comprehensive study submitted recently by Portugal on **restructuring of the national judicial system** shows that the whole judicial system, including the territorial scope of the judicial districts, needs to be reorganised in order to improve efficiency. According to statistics from the Council of Europe the number of first-instance courts in Portugal is relatively high: there are 2.2 courts per 100 000 inhabitants (compared with, for example, 0.1 in the Netherlands, 0.3 in Belgium, 1.1 in the UK and 3.9 in Greece). Therefore, increasing the efficiency of the court system might imply reducing the number of courts and court districts (including closing down underutilised courts; 10 court sections have already been closed down). Measures also have to be taken to ensure a more even distribution of the workload between the courts and judges and, possibly, better management of the courts. Building on this study and taking into account stakeholder consultations and international experience (including a conference in April 2012), Portugal will prepare a revised roadmap for the judicial reform by June 2012 and will submit a bill to implement it to Parliament by the end of September 2012.

Energy

62. Substantial further action will be necessary to set the surging debt of the electricity system (tariff debt) on a sustainable path by correcting the excessive rents associated to the production of energy. A report discussing some possible measures points to only limited actions so far. Moreover, the underlying information contained many gaps on the issue of rent reduction. However, the authorities have reiterated their commitment to addressing the problem, and the revised MoU contains some specific measures that, if properly implemented, would have a significant impact on the tariff debt. In particular:

- Rates of return granting excessive rents to producers under the *ordinary regime (CMECs)* will be renegotiated to bring them close to the cost of capital plus a possible risk premium. The existing regime is one of the main factors behind the continued build-up of the tariff debt.

- The government will redesign the investment incentives for future installed capacity under the *power guarantee mechanism*. It will take into account security of supply levels and the existence of other mechanisms, such as the interruptibility service, but the new mechanism should also make the system work closer to market conditions and account for developments in the Iberian electricity market. Moreover, investment incentives granted retroactively (i.e. prior to 2007, when the concept of a mechanism was first legislated) will be withdrawn.

- A revision of the support-scheme for *co-generation* (under special regime), where the government has committed to revise tariffs by end-April 2012 with the objective to reduce implicit subsidies by annual amounts raising from EUR 25 million in the first years to EUR 80 million by 2020 (the adoption of revised tariffs was already foreseen in a 2010 decree law). The government has not committed to a revision of the general framework, despite the identification of actions detailed in their report on the co-generation support mechanism which would further rationalise this scheme. A reflection is warranted on improving the general framework to ensure that it provides stable grid access conditions and on ways of bringing this support scheme closer to market principles.

- The authorities have provided an overview of the support schemes for *renewables* and of the evolution of feed-in tariffs over time. However, a cost-efficiency assessment of the support levels for the different technologies is still needed. Going forward, the government will address the renewables support schemes for capacity not granted by tender procedures.

63. The transposition of the Third Energy Package is advancing. The liberalisation of the energy sector in Portugal advanced with the adoption of decree-laws to phase out the remaining regulated tariffs for smaller and retail end-users of electricity and natural gas by 1 January 2013, which follows the earlier decreed tariff deregulation for larger and industrial customers by 1 July 2012. The decree-laws establish a transitory period of maximum three years and transitory tariffs designed so as to incentivise consumers to switch to the liberalised market. The transitory period can be shortened if the share of end customers supplied under conditions of free prices reaches 90 per cent. In addition, mechanisms were introduced to safeguard economically vulnerable end customers, in particular through the option of a supplier of last resort. Progress with the transposition of the remaining parts of the Third Energy package is steady. Further steps will be taken in particular as regards the powers of the national regulator with respect to arbitration and the imposition of sanctions. The lack of a common tarification system for use of gas networks in Portugal and Spain remains a major impediment to the development of the Iberian gas market (MIBGAS). A report analysing the cross-border transmission gas tariffs between Portugal and Spain was submitted to public consultation in January. On its basis, the regulators of the two countries will prepare a joint proposal for harmonising the cross-border tariffs. Other recent energy policy measures include the increase in the excise tax for electricity to EUR 1 per MWh as of 1 January 2012 and the removal of the tax incentives for investment in renewable energy equipment and energy efficiency in buildings overlapping with other policy instruments in the 2012 budget.

64. The government has taken steps to simplify and clarify the administrative procedures for the allocation of licences for renewable energy projects. This benefits especially micro- and mini-generation as well as mini-hydroelectric plants. A set of measures to further improve the current procedures has been identified. Their implementation now needs to be ensured.

Ports

65. The regulatory framework for the port sector has been improved. As part of the long-term vision for transport, the government is working on a strategy to integrate ports into the overall logistic and transport system. It should set national priorities for infrastructure development in order to reap economies of scale and to assure that scarce funds directed to investment projects address clear, demonstrated business needs. The regulation of commercial activities in the port sector and of maritime transport has been transferred to the newly created Institute of Mobility and Transport, which is also responsible for the regulation of land transport and road infrastructure. Moreover, with the transfer of the management of the two commercial ports still under the responsibility of the Institute of Ports and Maritime Transport (IPTM), the separation of regulatory activities from port management and commercial activities will be fully achieved. Governance structures need to improve further to ensure a stronger commercial orientation of port activities and making them more attractive for private investment. The reorganisation of port authorities should aim to reap economies of scale and to avoid a dispersion of port governance responsibilities. The revision of the legal framework governing port work requires careful preparation to assure that the Portuguese economy can take full advantage of the maritime potential and lower transport costs. A draft law is under preparation but more time will be needed before submitting it to Parliament. Significant progress has been achieved in the field of the Port Single Window and the Logistic Single Window with the primary aim of reducing the administrative burden on transport operators through a single point of contact with the authorities and through electronic document processing.

Telecommunications and postal services

66. Following major initial steps, the opening of the telecom market advanced only little. Important delays have accumulated in allowing market players to enter the universal service segment through a transparent and non-discriminatory public tender. The designation of the universal service provider(s) foreseen for December 2011 has not been launched. Renegotiations of the concession contract with the incumbent with a view to excluding the universal service are not terminated, and the tender documents, following a public consultation, are now being revised. In parallel, a public consultation is about to be launched on the functioning of a compensation fund to finance net costs in universal service. While deadlines were already extended in past review, this MoU requirement has not been complied with and the European Court Ruling of 7 October 2010 has not been respected.

67. Legislation to liberalise the postal sector is close to completion. The law transposing the Third Postal Directive was approved by Parliament on 9 March. This new framework enacts the liberalisation of the entire sector and strengthens the role and powers of the regulator. The framework law of the concessions contract would make clear that investment needs and return on investment have to be taken into account in the determination of new designation periods for the universal service provider(s). On-going discussions of the revised terms and conditions of the existing concessions contracts with the incumbent also need to reflect this new regulatory environment.

Other services sectors

68. Progress in the liberalisation of other service sectors and regulated professions is mixed. Despite significant efforts, many of the sector-specific amendments that are necessary to fully implement the Services Directive will not be approved within the deadline of Q1-2012. These amendments are needed to reduce barriers to entry for about 67 regimes of varying economic significance. In addition, a recent interpretation of the Constitution suggests that any amendments affecting the access or exercise of a profession need approval by law or by authorized decree-law, requiring submission to Parliament. This includes also sector-specific legislation regulating the exercise of those activities. A new roadmap has been submitted and the government will adopt or, when relevant, present to Parliament all the remaining draft amendments necessary by Q2-2012. Progress has been achieved since the last review on legislation on the recognition of professional qualifications. The Commission on Regulated Professions has advanced its work and analysed about 118 regulated professions, but delays imply that the deadline for the reducing of restrictions and reserves of activities in regulated professions will be postponed to July 2012. A decisive step has been taken towards liberalising the exercise and activity of highly regulated professions (such as lawyers, notaries - for which regulation involves a professional body) with the preparation of a draft framework law. It aims at implementing in an ambitious way the Services Directive, the E-Commerce Directive and the Professional Qualifications Directive for those highly regulated professions. The government will submit a law proposal to Parliament in Q2-2012, following public consultation. It is expected that the Parliament will be able to enact the law in Q3-2012; professional bodies will have to make the necessary adaptations of their statutes by Q4-2012.

69. In the important construction and real estate sector reform steps have been insufficient so far to eliminate the significant barriers to entry. In particular, the final draft for these sectors still needs to address the need for a significant easing of requirements for the establishment of service providers and the elimination of requirements for cross-border service providers, also contravening the European Services Directive. Due to the size of these sectors, the current situation in construction (6.8 per cent of GDP in 2007) and real estate services (7.3 per cent) has potentially highly damaging consequences for the entire economy. These sectors have traditionally been highly regulated in Portugal compared to other Member States. In view of the lack of progress on this measure, the existing pre-infringement procedure is to be continued by the Commission and the authorities need to urgently re-consider the reform and work on a new proposal. The deadline of Q4-2011 has been postponed to Q1-2012 for its submission to Parliament.

70. Reforms at creating a Point of Single Contact (PSC) to present clear information for established and for cross-border service providers are satisfactory. However, the quality of the translations provided needs to be improved. Single electronic forms will be available for two procedures in March 2012. Delays in the updating of information available in the PSC and in the availability of other single electronic forms seem to be directly linked to delays in the adoption of the required amendments of sector-specific and of recognition of professional qualifications legislation. For this reason, deadlines are now linked to the compliance dates for these legislation amendments. Due to technical problems and lack of a budget, measures linked to the "Zero Authorisation" procedures will be postponed by a quarter.

Competition and sectoral regulators

71. The government has taken bold steps to ensure an effective competition enforcement regime. The competition law has been submitted to Parliament in the beginning of February 2012 and is expected to be adopted by June 2012. This law is meant to ensure that the Portuguese Competition Authority (PCA) is able to effectively enforce competition rules and is equipped with adequate investigation powers in line with other competition authorities in the EU. This involves in particular the power to effectively carry out unannounced inspections in business premises, including the power to search, examine and copy or seize all types of business records and communications independent of the medium on which they are stored. To guarantee the PCA sufficient and stable financial means, the authorities are monitoring closely the implementation of the executive order which authorises the transfer of contributions from seven regulators and will revisit the PCA´s financing model following a forthcoming report (as mentioned below).

72. The study on independence and governance of the national regulatory authorities will not be available before end June, because authorities failed to launch a call for its tender. Strengthening the independence and the governance model of the regulators is particularly important at a moment where further liberalisations are taking place. This delay, caused in part by the obstacle faced in including in the terms of reference of the study one of the main regulators which answers only to the Parliament, will have also consequences on the advancement of other measures in the MoU, such as the improvement of the governance model of the ports and railway regulators. The call for tender for the study was launched and all consultants' proposals are expected until end of March.

73. Measures to improve the public procurement legal framework have been taken or are in the process of being adopted. A significant revision of the public procurement code is about to be adopted which will address in particular the regime for the award of additional works and services, errors and omissions, as well as the elimination of exemptions permitting direct awards and of the requirement to invest in R&D projects on contracts above EUR 25 million. A new bylaw extending the competences of the court of auditors to enforce compliance with public procurement law has recently been adopted, encompassing an enhanced role of this body in ex-ante monitoring of public contracts award and ex-post control of contracts for additional works/services. This bylaw also raises the level of fines applicable by the court to members of contracting authorities for non-compliance with the code thereby increasing their financial responsibility. Information on award procedures made available in the public procurement portal "Base" has been substantially improved together with the addition of new search functionalities thereby increasing the overall transparency of the system.

74. Concerning the existing shareholder agreement of CGD in Galp, the government has decided to further delay the sale of the 1 per cent share, therefore keeping a situation of special rights by the State. This MoU requirement has not been complied with and the European Court Ruling of 10 November 2011 has not been respected.

Business environment

75. First steps have been taken to reduce administrative burden on exporting companies and to improve effectiveness of existing instruments dealing with access to finance, export promotion, and competitiveness for SMEs. The "Simplex export" programme is well on track, and a report describing the existing system of financing and non-financing support measures, has been submitted. This report is a first step in making an overall assessment of consistency, effectiveness, and impact of support measures. Going further, the government will elaborate an action plan and modify or adopt those mechanisms to support SMEs.

IV. PROGRAMME FINANCING

76. The planned loan disbursement volume of EUR 14.9 billion for the second quarter of 2012 was confirmed during the mission. Updated calculations by staff of the EC, ECB, IMF and the Portuguese debt agency confirmed the disbursement schedule for the Portuguese Sovereign, as set out in the original Programme design. Successful completion of the third review will allow the release of EUR 9.7 billion from EFSF/EFSM and SDR 4.4 billion (EUR 5.2 billion) from the IMF. The forthcoming instalment is the second largest of the programme and will bring EU and IMF financing to around EUR 53 billion, representing more than two thirds of total available financial assistance. The EU instalment will be disbursed before the end of May.

Table 7. Disbursements to Portugal (in bn EUR)

	EU	IMF	Total
Programme mission	12.4	6.1	18.5
1rst review	7.6	4.0	11.6
2nd review	5.3	2.8	8.1
Total disbursed	25.3	12.9	38.2
Total undisbursed	26.7	14.2	40.9

Note: Total disbursements do not add up to EUR 78 bn due to changes in EUR-SDR rate.

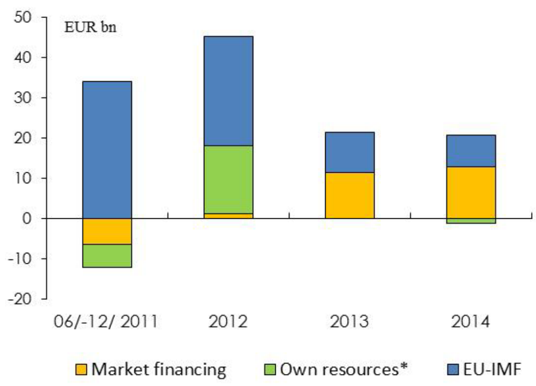
77. Financing needs for the rest of the programme period remain broadly in line with previous expectations. Additional financing needs result from the Economic Adjustment programme for Madeira, capital contributions to the ESM, accelerated redemption of saving certificates and the financing of state-owned enterprises. However, this is largely compensated by improved short-term financing, more frontloaded privatisation receipts, higher re-imbursement of structural funds as a consequence of the increase in the co-financing rate, and lower-than-expected immediate financing needs in relation to the resolution of Banco Português de Negócios (BPN). As a result, the cash position has been comfortable enough for IGCP to conduct some debt management operations in order to smoothen the redemption profile over coming months.

78. Recent funding operations by the Portuguese sovereign have been successful. The downgrade of the Portuguese sovereign long-term debt by S&P to non-investment grade in January has not affected the government's potential for raising short-term funds on the market. The stock of treasury bills at end-February amounted to EUR 14.7 billion. The roll-over risk has been lowered somewhat by the increasing maturity of latest auctions. On January 18, Portugal sold EUR 500 million of 11-month T-Bills at a yield below 5 per cent, which is 90 basis points less than at the last 12-month T-Bill auction in April 2011.

Graph 10: Financing needs

Source: Commission services

Graph 11: Financing sources

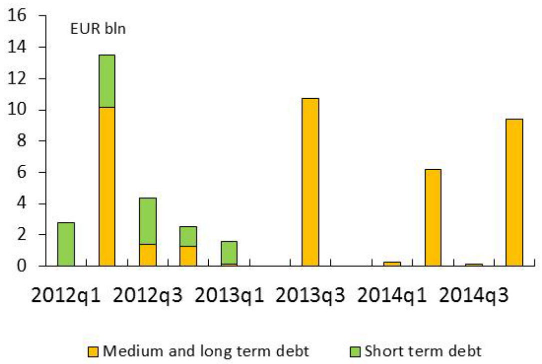


Source: Commission services
** Negative value indicates build-up of deposits.*

79. Long-term government bonds yields remain high. As of mid-March, 10-year government bond yields trade at around 13.7 per cent, which is close to the level of three months ago. The high yields illustrate that markets still need to be convinced about the feasibility of regaining market access. The EC/ECB/IMF continue to closely monitor the financing conditions for the Portuguese Sovereign and the associated risks for programme financing.

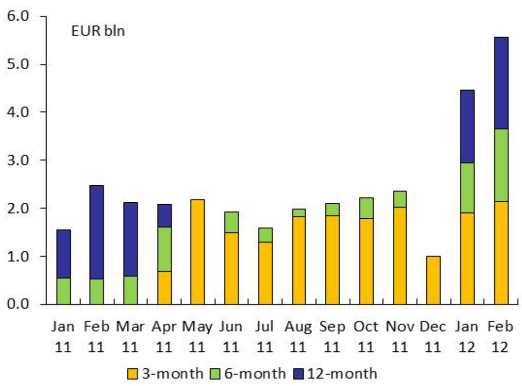
80. There is no need for Portugal to tap international bond markets in 2012. However a gradual return is expected for 2013 under current programme assumption. Continued effort to the full implementation of the programme is crucial to improve market confidence in Portuguese assets.

Graph 12: Maturing debt



Source: Bloomberg

Graph 13: Short-term auctions (amount at issue)



Source: Bloomberg

V. CONCLUSIONS

81. Overall, the programme is on track. The fiscal adjustment in 2011-2012 is remarkable by any standards. The necessary deleveraging of the financial sector is progressing in an orderly manner. Reforms in labour and product markets aimed at raising competitiveness, growth and job creation are advancing and framework conditions for doing business are being improved.

82. But important risks and challenges remain. On the budget side, risks are related to a further increase in unemployment. Also, revised reporting and control mechanisms, notably at the regional and local level, will have to pass their test. In health care, a number of measures need to be put in place rapidly to reach the ambitious cost savings targets. The government also still needs to devise a strategy that combines the settlement of the stock of arrears with incentives to avoid further arrears accumulation. The large debt overhang of state-owned enterprises calls for urgent resolution to avoid spill-over to the government budget. On the structural side, in view of the pressing need to unleash the economy's growth potential policy slippage cannot be afforded. Thus it is crucial that the government ensures that there are no delays in the implementation of the ambitious reforms in labour, product and services markets. As to labour market reform, it may be necessary to go beyond currently planned reform steps in specific areas such as the duration of unemployment benefits or the extension mechanism of collective agreements. In network industries, sheltered services and regulated professions, significant efforts will have to be made to eliminate barriers to competition and excessive rents that are stifling economic dynamism. Strong resolve will be necessary to overcome resistance from vested interests.

83. Raising the country's attractiveness for foreign investment is a crucial element for the success of the Programme. To assure the trust of the markets, a close and systematic monitoring is necessary to show that the reforms deliver the intended results. This must be underpinned by a continued strong commitment of the government and broad political and social consensus, together with a clear communication strategy on the benefits and necessity of the reforms.

ANNEXES

ANNEX 1: ASSESSMENT OF COMPLIANCE: MONITORING TABLE

Actions for the third review (to be completed by February 2012)	*Status*
Financial sector	
[2.3] Ensure that pension liabilities are in line with EU competition and state aid law.	**Ongoing.** Commission services are still to receive some figures to analyse.
[2.4] BdP to follow closely the banks in view of reaching a core Tier 1 capital ratio of 9%.	**Observed.** All financial institutions reached the ratio, but two holdings
[2.7] Finalise the framework for access to public capital.	**Ongoing.** The law has gone through parliament. The ordinance is under consultation between EC/ECB/IMF, Banco de Portugal, Ministry of Finance and the Bankers Association.
[2.12] Publish the new non-performing loans ratio in addition to the current ratio.	**Observed.** In its November financial stability report BdP published the new NPL ratio together with an explanation how it is calculated.
[2.16] Amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework and introduce a regime for the resolution of banks as a going concern under official control, by end-November. **(SB, MEFP ¶34)**	**Ongoing.** Plans on how to get the Resolution Fund fully operational by July were presented during the review. Furthermore Recovery and Resolution Plans regulations will be adopted in 2012.
[2.18] Amend the Insolvency Law to better facilitate effective rescue of viable firms and support rehabilitation of financially responsible individuals, by end-December. **(SB, MEFP ¶36)**	**Ongoing.** The law was approved by Cabinet and submitted to Parliament in December 2011. Parliament approved the amendments to the Insolvency Law on 9 March.
[2.20] Provide the EC/ECB/IMF with an assessment of existing support mechanism to SMEs (by December).	**Ongoing.** The Ministry of Economy has published on 20 January the first report providing an in depth assessment of support mechanisms for SMEs. The report will be fine-tuned in its subsequent versions and will encompass the assessment of any new measures created under the programme.
Fiscal-structural	
[1.7] Carry out measures with the 2012 Budget Law.	**Observed.** The 2012 budget was adopted as foreseen in the draft law, with little changes.
[3.2] Prepare and publish a consolidated monthly report on arrears for the general government.	**Observed.** The report is published in the monthly budgetary execution bulletin.
[3.4] Publish quarterly accounts for SOEs at the latest 45 days after the end of the quarter	**Observed.** Quarterly accounts available for all the SOEs inside general government. Financing needs data available for end-2011 for all SOEs.
[3.5] Develop intra-annual targets and corrective measures for the general government (monthly/quarterly, cash balance, expenditure, revenue targets).	**Observed.** Intra-annual targets were developed for the general government.
[3.6] Adopt the legislation to insure implementation of the commitment control.	**Observed.** The law on commitment control system has entered into force.
[3.11] Explore various options of settling the arrears.	**Partly observed.** An enhanced strategy for the settlement of arrears will be submitted with the supplementary budget.
[3.13] Ensure full implementation of the Budgetary Framework Law.	**Ongoing.** The authorities are working on the detailed definition of the proposed characteristics of the medium-term budgetary framework to be submitted with the annual fiscal strategy document in April.
[3.14] Insure that the Fiscal Council is operational.	**Broadly observed.** The Fiscal Council has been established,

	its operation should start in March.
[3.16] Present the roadmap and options for the revision of the local and regional finance laws.	**Not observed**. The draft proposal for the revision of the local and regional finance laws was postponed to Q2-2012. An IMF/EC TA mission took place in March.
[3.17] Prepare a financial arrangement with Madeira.	**Observed.** In conjunction with a small interim loan, a letter of intent by the Government of Madeira was sent in December. The full programme was concluded in January.
[3.20] Recruit a top tier international accounting firm to complete a more detailed study of PPPs. **(SB, MEFP ¶14)**	**Observed.** The tender was launched in December, a contractor was selected in February.
[3.25] Submit to Parliament a new legal framework for SOEs (January 2012).	**Partly observed.** A draft law on the legislative authorisation for the reform of the legal regime of the public enterprise sector was presented to EC/ECB/IMF, but its submission to the Parliament is pending.
[3.27] Prepare a plan to strengthen the governance of SOEs (at central, local and regional level).	**Observed.** The draft law mentioned under [3.25] is accompanied by an explanatory memorandum which sets out the key features of SOE governance, including at regional and local level.
[3.29] Prepare restructuring plans on local SOEs and the SOEs of each region.	**Partly observed.** The White Paper on local SOEs presented in November only made general recommendations but did not develop a more detailed strategy on how to restructure specific SOEs. The adjustment programme for Madeira includes a condition to present a detailed report for the restructuring of the regional SOEs by Q1-2012. The regional government of Azores continues to restructure its SOEs, including through the sale of stakes, but the documentation of the process should be improved.
[3.30] Financial closing of EDP privatisation.	**Observed.** The sale was finalised in January.
[3.30] Select bidders and initiate the 2nd phase of the REN privatisation.	**Observed.** Two bidders were selected in December and the mutual intentions for the sale of stakes by/to each of them signed in February.
[3.31] Prepare plan to privatise *Parpublica*.	**Not observed.** A new deadline was set for April 2012.
[3.33] Complete the design of the new structure that merges tax, customs and DGITA.	**Observed.** The merger of tax administration, customs administration and the information technology service (DIGITA) in a single entity called *Autoridade Tributária e Aduaneira* (AT) has been completed, implementation is underway.
[3.35] Review the assessment of audit performance.	**Observed.** The authorities have presented a report on audit performance based on both qualitative and quantitative indicators.
[3.35] Apply interest charges on outstanding debt over the court appeal period.	**Observed.** It has been observed with the 2012 budget adoption.
[3.37] Prepare an IT Strategic Plan for the new merged revenue authority.	**Observed.** The authorities have prepared an IT Strategic Plan, its implementation is underway.
[3.39] Reduce management positions and administrative units by 27% and 40%, respectively, in central government.	**Partly observed.** As of 9 February, for the 150 entities undergoing organisational changes, the legal acts for 46 are in force and those for 81 have been approved and are awaiting publication to enter into force.
[3.41] Submit law to Parliament to reduce management positions and administrative units in local administration; promote equivalent initiatives in regions.	**Observed.** The obligation for local governments is part of the central government budget 2012, with non-compliance inducing a reduction in transfers. The adjustment programme for Madeira has a condition to present such plans by Q1-2012. The government of Azores reported considerable reductions in public sector employment during 2010 and 2011, but the documentation of results should be improved.

[3.42] Carry out a cost/benefit analysis of public entities (foundations, institutes, etc).	**Partly observed.** A survey on foundations is ongoing on the basis of which an assessment will be made on whether to maintain, reduce or extinguish them. The same approach, adjusted as needed, will subsequently be applied to associations and other public and quasi-public entities. New deadlines to conclude this process have been set for foundations (Q3-2012) and associations (Q4-2012).
[3.43] Draft law on creation and functioning of public entities (foundations, institutes, etc) in central and local administration.	**Observed.** The Government submitted to Parliament in February a new legal framework for foundations.
[3.43] Take initiative to regulate the creation and functioning of public entities in regional administration	**Partly observed.** The adjustment programme for Madeira includes several conditions on the financial autonomy of services and autonomous funds.
[3.45] Identify inefficiencies and duplications between the central, local and locally based central administration.	**Not observed.** An inter-ministerial working group has been set up, but progress beyond defining the process is yet to be made. New deadlines have been set for the study (Q3-2012) and the subsequent reforms (Q4-2012).
[3.48] Prepare plan of mobility of human resources within the administration.	**Observed.** Implemented through the 2012 budget.
Health care system	
[3.51] Enact legislation on automatic indexation to inflation of NHS co-payments.	**Observed.** Legal documents (DL 113/2011; Portarias 306-A/2011 and 311-D/2011), published and enacted. Under implementation.
[3.52] Reduce the public expenditure on public health-benefits schemes by 30% in 2012, by 20% in 2013. Ensure further similar reductions in subsequent years with a view to have the health-benefits schemes self-financed by 2016.	**Not observed.** There have been expenditure cuts by the main sub-system but there is no progress in terms of ensuring the self-sustainability of the funds vis-à-vis the state. As the cuts of the 13th and 14th month salary have reduced beneficiaries' contributions by two months the contribution by the state remains at 2.5%, therefore increasing the state dependency of the system.
[3.53] Prepare the health sector strategic plan.	**Observed.** the authors are fine tuning the final draft, final publication expected by end of February.
[3.54 i] enact legislation setting the maximum price of the first generic to 50% of the branded product.	**Observed.** Legal documents (Law 62/2011, DL 112/2011) published and enacted.
[3.54 ii] Enact legislation which reduces the prices of medicines when their patent expires.	**Partly observed.** Legal documents prepared and under consultation; to be enacted by end March 2012.
[3.55] Move the responsibility of pricing medicines to the Ministry of Health.	**Partly observed.** DL 112/2011 created a single contact point and now there is the ongoing implementation of so-called "leis organicas" re-defining/ attributing responsibilities within public administration.
[3.56] Enacting the legislation regarding the revision of the existing pricing system for medicines based on external prices.	**Observed.** there is a new set of reference countries (Spain, Italy and Slovenia). Nevertheless, it would be important to assess this choice of countries in the future.
[3.57] Carry out the first quarterly feedback on prescription to each physician.	**Observed and ongoing.** A number of legal documents have been adopted (DL 108/2011, Dispatches 12950 and 17290) and a first feedback has been provided; authorities are now working on automatizing and standardizing the collection of some of the relevant information and further improving the feedback process notably vis-à-vis prescription guidelines.
[3.59] Enact the legislation to prescribe the International Non-proprietary Name (INN).	**Partly observed.** Legal documents approved by Parliament and awaiting President's signature; to be published and enacted by end March 2012.
[3.60] Establish rules for the prescription of drugs and complementary diagnostic exams (prescription guidelines).	**Observed and ongoing.** 60 guidelines have been published covering almost 80% of expenditure on medicines and more than 80% of expenditure on diagnostics. Authorities will continue to develop and publish further guidelines, will

	work on introducing these guidelines into the existing e-health systems and will monitor the implementation of the guidelines.
[3.61] Enact legislation to reduce the administrative/legal hurdles in generic medicines market.	**Observed and ongoing.** Legal documents (law 62/2011) published and enacted and several generics have already received a price and reimbursement decision. It will be important to assess the implementation of the legal changes.
[3.62] Effectively implement the existing legislation regulating pharmacies.	**Partly observed.** Legal documents prepared and under consultation; to be enacted by end March 2012
[3.63] Change the calculation of profit margins for wholesale companies and pharmacies to ensure that at least EUR 50 million in savings in public expense comes from reduction in profits of pharmaceutical sector.	**Observed.** Legal documents (DL 112/2011 and Portarias 3/2012 and 4/2012) published and enacted. It will be important to assess the implementation of the legal changes.
[3.65] Enact legislation regarding the administrative framework for a centralised procurement system.	**Observed.** Legal documents (DL 108/2011 and Dispatches 14545 and 14546/2011 and 1760/2012) published and enacted. Several tenders are ongoing.
[3.66] Finalise the uniform coding system and the common registry for medical supplies.	**Partly observed and ongoing.** Coding is there for medicines, has been established for cardiology devices and is being done for orthopaedic devices. This process also depends on the suppliers of devices registering their products which is a voluntary process.
[3.67] Reduce by 10 per cent in the overall spending (including fees) of the NHS with private providers delivering services to NHS – increase competition among private providers.	**Observed.** Dispatch 10569/2011 reduces by 12.5% the price paid for a set of services contracted with private providers including dialysis, imagiology and clinical tests.
[3.72] Implement a strategy to clear arrears. Put in place a mechanism to ensure strong coordination between Ministry of Finance and Ministry of Health.	**Partly observed and ongoing.** Authorities have surveyed the existing debt by hospitals and supplier, have identified the funds to pay the hospital arrears and are defining the strategy and timetable for the payments. There is a stricter monitoring procedures and there is now a law on commitments.
[3.75] Continue the publication of clinical guidelines.	**Observed and ongoing.** As with prescription guidelines a number of clinical guidelines are being developed and published. This is a continuous process.
[3.76] Improve selection criteria and adopt measures to ensure a more transparent selection of the chairs and members of hospital boards.	**Partly observed and ongoing.** the general legal framework for the public administration has been enacted (DL 8/2012) and as a result can now update the specific health sector legislation (DL 233/2005)
Labour market	
[4.1.i] Proposal to reduce the maximum duration of unemployment benefits to 18 month, while reduce the role of age in determining benefits duration.	**Partly observed**. The maximum duration was reduced from 38 to 26 months. Age still plays an important role in determining unemployment benefits duration.
[4.1.ii] Proposal to cap unemployment benefits at 2.5 times the social support index (IAS) and introducing a declining profile of benefits over the unemployment spell after six months of unemployment (a reduction of at least 10% in the benefit amount).	**Observed**. Unemployment benefits are capped at 2.5 times the IAS and a cut of 10% in the benefit amount after 6 months of unemployment is introduced.
[4.1.iii] Proposal to reduce the necessary contributory period to access unemployment insurance from 15 to 12 months.	**Observed**. The necessary contributory period to have access to unemployment insurance is reduced to 12 months.

[4.1.iv] Proposal for extending eligibility to unemployment insurance to clearly-defined categories of self-employed workers.	**Observed**. Self employed that obtain more than 80% of their annual income from a single entity - and if this entity is obliged by law to pay an additional contribution rate of 5% on the income of the self employed - are eligible to unemployment insurance.
[4.2] Draft legislation to revise the unemployment insurance.	**Observed**. Legislation was approved by the Council of Ministers and awaits promulgation and publication in the official journal. The legislation is in line with the proposals presented and therefore [4.1.i] applies. This measure was requested for Q1-2012.
[4.4.i] Alignment of severance payment entitlements of current employees in line with the reform for new hires.	**Observed**. Severance pay rules of current employees will be aligned with those of new contracts by 1 November 2012, while preserving accrued rights. The measure was requested for Q1-2012.
[4.5.i] Ease individual dismissals based on unsuitability.	**Observed**. Dismissals based on unsuitability will become possible also without the introduction of new technologies or other changes to the work place. The measure was requested for Q1-2012.
[4.5.ii] Ease individual dismissals based on the extinction of the job.	**Observed**. The employer will not need to follow a tenure rule to proceed with dismissals based on the extinction of the job. The measure was requested for Q1-2012.
[4.5.iii] Obligation of transfer the workers to a possible suitable position in consequence of the above dismissal is should be removed.	**Observed**. When a worker is unsuitable or his job post is extinguished the employer is not obliged to look for a possible suitable position in the firm. The measure was requested for Q1-2012.
[4.6.i] Prepare plan to promote the use of flexible working time arrangements.	**Observed**. A plan was presented by Q4-2011.
[4.6.ii] Implement the commitments on short-time working schemes in consequence of industrial crisis; implementation of bank of hours; reduce overtime pay.	**Observed**. Short-time working schemes are streamlined. A 150-hour bank account is introduced and can be activated by individual agreement between employer and employees. Overtime is reduced by 50% and the 25% time off per hour of overtime is removed. The measures were requested for Q1-2012.
[4.7.i] Commit that no increase in the minimum wage will take place over the programme period, unless justified.	**Observed**. There has been no increase in the minimum wage.
[4.7.ii] Ensure wage moderation by using the available discretion in the current legislation of not extending collective contracts until clear criteria is defined.	**Observed**. There were no extensions of collective agreements.
[4.8.i] Implement the "organised decentralisation".	**Observed**. It was introduced possibility for works councils to negotiate functional and geographical mobility, working time arrangements and remuneration.
[4.8.ii] promote the inclusion in sectoral collective agreements of conditions under which works councils can conclude firm-level agreements without the delegation of unions.	**Observed**. Related to the organised decentralisation that was enlarged to include the possibility for works councils to negotiate wage conditions.
[4.8.iii] reduce the firm size threshold for works councils to conclude agreements below 250 employees.	**Observed**. The firm-size threshold was reduced to 150 workers. The measure was requested for Q2-2012.
[4.9] Report on current activation policies and other active labour market policies (ALMP).	**Observed**. A follow up evaluation report is under preparation.
[4.9] Adopt an action plan to improve further activation policies and other ALMPs.	**Observed**. Some measures in place. To be further improved after the results of the evaluation report.
[4.10] Prepare a monitoring, assessment and reporting system to evaluate education and training policies.	**Observed**. The monitoring system will be improved in order to be fully operational by September.

Goods and services markets	
[5.1] Implement through legislation the roadmap setting the principles of liberalisation of electricity markets.	**Observed**. Decree Law 74/2012 on phasing out all remaining regulated tariffs for electricity was approved on 9 February 2012 and will enter into force on 1 June 2012.
[5.3] Take measures to accelerate the establishment of a functioning Iberian market for natural gas.	**Ongoing**. A report analysing the cross-border natural gas transmission tariffs between Portugal and Spain was submitted to public consultation in January 2012. On the basis of the outcome of this consultation, the regulators of the two countries will work on a proposal for harmonisation of the cross-border tariffs.
[5.4] Implement the roadmap proposed in the resolution of Council of Ministers of 28 July 2011.	**Observed**. Decree Law 75/2012 on phasing out all remaining regulated tariffs for natural gas was approved on 9 February 2012 and will enter into force on 1 June 2012.
[5.5] Report on lack of entry in gas market (reasons and measures).	**Observed**. A report outlining the main constraints for the development of the natural gas market and identifying possible lines of action was submitted. Follow-up action is needed.
[5.6] Revise downwards payment to electricity producers under guarantee compensation mechanism and long-term power-purchase agreements.	**Not observed**. No measures to this end have been taken so far. A report on measure 5.15 refers to some possible renegotiation result but with limited impact.
[5.7] Report on the efficiency of support schemes for co-generation and on adjusting downward the support **(SB, MEFP ¶41)**	**Partially observed.** The report includes some measures to rationalise the support mechanism. However, a more profound revision of the general framework is necessary including a reflection on ways of bringing this support scheme closer to market principles. On the new tariffs themselves (its publication is foreseen in the DL 23/2010 but it has not yet been published) it is not clear whether the tariffs presented in the report will be approved in a forthcoming executive order.
[5.8] Report on the efficiency of support schemes for renewable. **(SB, MEFP ¶41)**	**Partially observed.** A report was submitted, which describes the historical evolution of the support scheme for renewables. Further assessment of the cost-efficiency of the support schemes for renewables is necessary.
[5.9] Review the options for adjusting downwards the feed-in tariff for renewables. **(SB, MEFP ¶41)**	**Ongoing**. The negotiation process with the electricity producers is ongoing. The report submitted for [5.15.] contains some discussion of the issue.
[5.12] Streamline administrative procedures and increase transparency of charges for renewable energy producers.	**Partially observed.** A report was submitted, outlining proposals to improve the current procedures. These proposals have to be implemented.
[5.13 i] Take measures to modify energy policy instruments to ensure consistency and eliminate possible overlapping of energy policy instruments.	**Observed.** The fiscal incentives to promote investment in renewable energy equipment, energy efficiency in buildings and electric vehicles overlapping with other financing mechanisms or energy and tax policy instruments were discontinued in the 2012 budget. The only exception is the Mobi.E programme for electric vehicles for which a decision has to be taken in the context of the review of the electric mobility strategy.
[5.14] Increase excises for electricity.	**Observed**. The excise tax on electricity (ISP) was set at EUR 1 per MWh as of 1 January 2012 according to Article 6 of Ministerial Order No 320-D/2011.
[5.15] Adopt measures to set the national electricity system on a sustainable path.	**Delayed.** A report was received on 13 February but the strategy to be taken by the government remains unclear and the measures proposed in the report to address excessive rents are not sufficiently ambitious to stabilise the system

	until 2013. The government has committed to address the issue. The revised MoU contains some specific measures that could have a significant impact on the tariff debt.
[5.16] Launch a new tender process for designation of universal service provider(s).	**Not observed.** Draft tender documents received on 31 October and under public consultation until December 30th. Renegotiations of the concession contract with the incumbent with a view to excluding the universal service are not terminated, and the tender documents are now being revised. The government has not launched the tender.
[5.18] Liberalise the postal sector by transposing the Third Postal Directive.	**Ongoing.** The Law proposal was approved by Parliament on 9 March 2012. The mission could not yet assess the law.
[5.22 and 5.24] Prepare the Port Strategy and a proposal for legal framework to implement the Port Strategy for integration of ports into overall logistic and transport system and for improvement of governance.	**Ongoing.** The strategy for ports is under preparation and will be presented as part of the long-term vision for the transport system. Regulatory activities for commercial activities in ports and maritime transport, land transport as well as road infrastructure have been transferred to the newly created Institute of Mobility and Transport. Further steps are needed to improve the governance structure of ports.
[5.23] Submit to Parliament a revised legal framework governing port work.	**Ongoing.** The draft legislation is under preparation. Its submission to Parliament is postponed.
[5.25] Report on the objectives, instruments and efficiency gains on on-going and planned initiatives in the port sector.	**Observed.** A report was submitted. Significant progress has been achieved in the field of the Port Single Window and the Logistic Single Window with the primary aim of reducing the administrative burden on transport operators through a single point of contact and electronic document processing.
[5.27] Present to the Parliament the amendments to sector-specific legislation under the Services Directive in order to further liberalise the sector.	**Ongoing.** about 70 sector specific legislation to be modified to complete the transposition of the Service Directive. Several amendments' proposals have been received since November and about 20 have been completed or deemed closed and ready for approval.. Issue of need for Parliament approval for requirements affecting access to or exercise of a profession will further delay the process for a significant number of amendments.
[5.28] Eliminate unjustified restrictions to free establishment and to cross-border provision for construction and real estate, when transposing sector-specific regulation in accordance with the Services Directive.	**Not observed.** Following an exchange of successive draft versions, the decree laws still needs to address important concerns, in particular the need for further reduction of requirements for the establishment of service providers and elimination of unjustified requirements for cross-border providers. Deadline for submission to Parliament has been postponed to Q1-2012.
[5.29, 5.30 and 5.31] For those professions not regulated by Parliament: Adopt the law concerning professional qualifications, adopt measures to reduce the number of regulated professions, to review reserve of activities, and to further liberalize access and exercise whether for established or foreign qualified professionals from the EU.	**Not applicable.** In view of the constitutional concerns where Articles 47 and 161 require approval by law or by authorized decree-law of any amendments affecting the access or exercise of a profession, the Portuguese authorities have made clear during the review mission that all measures affecting regulated professions will need to be submitted to Parliament.
[5.29, 5.30 and 5.31] For those professions regulated by Parliament: Present the law to concerning professional qualifications, present measures to reduce the number of regulated professions, to review reserve of activities, and to further liberalize access and exercise whether for established or foreign qualified professionals from the EU to the Parliament.	**Ongoing.** Draft proposal of regulation further implementing the Law transposing the Directive on recognition of professional qualifications under revision following comments from the Commission. Executive Orders designating the competent authority for the recognition of specific qualifications need to be adopted (five Executive Orders were enacted and are already effective and the remaining Executive Orders are being finalised). The Portuguese commission reviewing the requirements on regulated professions has advanced its work and analysed about 118 regulated professions, they would deliver a report

	to the government end of March.
[5.32] Present a draft of a horizontal legal framework concerning the remaining requirements in regulated professions (which regulation involves a professional body 'Ordens or Camaras' and elimination of unjustified ones.	**Observed.** A working group produced a first framework law draft that was shared on 01 February. Comments on the draft have been sent to the government and a revised version is being finalised to be submitted to public consultation. .
[5.33 i] making available the PSC in 3 languages, improving the information to display for cross border services and for established providers	**Ongoing.** Progress has been achieved so as to present clearly information on the regimes that apply to established and to cross-border service providers although the quality of the automatic translations provided needs to be improved at least for two languages.
Housing market	
[6.1] Draft legislation amending the New Urban Lease Act Law 6/2006 to be submitted to Parliament.	**Observed**. The New Urban Lease Act must now be adopted by adopted by the Parliament by May 2012. Ideally the final Law should incorporate additional modifications asked by the Commission at the third review.
[6.2] Adopt legislation to simplify administrative procedures for renovation.	**Observed**. The new Law should be adopted by the Parliament by May 2012.
[6.3] Adopt the necessary changes to the legislation.	**Ongoing.** The Government adopted the necessary changes and the valuation of the housing is now on-going with the view to finalising it by the end of the year.
[6.4] Modify property taxation with a view to i) level incentives for renting versus acquiring housing and ii) shift the tax burden towards the recurrent real estate tax.	**Broadly observed.** The budget 2012 incorporates the level incentives for renting versus acquiring housing but does not yet shift the tax burden from property transfers to towards a recurrent real estate tax.
Judicial system	
[7.2] Establish an inter-agency task force. Prepare quarterly reports on implementation status.	**Observed.** The inter-agency task force was established by Order n. 16445/2011, of November 21. A first quarterly report has been submitted.
[7.3] Adopt a regulation to ensure the oversight`s body full access to the enforcement case files; preparation of an action plan.	**Observed.** Order 2/2012 of 2 January 2012; action plan has been prepared.
[7.4] Develop a roadmap to improve efficiency of the court system.	**Observed**.
[7.5] Assess court management to speeding up court proceedings and improving cost efficiency.	**Observed** as part of the judicial roadmap (see measure 7.4).
[7.6] Develop courts personnel management plan.	**Observed** as part of the judicial roadmap (see measure 7.4).
[7.7] Take measures to give priority to alternative dispute resolution enforcement	**Observed** by Law 63/2011 published 14 December 2011.
[7.10] Assess the need for separate Chambers within the Commercial Courts with specialised judges for insolvency cases.	**Observed** as part of the judicial roadmap (see measure 7.4).
[7.11] Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement. **(SB, MEFP ¶46)**	**Observed.**
[7.12] Prepare measures to expedite the resolution of tax cases.	**Ongoing**. Measure adapted. It was agreed that the creation of the task force of tax court judges will replace the special procedures for high value cases, Law 59/2011 of 28 November 2011. Measures 7.12 (iii) and (iv) deleted as identical to measure 3.35.
[7.13] Prepare report on the allocation of resources.	**Observed.** as part of the judicial roadmap (see measure 7.4).

Competition, public procurement, and business environment	
[7.15] Avoid shareholder agreements by public bodies; alienate CGD participation in Galp.	**Not observed.** There has been no alienation of share of CGD in Galp
[7.17ii] Propose a revision of the competition law.	**Observed.** Draft law adopted at Council of Ministers on 26 January, and it was submitted to Parliament on 06 February.
[7.17iii] Ensure that the Portuguese Competition Authority has sufficient and stable financial means to guarantee its operation.	**Ongoing.** As part of the response an executive order to authorize the contributions from 7 regulators was approved**.** A close monitoring will ensure effective implementation of the executive order.
[7.18] Launch the call for tender for the report on functioning of National Regulatory Authorities.	**Not observed.** In October it was decided that there would be a direct award to nominate authors. The study was tendered on 13 March with proposals expected by 22 March, which could however not be assessed by the mission. Difficulties to include the independent communications' regulator (ERC) in the study (and the terms of reference) added to the already existing delays.
[7.19] Eliminate exemptions permitting direct award of public contracts above the Public Procurement Directives thresholds.	**Ongoing.** Following comments from the Commission, drafts of changes on the Public Procurement Code shared. The draft is close to be finalized, and needs to be approved at Council of Ministers.
[7.20] Eliminate all special, permanent or temporary exemptions, permitting the direct award of public contracts below the Public Procurement Directive.	**Ongoing.** Following comments from the Commission, drafts of changes on the Public Procurement Code shared. The draft is close to be finalized, and needs to be approved at Council of Ministers.
[7.21] Amend the Public Procurement Code provisions on errors and omissions and additional works/services, and to eliminate the remaining exemptions permitting direct award of public contracts below the Public Procurement Directives thresholds.	**Ongoing.** Following comments from the Commission, drafts of changes on the Public Procurement Code shared. The draft is close to be finalized, and needs to be approved at Council of Ministers.
[7.22] Implement measures regarding irregular direct awards for additional works/services.	**Observed.** Court of Auditors' bylaws modified and published in Official Journal on 07 December
[7.23] Adopt measures making financially responsible contracting authorities for non-compliance with public procurement rules.	**Observed.** Court of Auditors' bylaws modified and published in Official Journal on 07 December.
[7.24] Establish rules ensuring ex-ante auditing/checks on public procurements by appropriate body.	**Observed.** Court of Auditors' bylaws modified and published in Official Journal on 07 December.
[7.25] Upgrade the national Public Procurement Portal (Base) based on Resolution 17/2010 of the National Parliament.	**Observed.** Status report received. The internet site had been updated and is functioning since 1st January 2012.
[7.26] Modify Art 42 of the Public Procurement Code concerning R&D projects for large public contracts.	**Ongoing.** Draft of the changes on the Public Procurement Code received on 04 November which was discussed in last review, and new text received on 15 December on 02 February following comments. The draft is close to be finalized, and needs to be approved at Council of Ministers.
[7.27] Adopt the "Simplex Exports" programme.	**Observed.** Status reports received. Out of 12 measures considered, it was agreed that 3 measures will only be implemented by August.
[7.28] Implement the strategy to facilitate access to finance and export markets for companies, in particular SMEs.	**Partially observed.** Report reviewing overall system received. Going further, an assessment by the government is to be carried out on effectiveness and impact of existing measures and concrete policy actions to be taken, if necessary.

ANNEX 2: COMMISSION SERVICES MACROECONOMIC PROJECTIONS 2011-2015

Table 1: Use and supply of goods and services (volume)

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	2.1	-3.8	-5.8	-0.9	1.1	0.8
2. Government consumption expenditure	0.9	-3.1	-2.9	-2.6	-1.1	-0.1
3. Gross fixed capital formation	-4.1	-11.3	-11.8	0.7	4.4	4.4
4. Final domestic demand	**0.7**	**-5.0**	**-6.3**	**-1.0**	**1.3**	**1.2**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**0.8**	**-5.5**	**-6.5**	**-0.7**	**1.5**	**1.3**
7. Exports of goods and services	8.7	7.2	2.0	4.7	5.4	5.4
7a. - of which goods	9.7	7.2	1.9	4.6	5.2	5.2
7b. - of which services	6.3	7.2	2.2	5.0	5.9	5.9
8. Final demand	**2.4**	**-2.6**	**-4.3**	**0.8**	**2.6**	**2.5**
9. Imports of goods and services	5.4	-5.7	-6.9	1.9	4.0	4.0
9a. - of which goods	5.7	-6.8	-7.1	1.8	3.9	3.9
9b. - of which services	3.6	0.7	-5.8	2.4	4.4	4.4
10. Gross domestic product at market prices	**1.4**	**-1.5**	**-3.3**	**0.3**	**2.1**	**1.9**
Contribution to change in GDP						
11. Final domestic demand	0.7	-5.4	-6.6	-1.0	1.3	1.2
12. Change in inventories + net acq. of valuables	0.1	-0.5	-0.1	0.2	0.2	0.1
13. External balance of goods and services	0.5	4.4	3.4	1.1	0.6	0.6

Table 2: Use and supply of goods and services (value)

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	3.8	-0.5	-2.7	0.6	2.5	2.3
2. Government consumption expenditure	0.1	-5.7	-10.2	-2.8	-0.8	1.0
3. Gross fixed capital formation	-1.5	-9.9	-10.1	2.6	6.4	6.0
4. Final domestic demand	**2.0**	**-3.3**	**-5.4**	**0.3**	**2.5**	**2.7**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**2.2**	**-3.7**	**-5.5**	**0.5**	**2.8**	**2.8**
7. Exports of goods and services	13.4	13.5	5.0	6.3	7.0	7.1
8. Final demand	**4.5**	**0.1**	**-2.8**	**2.1**	**4.0**	**4.1**
9. Imports of goods and services	10.4	1.8	-4.0	3.2	5.4	5.7
10. Gross national income at market prices	3.3	-0.9	-2.8	1.3	3.4	3.4
11. Gross value added at basic prices	1.6	-1.2	-3.6	1.6	3.5	3.5
12. Gross domestic product at market prices	**2.4**	**-0.5**	**-2.3**	**1.7**	**3.4**	**3.4**

Table 3: Implicit price deflators

% change in implicit price deflator	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	1.6	3.5	3.3	1.5	1.3	1.5
2. Government consumption expenditure	-0.7	-2.7	-7.5	-0.2	0.3	1.1
3. Gross fixed capital formation	2.8	1.6	1.9	1.8	1.9	1.6
4. Domestic demand	**1.4**	**1.9**	**1.0**	**1.2**	**1.3**	**1.4**
5. Exports of goods and services	4.3	5.9	2.9	1.5	1.5	1.6
6. Final demand	**2.0**	**2.8**	**1.6**	**1.3**	**1.3**	**1.5**
7. Imports of goods and services	4.8	7.9	3.2	1.3	1.5	1.6
8. Gross domestic product at market prices	**1.0**	**1.0**	**0.9**	**1.3**	**1.3**	**1.4**
HICP	**1.4**	**3.6**	**3.2**	**1.3**	**1.5**	**1.5**

Table 4: Labour market and cost

Annual % change	2010	2011	2012	2013	2014	2015
1. Labour productivity (GVA per employee)	2.9	-0.7	-2.2	-0.1	1.2	0.8
2. Compensation of employees per head	1.4	-0.9	-3.0	-0.5	0.5	0.6
3. Unit labour costs	-1.5	-0.2	-0.8	-0.4	-0.6	-0.1
4. Total population	0.0	0.1	0.0	0.0	0.0	0.0
5. Population of working age (15-64 years)	-0.2	-0.3	-0.3	0.0	0.1	0.1
6. Total employment	-1.5	-1.5	-2.5	0.2	1.0	1.3
7. Calculated unemployment rate - Eurostat definition (%)	11.0	12.7	14.4	13.9	13.1	12.4

Table 5: External balance

levels	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	38.9	44.5	46.7	49.6	52.9	56.6
2. Imports of goods (fob)	56.2	56.7	54.5	56.4	59.5	62.9
3. Trade balance (goods, fob/fob) (1-2)	**-17.3**	**-12.2**	**-7.8**	**-6.8**	**-6.5**	**-6.2**
3a. p.m. (3) as % of GDP	*-10.0*	*-7.1*	*-4.7*	*-4.0*	*-3.8*	*-3.4*
4. Exports of services	14.6	16.3	17.0	18.1	19.4	20.8
5. Imports of services	9.7	10.4	10.0	10.4	10.9	11.5
6. Services balance (4-5)	**4.9**	**5.9**	**7.0**	**7.7**	**8.5**	**9.3**
6a. p.m. 6 as % of GDP	*2.8*	*3.5*	*4.2*	*4.6*	*4.8*	*5.1*
7. External balance of goods & services (3+6)	**-12.4**	**-6.3**	**-0.8**	**1.0**	**1.9**	**3.0**
7a. p.m. 7 as % of GDP	*-7.2*	*-3.7*	*-0.5*	*0.6*	*1.1*	*1.7*
8. Balance of primary incomes and current	-4.3	-5.2	-5.9	-6.7	-7.0	-7.3
8a. - of which, balance of primary income	*-5.6*	*-6.3*	*-6.9*	*-7.6*	*-8.0*	*-8.2*
8b. - of which, net current Transfers	*1.3*	*1.1*	*1.0*	*0.9*	*0.9*	*0.9*
8c. p.m. 8 as % of GDP	*-2.5*	*-3.0*	*-3.5*	*-4.0*	*-4.0*	*-4.0*
9. Current external balance (7+8)	**-16.7**	**-11.5**	**-6.7**	**-5.7**	**-5.1**	**-4.2**
9a. p.m. 9 as % of GDP	-9.7	-6.7	-4.0	-3.4	-2.9	-2.4
10. Net capital transactions	2.3	2.4	2.3	2.4	2.4	2.5
11. Net lending (+)/ net borrowing (-) (9+10)	**-14.4**	**-9.1**	**-4.4**	**-3.4**	**-2.7**	**-1.7**
11a. p.m. 11 as % of GDP	*-8.3*	*-5.3*	*-2.6*	*-2.0*	*-1.5*	*-1.0*

Table 6: Fiscal accounts

	2010	2011	2012	2013	2014	2015
			% of GDP			
Indirect taxes	13.3	13.8	15.2	15.2	15.1	15.1
Direct taxes	8.9	9.4	9.5	9.4	9.4	9.5
Social contributions	12.3	12.3	12.0	11.9	11.6	11.4
Sales and other current revenue	4.4	4.6	4.9	4.8	4.8	4.8
Total current revenue	**38.9**	**40.3**	**41.5**	**41.3**	**40.9**	**40.8**
Capital transfers received	2.7	4.4	1.3	1.3	1.3	1.3
Total revenue	**41.6**	**44.7**	**42.8**	**42.6**	**42.2**	**42.1**
Compensation of employees	12.2	11.5	10.1	9.7	9.3	9.1
Intermediate consumption	5.0	4.5	4.6	4.3	4.1	4.0
Social transfers in kind via market produc	4.9	4.6	4.6	4.4	4.3	4.2
Social transfers other than in kind	17.0	17.2	17.3	17.3	17.0	16.8
Interest paid	3.0	4.1	4.8	4.7	4.9	4.8
Subsidies	0.7	0.6	1.0	0.8	0.7	0.7
Other current expenditure	2.8	2.2	2.2	2.0	1.8	1.8
Total current expenditure	**45.8**	**44.6**	**44.5**	**43.1**	**42.2**	**41.6**
Gross fixed capital formation	3.6	2.6	2.1	1.8	1.8	1.8
Other capital expenditure	2.1	1.4	0.7	0.7	0.6	0.6
Total expenditure	**51.4**	**48.7**	**47.3**	**45.6**	**44.5**	**43.9**
General Government balance (EDP)	**-9.8**	**-4.0**	**-4.5**	**-3.0**	**-2.3**	**-1.9**
			% change			
Indirect taxes	7.9	4.0	6.1	2.2	2.6	3.6
Direct taxes	0.7	5.6	-1.9	1.1	3.5	4.2
Social contributions	0.4	0.0	-5.0	0.5	1.2	1.4
Sales and other current revenue	-1.2	2.2	5.6	-1.1	3.5	2.5
Total current revenue	**2.7**	**2.9**	**0.8**	**1.1**	**2.5**	**3.0**
Capital transfers received	195.1	63.0	-71.4	4.1	2.3	3.4
Total revenue	**7.2**	**6.8**	**-6.4**	**1.2**	**2.5**	**3.0**
Compensation of employees	-0.9	-6.8	-13.9	-2.5	-0.6	1.5
Intermediate consumption	4.1	-11.3	-0.4	-3.7	-1.3	1.3
Social transfers in kind via market produc	2.2	-6.3	-2.4	-4.2	1.7	1.7
Social transfers other than in kind	0.6	0.3	-1.7	1.5	1.9	2.3
Interest paid	6.8	33.6	14.9	0.1	7.1	2.4
Subsidies	-11.1	-7.3	48.2	-19.8	-0.7	2.5
Other current expenditure	12.8	-24.7	-1.1	-8.4	-4.6	2.2
Total current expenditure	**2.3**	**-3.0**	**-2.5**	**-1.6**	**1.2**	**2.0**
Gross fixed capital formation	24.1	-27.0	-22.7	-10.6	-0.5	2.9
Other capital expenditure	84.7	-30.8	-51.7	-2.3	-9.5	2.3
Total expenditure	**5.5**	**-5.8**	**-5.0**	**-2.1**	**1.0**	**2.0**
Nominal GDP, EUR bn	172.6	171.7	167.7	170.5	176.3	182.3

Table 7: Government debt developments

	2010	2011	2012	2013	2014	2015
EDP deficit (% of GDP)	**-9.8**	**-4.0**	**-4.5**	**-3.0**	**-2.3**	**-1.9**
EDP gross debt (% of GDP)	93.4	106.8	112.4	115.3	114.4	112.7
			levels, EUR bn			
EDP deficit	**-16.9**	**-6.9**	**-7.5**	**-5.1**	**-4.0**	**-3.4**
Gross debt	161.3	183.3	188.5	196.7	201.6	205.4
Change in gross debt	21.3	22.1	5.1	8.2	4.9	3.8
Nominal GDP	172.6	171.7	167.7	170.5	176.3	182.3
Real GDP	162.1	164.4	169.9	169.3	165.7	162.5
Real GDP growth (% change)	**1.4**	**-1.5**	**-3.3**	**0.4**	**2.1**	**1.9**
Change in gross debt (% of GDP)	12.3	12.9	3.1	4.8	2.8	2.1
Stock-flow adjustments (% of GDP)	2.6	8.9	-1.4	1.8	0.5	0.2
			% of GDP			
Gross debt ratio	**93.4**	**106.8**	**112.4**	**115.3**	**114.4**	**112.7**
Change in gross debt ratio	10.4	13.3	5.6	2.9	-1.0	-1.7
			Contribution to change in gross debt			
Primary balance	6.8	-0.1	-0.3	-1.7	-2.6	-3.0
"Snow-ball" effect	0.9	4.5	7.8	3.7	1.0	1.0
of which						
Interest expenditure	*3.0*	*4.1*	*4.8*	*4.7*	*4.9*	*4.8*
Real growth effect	*-1.1*	*1.4*	*3.5*	*-0.4*	*-2.4*	*-2.2*
Inflation effect	*-1.0*	*-1.0*	*-0.6*	*-0.7*	*-1.4*	*-1.6*
Stock-flow adjustments	**2.6**	**8.9**	**-1.4**	**1.8**	**0.5**	**0.2**
Implicit interest rate	*3.7*	*4.3*	*4.4*	*4.3*	*4.4*	*4.4*

ANNEX 3: INDICATIVE FINANCING NEEDS AND SOURCES

Table 8: Financing needs and sources (EUR billion)[1]

	2011 Jun-Dec	2012 Year	2013 Year	2014 Year	2011-2014 Total
Public sector deficit	**11.3**	**14.9**	**6.8**	**4.7**	**37.7**
General government (GG) deficit [2]	7.1	8.4	4.9	4.1	24.5
Other public sector cash needs [3]	4.2	6.5	1.9	0.6	13.1
Amortization [4]	**9.5**	**16.9**	**10.2**	**14.3**	**50.9**
Medium- and long-term debt	4.9	12.8	9.8	14.3	41.8
Other debt (retail, repos), net [5]	4.6	4.1	0.4	0.0	9.1
Banking support [6]	**1.0**	**13.5**	**4.4**	**0.4**	**19.3**
Financing needs	**21.8**	**45.3**	**21.4**	**19.4**	**107.9**
Market financing	**-6.4**	**1.1**	**11.3**	**12.8**	**18.9**
Medium- and long-term debt	0.0	0.0	9.8	14.3	24.2
T-Bills, net [7]	-6.4	1.1	1.5	-1.5	-5.3
Own resources [8]	**-5.7**	**16.8**	**0.1**	**-1.3**	**9.9**
EU-IMF loan	**34.0**	**27.3**	**10.0**	**7.8**	**79.2**
EFSM/EFSF	21.0	19.3	6.6	5.1	52.0
IMF [9]	13.0	8.0	3.4	2.7	27.1
Financing sources	**21.8**	**45.3**	**21.4**	**19.4**	**107.9**

Source: Portuguese authorities and Commission services' estimates.

[1] Subject to revision.

[2] Calendar-year basis.

[3] Includes financing to state-owned enterprises, contributions to the ESM and the economic adjustment programme for Madeira, and repayment of arrears.

[4] Central government

[5] Does not include T-Bills.

[6] Includes contributions to Bank Solvency Support Mechanism (EUR 12.0 billion), projected costs for CGD recapitalization, costs related to BNP resolution and reassignment of bank loans to state-owned enterprises.

[7] Negative values indicate reduction in stock of T-bills.

[8] Includes in particular privatisation receipts, and use of deposits and pension fund assets.

[9] Numbers do not add up to EUR 26 bn due to changes in EUR-SDR rate compared to beginning of programme.

Table 9: Planned quarterly disbursements

Review	Period covered by disbursement	Approximate disbursement period	Loan disbursements[1]	of which IMF [2] (⅓)	of which EU (⅔)
Approval	Jun-Sept 2011	Jun 2011	**18.5**	6.1	12.4
1	Q4-2011	Sept 2011	**11.6**	4.0	7.6
2	Q1-2012	Dec 2011	**8.1**	2.8	5.3
3	Q2-2012	April 2012	**14.9**	5.2	9.7
4	Q3-2012	July 2012	**4.0**	1.4	2.6
5	Q4-2012	October 2012	**4.3**	1.5	2.8
6	Q1-2013	January 2013	**2.4**	0.8	1.6
7	Q2-2013	April 2013	**2.0**	0.7	1.3
8	Q3-2013	July 2013	**2.7**	0.9	1.8
9	Q4-2013	October 2013	**2.9**	1.0	1.9
10	Q1-2014	January 2014	**2.7**	0.9	1.8
11	Q2-2014	April 2014	**2.5**	0.9	1.7
12	Q3-2014	July 2014	**2.6**	0.9	1.7
	TOTAL		**79.2**	27.2	52.0

[1] Data are subject to revision.
[2] IMF disbursements are defined in SDR. Due exchange rate fluctuation, the sum of the IMF first two disbursements was EUR 0.4bn higher than calculated at the Programme exchange rate.

ANNEX 4: PROVISION OF DATA (REPORTING REQUIREMENTS)

During the Programme, the following indicators and reports shall be shared with the European Commission, the ECB and the IMF by the authorities on the agreed periodic basis. Data for past periods should also be included in subsequent transmissions in case of revision. Other indicators may also be requested to and reported by the Portuguese Authorities.

To be provided by the Ministry of Finance (or INE)

1.	Data on cash balances of the State Budget. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published by the Ministry of Finance (MoF). Data on tax revenue should be decomposed in gross tax revenue received and tax reimbursements paid by the State (detailed per main individual taxes)	Monthly, 3 weeks after the end of the month
2.	Data on the cash balances of the other parts of General Government (Autonomous Funds and Services, Social Security and Other entities, including Incorporated State-owned enterprises (ISOEs) or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government; [Regional and Local Governments (*Administrações Regionais and Locais*); Regional and local government-owned enterprises or companies, foundations, cooperatives, and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government, as defined in paragraph 4 of the TMoU) – progressively enlarged	Monthly, as soon as the data are available and no later than 7 weeks after the end of the month
3.	Accrual data on budget execution of the National Health System (NHS)	Monthly, 3 weeks after the end of each month
4.	Consolidated cash data on the General Government budget execution initially comprising the Central Government and Social Security and enlarging progressively the scope as in indicated in the TMoU, MoU and MEFP	Monthly, 7 weeks after the end of each month
5.	Publish information on: number of general government staff on a quarterly basis (no later than 45 days after the end of the quarter); stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, special mobility condition flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. The regional and local administration will transmit the necessary information. Information on employment in SOEs (central, local and regional) and other public entities and/or bodies will also be compiled	Quarterly, no later than 30 days after the end of the quarter (as of March 2012)
6.	Consolidated account on an accrual basis of the non-financial SOEs that are classified within the Central Government	Quarterly, 90 days after the end of the quarter (as of March 2012)
7.	Data on the past and projected financing needs of SOEs, including for the major SOEs details on the financing needs for the operational balance, capital expenditure, interest payments and debt principal repayments	Monthly, 4 weeks after the end of the month
8.	Data on arrears of: • the General Government, detailed by subsector • the incorporated (SOEs) government-owned hospitals that are not part of the General Government • other non-financial SOEs that are not part of the General Government	Monthly, 7 weeks after the end of each month (as of September 2011)

9.	Information on Public-Private Partnerships (PPP) related revenue and expenditure, for those PPP reclassified within the General Government (in line with paragraph 5.2 of the TMoU)	Monthly, 30 days after the end of the each month
10.	New guarantees granted by the State to SOEs, PPPs, banks and the non-financial private sector	Monthly, 30 days after the end of each month
11.	Detailed information on called guarantees of the State	Monthly, 30 days after the end of each month
12.	Data on proceeds from asset sales by the Central, Regional and Local Government	Monthly for Central Government Quarterly for Regional and Local Government 30 days after the end of reference period
13.	Quarterly data on General Government accounts as per the relevant EU regulations on statistics, showing also the main items of the transition from cash balances to the General Government balances in national accounts	Quarterly, 90 days after the end of each quarter
	To be provided by ESAME	
14.	Report on progress with fulfilment of economic policy conditionality on a quarterly basis. In addition, a short summary report should be sent on a monthly basis	Quarterly (report), two weeks after the end of each quarter. Monthly (short summary report) two weeks after the end of each month for which a report is not due.
	To be provided by the Debt Management Office	
15.	Accrual data on interest spending of the State	Quarterly, 7 weeks after the end of the quarter
	To be provided by the Ministry of Labour	
16.	Data on labour market as follows: a. layoffs by type b. collective agreements by type and number of collective agreements that are extended by the Ministry of Labour to non-signatory firms c. number of collective agreements that regulate the use of the Bank of Hours working time arrangement d. proportion of unemployed receiving unemployment benefits e. distribution of the unemployed in terms of amount of benefits received (mean of benefits received, median, number of unemployed receiving an unemployment benefit amount equal to the IAS and number of unemployed receiving the maximum amount of unemployment benefits allowed) f. unemployment duration	Every six months, 6 weeks after the end of each semester
	To be provided by Ministry of Justice	
17.	Publishing quarterly reports on recovery rates, duration and costs of corporate insolvency cases	Quarterly, starting in 2011 Q3, within four months after the end of each quarter.

ANNEX 5. PROGRAMME DOCUMENTS

LETTER OF INTENT

Lisbon, 15 March 2012

Mr Jean-Claude Juncker
President
Eurogroup

Ms Margrethe Vestager
Minister for Economic Affairs and the Interior
Denmark

Mr Olli Rehn
Vice President
European Commission

Mr Mario Draghi
President
European Central Bank

Dear Madam, dear Sirs,

1. The Council granted financial assistance to Portugal (Council Implementing Decision 2011/344/EU of 17 May 2011) in support of our comprehensive adjustment and reform programme as laid down in the Memorandum of Economic and Financial Policies (MEFP) and in the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU). In the attached update we describe progress and additional policy steps towards meeting the objectives of our economic programme.

2. Aided by one-off revenues, we met the end-year deficit target under the programme, even as slippages emerged throughout the year. Nonetheless, fiscal consolidation in 2011 was sizeable – with the structural primary balance improving by some 3½ per cent of GDP – and we have put in place a number of expenditure controls which already yielded results in late 2011. Although the continuous indicative target on the non-accumulation of new domestic arrears by the general government was breached in October and November, the overall stock of arrears declined in December. To prevent further breaches, we have approved and started to implement the new law on commitment controls and will ensure adequate budgetary allocations to the health sector through a supplementary budget. We have also met all but one of the ten structural benchmarks under the programme, some with minor delays. We will now meet the benchmark on the regional finance law by December, allowing us to also include the changes stemming from the strengthened EU fiscal policy framework with one round of amendments.

3. Wide-ranging fiscal structural reform efforts will continue to reduce fiscal risks to the consolidation process. We have improved our budget monitoring system, and have successfully merged tax, customs, and IT services to improve the overall efficiency of our revenue administration. Beyond our commitments in the MoU and MEFP, we are also progressing well with a deep-seated reform of public administration, increasing the efficiency and cost-effectiveness of the public sector through consolidating administrative units and rationalising managerial practices. Our plans to restructure the SOE sector are proceeding well, and we are confident we will reach our objective of operational balance for the sector as a whole by end-2012. In January, we signed a financial arrangement with the Autonomous Region of Madeira.

4. Our policy efforts to support financial system stability continue. We will continue to monitor the pace and composition of the deleveraging process, which needs to remain consistent with the

programme's macroeconomic framework. In particular, sufficient credit must be available to productive SMEs and exporting firms so that they can support economic recovery. Banks have so far been strengthening their capital positions without recourse to public funds. Going forward, we stand ready to support banks' efforts to meet their additional capital needs by end-June 2012, through the provision of public resources on appropriate terms.

5. We continue our reform efforts to increase competitiveness and promote growth and employment. We have reached an agreement with social partners for a broad and ambitious labour market reform, which increases flexibility by introducing banks of hours and reducing the cost of dismissals, promotes wage setting mechanisms that take account of economic conditions and raises productivity by cutting the number of holidays. We seek to improve the burden-sharing of the economic adjustment process, and commit to take measures that will reduce excess rents in the electricity sector and alleviate the pressure they place on consumer prices. Finally, we continue to improve economic framework conditions. We have sent a comprehensive revision to the Competition Law to Parliament (end-January structural benchmark), we are lifting the burden that government imposes on doing business, by, for example, reducing licensing requirements and other legal requirements for over 90 per cent of firms. We have also revised the urban lease law with a view to promoting geographical mobility and have made good progress with reforming the judicial system.

6. On the basis of the policies defined in this letter, we request completion of the third review under the Economic Adjustment Programme. The attached MoU and MEFP propose prior actions in the fiscal area and competitiveness agenda, and new structural benchmarks relating to the fiscal area (bringing the Large Taxpayer Office to full operation by December, and developing a strategy to unwind the public holding company Parpública by April 2012), structural reform (in electricity, and both by April 2012, eliminate the Power Guarantee investment incentive for plants existing or licensed prior to the decree law governing the incentive, and set the new reference tariffs for the cogeneration regime, and in regulatory reform, implement the key recommendations from the independent report on the main sectoral regulators by mid August 2012), the financial sector (implement the amendments to the corporate insolvency law by mid-June 2012, and prepare a proposal on diversifying financing options for corporations by end-July 2012), and the judicial process (submit to Parliament amendments to the Code of Civil Procedure and a bill to implement the judicial roadmap to improve court structure, both by September 2012).

7. We remain confident that the policies described in the current and previous MoUs and MEFPs are adequate to achieve the objectives under the programme. We stand ready to take additional measures that may be needed to meet the objectives of the Economic Adjustment Programme and will consult with the European Commission, the ECB, and the IMF in advance of any necessary revisions to the policies contained in this letter and attached Memoranda.

8. This letter is copied to Ms Christine Lagarde.

Sincerely yours,

/s/	/s/
Vítor Gaspar	Carlos da Silva Costa
Minister of State and Finance	Governor of the Banco de Portugal

Attached: Memorandum of Understanding (MoU); Memorandum of Economic and Financial Policies (MEFP); Technical Memorandum of Understanding (TMU)

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

March 15, 2012

I. MACROECONOMIC OUTLOOK

1. **The good performance of exports led to a better than expected macroeconomic outcome in 2011, when compared to the initial and the two previous reviews' program projections.** Nevertheless, lower external demand in the context of domestic consolidation efforts has weakened somewhat the outlook for 2012 growth. With demand from key trading partners already contracting, we expect a decline in domestic output of about 3¼ per cent, compared with 3 per cent at the time of the second review last December. Uncertainty remains high. The sharp deterioration in the labor market in the fourth quarter of 2011 needs to be monitored carefully.

2. **After a sizeable 3½ per cent of GDP improvement in the current account balance in 2011, further adjustment is expected in 2012.** We are encouraged by the strong and broad-based export growth seen in 2011 and the emerging signs that exporters are slowly increasing market shares outside of the EU area. However, given the prospects for a difficult year in Europe, our expectations for support to growth from exports in 2012 are prudently conservative. To ensure a durable structural adjustment in the external balance and a more dynamic export sector, we are implementing—and will continue to re-examine closely—policies reducing production costs, as outlined below.

II. FISCAL POLICY

3. **In 2011, we made significant progress toward our fiscal program objectives.** The central fiscal policy objective—bringing the primary balance up to over [2] per cent of GDP and stabilizing debt by 2013—remains on track.

- *The general government deficit is estimated to have reached 4 per cent of GDP—against a 5.9 per cent of GDP target.* This over-performance reflects the one-off revenues from the partial transfer of banks' pension funds to the state social security system (3½ per cent of GDP), which more than offset deviations with respect to the program target. Nevertheless, structural adjustment excluding one-off factors was very large (in the order of 3½ per cent of GDP for the primary structural balance). Moreover, expenditure control improved tangibly in the second half of the year.

- Although the continuous indicative target on the non-accumulation of domestic arrears was breached in October and November, the overall stock of arrears was reduced by EUR 300 million in December. This brought the end-year stock to below the September level (EUR 5.3 billion).

4. **Downside risks to the 2012 fiscal outlook have increased, but we remain confident that our deficit objective (4.5 per cent of GDP)—which entails another 4 per cent of GDP of structural adjustment— is achievable.** The deterioration in the macroeconomic environment and labor market conditions will likely weigh on tax and social contributions revenues, and entail higher unemployment benefits. However, we expect these developments to be offset, namely by savings on net interest payments (as a result of the transfer of pension funds' assets as well as lower margins on EFSF/EFSM loans), and net project spending as a result of reprogramming of EU co-financing. A supplementary budget [will be] submitted to parliament, mainly to regularize a number of revenue and expenditure developments that largely offset each other. At this stage,

no additional fiscal measures seem to be necessary to attain the 2012 fiscal objectives. However, we will remain vigilant and follow budgetary developments closely in order to ensure our fiscal target is met.

III. Containing Fiscal Risks

A. Public Financial Management

5. **We are intensifying our efforts in the area of public financial management reform.** We have improved our budgetary monitoring system through monthly assessments of deviations against fiscal targets, allowing for timely corrective interventions if needed. To further advance our reform, we will prepare by end-June 2012, a proposal to (i) reduce budget fragmentation and (ii) assess the scope to expand the coverage of the Single Treasury Account. The fiscal risks statement will be finalized by April 2012 and included in our Fiscal Strategy Program. Finally, we will reschedule lower priority measures, such as the move to full accrual-based IPSAS accounting, which should be adopted in 2014.

6. **Arresting and reversing domestic arrears accumulation is a priority objective.** Our two-pronged strategy includes: (i) the implementation of a new system of expenditure commitment controls to halt the flow of arrears; and (ii) a comprehensive plan to settle the stock of arrears over time.

- The new law on spending commitment controls is already in force, and we will now focus on swift implementation across general government and at SOE hospitals. We will ensure that all budgetary entities will start controlling expenditure against available funds. Through a proper risk-based approach, the Inspectorate General of Finance (IGF) will verify compliance of commitment control systems with the new law.

- A revised strategy document to clear the stock of arrears will be approved by the Council of Ministers (prior action), before the supplementary budget is submitted to Parliament. We will give priority to the settlement of the health sector arrears that were caused by chronic underfunding over the past years (EUR 1.5 billion). We will ensure that local governments will reduce their stock of arrears by ten per cent as envisaged in the 2012 budget. The strategy document will lay out the prioritization criteria for paying creditors, as well as governance arrangements to ensure a fair and transparent settling process. IGF will validate the claims (valuation, existence, title, age). We will put strong safeguards in place as payments will only be made in connection to arrears that have been properly validated and whose originating entity has changed its commitment system in accordance with the new law.

B. State-Owned Enterprises

7. **Our plans to restructure the SOE sector and privatize viable commercial firms are advancing.** We maintain our objective of reaching operational balance for the sector as whole by end-2012. Cost reductions are proceeding well, with, in particular, take-up of voluntary redundancy programs above expectations. These will have strong net benefits on firms' cost bases starting this year. Tariff increases have also substantially reduced the deficits in the transport sector. These developments have lowered our projections of the exceptional financing we need to provide to SOEs, to less than half of what was needed in 2011.

8. **We will continue our intensive efforts to make SOEs more productive, and eliminate the fiscal and financial pressures they are creating.** We will continue to maximize efforts to ensure that cost reductions in the largest area of spending—workers' benefits—are achieved through voluntary means, before proceeding to involuntary redundancies. Should unexpected developments put our final objective of operational balance by the end of 2012 in jeopardy, we will implement additional measures, as appropriate. We must now begin to address the debt overhang of several SOEs, bearing in mind the implications for the state's debt and deficit. Several firms—in particular the train operator Comboios de Portugal (CP) and the financial holding company Parpública—have liabilities that they are unlikely to be able to fully cover from their own resources over the next years. Based on the study on the financial conditions of SOEs (completed [in March]), we will develop specific programs for unwinding Parpública (structural benchmark for end-April 2012) and managing the liabilities of CP and other firms outside the General Government (by end-June 2012).

9. **We will continue to ensure the state retreats from commercial activities through privatizations.** Our privatization program has started strongly, with both EDP and REN attracting strong bids from international strategic investors and sales taking place at higher-than-expected prices. In both cases, the new investors will bring additional external financing for investment. Looking ahead, we will continue to ensure the state retreats from commercial activities through privatizations: we plan to launch privatization processes for the airport operator ANA and the airline TAP in the second and early in the third quarters this year, with a view to completing these transactions in 2012. We will launch the privatization/concession of the cargo handling subsidiary of CP (CP Carga) in the second quarter of 2012. The partial sale of a public television channel (RTP) is also being considered in 2012. In 2013, we are considering privatization of the postal company CTT, once changes underway in regulation of this sector have their full impact. By the end of 2012, we will prepare a strategy assessing the competitive and regulatory environment, and the organisational consequences, of introducing private capital and management in the water company, Águas de Portugal.

C. Public-Private Partnerships

10. **A new fiscally-prudent PPP institutional framework will be adopted.** This framework to be approved by the Council of Ministers by end-March 2012 will significantly enhance the role of the MoF in managing PPPs at all stages of a project life-cycle. We launched a tender to hire a top-tier accounting firm to review all PPP contracts (end-2011 structural benchmark) and the winning bid was selected in March 2012. In order to increase transparency, all PPP contracts are now publicly available (except documents subject to confidentiality clauses).

D. Revenue Administration

11. **We have significantly strengthened our revenue administration framework**. The new *Autoridade Tributária e Aduaneira* was successfully created through the merger of the tax, customs, and IT services with a view to improve the overall efficiency of our operations. We are implementing the Plan to Combat Fraud and Evasion, and have taken targeted measures to curb non-compliance. The process of property evaluation—for which the support of local governments is paramount—is under way and should be finalized by end-December 2012. In 2011, a task force of judges has more than doubled the pace of its work on high-value tax cases in relation to the previous year. We remain committed to clear the remaining high-value tax cases in courts.

12. **We will develop a modern tax compliance management framework to curb non-compliance.** We will conclude the implementation of a full-fledged Large Taxpayers Office

(LTO) (structural benchmark by end-December 2012). Based on the experience of the task force of judges, we will assess the need to create special chambers within the tax tribunals to handle such cases by mid-November 2012. We will analyze the impact of VAT issues on the backlog of enforcement cases and assess possible options, by end-April 2012, to address such cases, taking into account tax fraud and erosion risks. We will improve transparency by publishing quarterly reports on recovery rates, duration and costs of tax cases, starting in 2012 Q2 within four months after the end of each quarter.

E. Regional and Local Public Finances

13. **We have established a working group to revise the regional and local public finance laws on a new timeline**. Some goals of the regional finance law revision have already been accomplished through our program with the Autonomous Region of Madeira, which was concluded in January 2012. Nevertheless, the revision in the regional and local finance laws should now be designed in light of our new commitments at the European level regarding the internalization of the new fiscal stability framework into Portuguese legislation. Against this background, we will submit to Parliament the revised regional and local finance laws by end-December 2012 (resetting the end-March structural benchmark that we cannot meet and adopting a new structural benchmark on the submission of the local finance law).

IV. PROTECTING THE FINANCIAL SYSTEM AMIDST DELEVERAGING AND SOVEREIGN CRISES

14. **Deleveraging of the economy remains a key objective.** At the same time, this deleveraging has to be orderly in order to ensure that productive firms, in particular SMEs and firms operating in the tradable sector, do not face undue funding strains. A number of recent developments should mitigate this risk, including the easing of bank liquidity pressures, the recapitalization envisaged under the program, as well as the reduction in public sector financing needs as fiscal consolidation and the restructuring of SOEs continues. In addition, BdP will continue to discourage ever-greening of problematic loans, and is planning additional measures to this effect, with a view to facilitate an effective adjustment of bank balance sheets. These steps will be undertaken without burdening or posing risks to public finances. The Ministry of Finance, together with BdP and other stakeholders, will also prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector (end-July structural benchmark). Banks' funding and capital plans and broader credit market developments will continue to be monitored closely. There is room for the necessary deleveraging to take place in an orderly manner, and it is crucial that the pace and composition of the necessary deleveraging remains consistent with the program's macroeconomic framework.

15. **Adequate bank liquidity remains critical to preserve financial stability.** Against the background of heightened risks across the euro area, recent measures announced by the ECB—consisting of longer-term refinancing operations, a reduction of the reserve ratio, and a broadening of the collateral eligibility criteria for Eurosystem refinancing—is helping ease potential constraints to bank lending. We continue to encourage banks to strengthen their collateral buffers on a sustainable basis and reduce their dependence on Eurosystem liquidity over the medium term.

16. **The proceeds of the partial transfer of the banks' pension funds will be used in agreement with the EC, ECB and IMF.** We have reached agreement with the banks on the modalities of the partial transfer of their pension plans, respecting EU state aid rules. The first

tranche of the transfer been completed by end-2011, while the second tranche will be delivered by the banks during the first semester of 2012. At the current juncture, we intend to utilize the proceeds to augment our financing buffers under the program. We will carry out a credit assignment of up to EUR 3 billion from the banks to the general government—subject to strict eligibility criteria—while maintaining the contractual obligations of the debtors.

17. **Banks have successfully strengthened their capital positions.** All but two banking groups subject to BdP supervision met the 9 per cent Core Tier 1 target set under the program for end-2011. Nevertheless, the target was met by all the eight largest banks of these banking groups (accounting for 83 per cent of the banking system's assets). The BdP is reviewing the banks' plans for meeting additional capital needs by end-June 2012, stemming from the new requirements announced by the European Banking Authority (EBA) in December 2011, as well as the capital needs that are driven by the partial transfer of banks' pension funds and the special on-site inspections program (SIP).

18. **The Bank Solvency Support Facility (BSSF) remains available to support viable banks under the program.** While banks continue to seek private solutions to augmenting capital, some resources of the BSSF will need to be deployed to help some of the viable banks meet the additional capital needs. Meanwhile, the BdP will continue to assess the banking sector's resilience, inter alia via quarterly stress tests starting in June 2012, which are reviewed jointly with the EC, ECB and IMF.

19. **Work on the rules governing the provision of public capital support to banks has been completed.** The amended law on extending temporary public support to viable banks has entered into force on February 12, 2012 and the accompanying Ministerial Order ("Portaria") is being finalized, after consultation with all relevant stakeholders. The legislation and the range of instruments deemed acceptable for capitalization purposes by regulators will be consistent with EU state aid rules. Banks receiving public support will be subjected to strict conditionality, aimed at protecting the taxpayer's interests while enhancing the banks' resilience to future shocks, inter alia though fundamental restructuring and better risk control and corporate governance. The legislation foresees a public divestment period of maximum five years. The legislation allows for soundly run banks that continue to comply with their recapitalization plans to remain privately managed. The banks' shareholders have the possibility to redeem the public share during this period. BdP will closely monitor and supervise banks that receive public support and will provide quarterly status reports to the Minister of Finance.

20. **Efforts to streamline the state-owned Caixa Geral de Depósitos (CGD) are continuing.** CGD met the Core Tier 1 capital ratio target of 9 per cent by end-2011 through internal resources within the given timeline. However, the EBA capital exercise, and the requirement to build an additional buffer for sovereign exposures, has created the need to raise additional capital that cannot be met through internal resources within the given timeline. In this context, we stand ready to support CGD in its efforts to meet its additional capital needs by end-June 2012, from cash buffers outside of the BSSF, in line with EU state aid rules. The Portuguese government will, in its role as shareholder, encourage CGD to finalize the sale of its insurance arm to a third party before end-2012, and to initiate the sale of non-strategic participations and a review of CGD's overall portfolio.

21. **Negotiations on the sale of Banco Português de Negócios (BPN) are expected to be completed by end-March 2012.** The separation of the distressed assets from BPN has been completed and the Portuguese government remains committed to a transaction that minimizes the

costs to the Portuguese taxpayers and the economy as a whole, while safeguarding financial stability. Once a final solution for BPN has been found, CGD's state guaranteed claim will be gradually settled in cash. Any recoveries in assets held by the state-owned SPVs will also be used promptly to repay CGD. We will develop and implement, by end-March 2012, a more effective strategy for the recovery of the distressed assets and the management of the SPVs. Moreover, we intend to commission an audit, while complying with procurement laws, to confirm the prospective recoverable value of the distressed assets held by the state-owned SPVs. This audit will be completed by the time of the fourth review.

22. **BdP continues to strengthen its supervisory capacity.** BdP is hiring specialist resources, and has established a new division tasked with the execution of multiple initiatives to (i) enhance the supervisory organization and further improve the competences of supervisory staff, (ii) optimize supervisory processes and (iii) maintain existing and develop and implement new supervisory methodologies and tools. As part of its activities, the new division will ensure that the experiences obtained via the SIP are properly disseminated across the supervisory functions of BdP. Furthermore, steps have been taken to improve the coordination with home and host country supervisors, both within and outside the EU.

23. **The early intervention, resolution, and deposit insurance framework has been strengthened.** Legislative amendments have been passed and we are examining the implementation details of the new legislative framework, particularly in relation to the operational details to render fully operational the recently established resolution fund and to put in place its funding arrangements. We will pass regulations relating to the resolution fund as well as notices for recovery and resolution plans by July-2012 and notices for the establishment of bridge banks by end-September 2012. We will implement the EU Directive on resolution as soon as it enters into force.

24. **We continue to improve the legal framework for corporate debt restructurings.** The corporate insolvency law amendments to support better early rescue of viable firms (end-December 2011 structural benchmark), were approved by the Council of Ministers in December 2011 and by Parliament on March 9^{th}. These amendments will become effective by mid-June 2012 (structural benchmark). We also will step up actions to raise public awareness of the new restructuring tools.

25. **We are assessing and improving existing mechanisms to support SMEs.** A report assessing the overall consistency, effectiveness, and the impact of existing support measures will be revised by end-June 2012. The report will discuss policy actions aimed at improving and implementing support mechanisms to facilitate access to credit, encourage internationalization, and improve competitiveness of SMEs, while respecting EU competition rules. In addition, we are finalizing the amendments to the conciliation framework mediated by IAPMEI, a public entity, to facilitate extrajudicial corporate debt restructurings for viable SMEs.

V. Structural Reform: Growth and Competitiveness Agenda

A. Competition Framework

26. **We continue to deliver reforms in line with our commitment to increasing competition, encouraging innovation, and reducing rent-seeking in all sectors.** We have sent a comprehensive revision to the Competition Law to Parliament, which we expect to be approved by mid-year. We are reviewing the public procurement code to ensure transparency in the

allocation of public contracts, to be approved by March 2012. The hiring of consultants for an independent report reviewing and benchmarking the responsibilities, resources, and independence of the main sectoral regulators has been delayed, but we remain committed to prepare a proposal to implement identified best international practices in order to reinforce the independence of regulators, by mid-August 2012 (structural benchmark).

B. Margins in Regulated Non-Tradable Sectors

27. **We are committed to addressing excessive mark-ups in network industries and non-tradable sectors**. Our policies aim to reduce price pressures on end-users that cascade through the economy, weaken the competitiveness of producers, or are ultimately borne by consumers and taxpayers. We have already made significant progress in some areas. For example, in the telecommunications sector, we continue to reduce high mobile termination rates which put small operators at a disadvantage, and we have conducted a successful spectrum auction which, while not attracting new entrants, has broadened access of all operators to existing networks. In the health sector, we have revised the margins of pharmacies and wholesalers and have set specific targets for the reduction of pharmaceutical expenditure.

28. **In the electricity sector, we have identified measures that will reduce mark-ups and eliminate by 2020 the tariff deficit.** We will now take measures that will reduce excess rents and alleviate the pressure they place on end-user electricity prices. We have studied the nature of all types of incentives under the existing energy policy, and have identified instances in the electricity sector where the link between the risk borne by generators and the magnitude of incentives granted is weak. On that basis, we will focus our efforts, including through multilateral negotiations with the stakeholders, on three compensation schemes, described below, which also have an important weight in final electricity prices. To achieve these goals we will appoint an independent negotiator, by end-March 2012, and will discuss progress in this area during the fourth program review.

CMECs (Compensation for Early Termination of PPAs)

29. **We will take measures to limit the policy costs embedded in CMECs.** In particular, we will negotiate the revision of the rate of return to bring it in line with cost of capital at the moment the compensation was defined plus, if warranted, a risk premium. This premium will be linked to the risk of the assets that the mechanism remunerates. The immediate objective will be to reduce rents and stabilize the tariff debt (*défice tarifário*).

Co-generation Incentives

30. **Our objective is to accelerate convergence to market-based pricing for co-generation operators**. The remuneration scheme for co-generation will be revised to improve efficiency of the support system and reduce explicit subsidies through creating a transitional regime during which the tariffs will decline at an increasing rate. We will publish the Executive Order defining the new reference tariff and the formula for updating tariffs in the future, by end-April 2012 (structural benchmark). These measures are estimated to reduce policy costs implicit in electricity prices starting at EUR 25m per year in 2012, rising to EUR 80m in 2020.

Power Guarantee Investment Incentives

31. We will eliminate, by end-April 2012, the incentive to invest in cases where investment decisions had already been taken without the expectation of an additional incentive, i.e. for the set of power plants existing or already licensed prior to the 2007 Decree Law governing this incentive (structural benchmark). We will redesign the Power Guarantee mechanism, establishing a new rationale that provides incentive to build additional generating capacity in the future which takes into account adequate security of supply levels and the existence of other mechanisms, such as interruptibility services. These measures are estimated to reduce policy costs by about EUR 60 million per year.

C. Wage Competitiveness

32. **We recognize the need to promote wage developments consistent with improving firms' competitiveness—particularly for smaller firms,** and have taken the following steps:

- **We have suspended the previous practice of virtually automatic extension of most collective agreements.** Extensions shall only take place when the respective collective agreements are clearly shown to be representative. We will keep ensuring wage moderation by using the available discretion in the current legislation of not extending collective agreements until clear criteria are defined.

- **We have improved the conditions under which works councils can negotiate working time arrangements and remuneration**. Revisions to the Labor Code, currently in Parliament, provide for "organized decentralization": allowing that a collective agreement concluded at a higher level defines conditions under which works councils can engage in firm-level bargaining, without the need for further delegation to a specific works council.

- **We are eliminating four holidays and three paid holiday bonus days (that were due in the case of no absenses), contributing to the reduction in unit labor costs.**

33. **Given the need to ensure sufficient wage flexibility, we will assess the need to adjust policies further.**

- **We will assess the experience with actual use of the flexibility granted to firms under the revisions to the Labor Code**, allowing employers to negotiate with works councils at the firm level. Namely, we will provide evidence by end-March 2013 on how these measures are being applied in collective agreements. If needed, we will prepare an action plan, in consultation with social partners, by end-[June 2013] to ensure that works councils are given real possibility to negotiate wages at firm level.

- **We will explore the merits of and scope for more fundamental changes to the extension mechanism**. We are currently collecting data on the representativeness of social partners, to be part of a set of clear criteria to be followed for the extension of collective agreements. On the basis of this data, we will consider extending collective agreements subscribed by employer's associations representing at least 50 per cent of workers in the sector. Once that threshold is reached, a decision on extension will consider criteria that will prevent an undue burden on the competitive position of non-affiliated firms in the sector—including the implication for external competitiveness.

D. Increasing Employment

34. **We are committed to taking measures to address rising cyclical and structural unemployment, particularly among young workers**.

- **Short term stimulus programs**. We have put in place a stimulus program, providing wage subsidies for firms that hire and train workers who have been registered with public employment services (PES) and fulfill some additional conditions.

- **We are considering measures to effectively lower the reservation wage for certain categories of unemployed**, providing incentives to take up lower paying job matches by topping up wages with a share of unemployment benefits.

- **Employability of young workers**. While some existing ALMPs cater specifically to the needs of the young unemployed, we will be tackling this challenge in the context of a cross-country task force.

- **Unemployment benefits duration**. We have amended the unemployment benefit system, introducing a declining profile for unemployment benefits, reducing the maximum monthly amount of benefits, and shortening the maximum benefits duration. However, given that the duration of benefits remain more generous than unemployment insurance schemes in Europe, we will prepare by end-December 2012 an analysis on benefit dependency and long-term unemployment with a view to assess whether further measures are needed. If needed, we will take measures that will minimize distortions to employability, by end-March 2013.

E. Housing Reform

35. **Progress has been achieved to promote the efficiency of the housing market, boost urban renovation, and foster labor mobility.** To these ends, changes in the Urban lease law and draft legislation to simplify administrative procedures for renovation have been submitted to Parliament as planned.

F. Judicial Reform

36. **We are pushing ahead with targeted measures to reduce the backlogged enforcement cases**. About 50,000 enforcement cases have been cleared since last November, and the inter-agency task force has set quarterly targets for closing enforcement cases by mid-May. In addition, we will develop measures by end-May to resolve pending small claim cases. We have prepared an action plan to strengthen the legal and institutional framework for enforcement agents and will refine the plan based on extensive consultation and cross country experience by mid-May. While the oversight body for enforcement agents currently has access to most enforcement case files, we will take additional measures to ensure full access by end-June. Finally, we continue overhauling the information system to facilitate the speedy processing of court cases.

37. **We are advancing the reforms to improve efficiency of the court system**. Ten court sections have been closed since November, and we have developed a comprehensive judicial roadmap to further reduce the number of courts and streamline the court structure. A bold proposal to amend the Code of Civil Procedure has been prepared to speed up the judicial process. We are conducting an extensive consultation with stakeholders on these proposals, including through workshops to be held in April with the IMF and EC technical assistance. In addition, we

have also made significant progress in strengthening the alternative dispute resolution (ADR) framework. In particular, we have adopted measures to give priority to the ADR enforcement cases in courts, and arbitration centers have become fully operational (end-February structural benchmark). While the bill to improve the Justice for the Peace regime has been prepared, we will submit it to Parliament by end-September as the bill needs to be informed by the judicial roadmap.

Table 1. Portugal: Quantitiative Performance Criteria
(In billions of Euros, unless otherwise specified)

	Performance Criteria (unless indicated otherwise)								Indicative Targets	
	Jun-11		Sep-11		Dec-11					
	Program	Actual	Program	Actual	Program	Actual	Mar-12	Jun-12	Sep-12	Dec-12
1. Floor on the consolidated General Government cash balance (cumulative)	-5.4	-5.1	-6.7	-5.7	-10.3	-7.1	-1.9	-4.4	-5.9	-7.6
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target)	…	…	0	0.2	0	Not met 1/	0	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	167.9	175.9	170.8	175.9	167.8	182.0	175.0	175.0	175.0
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government (continuous performance criterion)	0	0	0	0	0	0	0	0	0	0

1/ Domestic arrears increased by €159 million in October and €74 million in November. They decreased by €301 million in December.

Table 2. Portugal: Structural Conditionality: Third Review Under the EFF

	Measure	Timing	Status
Prior Actions			
1	Pass a resolution of the Council of Ministers on a strategy document to clear the stock of domestic arrears of the general government and SOE hospitals, establishing the governance arrangements for prioritization and payment decisions.		
Structural Benchmarks			
A. Strengthen financial stability			
2	Amend relevant legislation in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework, introduce a regime for restructuring of banks as a going concern under official control and strengthen deposit insurance framework.	End-Dec. 2011	Met
3	Amend the Insolvency Law to better facilitate effective rescue of viable firms. 1/	End-Dec. 2011	Met with delay
4	Amend the framework (Law No. 63-A/2008) for bank access to public capital	End-Jan. 2012	Met
5	Make effective the amendments to the Corporate Insolvency Law to better support rescue of viable firms (after completing all necessary legislative and publication requirements)	Mid-June 2012	
6	Prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector.	End-July 2012	
B. Enhance competitiveness and address bottlenecks to growth			
7	Submit to Parliament legislation revising the Competition Law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonized with the European Union competition legal framework.	End-Jan. 2012	Met with delay
8	Prepare a proposal on measures to be used to correct excessive rents in special (co-generation and renewables) and standard regimes (CMECs, PPAs, and power guarantee mechanism). The proposal will consider the merits of a full range of measures and cover all sources of rents.	End-Jan. 2012	Met with delay
9	Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011	Met
10	Take all necessary legal, administrative, and other steps to make arbitration fully operational.	End-Feb. 2012	Met
11	Eliminate the Power Guarantee investment incentive for the set of power plants existing or already licensed at the time of the approval of the 2007 Decree Law (264/2007) governing this incentive	End-April 2012	
12	Publish the Ministerial Order defining the new reference tariff and formula for updating tariffs in the future for the electricity co-genereration regime.	End-April 2012	
13	Prepare a proposal to implement identified best international practices in order to reinforce the independence of the main sectoral regulators.	mid-Aug. 2012	
14	Submit to Parliament amendments to the Code of Civil Procedure to streamline and speed up the court procedures	End-Sept. 2012	
15	Submit to Parliament the bill to implement the judicial roadmap to improve the court structure.	End-Sept. 2012	
C. Strengthen fiscal institutions and reduce fiscal risks			
16	Launch a tender to hire a top tier international accounting firm to review and complete a more detailed study of all 36 PPP contracts at the national level.	End-Dec. 2011	Met
17	Prepare a report on SOEs based on forecast financial statements assessing their financial prospects, potential government exposure, and scope for orderly privatization.	End-Feb. 2012	Met with delay
18	Develop a specific program for unwinding Parpublica.	End-April 2012	
19	Revise and submit to Parliament the draft regional and local public finance law.	End-Dec. 2012	Reset from end-March 2012
20	Implement a full-fledged Large Taxpayer Office (LTO), to cover audit, taxpayer services, and legal functions concerning all large taxpayers, including the adoption of account managers.	End-Dec. 2012	

1/ The amendments were approved by the Council of Ministers and submitted to Parliament in December 2011, but were approved by Parliament on March 9, 2012.

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

March 15, 2012

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the tables annexed to the Memorandum of Economic and Financial Policies. It also describes the methods to be used in assessing the Program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the EC, the ECB, and the IMF before modifying measures contained in this letter or adopting new measures that would deviate from the goals of the Program, and provide the EC, the ECB, and the IMF with the necessary information for Program monitoring.

2. For Program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "Program exchange rates" as defined below, with the exception of the items affecting government fiscal balances, which will be measured at spot exchange rate (i.e., the rate for immediate delivery) prevailing on the date of the transaction. The Program exchange rates are those that prevailed on May 5, 2011. In particular, the exchange rates for the purposes of the Program are set EUR 1 = 1.483 U.S. dollar, EUR 1 = 116.8390 Japanese yen, EUR 1.09512 = 1 SDR.

3. For reporting purposes, the MoF and BdP will employ the reporting standards and templates considered to be appropriate given the transmission of data covered by this TMU, unless otherwise stated or agreed with the EC, the ECB and the IMF.

General Government

4. **Definition**: For the purposes of the Program, the General Government, as defined in the Budget Framework Law, Law No. 91/2001 of August 20, amended by Law 22/2011 of May 20, includes**:**

4.1. The Central Government. This includes:

4.1.1. The entities covered under the State Budget, which covers the budgets of the Central Administration, including the agencies and services that are not administratively and financially autonomous, agencies and services that are administratively and financially autonomous (*Serviços e Fundos Autónomos* – SFA).

4.1.2. Other entities, including Incorporated State-owned enterprises (ISOE), or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government.

4.2. Regional and Local Governments, that include:

4.2.1. Regional Governments of Madeira and Azores and Local Governments (*Administrações Regionais and Locais*);

4.2.2. Regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95

Manual on Government Deficit and Debt rules, classified by the INE as Local Government.

4.3. Social Security Funds comprising all funds that are established in the general social security system.

This definition of General Government also includes any new funds, or other special budgetary and extra budgetary programs or entities that may be created during the Program period to carry out operations of a fiscal nature and which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE in the correspondent subsector. The MoF will inform the EC, ECB, and IMF of the creation of any such new funds, programs, entities or operations at the time of its creation or statistical re-classification or, in the case of Regional and Local Governments, at the time the Government acknowledges its creation.

The General Government, as measured for purposes of Program monitoring in 2012, shall not include entities nor operations (including pension funds) that are re-classified into the General Government during 2012, but shall include those reclassified in 2011.[1]

5. **Supporting Material**

5.1. Data on cash balances of the State Budget will be provided to the EC, the ECB and the IMF by the MoF within three weeks after the end of the month. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published by the MoF.

5.2. Data on the cash balances of the other parts of General Government as defined in paragraph 4[2] will be provided to the EC, the ECB and the IMF by the MoF within seven weeks after the end of the month. Data will include detailed information on revenue and expenditure items. Data will also include detailed information on PPP-related revenues and expenditures for those PPP reclassified within the General Government sector according to ESA 95, and called guarantees.

5.3. Data on domestic and external debt redemptions (securities), new domestic and external debt issuance (securities), change in the domestic and foreign currency assets and liabilities of the Central Government at the BdP and other financial institutions will be provided to the EC, the ECB, and the IMF by the BdP within 40 days after the closing of each month.

5.4. BdP will provide to the EC, the ECB, and the IMF detailed monthly data on the financing of the General Government, as defined in ESA95, within seven weeks after the closing of each month.

5.5. Data on the revenues, operating expenses, capital expenditure, remuneration of personnel, EBITDA, and number of staff will be provided for state-owned enterprises (SOEs) on a quarterly basis, within 7 weeks after the end of each quarter. Aggregate data for the SOEs

[1] An operation refers to part of a legal entity that is involved in the production or delivery of goods and services—including government services provided on a nonmarket basis. As such, it does not include transactions relating to the assets or liabilities of an entity. For example, should an entity handle a number of PPPs, reclassifying only one PPP would be considered as reclassifying an operation. In contrast, taking over part of an entity's debt by the government would not qualify for the exclusion. On this issue, see also paragraph 13.

[2] In 2011, data exclude regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government, i.e., entities referred in paragraph 4.2.2.

within the perimeter will be provided, with company-specific information for REFER, Estradas de Portugal, Metro de Lisboa, and Metro de Porto. Furthermore data for Comboios de Portugal and Parpública (outside the perimeter) will also be provided.

QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILINGS, AND CONTINUOUS PERFORMANCE CRITERIA: DEFINITIONS AND REPORTING STANDARDS

A. Floor on the Consolidated General Government Cash Balance (Performance Criterion)

6. **Definition**: The consolidated General Government cash balance (CGGCB) is defined as the sum of the cash balances of the entities covered by the State Budget, the ISOE, the Regional and Local Governments, and the Social Security Funds, and other entities and EBFs, as defined in paragraph 4. Privatization receipts will be excluded from cash receipts. In 2012 and beyond, revenues from the reclassification of pension funds into the general government will not be accounted for as cash revenues for the purpose of the calculation of the consolidated general government cash balance. The net acquisition of financial assets for policy purposes, including loans and equity participation will be recorded as cash expenditures, except for transactions related to the banking sector support and restructuring strategy under the Program. Called guarantees (excluding those related to the banking sector support and restructuring strategy), where entities of the General Government make cash payments on behalf of entities that are not part of the General Government, will be recorded as cash expenditures.

6.1. **The cash balance of the State Budget.** The cash balance of the State Budget will be measured from above the line, based on budget revenues (recurrent revenue plus nonrecurrent revenue, including EU revenues, minus tax refunds) minus budget expenditures of the State Budget as published monthly on the official website of the DGO of the MoF, and in line with the corresponding line items established in the State Budget. Budget expenditures will exclude amortization payments but include salaries and other payments to staff and pensions; grants to Social Security Funds, medical care and social protection; operational and other expenditure, interest payments; cash payments for military equipment procurement; and EU expenses.

6.2. **The cash balance of the Regional and Local Governments, Social Security Funds, ISOE and other entities or EBFs**. The cash balance of each of these parts of the General Government will be measured from above the line, based on revenues minus expenditures as it will be provided by the DGO of the MoF in the monthly General Government budget execution report (see Para 5), and in line with the corresponding line items established in their respective budgets. All entities including ISOE that prepare accrual-based financial statements will submit monthly cash flow statement in accordance with form and content specified by the MoF. The reporting by Local Government will be phased as set out in paragraph 8 below.

6.3 **Adjustor.** If in IMF/EC/ECB's staff judgment (based on assessment during the third review) there are sufficient safeguards to prevent further accumulation of arrears and that part of the remaining funds (available after meeting the 2011 deficit target) from the envisaged 2011 banks pension fund transfer may be used to settle domestic arrears, the following adjuster will apply. The 2012 quarterly floors on the consolidated general government cash balance, as well as the accrual government balance objectives, will be adjusted, if necessary, by the amount of arrears to be cleared.

Other provisions

7. For the purpose of the program, the expenditure of the central government that is monitored excludes payments related to bank support, when carried out under the program's banking sector and restructuring strategy. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to the EC, ECB, and IMF.

8. Quarterly consolidated accounts for the General Government on a cash basis will be reported for internal, EC, ECB, and IMF monitoring 7 weeks after the reference period, starting with the first quarter of 2012. The reports will be published externally starting with December 2011 data. SOEs will be consolidated with the general government accounts starting with the first quarter 2012. The larger municipalities (defined as those with a population of 100,000 voters or more) are required to provide monthly reports under current arrangements, and their cash balance will be included in the calculation of the monthly cash General Government balance. The cash balance of the smaller municipalities, i.e. those with a population of under 100,000 voters, will be excluded until any necessary legal changes requiring them to provide monthly reports have been put in place. In this transitory period, the MoF will provide a monthly estimate of the cash balance of these smaller municipalities excluded from the General Government reports to the EC, the ECB, and the IMF.

9. **Supporting material**.

9.1. Data on cash balances of the State Government, ISOEs, Regional and Local Government and Social Security Funds will be provided to the EC, the ECB and the IMF by the MoF within seven weeks after the end of each month. The information provided will include general government net acquisitions of financial assets for policy purposes, including loans and equity participations, as well as called guarantees where entities that are part of the General Government make cash payments on behalf of entities that are not part of the General Government.

9.2. The MoF will submit quarterly data on General Government accounts determined by the INE in accordance with ESA 95 rules, showing also the main items of the transition from cash balances to the General Government balances in national accounts. The reconciliation will be accompanied by necessary explanatory materials for any indication of potential deviation of the annual general government cash target from the annual general government accrual target determined in accordance with ESA 95 rules.

B. Non-Accumulation of New Domestic Arrears by the General Government (Continuous Indicative Target)

10. **Definitions**. Commitment, liabilities, payables/creditors, and arrears can arise in respect of all types of expenditure. These include employment costs, utilities, transfer payments, interest, goods and services and capital expenditure. Commitments are explicit or implicit agreements to make payment(s) to another party in exchange for that party supplying goods and services or fulfilling other conditions. Commitments can be for specific goods and services and arise when a formal action is taken by a government agency, e.g., issuance of a purchase order or signing a contract. Commitment can also be of a continuing nature that require a series of payments over an indeterminate period of time and may or may not involve a contract, e.g. salaries, utilities, and entitlement payments. Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources (usually cash) embodying economic benefits or service potential. In relation to commitment, the liability arises when a third party satisfies the terms of the contract or similar arrangement. Payables/creditors are a subset of liabilities. For the

purposes of the program payables/creditors exclude provisions and accrued liabilities. Arrears are a subset of payables/creditors. For the purposes of the Program domestic arrears are defined as payables/creditors that have remained unpaid for 90 days or more beyond any specified due date (regardless of any contractual grace period). In case no due date is specified, arrears are defined as payables/creditors that have remained unpaid for 90 days or more after the date of the invoice or contract. Data on arrears will be provided within seven weeks after the end of each month. The continuous indicative target of non-accumulation of new domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the end of the previous month—based on the same perimeter with respect to the entities covered. This also includes arrears that are being accumulated by the SOEs not included in the General Government.

11. **Supporting material.** The stock of arrears will be measured through a survey. Reports on the stock of arrears of the General Government are being published monthly. The MoF will provide consistent data on monthly expenditure arrears of the General Government, as defined above. Data will be provided within seven weeks after the end of each month and will include total arrears classified by the different constituent sectors of the General Government sub-sector as defined in paragraph 4.

12. **Adjustor.** The monthly change in the stock of arrears will be adjusted for any stock adjustment related to the arrears clearance strategy. This will allow monitoring the underlying flow of new arrears.

C. Ceiling on the Overall Stock of General Government Debt (Performance Criterion)

13. **Definition**. The overall stock of General Government debt will refer to the definition established by Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the Excessive Deficit Procedure annexed to the Treaty establishing the European Community. For the purposes of the Program, the stock of General Government debt will exclude: (i) debt contracted for bank restructuring, when carried out under the Program's banking sector support and restructuring strategy; (ii) IGCP deposits; and (iii) (from end-September 2011) the *'prepaid margin'* on all EFSF loans.

14. **Adjusters**. For 2012, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock at end-December 2011 general government debt of EUR183.33 billion. From 2013 onwards, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) reclassification of entities or operations that affects the stock at end-December of the previous year.

15. **Supporting material**. Quarterly data on the total stock of General Government debt as defined in paragraph 12 will be provided to the EC, ECB and IMF by the BdP no later than 90 days after the end of each quarter, as reported to the ECB and the Eurostat. Monthly estimates will be provided to the EC, ECB and IMF by BdP no later than seven weeks after the end of each month.

D. Non-Accumulation of New External Debt Payments Arrears by the General Government (Continuous Performance Criterion)

16. **Definition**. For the purposes of the Program, the definition of debt is the same as in paragraph 12. An external debt payment arrear will be defined as a payment on debt to nonresidents,

contracted or guaranteed by the general government, which has not been made within seven days after falling due (taking into account any applicable contractual grace period). The performance criterion will apply on a continuous basis throughout the Program period.

17. **Supporting material**. Any external debt payment arrears of the General Government will be immediately reported by the MoF.

E. Bank Solvency Support Facility

18. EUR 1 billion has been provided in cash and is made available in a separate dedicated account to be set up at the Bank of Portugal by end-June 2011. An additional EUR 3 billion has been deposited so far in 2012. Future amounts for the bank support fund will be deposited into the dedicated account to the extent that there is a need for bank capital.

F. Overall Monitoring and Reporting Requirements

19. Performance under the Program will be monitored from data supplied to the EC, the ECB, and the IMF by the MoF and BdP. The authorities will transmit to the EC, ECB, and IMF any data revisions in a timely manner.

MEMORANDUM OF UNDERSTANDING ON
SPECIFIC ECONOMIC POLICY CONDITIONALITY
Third Update – 15 March 2012

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism (EFSM), and in particular Article 3(5) thereof, the third update of the Memorandum of Understanding on specific economic policy conditionality (MoU) details the general economic policy conditions as embedded in Council Implementing Decision 2011/344/EU of 17 May 2011 on granting Union financial assistance to Portugal.[1]

The first disbursement of financial assistance from the EFSM took place following the entry into force of the MoU and of the Loan Agreement.

The Council Implementing Decision specifies that the release of further instalments is conditional on a positive conclusion of the reviews of conditionality that will take place throughout the three-year duration of the programme. These reviews will assess progress made with respect to the policy criteria in the Council Implementing Decision and specified in the Memorandum of Economic and Financial Policies (MEFP) and in this updated MoU, as well as Council Recommendations in the context of the Excessive Deficit Procedure.

The third quarterly review was carried out in February 2012. It assessed compliance with the conditions to be met by end-February and the need and scope for additional policy steps. This third update of the MoU reflects the findings of the third review. The following reviews taking place in any given quarter will assess compliance with the conditions to be met by the end of the previous quarter or, where applicable, up to date of the mission.

If targets are missed or expected to be missed, additional action will be taken. The authorities commit to consult with the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) on the adoption of policies falling within the scope of this updated Memorandum, allowing sufficient time for review. Staff of the EC, the ECB and the IMF will, in cooperation with the Portuguese authorities, monitor and assess progress in the implementation of the programme and track the economic and financial situation. Staff will also monitor whether the implementation and effects of measures taken by the Portuguese authorities fall short of the commitments of previous versions of the MoU; such commitments might be re-inserted. To this effect the authorities commit to provide all required information as soon as available. In areas where there are risks of significant delays in the implementation of policies under this programme the authorities in cooperation with the EC, the ECB and the IMF consider making use of technical assistance.

Prior to the release of the instalments, the authorities shall provide a compliance report on the fulfilment of the conditionality.

1. Fiscal policy

Objective
First, reduce the government deficit to below EUR 7,645 million (4½ per cent of GDP) in 2012. This should allow to reach a deficit target of 3 per cent of GDP by 2013. Second, bring the government

[1] On 8 April 2011, Eurogroup and ECOFIN Ministers issued a statement clarifying that EU (European Financial Stabilisation Mechanism, EFSM) and euro-area (European Financial Stability Facility, EFSF) financial support would be provided on the basis of a policy programme supported by strict conditionality and negotiated with the Portuguese authorities, duly involving the main political parties, by the Commission in liaison with the ECB, and the IMF. Further to the EU support from the EFSM, loans from the EFSF will contribute to the financial assistance. The Loan Facility Agreement on the EFSF financing contribution specifies that the disbursements there under are subject to the compliance with the conditions of this Memorandum.

debt-to-GDP ratio on a downward path as of 2013. Third, maintain fiscal consolidation over the medium term up to a balanced budgetary position, notably by containing expenditure growth. This consolidation will be achieved by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups.

Fiscal policy in 2012

In 2011, the general government deficit fell below the target of EUR 10,068 million on a European System of Accounts (ESA95) basis according to available data in February 2012. The deficit is now estimated at around 4 per cent of GDP compared to a target of 5.9 per cent of GDP. The target has been achieved mainly by means of a large one-off transfer of the banks' pension funds to the public social security system of around EUR 6 billion (3½ per cent of GDP). Without this one-off transfer, the fiscal gap is estimated to be 1½ per cent of GDP. Primary expenditure overruns that occurred in the first half of the year have been reversed in the second half. The remaining fiscal gap has been caused mainly by non-recurrent factors at the level of sales of concessions and real estate, reclassification of capital operations and PPP investment. The recapitalisation costs of the troubled bank BPN added 0.3 per cent of GDP to the fiscal gap on an ESA95 basis[2].

1.1. The government will achieve a general government deficit of no more than EUR 7,645 million (4½ per cent of GDP) in 2012.[3] **[Q4-2012]** The Government has not implemented the 'fiscal devaluation' as a tool to cut labour costs. As an alternative, the government has introduced a number of other measures to boost the competitive position of Portuguese firms. Substantial efforts continue to be necessary to raise competitiveness which remains a central aim of the programme.

1.2. The Government will adopt a Supplementary Budget by **[Q1-2012].** Main elements to be included: i) the additional expenditure on pensions due to the banks' pension funds transfer in 2012 of about EUR 520 million; ii) the strategy for the settlement of arrears in the health sector; iii) budgetary costs of the Madeira programme; and iv) ways of addressing increased downside risks to economic activity by using additional interest savings, such as the interest received from deposits, the EFSF margin removal from loans disbursed in May/June and lower interest on EFSF/EFSM loans disbursed afterwards and savings from the reprogramming of EU structural funds.

1.3. The banks' pension funds transfer has created additional expenditure on pensions for the government that will have a negative impact, although decreasing in time, on the overall fiscal balances. The government will adopt measures to cover the additional expenditure and keep the fiscal balances unaffected. For 2012, these measures will be covered by the Supplementary Budget. For later years, these measures are still to be fully specified and will be included in the 2012 fiscal strategy document in compliance with the Stability and Growth Pact together with detailed medium-term fiscal projections and a list of contingency measures in case of budgetary slippages. [**April 2012]**

1.4. Throughout the year, the government will rigorously implement the Budget Law for 2012. Within the year, progress will be assessed against the (cumulative) quarterly ceilings for the consolidated general government cash balance in the MEFP, as defined in the TMU, without prejudice to full-year ESA-95 deficit targets. **[Q1, Q2, Q3 and Q4-2012]**

1.5. The discussion in Parliament of the 2012 Budget Law has led to a change in the salary and pension threshold to EUR 1,100 above which the 13th and 14th monthly payments are fully suspended, and to between EUR 600 and EUR 1,100 for implementing the progressive suspension. The change was done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital income (dividends and interest payments) from 21.5 per cent to 25 per cent.

[2] Transactions related to the banking sector support and restructuring strategy under the programme are excluded from the deficit definition of the TMU.

[3] In 2012, operations related to the banking sector support and restructuring strategy under the programme and lump-sum revenues from transfers of pension funds to the government sector will not be considered for the assessment of compliance with the programme target for the general government deficit. Conversely, if during the fourth review there is an agreement that there are sufficient safeguards to prevent further accumulation of arrears, part of the remaining funds from the 2011 banks pension transfer may be used to settle domestic arrears, the accrual government balance objectives may be adjusted.

1.6. The measures listed below, worth 5.3 per cent of GDP, when compared with the estimated outturn for 2011 (and above 6 per cent of GDP when compared with a scenario of unchanged policies), will be carried out as adopted in the 2012 Budget Law, unless elsewhere specified. Overall, expenditure reduction accounts for two thirds of that fiscal effort and revenue increases for one third.

Expenditure

1.7. Ensure that the public sector wage bill decreases in gross terms in 2012 by at least EUR 3,000 million:

i. reduce wages for all general government sector employees in 2012 by (i) suspending the 13th and 14th monthly salary payments for those workers with monthly salaries of EUR 1,100 or more, (ii) suspending on average and in a progressive way the equivalent of one of those two salaries for those workers with monthly salaries between EUR 600 and EUR 1,100. Similar measures will apply to all SOEs classified inside and outside the perimeter of the government sector, and in any other public entity even if falling outside the perimeter of the government sector;

ii. reduce the number of government employees by (i) limiting staff admissions in order to achieve annual decreases of 2 per cent (full-time equivalent) in 2012-2014 in the permanent staff of central, regional and local governments, (ii) decreasing the number of temporary positions in specific areas of public administration. To support these objectives, binding numeric targets for staff reductions per main area of the administration will be defined by **Q1-2012**;

iii. make room to reverse any possible slippage recorded in 2011;

iv. suspend all promotions in 2012;

v. reduce the overall budgetary cost of health benefits schemes for government employees schemes (ADSE, ADM and SAD) on the basis of the measures presented below under 'Health care system';

vi. savings from the public administration restructuring on the basis of the measures presented below under 'Public administration'.

1.8. Reduce pension expenditure in gross terms in 2012 by at least EUR 1,140 million by: (i) suspending the 13th and 14th monthly payments for those pensioners with monthly pension benefits of EUR 1100 or more, (ii) suspending on average and in a progressive way the equivalent of one of those monthly benefits for those with monthly pension benefits between EUR 600 and EUR 1100. The pensions of those receiving benefits below EUR 600 will be frozen and the lowest pensions will be marginally increased. In case a pensioner receives more than one pension, the consolidated pension income will be considered for the application of the thresholds defined here. These rules will also apply to subventions or subsidies paid by the government that take the nature of pensions even if designed otherwise.

1.9. Control costs in health sector on the basis of detailed measures listed below under 'Health-care system', achieving savings worth some EUR 1000 million.

1.10. Reduce costs with SOEs classified inside the perimeter of the general government on a ESA95 basis with the aim of saving at least EUR 500 million by means of:

i. sustaining an average permanent reduction in operating costs by at least 15 per cent;

ii. tightening compensation schemes and fringe benefits in line with the rest of the government sector;

iii. rationalising investment plans for the medium term. The increase in EU co-financing rates allowed for countries under an Economic Adjustment Programme and a re-programming of EU funds in the context of the current National Strategic Reference Framework (NSRF) will also give a contribution to this end;

iv. SOEs will also relieve pressure on government accounts by raising their revenue coming from market activities, including by raising tariffs and prices.

1.11. Reduce costs in the area of education, with the aim of saving EUR 380 million by rationalising the school network including by creating school clusters; lowering staff needs; centralising procurement; and reducing and rationalising transfers to private schools in association agreements and making a more intensive use of EU funds to finance activities in the area of education.

1.12. Reduce capital expenditure by EUR 200 million by prioritising investment projects and making more intensive use of funding opportunities provided by EU structural funds. The increase in EU co-financing rates allowed for countries under an Economic Adjustment Programme and a re-programming of EU funds in the context of the current National Strategic Reference Framework (NSRF) will give an important contribution to this end.

1.13. Reduce cash social transfers (other than pensions) by at least EUR 180 million by tightening eligibility criteria and decreasing average benefits in selected cases.

1.14. Reduce transfers to local and regional authorities by at least EUR 175 million with a view to having these subsectors contributing to fiscal consolidation.

1.15. Improve the working of the central administration by increasing efficiency, reducing and eliminating services that do not represent a cost-effective use of public money. This should yield annual savings worth at least EUR 130 million. Detailed plans will be presented by the Portuguese authorities by **Q1-2012**; the budgetary impacts will spread beyond 2012. To this end, the government will:

i. reduce the number of services while maintaining quality of provision;

ii. create a single revenue administration and promote services' sharing between different parts of general government;

iii. reorganise the provision of central administration services at local level and regularly assess the value for money of the various public services;

iv. promote mobility of staff in central, regional and local administrations;

v. reduce transfers from the state to public bodies and other entities;

vi. revise compensation schemes and fringe benefits in public bodies and entities that independently set their own remuneration schemes;

vii. reduce subsidies to private producers of goods and services.

1.16. Reduce costs in other public bodies and entities and in transfers and subsidies to SOEs classified outside the perimeter of the general government on an ESA95 basis by at least EUR 90 million. These SOEs at the level of central, regional will carry out adjustment efforts similar to those SOEs classified inside the perimeter of the general government on a ESA95 basis as listed above, namely by: rationalising investment plans for the medium term; sustaining an average permanent reduction in operating costs by at least 15 per cent; tightening compensation schemes and fringe benefits; increasing revenues from market activities, including by raising tariffs and prices charged. These adjustments will also be instrumental to contain risks that the financial situation of some of these SOEs put to government accounts in 2012 and beyond.

Revenue

1.17. Introduction of a standstill rule to all tax expenditure, blocking the creation of new items of tax expenditure and the enlargement of existing items. The rule will apply to all kinds of tax expenditure, of a temporary or permanent nature, at the central, regional or local level.

1.18. Raise VAT revenues through an increase in the efficiency of the VAT structure with a yield of at least EUR 2,024 million in 2012. For this purpose, a set of categories of goods and services were moved from the reduced and intermediate VAT rates to higher ones. This includes the additional impact of the increase in the VAT rate for natural gas and electricity to the standard rate introduced in October 2011.

1.19. Increase personal income taxes with a yield of at least EUR 265 million in 2012 (taking into account the losses of revenues as result of the reductions of public wages and pension incomes listed under 1.8 and 1.9 above) by:

i. capping and cutting substantially (by two thirds overall) tax allowances for health expenditure;

ii. (i) eliminating the deductibility of mortgage principal; (ii) eliminating interest income deductibility for new mortgages; (iii) phasing out the deductibility of mortgage interest payments for owner-occupied housing and of rents;

iii. harmonising personal income tax deductions applied to pensions and labour income;

iv. capping the maximum deductible tax allowances according to tax bracket for most of the income brackets except the bottom two with lower caps applied to higher incomes and a zero cap for the two highest income brackets;

v. revising the taxation of income in kind;

vi. introducing a surcharge on the income of the top tax bracket and increasing the tax rate on capital gains;

vii. the one-time surcharge in the context of the personal income tax in 2011 that will be collected in 2012.

1.20. Increase corporate tax revenues by at least EUR 330 million in 2012 by:

i. abolishing all reduced corporate income tax rates;

ii. limiting the deductions of losses in previous years to 75 per cent of the taxpayer's taxable profit;

iii. curbing tax benefits;

iv. increasing the rates and the basis of the state surcharge on corporate profits.

1.21. Increase excise taxes to raise at least EUR 200 million in 2012. In particular by:

i. raising taxes on car sales, tobacco and alcohol products;

ii. introducing electricity excise taxes in compliance with EU Directive 2003/96;

iii. indexing excise taxes to core inflation.

1.22. Change property taxation to raise revenue by at least EUR 50 million by reducing substantially the temporary exemptions for owner-occupied dwellings acquired as of 2012 and by increasing rates.

1.23. Increase efforts to fight tax evasion, fraud and informality to raise revenue by at least EUR 175 million for various types of taxes inter alia by increasing means available for audits, increasing penalties for the most serious tax crimes and introducing electronically-transmitted invoices.

Fiscal policy in 2013

1.24. The government will achieve a general government deficit of 3 per cent of GDP or below. **[Q4-2013]**

1.25. Throughout the year, the government will rigorously implement the Budget Law for 2013. Within the year, progress will be assessed against the (cumulative) quarterly ceilings for the consolidated general government cash balance in the Memorandum of Economic and Financial Policies (MEFP), as defined in the Technical Memorandum of Understanding (TMU), without prejudice to full-year ESA-95 deficit targets. **[Q1, Q2, Q3 and Q4-2013]**

1.26. The measures listed below will be detailed and carried out with the 2013 Budget Law **[Q4-2012]**, unless otherwise specified:

Expenditure

1.27. Further measures introduced in the 2012 Budget Law with a view to reducing expenditure in the area of:

i. central administration functioning: EUR 500 million. Detailed plans will be presented and assessed **[Q3-2012]**;

ii. wage bill: decrease of 2 per cent (full-time equivalent) in the permanent staff of central, regional and local governments and decrease the number of temporary positions in specific areas of public administration;

iii. health sector: EUR 375 million;

iv. capital expenditure: EUR 350 million;

v. transfers to local and regional authorities: EUR 175 million;

vi. education and school network rationalisation: EUR 175 million;

vii. costs in other public bodies and entities, and in SOEs: EUR 175 million;

viii. health benefits schemes for government employees: EUR 100 million;

ix. freeze wages and pensions except for the lowest pensions.

1.28. In addition, the government will extend the use of means testing and better target social support achieving a reduction in social benefits expenditure of at least EUR 250 million. Social transfers will also decline following the implementation of the measures on unemployment insurance listed below under 'Labour market and education'.

Revenue

1.29. Further measures introduced in 2012 Budget Law, leading to extra revenue in the following areas:

i. personal income tax benefits and tax deductions: EUR 175 million;

ii. broaden corporate tax bases and reduce tax benefits and tax deductions: EUR 150 million;

iii. excise taxes: EUR 150 million.

1.30. Update the notional property value of all real estate assets for tax purposes to raise revenue by at least EUR 250 million in 2013. Transfers from the central to local governments will be reviewed to ensure that the additional revenues are fully used for fiscal consolidation**.**

Fiscal policy in 2014

1.31. The government will aim at achieving a general government deficit in 2014 in line with the Medium-Term Fiscal Strategy defined in August 2011. The necessary measures will be defined in the 2014 Budget Law. **[Q4-2013]**

1.32. Within the year, progress will be assessed against the (cumulative) quarterly ceilings for the consolidated general government cash balance in the Memorandum of Economic and Financial

Policies (MEFP), as defined in the Technical Memorandum of Understanding (TMU), without prejudice to full-year ESA-95 deficit targets. **[Q1 and Q2-2014]**

With the 2014 Budget Law, the government will further deepen the measures introduced in the 2012 and 2013 with a view in particular to broadening tax bases and moderating primary expenditure to achieve a declining ratio of government expenditure over GDP.

2. Financial sector regulation and supervision

Preserve financial sector stability; maintain liquidity and support a balanced and orderly deleveraging in the banking sector; ensure adequate financing and working capital for the productive sectors; strengthen banking regulation and supervision; bring closure to the Banco Português de Negócios case and streamline state-owned Caixa Geral de Depósitos; strengthen the bank resolution framework and reinforce the Deposit Guarantee Fund and the Guarantee Fund for Mutual Agricultural Credit Institutions; reinforce the corporate and household insolvency frameworks; ensure that the pension fund transfer from the banking sector into the social security system is done under conditions that are actuarially fair to all partners and the state.

Maintaining liquidity in the banking sector

2.1. Encourage banks to strengthen their collateral buffers on a sustainable basis and to take full advantage of the broadening of the range of eligible collateral for the purpose of Eurosystem re-financing. The Banco de Portugal (BdP), in close cooperation with the ECB, will continue to monitor closely the liquidity situation of the banking system and stands ready to take the appropriate measures to maintain sufficient system liquidity. Monitor the issuance of the government guaranteed bank bonds, which has been authorised up to EUR 35 billion in line with EU State aid rules. **[Ongoing]**

Deleveraging in the banking sector

2.2. The banking system should in the medium run eliminate its funding imbalances. Monitor the banks' implementation of the funding plans aiming at an indicative loan-to-deposit ratio of about 120% in 2014. It is important that the pace and composition of deleveraging should not jeopardise the provision of appropriate credit to finance productive investment and working capital in the private sectors of the economy, not least SMEs. Fiscal adjustment and an attendant reduction in the public sector’s financing are crucial for reconciling potentially conflicting objectives. In addition, the Bank of Portugal will take appropriate measures to discourage ever-greening of doubtful loans with a view to facilitating an effective adjustment of bank balance sheets respecting EU state aid rules and will adopt additional appropriate measures to this effect. These steps will be taken without burdening or posing risks to public resources. The Ministry of Finance, the BdP, and other stakeholders, will also prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector **by end-July**[4]. Banks' funding and capital plans and broader credit developments will continue to be monitored closely. There is room for the necessary deleveraging to take place in an orderly manner and it is crucial that the pace and composition of the necessary deleveraging remain consistent with the macroeconomic framework of the programme. **[Ongoing]**

Pension fund transfer

2.3. Ensure that proceeds associated with the pension transfer will be used respecting EU state aid rules **[Ongoing].** Additional capital requirements resulting from this transfer will be sought from private sources, as in other upcoming recapitalisation efforts. However, if necessary, help will be offered to banks to cover the loss and impact on capital by using part of the transfer itself in the context of the larger recapitalisation process and acquire common equity in banks under the conditions set in the recapitalisation framework. Authorities will carry out, under strict eligibility criteria, a credit

[4] Structural benchmark in the Memorandum of Economic and Financial Policies.

assignment of up to EUR 3 billion from the banks to the general government, while maintaining the contractual obligations of the debtor.

Capital buffers

2.4. BdP is following closely the plans the banks presented to reach a core Tier 1 capital ratio of 10 per cent at the latest by **Q4-2012**.

2.5. In addition to the targets and deadlines set under the program, further strengthen the banks' capital position. The capital exercise announced by the European Banking Authority (EBA) on 8 December 2012, including a new temporary buffer for sovereign exposures, requires substantial additional bank capital. Still more capital will be needed as a result of the partial transfer of banks' pension plans as well as from the special on-site inspections program (SIP).

2.6. The BdP has requested banks to present plans to augment their capital. In addition to the EBA requirements in this field, banks will provide plans by **end-February 2012** on how they intend to meet all their capital needs and the applicable deadlines, including their possible need for public capital. For the pension plan transfers and the SIP, the deadline for providing the capital will be the same as for the EBA exercise, namely by **Q2-2012**.

2.7. The amended law on extending temporary public support to viable banks has entered into force on 12 February 2012 and the accompanying Ministerial Order ('Portaria') is being finalised, after consultation with all relevant stakeholders. The rules governing the provision of capital from public sources to banks state that whenever a beneficiary bank will cease to comply with the steps and deadlines agreed under the recapitalisation plan or does not manage to achieve the Core Tier 1 requirements within a time frame established by law, the government will start to exercise its full ownership rights. The price for shares issued as part of the public support will be in line with EU guidelines, and will include a sizeable discount to provide a large safety margin for the taxpayer. In order to avoid that the private shareholders are effectively subsidised by the public sector, and to enhance the prospects for capital injections, banks will be required to demonstrate that they have tried everything to achieve the capital increase via private sources before banks receive any public funds. It will also include increasing incentives for early repayment. The repurchase price incorporates an accrued remuneration plus a share of any increase in value. The BdP will closely monitor and supervise banks that receive public support, and will provide quarterly status reports to the Minister of Finance. **[Ongoing]**

Caixa Geral de Depósitos (CGD)

2.8. Continue to streamline the state-owned CGD group to increase the capital base of its banking arm as needed. The sale of the insurance arm is expected to take place **in 2012** directly to a final buyer and to contribute to meeting that year’s additional capital needs, while a start is made to sell non-strategic participations and a review of CGD's overall portfolio is ongoing. Insofar as these needs cannot be met from internal group sources by **end-June 2012**, CGD will be provided with government capital support from cash buffers outside of the BSSF subject to EU state aid rules.

Monitoring of bank solvency

2.9. In the context of the stress test exercise planned for the **fifth review**, the BdP will ensure that banks incorporate the available results of the SIP. The exercise, based on the upgraded models of the banks following the SIP, will be performed quarterly with a three-year horizon and a 6% Core Tier 1 threshold. **[Ongoing]**

2.10. A scenario is prepared by the BdP and agreed with the EC/ECB/IMF and the quality of the results will be assessed by all parties. The BdP will continue to monitor on a **quarterly** basis the banks’ potential capital needs with a forward looking approach under stress conditions.

Banking regulation and supervision

2.11. The BdP is asked to continue to strengthen its supervisory capacity, making progress in widening the ranks of its specialist staff, and establish a new division tasked with the maintenance and development of supervisory methodologies and tools, including the dissemination across its supervisory function of the experiences obtained via the SIP. **[Ongoing]**

2.12. Remain committed to close coordination with home and host country supervisors, both within and outside the EU. **[Ongoing]**

Banco Português de Negócios

2.13. The authorities are asked to resolve the case, taking into account the decision by the EC which has examined, inter alia, the transaction's legal certainty and the implications for the Portuguese taxpayer and the economy as a whole, including financial stability. **[Ongoing]**

2.14. Once the case is resolved, the CGD's state guaranteed claims on BPN and all related special purpose vehicles (SPVs) will be settled gradually in cash. Any recoveries on the assets held by the state-owned SPVs will also be used to promptly repay CGD. **[Ongoing]**

2.15. The authorities will develop and implement a more effective strategy for the recovery of the distressed assets and the management of the SPVs with the overarching objective to maximise returns for the tax payer within a reasonable timeframe **[end-March]**. Moreover, they will commission an audit, while complying with procurement laws, to confirm the prospective recoverable value of the distressed assets held by the SPVs by the time of the **[fourth review]**, in the context of the larger recapitalisation process

Bank resolution framework

2.16. The early intervention, resolution and deposit insurance framework has been strengthened. Legislative amendments have been passed and are effective as of mid-February 2012. The authorities are asked to prepare the implementing measures with a view to rendering the new legal framework fully operational at the latest by the **end of 2012**. In particular, the following actions will be taken: (a) setting-up of the Resolution Fund with a view to ensuring that it is fully operational by **July 2012**: (b) Recovery and Resolution Plans regulations will be adopted by **mid-2012** taking into account, to the extent possible in view of the deadline, the EBA recommendations and templates; (c) rules applicable to setting-up and operation of bridge banks in line with EU competitions rules will be adopted **end September 2012**.

2.17. The legislator will closely follow the process of adoption of the EU Directive on resolution and revise the national resolution framework as soon as the Directive enters into force. **[Ongoing]**

Corporate and household debt restructuring framework

2.18. The corporate insolvency law amendments to support better early rescue of viable firms, which were approved by the Council of Ministers in December 2011, are being discussed in Parliament. These amendments will become effective, in principle, by **mid-June 2012**[5].

2.19. Implement an action plan to raise public awareness of the restructuring tools. **[Ongoing]**

Monitoring of corporate and household indebtedness

2.20. Continue to enhance the monitoring of the high indebtedness of the corporate and household sectors. The quarterly monitoring report will be further improved concerning its information content. A report assessing the overall consistency, effectiveness, and the impact of existing support mechanisms to SMEs will be revised by **Q2- 2012.** The report will discuss policy actions aimed at improving and implementing support mechanisms to facilitate access to credit, encourage internationalisation, and improve competitiveness of SMEs in line with EU competition rules. In

[5] Structural benchmark in the Memorandum of Economic and Financial Policies.

addition, finalise the amendments to the conciliation framework mediated by IAPMEI, a public entity, to facilitate extrajudicial corporate debt restructurings for viable SMEs.

3. Fiscal-structural measures

Objectives
Improve the efficiency of the public administration by eliminating redundancies, simplifying procedures and reorganising services; regulate the creation and functioning of all public entities (e.g. enterprises, Public-Private Partnerships, foundations, associations); re-focus their activities to core public policy objectives and enhance their cost efficiency and fiscal sustainability; streamline the budgetary process through the newly approved legal framework, including by adapting accordingly the budgetary and legal frameworks of finance; strengthen risk management, accountability, reporting and monitoring of all parts of the general government. Government action will build on the recommendations provided by the IMF/EU technical assistance missions that took place in July 2011.

Public Financial Management framework

To strengthen the public financial management framework the government is taking the following measures:

Reporting and Monitoring

3.1. Publish quarterly cash balance targets for the general government as defined in national accounts and corrective measures in case of deviation from targets. [Q1-2012]

3.2. Publish a comprehensive report on fiscal risks each year as part of the budget. The report will outline general fiscal risks and specific contingent liabilities to which the general government may be exposed, including those arising from Public-Private Partnerships (PPPs), SOEs and explicit guarantees to the banks. This year the fiscal risks report in the 2012 Budget will be enhanced, in cooperation with the EC and IMF staff and published by **April-2012**.

3.3. Following the inventory on tax expenditures, the authorities are making progress on the annual report on tax expenditures to be completed by **Q1-2012** in cooperation with EC and IMF staff. This tax expenditure report will be published each year as part of the budget, in line with international best practices. The report will cover central, regional and local administrations.

3.4. To further advance the reform of the budgetary monitoring system, a proposal to reduce budgetary fragmentation will be submitted by **[Q2-2012].**

Arrears

3.5. Implement any changes to the budget execution rules and procedures necessary to align them with the new law on commitments control. The law will be implemented across all general government entities including the regional and local administration and the SOE hospitals. The Inspecção Geral de Finanças (IGF) will carry out inspections to verify compliance of the commitment control system through a risk based approach. **[Q2-2012]**

3.6. The stock of domestic arrears will be significantly reduced by the end of the program period. To this effect, a revised strategy document will be approved by the Council of Ministers[6], **before the supplementary budget is submitted to Parliament**. The strategy document will lay out the prioritization criteria for paying creditors, as well as governance arrangements to ensure a fair and transparent settling process across all sectors. IGF will be responsible for validating the claims (valuation, existence, title, age). Payments will only be made in connection to arrears that have been

[6] Prior action in the Memorandum of Economic and Financial Policies.

properly validated and whose originating entity has changed its commitment system in accordance with the new law.

Budgetary framework

3.7. Publish a fiscal strategy document for the general government annually in **April**. The document will be in compliance with the requirements of the Stability and Growth Pact and will specify 4-year medium-term economic and fiscal forecasts and 4-year costs of new policy decisions. Budgets will include a reconciliation of revisions to the 4 year fiscal forecasts attributable to policy decisions and parameter revisions e.g. policy decisions, changes in the macroeconomic environment.

3.8. Ensure full implementation of the Budgetary Framework Law adopting the necessary legal changes to define in detail the proposed characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry-over rules, commitment controls, and appropriate contingency reserves and related access rules. **[Q2-2012]**

3.9. The Fiscal Council has been established and will be operational by **[Q1-2012]**.

Regional and local budgetary frameworks

3.10. The government will ensure that the measures to implement the new budgetary framework at central government level will also be applied at regional and local level. Adequate structures of monitoring, fiscal reporting, and commitment control will be put into place. **[Ongoing]**

3.11. The budgetary frameworks at local and regional levels will be considerably strengthened, in line with recommendations by the IMF/EC technical assistance mission of July 2011 and the new EU fiscal policy framework. A draft proposal to revise the regional finance law[7] and the local finance law will be discussed with EC/IMF/ECB by **[Q2-2012]** and submitted to Parliament by **[Q4-2012]**. They will include the following main elements:

i. fully adapt the local and regional budgetary frameworks to the principles and rules in the revised Budgetary Framework Law, namely in what concerns (i) the inclusion of all relevant public entities in the perimeter of local and regional government; (ii) the multi-annual framework with expenditure, budget balance and indebtedness rules, and programme budgeting; and (iii) the interaction with the function of the Fiscal Council. The revision will also foresee that: (i) the Fiscal Council reviews local and regional governments own revenue projections and multi-annual fiscal plans (ii) a contingency reserve is included under the overall current expenditure envelope as a buffer against negative revenue surprises or erroneous expenditure planning, and (iii) the revised legal and institutional PPP framework is applied (see below).

ii. strengthen fiscal accountability, in particular by: i) tighter financial requirements for regional and local SOEs and other regional and local public bodies; ii) a revision of the regime of transfers between the State and the regions and the local authorities; iii) strengthening the supervisory power from the State on budgetary execution and iv) apply tighter debt ceilings combined with the adoption of a multi-tiered monitoring system as suggested by the July 2011 technical assistance mission. This reform should follow international best practices.

iii. limit the scope for lower tax rates in the Autonomous Regions vis-à-vis the rates applied in the mainland and ensure that the resulting additional revenues from increasing the regional rates are used as a priority for fiscal consolidation.

3.12. The Government's financial arrangement with the Autonomous Region of Madeira (RAM), which is in full compliance with the Memorandum of Understanding, will be implemented. The

[7] Structural benchmark in the Memorandum of Economic and Financial Policies.

Portuguese Government will monitor progress of implementation by RAM and present the results on a quarterly basis in advance of the reviews of the Memorandum of Understanding, with a first report due in **[April-2012].**

Public Private Partnerships

An assessment of 36 PPPs and 24 concessions that are under the responsibility of the central government, projecting future cash flows and risks, showed rapidly increasing spending pressures that is being reduced by increasing revenues and seeking renegotiation of contracts. In addition, the government will:

3.13. Sign a service contract to recruit a top tier international accounting firm to undertake a more detailed study to review PPP contracts of the central administration in consultation with National Statistical Institute (INE) and the Ministry of Finance. **[March-2012].** The review will identify and, where practicable, quantify major contingent liabilities and any related amounts that may be payable by the government. It will assess the probability of any payments by government in relation to the contingent liabilities and quantify such amounts. The study, to be completed three months after the awarding of the contract**,** will assess the costs and benefits of renegotiating any PPP or concession contract to reduce the government financial obligations. The study will be the basis for a strategic plan specifying how to deal with existing PPPs and providing a framework for future engagements in PPPs. Until such a framework is in place the government will not engage in any new PPP.

3.14. In order to ensure a fiscally prudent model, put in place a strengthened legal and institutional framework, within the Ministry of Finance, for assessing fiscal risks *ex-ante* of engaging into PPP, concessions and other public investments, as well as for monitoring their execution. The Court of Auditors must be informed of this ex-ante risk assessment. **[Q1-2012].** It will be ensured that the same commitments apply for regional PPPs, and that local governments do not enter into any PPP contracts.

3.15. Enhance the annual PPP and concessions report prepared by the Ministry of Finance with a comprehensive assessment of the fiscal risks stemming from PPPs and concessions. The report will provide information and analysis at sectoral level. The annual review of PPPs and concessions will be accompanied by an analysis of credit flows channelled to PPPs through banks (loans and securities other than shares) by industry and an impact assessment on credit allocation and crowding out effects. This particular element will be done in liaison with the Bank of Portugal. **[Q3-2012]**

State-owned enterprises[8]

The government aims at implementing a strategy to restructure State-owned enterprise (SOE), to reduce their indebtedness and to ensure improved conditions for market financing. Focus should be on attaining the cost savings of the 2012 budget, notably to reduce operational costs across the sector by 15 per cent with respect to 2009. While respecting EU competition and state aid rules, the government will make further progress in restructuring the SOE sector along the following lines:

3.16. SOEs with commercial activity will reach operational balance by **end of 2012**. This will be achieved by substantially reducing operational costs and raising revenues. To this end the government is implementing the comprehensive SOEs strategy by reviewing the tariff structure and service provision of SOEs, with numerical targets on cost reductions, including measures to realign wages or reduce employment, and additional measures as appropriate. **[Q4-2012].** A progress report will be prepared by **[Q2-2012].**

3.17. The authorities will assess SOEs' financial prospects, potential government exposure, and scope for privatisation. On this basis they will prepare restructuring plans for SOEs with significant

[8] State-owned enterprises comprise those pertaining to central, local and regional administration.

risks of not achieving operational balance. Most subsidiaries and shareholdings in non-core activities will be eliminated by 2014 on the basis of concrete proposals on these divestments. **[Q2-2012]**[9]

3.18. The excessive increase in the overall borrowing requirements of the SOE sector, both inside and outside general government, will be limited. In parallel with progress towards eliminating operational deficits, a strategy for managing the heavy debt load of SOEs will be developed, including the sale of assets in non-core areas of these firms, and in consultation with staff from EC, ECB and IMF. **[Q2-2012]**

3.19. Prepare a model to strengthen governance of SOEs in accordance with international best practices. It will review the existing shareholder approach, giving the Ministry of Finance a decisive role in financial matters of the enterprises, including in regional and local SOEs, while respecting the administrative autonomy as foreseen in the law. This will enhance the monitoring powers of the central administration over all SOEs. In addition, the timing and content of financial and operational reporting will be defined. The decisions adopted at central level to improve the efficiency of the enterprises while reducing their financial burden will be implemented at all SOEs, taking into account their specificities. It will include the prohibition for SOEs within the general government to incur new debt with the private sector. To this end, the government will submit to Parliament a draft law to regulate the creation and the governance of SOEs. **[Q1-2012]** No additional SOEs will be created until this law is adopted.

3.20. Equivalent measures on operational results, debt, restructuring and governance will be taken at the local and regional levels. Progress on these measures will be reported in four annual SOEs reports at central, local and the two regional levels. On the basis of these reports, the government will include a fiscal risk analysis, including all (explicit and implicit) liabilities, in preparation for the annual budget. **[Q2-2012]**

Privatisation

3.21. The government is implementing its privatisation programme under the new framework law for privatisation. The privatisation plan targets front-loaded proceeds of about EUR 5 billion through the end of the program. The sale of the energy company (EDP) and the energy network company (REN) are being concluded. The sale of GALP and the small remaining stake in REN on the free market have been delayed until market conditions improve. The privatisation or concession of the cargo handling subsidiary of CP (CP Carga) will be launched in the **second quarter of 2012**. The privatisation process for the national air carrier (TAP) and the airport operator Aeroportos de Portugal (ANA) will be launched in the **second and early in the third quarters**, with a view to completing these transactions in 2012. The privatisation of Correios de Portugal (CTT) will be launched, once changes underway in regulation of this sector have their full impact, in order to complete the sale in 2013. The partial sale of a public television channel (RTP) and concessions for transport operators in Lisbon and Porto upon completion of restructuring of the public transport firms in these cities are being considered. The direct sale of CGD's insurance arm (Caixa Seguros) to a final buyer is expected to take place in 2012.

3.22. With a view to introducing private capital and management in the water company Águas de Portugal (AdP), a strategy will be prepared. This strategy will include considerations of the competitive and regulatory environment and organisational consequences. **[Q4-2012]**

3.23. A strategy for the government's financial holding company Parpública will be prepared, given that its sources of income will be affected by privatisation. **[April-2012].** The strategy will reconsider the role of Parpública as a public company and the possibility of winding down the company or consolidating it with the general government. In the interim, the government will ensure that Parpública will have sufficient income-generating assets to manage its debt and financing needs. The process of winding down Parpública will begin in **2013**[10]**.**

[9] Structural benchmark in the Memorandum of Economic and Financial Policies.
[10] Structural benchmark in the Memorandum of Economic and Financial Policies.

3.24. In order to identify the scope for further privatisation, the Government will prepare an inventory of assets, including real estate, owned by municipalities and regional governments. **[Q2-2012]**

Revenue administration

3.25. The Government will conclude implementation of the undergone merger of the tax administration, customs administration and the information technology service (DGITA) in a single entity, *Autoridade Tributária e Aduaneira* (AT) by **Q4-2012** and study the costs and benefits of including the revenue collection units of the social security administration in the new entity. **[Q1-2012].** It will proceed with the broader merger if the assessment is favourable. **[Q4-2013]**

3.26. Following the creation of AT, the focus in 2012 will be to merge central and support functions and reduce the number of branches. The reform will be deepened in **2013** by targeting a business function-type structure. In particular, the following elements will be implemented:

i. review the experience with the task force of tax judges for cases with value above EUR 1 million and assess the need to establish special chambers within the tax tribunals to handle such cases **[mid-November 2012];**

ii. reducing the number of municipal offices by at least 20 per cent per year in 2012 and 2013 **[Q4-2012 and Q4-2013];**

iii. increase in the resources devoted to auditing in the tax administration to at least 30 per cent of the total staff, mostly through reallocations of staff within the tax administration and other parts of the public administration. The threshold should be attained by **Q4-2012**;

iv. analyse the impact of VAT issues on backlog enforcement cases and assess possible options to address such cases, taking into account tax fraud and erosion risks. **[end-April 2012];**

v. publish quarterly reports on recovery rates, duration and costs of tax cases starting from **Q2-2012** within four months after the end of the relevant quarter.

3.27. The government will address the bottlenecks in the tax appeal system by progressing with clearing cases worth above EUR 1 million [**Q4-2012]** with the support of the tax court judges.

3.28. The government will draft a proposal by **[Q2-2012]** to strengthen the auditing and enforcement powers of the central tax administration to exercise control over the whole territory of the Republic of Portugal including currently exempt tax regimes and to reserve to the central administration the power to issue interpretative rulings on taxes with national scope in order to ensure its uniform application. Based on this proposal, a draft law will be submitted to Parliament by **[Q4-2012]**.

3.29. The tax administration has concluded the strategic plan to combat fraud and evasion for 2012-2014 and has taken important steps for its implementation. In particular, e-invoicing mechanisms will be adopted in order to facilitate compliance and improve control. The authorities will finalise the assessment of the net financial impact of the proposed incentive scheme that grants up to 5 per cent rebate, subject to a limit per taxpayer, on VAT paid through electronically transmitted invoices in selected sectors **[Q1-2012]** and consult with the EC and IMF before implementing the scheme.

3.30. The tax administration will develop a modern tax compliance management framework as an important tool to curb non-compliance. As part of this effort, the focus on large taxpayers will be enhanced through the implementation, by **[Q4-2012]**, of a full-fledged Large Taxpayer Office (LTO)[11].

[11] Structural benchmark in the Memorandum of Economic and Financial Policies.

Public administration

The government has adopted steps towards the overall goal of rationalising the public administration and its perimeter. At the central level, the measures set out in the July PREMAC plan are being implemented and going significantly beyond initial plans. At the local level, following a "Green Paper for Local Administration Reform" in October draft law was submitted to Parliament with the objective of implementing a reorganisation of local government **by end-June 2012**. The government will take the following measures to increase the efficiency and cost-effectiveness of the public administration:

Central, regional and local administration

3.31. Reduce management positions and administrative units in the central administration according to the PREMAC report of 15 September 2011 by 27 per cent and 40 per cent, respectively. Following the approval and publication of most organic laws of the ministries, the legislation of the remaining entities will be finalised. **[April 2012]**.

3.32. In view of improving the efficiency of the central administration and rationalising the use of resources, implement a second phase of the public administration restructuring programme (PREMAC) that implies the definition of the internal organisation and the roster of each entity. **[Q2-2012]**

3.33. As stipulated in the 2012 State budget, each municipality will have to present its plan to attain the target of reducing their management positions and administrative units by at least 15 per cent by the end of 2012. **[Q2-2012]** In what concerns regions, the government will promote the initiatives needed so that each region will present its plan to attain the same target. **[Q1-2012]**

3.34. Prepare a detailed cost/benefit analysis of all public and quasi-public entities:

i. Based on the analysis on foundations, using the results of the compulsory census **[Q2-2012]** and recommendations, the central, regional or local administration responsible for each foundation or its financial support will decide accordingly whether to maintain, reduce or extinguish them in respect of the applicable law (see below). **[Q3-2012]**

ii. the approach on foundations – the compulsory census and the subsequent analysis, adjusted as needed - will also be applied to associations and extended later to other public and quasi-public entities across all levels of government. **[Q4-2012]**

3.35. Regulate by law the creation and the functioning of foundations, associations, and similar bodies by the central, regional and local administration, facilitating the closure of existing entities when warranted. Such a law will be prepared in coordination with a similar framework to be defined for SOEs and define the monitoring and reporting mechanisms to be put in place to evaluate performance. **[Q2-2012]** Furthermore, the classification as general government revenues, on a case-by-case basis, of all own revenues of these funds that arise directly or indirectly from the use of the sovereign powers of the government (e.g. court fees, fines, fees for licenses or permits, and audit fees charged by the Court of Auditors) will be regulated by law. In addition, the government will promote the initiatives needed so that the same objective is achieved by the regions. **[Q2-2012]**

3.36. Reorganise local government administration. There are currently 308 municipalities and 4,259 parishes. By **July 2012**, the government will develop a consolidation plan to reorganise and significantly reduce the number of such entities. The government will implement these plans based on agreement with EC and IMF staff. These changes, which will come into effect by the beginning of the next local election cycle, will enhance service delivery, improve efficiency, and reduce costs.

3.37. Carry out a study to identify potential duplication of activities and other inefficiencies between the central administration, local administration and locally-based central administration services. **[Q3-2012]** Based on this analysis, reform the existing framework to eliminate the identified inefficiencies. **[Q4-2012]**

Shared services

3.38. Develop the use of shared services in the central administration by fully implementing the ongoing projects and by regularly assessing the scope for further integration:

i. complete the implementation of the strategy of shared services in the area of financial resources (GeRFIP). **[Q4-2012];**

ii. fully implement the strategy of shared services in the area of human resources (GeRHup) in the Ministry of Finance's entities **[Q4-2012]**, with the exception of the Tax Authority for which this is scheduled for **end-January 2013**. Other Ministries will follow in 2013;

iii. rationalise the use of IT resources within the central administration by implementing shared services and reducing the number of IT entities in individual Ministries or other public entities in line with the "Overall Strategic plan to rationalise and reduce costs on ICT in Public Administration". **[Q4-2012]**

3.39. Reduce the number of local branches of line ministries (e.g. tax, social security, justice). The services should be merged in citizens' shops covering a greater geographical area and developing further the e-administration over the duration of the programme. **[Q4-2013]**

Human resources

3.40. The 2012 budget promotes flexibility, adaptability and mobility of human resources across the administration, including by providing training and requalification where appropriate. In addition, the mobility schemes, namely geographic mobility, will be reinforced as an instrument to manage human resources across administrations. **[Q2-2012]**

3.41. Limit staff admissions in public administration to achieve annual decreases in **2012-2014** of 2 per cent per year (in full-time equivalents) in the staff of central administration and 2 per cent in local and regional administrations (in full-time equivalents). The government will ensure the implementation of this measure at local administration level and will promote the initiatives needed so that each region will present its plan to achieve the same target. **[Ongoing]**

3.42. The government will prepare a comprehensive review of wage scales in the public sector, including entities classified outside the general government, to identify unwarranted differences in remuneration between the public and the private sector for similar types of qualifications **[Q4-2012]**.

Health care system

Objectives

Improve efficiency and effectiveness in the health care system, inducing a more rational use of services and control of expenditures; generate additional savings in the area of pharmaceuticals to reduce the overall public spending on pharmaceutical to 1.25 per cent of GDP **by end 2012** and to about 1 per cent of GDP in **2013**; generate additional savings in hospital operating costs and devise a strategy to eliminate arrears.

The government will take the following measures to reform the health system:

Financing

3.43. The revision of NHS moderating fees (*taxas moderadoras*) will result in additional revenues of EUR 150 million in 2012 and an additional 50 million in 2013. **[Q4-2012]**

3.44. In the light of the urgency and size of the savings needed in the health sector to address large arrears and budget limitations, plans to achieve a self-sustainable model for health-benefits schemes for civil servants will be accelerated. The current plan foresees that the overall budgetary cost of existing schemes – ADSE, ADM (Armed Forces) and SAD (Police Services) - will be reduced by 30 per cent in 2012 and by further 20 per cent in 2013 at all levels of general government. The system would become self-financed by 2016. The costs of these schemes for the public budget will be reduced by lowering the employer's contribution rate, and adjusting the scope of health benefits. The adjustment path will be assessed in the **fifth review**.

3.45. Produce a health sector strategic plan, in the context of and consistent with the Medium-Term Fiscal Strategy. **[Q1-2012]**

Pricing and reimbursement of pharmaceuticals

3.46. Enact legislation which automatically reduces the prices of medicines when their patent expires to 50 per cent of their previous price. **[Q1-2012]**

3.47. Complete the transfer of the responsibility of pricing medicines to the Ministry of Health (for example to Infarmed). **[Q1-2012]**

3.48. The government implements an annual revision of prices of medicines and of countries of reference in order to achieve cost savings. First price revision to be published in **[April 2012]**.

3.49. The government will monitor monthly pharmaceutical expenditures and ensure that that the overall public pharmaceutical expenditure does not exceed the target of 1.25 per cent of GDP in 2012 and 1 per cent of GDP in 2013. **[Ongoing]**

Prescription and monitoring of prescription

3.50. Continue to improve the monitoring and assessment system of doctors' prescription behaviour regarding medicines and diagnostic in terms of volume and value and vis-à-vis prescription guidelines and peers. Feedback continues to be provided to each physician on a regular basis (e.g. quarterly), in particular on prescription of costliest and most used medicines. **[Ongoing]**

3.51. Continue to devise and enforce a system of sanctions and penalties, as a complement to the assessment framework. **[Q1-2012]**

3.52. The Parliament approved legislation making it compulsory for physicians at all levels of the system, both public and private, to prescribe by International Nonproprietary Name (INN) to increase the use of generic medicines and the less costly available product. Enactment of legislation is expected by **[Q1-2012].**

3.53. Continue to publish prescription guidelines with reference to medicines and the realisation of complementary diagnostic exams on the basis of international prescription guidelines and integrate them in the electronic prescription system. **[Ongoing]**

3.54. The government will produce a report assessing the effectiveness of the enacted legislation aimed at removing all effective entry barriers for generic medicines, in particular by reducing administrative/legal hurdles in order to speed up the use and reimbursement of generics. **[Q1-2013]**

3.55. The above measures should aim at gradually and substantially increasing the share of generic medicines to at least 30 per cent of all outpatient prescription (in volume) in 2012 and substantial further increases in 2013. **[Ongoing]**

Pharmaceutical retailers and wholesalers

3.56. Effectively implement the new legislation regulating pharmacies. **[Q1-2012]**

3.57. The Government will produce an intermediate assessment of the savings related to the revision of the calculation of profit margins for wholesale companies and pharmacies. **[Q3-2012**]

3.58. If the revision does not produce the expected reduction in the distribution profits of at least EUR 50 million, an additional contribution in the form of an average rebate (pay-back) will be introduced, which will be calculated on the mark-up. The rebate will reduce the new mark-up on producer prices further by at least 2 percentage points on pharmacies and 4 percentage points on wholesalers. The rebate will be collected by the government on a monthly basis through the Centro de

Conferência de Facturas, preserving the profitability of small pharmacies in remote areas with low turnover. **[Q3-2013]**

3.59. Reinforce the centralised acquisition of vehicles, utilities, external services and other cross functional goods and services by all entities included in the NHS, in order to reduce costs through price volume agreements and fighting waste. A detailed action plan will be published by **November 2012.**

Centralised purchasing and procurement

3.60. INFARMED will continue implementing the uniform coding system and a common registry for medical supplies. **[Ongoing]**

3.61. Take further measures to increase competition among private providers and reduce by an additional 10 per cent the overall spending (including fees) of the NHS with private providers delivering diagnostic and therapeutic services per cent. Regularly revise (at least every two years) the fees paid to private providers with the aim of reducing the cost of more mature diagnostic and therapeutic services. **[Q4-2012]**

3.62. Implement the centralised purchasing of medical goods through the recently created Central Purchasing Authority (SPMS), using the uniform coding system for medical supplies and pharmaceuticals. **[Ongoing]**

3.63. Assess compliance with European competition rules of the provision of services in the private healthcare sector and guarantee increasing competition among private providers. **[Q1-2012]**

Primary care services

3.64. As part of the reorganisation of health services provision and notably the concentration and specialisation of hospital services and the further development of a cost-effective primary care service, the Government reinforces measures aimed at further reducing unnecessary visits to specialists and emergencies and improving care coordination **[Ongoing]**. This will be done through:

i. increasing the number of USF (*Unidades de Saúde Familiares*) units contracting with regional authorities (ARSs) using a mix of salary and performance-related payments as currently the case. Extend performance assessment to the other primary care units (UCSPs). Make sure that the new system leads to a reduction in costs and more effective provision;

ii. setting-up a mechanism to guarantee the presence of family doctors in needed areas to induce a more even distribution of family doctors across the country;

iii. moving human resources from hospital settings to primary care settings and reconsidering the role of nurses and other specialties in the provision of services;

iv. increasing by at least 20 per cent the maximum number of patients per primary care/family doctor for health centres and by 10 per cent for the USF.

Hospital services

3.65. A strategy with a binding timetable to clear arrears in the health sector, within the overall strategy for settling and avoiding the re-emergence of arrears, will be implemented. The strategy will include the introduction of standardised and tight control procedures for all health sector entities to prevent the re-emergence of arrears. In addition, a mechanism is put in place to ensure strong coordination between the Ministry of Health and the Ministry of Finance for the application of the same monitoring and control criteria to all types of hospitals. **[Q1-2012]**

3.66. Hospital SOEs will change the existing accounting framework and adopt accounting standards in line with the requirements for private companies and other SOEs. This will help improving the management of the enterprises and the quality of the financial oversight by the general government. **[Q4-2012]**

3.67. Implement measures aimed at achieving a reduction of at least EUR 200 million in the operational costs of hospitals **in 2012**. This is to be achieved through the reduction in the number of management staff, concentration and rationalisation in state hospitals and health centres with a view to reducing capacity. **[Q1-2012]**

3.68. Continue the publication of clinical guidelines and set in place an auditing system of their implementation. **[Ongoing]**

3.69. Improve selection criteria and adopt measures to ensure a more transparent selection of the chairs and members of hospital boards. Members will be required by law to be persons of recognised standing in health, management and health administration. **[Q2-2012]**

3.70. On the basis of the comprehensive set of indicators, produce regular annual reports comparing hospital performance (benchmarking). The first report is to be published **by end 2012** and its results should be used to establish targets for less performing hospitals. **[Q4-2012]**

3.71. Ensure full interoperability of IT systems in hospital, in order for the ACSS to gather real time information on hospital activities and to produce monthly reports to the Ministry of Health and the Ministry of Finance. **[Q1-2012]**

3.72. Continue with the reorganisation and rationalisation of the hospital network through specialisation, concentration and downsizing of hospital services, joint management (building on the Decree-Law 30/2011) and joint operation of hospitals. The aim is to adjust hospital provision within the same health region, notably in the presence of newly established PPP hospitals, adjust the activity of some hospitals from curative care towards areas such as rehabilitation, long-term and palliative care and revise emergency and transplantation structures. These improvements aim at eliminating unnecessary duplication, achieving economies of scale and deliver additional cuts in operating costs by at least 5 per cent in 2013 while improving the quality of care provided. A detailed action plan is published **by 30 November 2012** and its implementation is finalised **by end-2013**. Overall, from **2011 to 2013**, hospital operational costs must be reduced by at least 15 per cent compared to 2010 level. **[Q4-2012]**

3.73. Reinforce the centralised monitoring of PPP contracts by the Treasury in cooperation with the ACSS **[Q2-2012]**

3.74. Annually update the inventory of all health staff and prepare regular annual reports presenting plans for the allocation of human resources in the period up to 2014. The report specifies plans to reallocate qualified and support staff within the NHS. **[Q2-2012]**

3.75. Update the current legal framework applying to the organisation of working time of healthcare staff, including introduction of rules to increase mobility within and across Health Regions, adoption of flexible time arrangements and review of payment mechanisms for emergency work, the prevention regime and per call payments. In this context, overtime compensation should be reduced by 20% in 2012 and another 20% in 2013. **[Q4-2012**]

Regional health authorities

3.76. Improve monitoring, internal control and fiscal risks management systems of the Administrações Regionais de Saúde. **[Q4-2012]**

Cross services

3.77. Finalise the set-up of a system of patient electronic medical records and ensure access to all relevant health care facilities. **[Q2-2012]**

3.78. Reduce costs for patient transportation by one third compared to 2010. **[Q4-2012]**

4. Labour market and education

Labour market

Objectives
Revise the unemployment insurance system to reduce the risk of long-term unemployment while strengthening social safety nets; reform employment protection legislation to tackle labour market segmentation, foster job creation, and ease the transition of workers across occupations, firms, and sectors; ease working time arrangements to contain employment fluctuations over the cycle, better accommodate differences in work patterns across sectors and firms, and enhance firms' competitiveness; promote labour cost developments consistent with job creation and enhanced competitiveness; ensure good practices and appropriate resources to Active Labour Market Policies to improve the employability of the young and disadvantaged categories and ease labour market mismatches.

Address early school leaving and improve the quality of secondary education and vocational education and training, with a view to raising the quality of human capital and facilitate labour market matching.

Reforms in labour and social security legislation will be implemented after consultation with social partners, taking into account possible constitutional implications, and in respect of EU Directives and Core Labour Standards.

Unemployment benefits

4.1. Following the reform of the unemployment benefit system (DL 267/2011 and DL 268/2011 approved by the Council of Ministers of 19-01-2012 and awaiting promulgation and publication in Diário da República) - which introduces a declining profile for unemployment benefits, reduces the maximum monthly amount of benefits, reduces the maximum unemployment benefits duration and increases coverage by reducing the contribution period for eligibility and by extending the system to a clearly-defined category of self-employed - the government will prepare by **Q4-2012** an analysis on benefit dependency and long-term unemployment with a view to assessing whether further measures are needed to address possible deficiencies by **Q1-2013**.

Employment protection legislation

4.2. The government will carry out reforms in the employment protection system aimed at tackling labour market segmentation, fostering job creation, and easing adjustment in the labour market. **[Ongoing]**

4.3. Severance payments **[Ongoing]**. Following the entry into force of law n. 53/2011 concerning the reform in the severance payments for new hires in line with the MoU (which reduces severance payments to 20 days per year of work for both open-ended and fixed-term contracts, while introducing a cap of 12 months of pay and eliminating the 3 months of pay irrespective of tenure for permanent contracts, and makes compulsory the partial financing of severance payments via a compensation fund) and the submission of draft law n. 46/XII to Parliament (which aligns the level of severance payments to current employees), the government will further reduce severance payments and implement the compensation fund to partly finance severance payments. Until the fund is operational, the employers remain responsible for the total of severance payments.

i. by **Q1-2012**, in consultation with the social partners, the government will prepare a proposal aiming at:
   - aligning the level of severance payments to the EU average of 8-12 days;
   - implementing the compensation fund for severance payments allowing the severance pay entitlements financed from the fund to be transferable to different employers by means of the creation of notional individual accounts.

ii. on the basis of this proposal, draft legislation will be submitted to Parliament no later than **Q3-2012**.

4.4. Following the changes to the dismissal rules as stated in draft law n. 46/XII, the government will prepare a report on the effects of these changes on relevant labour market indicators by **Q2-2013**.

Wage setting and competitiveness

4.5. The government will promote wage developments consistent with the objectives of fostering job creation and improving firms' competitiveness with a view to correcting macroeconomic imbalances. To that purpose, the government will:

i. commit that, over the programme period, any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of the programme review **[Ongoing]**;

ii. ensure wage moderation by using the available discretion in the current legislation of not extending collective agreements until clear criteria are defined as foreseen by point 4.5(iii);

iii. define clear criteria to be followed for the extension of collective agreements and commit to them. The representativeness of the negotiating organisations and the implications of the extension for the competitive position of non-affiliated firms will have to be among these criteria. The representativeness of negotiating organisations will be assessed on the basis of quantitative indicators. To that purpose, the government will take the necessary steps to collect data on the representativeness of social partners. Based on this data, a collective agreement subscribed by employers associations representing less than 50 per cent of workers in a sector cannot be extended. When that threshold is reached a decision on extension will have to take into consideration the implications on competitiveness of firms in the sector. Draft legislation defining criteria for extension and modalities for their implementation will be submitted to Parliament by **Q2-2012**, with a view to entering into force by **Q1-2013**.

iv. prepare an independent review by **Q2-2012** on**:**

   - how the tripartite concertation on wages can be reinvigorated with a view to defining norms for overall wage developments that take into account the evolution of the competitive position of the economy and a system for monitoring compliance with such norms;
   - the desirability of shortening the survival (sobrevigência) of contracts that are expired but not renewed (art 501 of the Labour Code).

4.6. The Government will promote wage adjustments in line with productivity at the firm level. Following the implementation of the organised decentralisation (which creates the possibility for collective agreements to define conditions under which works councils can negotiate functional and geographical mobility, working time arrangements and remuneration) and the decrease of the firm size threshold to 150 workers for unions to delegate power to conclude collective agreements to works councils, the government will, by **Q1-2013,** assess in a report the effects of these measures and how they are being applied in collective agreements. If needed, an action plan will be prepared in consultation with the social partners by **Q2-2013** to ensure that works councils are given the possibility to negotiate wages at firm level.

Active labour market policies

4.7. The Government will ensure good practices and an efficient amount of resources to activation policies to strengthen job search effort by the unemployed and to other Active Labour Market Policies (ALMPs) to improve the employability of the young and disadvantaged categories and ease labour market mismatches. Following the progress made until Q4-2011, the Government will present by **Q2-2012**:

i. an assessment of the effectiveness of current activation policies and other ALMPs in tackling long-term unemployment, improving the employability of the young and disadvantaged categories, and easing labour market mismatch;

ii. an action plan for possible improvements and further action on activation policies and other ALMPs, including the role of Public Employment Services.

Education and training

4.8. The government will continue action to tackle low education attainment and early school leaving and to improve the quality of secondary education and vocational education and training, with a view to increase efficiency in the education sector, raise the quality of human capital and facilitate labour market matching. To this purpose, the government will:

i. set up an analysis, monitoring, assessment and reporting system in order to accurately evaluate the results and impacts of education and training policies, notably plans already implemented (notably concerning cost saving measures, vocational education and training and policies to improve school results and contain early school leaving). Following the progress made until Q4-2011, the government will continue to improve the system with a view to having an operational management tool by **Q3-2012;**

ii. present an action plan to improve the quality of secondary education services including via: (i) the generalisation of trust agreements between the government and public schools, establishing wide autonomy, a simple formula-based funding framework comprising performance evolution criteria, and accountability; (ii) a simple result-oriented financing framework for professional and private schools in association agreements based on fixed per-class funding plus incentives linked to performance criteria; (iii) a reinforced supervisory role of the General Inspectorate. **[Q1-2012];**

iii. present an action plan aimed at (i) ensuring the quality, attractiveness and labour market relevance of vocational education and training through partnerships with companies or other stakeholders; (ii) enhancing career guidance mechanisms for prospective students in vocational educational training. **[Q1-2012]**

5. Goods and services markets

Objectives

Reduce entry barriers in network industries and sheltered sectors of the economy such as services and regulated professions so as to increase competition and reduce excessive rents. These measures should help improving the competitiveness of the Portuguese economy by lowering input prices, raising productivity and improving the quality of the products and services provided. This should contribute decisively to the social balance of the programme by reducing unwarranted sector protection and rents so that all segments of the society participate in the burden sharing of the needed adjustment.

Energy markets

Objectives

Complete the liberalisation of the electricity and gas markets; ensure the sustainability of the national electricity system and avoid further unfavourable developments in the tariff debt; ensure that the reduction of the energy dependence and the promotion of renewable energies is made in a way that limits the additional costs associated with the production of electricity under the ordinary and special (co-generation and renewables) regimes; ensure consistency of the overall energy policy, reviewing existing instruments. Continue promoting competition in energy markets and to further integrate the Iberian market for electricity and gas (MIBEL and MIBGAS).

Liberalisation of electricity and gas markets

5.1. Take further steps towards the full transposition of the Third EU Energy Package. In particular, submit to Parliament the law on the penalty system of the regulator and adopt the decree-laws transposing the electricity and gas directives by **Q2-2012.** This will ensure the National Regulator Authority's independence and all powers foreseen in the package.

5.2. Take measures to accelerate the establishment of a functioning Iberian market for natural gas (MIBGAS), through regulatory convergence and the harmonisation of the tariff structures in Portugal and Spain. In particular, in accordance with the roadmap of 30 September 2011 agreed with the Spanish authorities, the regulators of each country will present proposals to harmonise the tariffs for access to the interconnection networks taking into account the outcome of the public consultation conducted in January 2012 **[Q3-2012]**, with a view to the future elimination of pancaking for cross-border flows. Portugal will apply a harmonised allocation and congestion management mechanism to all the interconnection capacity between Portugal and Spain, in line with the EU network codes and guidelines in this respect. **[Q1-2013]**

5.3. Clarify the national legal framework with respect to the scope of competencies of the logistics operator and define based on a cost-benefit analysis a way of convergence of the existing two platforms for electricity and natural gas. **[Q4-2012]**

5.4. Fulfill the obligations under the security of supply Regulation 994/2010 by submitting to the European Commission a Risk Assessment report **[Q1-2012].** Prepare a report addressing the harmonised mechanism for capacity allocation and congestion management of cross-border flows with Spain. **[Q1-2013]**

Ensure sustainability of the national electricity system

5.5. Take measures to reduce excessive rents and eliminate the tariff debt (defice tarifário) by 2020, alleviating the pressure on end-user electricity prices. Efforts, including through multilateral negotiations with the stakeholders, will focus on the following compensation schemes: power guarantee, special regime (renewables - excluding those granted under tender mechanisms – and cogeneration), CAE's (power purchase agreements) and CMECs, which have an important weight in final electricity prices. To achieve these goals the government will appoint an independent negotiator, by **Q1-2012**, and progress in this area will be discussed during the **fourth review**.

Policy costs associated with electricity ordinary regime

5.6. Take measures to limit the policy costs embedded in CMECs. In particular, negotiate the revision of the rate of return to bring it in line with the cost of capital at the moment the compensation was defined plus, if warranted, a risk premium. This premium will be linked to the risk of the assets that the mechanism remunerates. The immediate objective will be to reduce rents and stabilize the tariff debt (défice tarifário). Progress in this area will be discussed during the **fourth review**.

Support schemes for production of energy under the special regime (co-generation and renewables)

5.7. Accelerate convergence to market-based pricing for co-generation operators. The remuneration scheme for co-generation will be revised to improve efficiency of the support system and reduce explicit subsidies through creating a transitional regime during which the tariffs will decline at an increasing rate. Publish the Executive Order defining the new reference tariff and the formula for updating tariffs in the future, by **[April 2012]**[12] . These measures are estimated to reduce policy costs implicit in electricity prices starting at EUR 25 million per year **in 2012**, rising to EUR 80 million **in**

[12] Structural benchmark in the Memorandum of Economic and Financial Policies.

2020. Ensure through audits that plants not fulfilling the requirements for co-generation do not receive the support, and report on the progress. **[Q2-2012, Q2-2013]**

5.8. For new contracts in renewables, revise downward the feed-in tariffs and ensure that the tariffs do not over-compensate producers for their costs and they continue to provide an incentive to reduce costs further, through digressive tariffs. For more mature technologies develop alternative mechanisms (such as feed-in premiums). Reports on action taken will be provided annually in **Q3-2012** and **Q3-2013**.

5.9. Decisions on future investments in renewables, in particular in less mature technologies, will be based on a rigorous analysis in terms of its costs and consequences for energy prices. International benchmarks will be used for the analysis and an independent evaluation will be carried out. Reports on action taken will be provided annually in **Q3-2012** and **Q3-2013**.

Energy policy instruments and taxation

5.10. Modify tax and energy policy instruments to ensure that they provide incentives for rational use, energy savings and emission reductions. In particular:

i. subject to a cost-benefit analysis, eliminate the exemption from the tax on oil and energy products (ISP) applicable to certain industrial fuels used in cogeneration, which overlaps with the feed-in-tariff, as well as other energy and tax policy instruments, i.e. accelerated depreciation rate under the corporate income tax **[Q2-2012];**

ii. conduct a cost-benefit analysis to evaluate the effectiveness of the System for the Management of Energy-Intensive Consumption and the associated exemption from the tax on oil and energy products (ISP) for industrial fuels **[Q2-2012];**

iii. review, based on a cost-benefit analysis, the effectiveness of the other exemptions and reduced rates of the tax on oil and energy products (ISP) under the Excise Tax Code **[Q2-2012];**

iv. take measures to eliminate possible overlaps, and foster synergies, between the Plan for Promoting Efficient Consumption (PPEC) and the Energy Efficiency Fund (EEF). **[Q2-2012]**

Power Guarantee "Garantia de potencia"

5.11. Eliminate, by **April 2012**, the incentive to invest in cases where investment decisions had already been taken without the expectation of an additional incentive, i.e. for the set of power plants existing or already licensed prior to the 2007 Decree Law governing this incentive[13]. Redesign the Power Guarantee mechanism, establishing a new rationale that provides incentive to build additional generating capacity in the future which takes into account adequate security of supply levels and the existence of other mechanisms, such as interruptibility services. These measures are estimated to reduce policy costs by about EUR 60 million per year.

Telecommunications and postal services

Objectives

Increase competition in the market by lowering entry barriers; guarantee access to network/infrastructure; strengthen power of the National Regulator Authority.

Telecommunications

5.12. Ensure an efficient, objective, transparent and non-discriminatory mechanism for the designation of the universal service provider(s), in compliance with the Court of Justice ruling of 7 October 2010. Re-negotiate the concession contract with the undertaking currently providing the

[13] Structural benchmark in the Memorandum of Economic and Financial Policies.

universal service, by reducing the scope of the services covered, so as to exclude the universal service and launch a new tender process for designation of universal service provider(s). **[Q1-2012]**

5.13. Adopt measures to increase competition in the fixed communications market by reviewing barriers on entry and adopting measures to reduce them. **[Q1-2012]**

Postal services

5.14. Further liberalise the postal sector by i) concluding the adoption of the transposing law on the Third Postal Directive, recently submitted to Parliament, ensuring that powers and independence of the National Regulator Authority are appropriate in view of its increased role in monitoring prices and costs **[**expected by **Q1-2012]**; ii) subsequently amending the decree-law laying down the framework of the concession contract and renegotiating the amendment of said contract with CTT, in order to reflect the new law transposing the postal directive; ensuring in particular that the current designation period for the universal service provision is shortened to 2020 and that investment needs and return on investment are taken into account when setting new designation periods. **[Q2-2012]**

Transport

Objectives

Adopt a strategic plan to: rationalise networks and improve mobility and logistic conditions in Portugal; improve energy efficiency and reduce environmental impact; reduce transport costs and ensure financial sustainability of the companies; strengthen competition in the railways sector and attract more traffic; integrate ports into the overall logistic and transport system, and make them more competitive.

The government will take the following measures in the transport sector:

Strategic Plan for Transport

5.15. Implement the Strategic Plan for Transport for 2011-2015 **[Q4-2012]**, namely:

i. introduce reforms in the transport SOEs to achieve their EBITDA balance, by focusing efforts on the reduction of operational costs;

ii. reduce the forecast debt burden of Estradas de Portugal through the reduction of PPP contracts' scope still in the construction phase, revision of shadow-toll schemes and the adjustment of the CSR (Road Service Contribution) to the inflation level. Analyse additional measures to further reduce the forecast debt burden of Estradas de Portugal;

iii. attract new low-cost airline companies and/or routes, making use of the existing infrastructures;

iv. focus the investment priorities in projects that present a positive cost-benefit ratio and contribute to the competitiveness of Portuguese exports, namely in the port and freight rail sectors;

v. reform the transport and infrastructures' regulatory framework in order to improve the effectiveness, efficiency and independence of the entities regulating the transport sector. **[Q1-2013]**

5.16. Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability **[Q3-2012]**. It will specifically include:

i. an in-depth analysis of the transport system including an assessment of existing capacity, forecast demand, and projected traffic flows;

ii. an in-depth analysis of the competitive position of the different transport modes vis-à-vis each other with the objective to reduce dependence on road transport;

iii. measures to integrate rail, port and air transport services into the overall logistic and transport system, notably by improving competition in these transport modes;

iv. a set of priorities for investment on the basis of points i., ii and iii. taking also into account TEN-T networks, with an estimate of the financial needs and the foreseen sources of financing;

v. an assessment of energy savings and greenhouse gas emission reductions from the transport sector.

Measures will be concrete, including the exact instruments used to achieve them. Measures will be chosen based on criteria of cost-effectiveness (comparing savings/costs).

Railways sector

5.17. Continue with the transposition of the EU Railway Packages and in particular:

i. ensure that the rail regulator enjoys the independence required under the EU rail Directives, in particular regarding the rules of appointment and dismissal of the director of the rail regulator. Strengthen the capacities of the railway regulator to fulfil its regulatory mandate effectively, including by exploring synergies with other transport regulators in the context of the revision of national regulatory agencies. **[Q4-2012]**;

ii. implement the ongoing plans to bring the infrastructure manager to operational balance by **[Q4-2013]**, by focusing efforts on the reduction of operational costs. In particular, reduce operational costs by at least 23 per cent in 2012 compared to 2010 **[Q4-2012].** On the revenue side, track access charges for freight services should not be increased in order to prevent a deterioration of the competitiveness of rail freight services. Provide annual progress reports on the implementation of balancing revenues and expenditures **[Q2-2012, Q2-2013]**;

iii. implement the plans of network and service rationalisation presented in the Strategic Plan for Transport **[Q1-2012].** Analyse the potential for further rationalisation in loss-making and low-demand lines and services **[Q3-2012]**;

iv. ensure that the new Public Service Obligation (PSO) contracts concluded on rail passenger transport respect EU legislation including Regulation (EC) No 1370/2007, and in particular provide a detailed breakdown of state contributions for each line under PSO **[Q2-2012].** Develop administrative capacity for a stepwise introduction of competitive tendering of PSOs starting with some suburban services. Ensure that the awarding authority has the required level of independence and competence and guarantees fair conditions of tendering **[Q4-2012]**;

v. make the performance scheme on infrastructure charges fully operational, in particular by effectively collecting payments from operators **[Q2-2012]**;

vi. apply yield management on long-distance passenger ticket prices. **[Q1-2012]**;

vii. privatise the freight branch of the state-owned rail operator. Ensure that the rail terminals currently owned by CP Carga are transferred to another entity that will guarantee non-discriminatory access to all rail freight operators. **[Q2-2012].**

Ports

5.18. Submit to Parliament a revised legal framework governing port work to make it more flexible, including narrowing the definition of what constitutes port work, bringing the legal framework closer to the provisions of the Labour Code. **[Q2-2012]**

5.19. Take further steps to improve the governance model of the ports system with the objective to enhance the competitiveness and the efficiency of ports in line with the strategy to be adopted. **[Q2-2012]**

Road pricing

5.20. Adopt the necessary legislative amendments in order to achieve full compliance with Directive 1999/62/EC (Eurovignette Directive) and the EU Treaty and, in particular, to guarantee non-discriminatory application of tolling schemes to non-resident road users **[Q4-2012]**. After the deadline of this measure, rebates in tolling schemes that pursue compelling reasons of territorial and social cohesion may only be applied if their compliance with the EU law is demonstrated.

Other services sector

Objectives
Eliminate entry barriers in order to increase competition in the services sector; soften existing authorisation requirements that hinder adjustment capacity and labour mobility; reduce administrative burden that imposes unnecessary costs on firms and hamper their ability to react to market conditions.

Sector-specific legislation of Services

5.21. Adopt the remaining necessary amendments to the sector specific legislation to fully implement the Services Directive, easing the requirements related to establishment and reducing the number of requirements to which cross-border providers are subject. Adopt the remaining required amendments and submit them to Parliament by **[Q2-2012]** in view of approval by **[Q3-2012]**.

5.22. Adopt the necessary sector-specific amendments in the areas of construction and real estate to make both regimes fully compatible with the Services Directive and with the Treaty on the Functioning of the European Union. This includes making less burdensome the requirements applying to cross-border providers, both for construction and real estate activities, and reviewing obstacles to the establishment of service providers such as restrictions on subcontracting (for construction) and on excessive liquidity obligations and physical establishment (for real estate). Submit to Parliament by **[Q1-2012]** in view of approval by **[Q2-2012].**

Professional qualifications

5.23. Improve the recognition framework on professional qualifications by submitting to the Parliament an amendment proposal to Law 9/2009 on the recognition of professional qualifications and adopting the remaining executive orders (portarias) complementing the Law in compliance with the Professional Qualifications Directive by **[Q1 2012]**. Following the amendment of Law 9/2009, adopt the executive order (portaria) on the services provider prior declaration **[Q2-2012]**.

Regulated professions

5.24. Review and reduce the number of regulated professions and in particular eliminate reserves of activities on regulated professions that are no longer justified. Submit to Parliament the law for professions where regulation does not involve a professional body (*Ordens or Câmaras*) in **[April-2012]** in view of approval by **[July-2012]**.

5.25. Further improve the functioning of the regulated professions (such as accountants, lawyers, notaries) for which regulation involves a professional body (*Ordens or Câmaras*) by carrying out a comprehensive review of requirements affecting the exercise of activity and eliminate those not justified or proportional, including: i) adopting the measures included in 5.23, and 5.24; ii) eliminating restrictions to the use of commercial communication (advertising), as required by the Services Directive. To achieve the two conditions above the government will, after public consultation, submit a draft horizontal legal framework to Parliament by **[Q2-2012]**, in view of approval by **[Q3-2012]**. Upon enactment, the professional bodies will make the necessary changes in their statutes by **[Q4-2012]**.

Administrative burden

5.26. Continue the simplification reform effort by:

i. improving the quality of the translations (in two languages at least) of the information currently available on requirements applicable to established providers and to cross-border ones in the Point of Single Contact (PSC) which will ease the access for EU/EEA service providers by **[Q1-2012]**. Make available in the PSC single electronic forms, seamless of the municipality, for at least two procedures covered by the Services Directive of the responsibility of municipalities **[Q1-2012];**

ii. adapting the content and responsive to the new legislation to be adopted to ensure conformity with the Services Directive (see 5.21 and 5.22 above) at the latest 1 month after the adoption of each sector-specific regime, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by making available online forms and extend on-line procedures for all sectors covered by the Services Directive no later than 2 months after adoption of the sector-specific regime;

iii. adapting the content and information available at the PSC to the new legislation to be adopted to ensure conformity with the Professional Qualifications Directive at the latest 1 month after the adoption of amendments mentioned in 5.23, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by extending on-line forms and procedures for each profession no later than 2 months after adoption of amendments;

iv. making available in PSC on-line procedures for the registration of establishments covered by "Zero authorization" (DL 48/2011) by **[April 2012]**. Make fully operational the “Zero Authorisation” project that abolishes authorisations/licensing and substitute them with a declaration to the PSC for the wholesale and retail sector and restaurants and bars **[Q3-2012]**. The platform will be available to all levels of administration, including all municipalities **[Q4-2012]**;

v. extending PSC to services not covered by the Services Directive **[Q2-2013]**;

vi. extending the Zero Authorisation project to other sectors of the economy **[Q3-2013]**.

6. Housing market

Objectives

Improve access to housing; foster labour mobility; improve the quality of housing and make better use of the housing stock; reduce the incentives for households to build up debt.

Rental market and administrative procedures for renovation

6.1. The Government submitted to the Parliament the Decree Law which amends the New Urban Lease Act Law 6/2006 and the Decree Law which simplifies the administrative procedures for renovation in view of their adoption by **May 2012**. Both Acts are a significant step forward to ensure balanced rights and obligations of landlords and tenants and reduce the perpetuity of lease agreements. The final adopted legislation will include all the objectives set out in the Memorandum. In particular, the rental market legislation will: i) broaden the conditions under which renegotiation of open-ended residential leases can take place, including to limit the possibility of transmitting the contract to first degree relatives; ii) introduce a framework to improve households' access to housing by phasing out rent control mechanisms, considering the socially vulnerable; iii) reduce the prior notice for termination of leases for landlords; iv) grant landlords the possibility to ask for termination of the lease contract for major renovation works (affecting the structure and stability of the building) with a maximum 6 months of prior notice; v) simplify rules for the temporary relocation of tenants of building subject to rehabilitation works with due regard of tenants needs and respect of their living conditions; vi) provide for an extrajudicial eviction procedure for breach of contract, aiming at shortening the eviction time to three months; and vii) strengthen the use of the existing extrajudicial procedures for cases of division of inherited property. The renovation works legislation will: i) simplify administrative procedures for renovation works, safety requirements, authorisation to use and formalities for innovations that benefit and enhance the building's quality and value (such as energy savings measures) The majority of apartment owners will be defined as representing the majority of the total value of the building; and ii) standardise the rules determining the level of conservation status of property and the conditions for the demolition of buildings in ruin.

Property taxation

6.2. The government will continue to step up the appraisal of the taxable value of the housing stock. In particular, the measures will: (i) ensure that **by end 2012** the taxable value of all property is close to the market value and (ii) property valuation is updated regularly (every year for commercial real estate and once every three years for residential real estate as foreseen in the law). **[Q4-2012]**

6.3. The government will gradually rebalance property taxation towards the recurrent real estate tax (IMI) and away from the transfer tax (IMT), while considering the socially vulnerable. **[Q3-2012]** Temporary exemptions of IMI for owner-occupied dwellings were considerably reduced with the 2012 budget. This measure will be assessed with the annual tax expenditure report.

Comprehensive Review

6.4. The government will undertake a comprehensive review of the functioning of the housing market with the support of internationally-reputed experts. **[Q2-2013]**

7. Framework conditions

Judicial system

Objectives

Improve the functioning of the judicial system, which is essential for the proper and fair functioning of the economy, through: (i) ensuring effective and timely enforcement of contracts and competition rules; (ii) increasing efficiency by restructuring the court system, and adopting new court management models; (iii) reducing slowness of the system by eliminating backlog of courts cases and by facilitating out-of-court settlement mechanisms.

Court backlog

Recognising the urgency of the judicial reform to make the judicial system more efficient and more effective, the government will:

7.1. Eliminate court backlogs by **Q2-2013.**

7.2. Implement targeted measures to achieve steady reduction of the backlogged enforcement cases. In particular, set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, by an inter-agency task force, with the second report to be completed by **15 May 2012**. In addition, provide data on small claim cases pending as of 31 December 2011 and a concept note on measures to resolve such cases by **end-March 2012**. Finalise an action plan on resolving the above cases with concrete measures and specific deadlines by **end-May 2012**.

7.3. Strengthen the legal and institutional framework for enforcement agents in line with international practice with a particular focus on the financing structure and authority of the oversight body. To improve the legal and institutional framework for the enforcement agents, prepare an action plan by **end-February 2012** to (i) identify measures over the next twelve months to achieve the objectives of strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, and (ii) include an analysis of the feasibility of a fee structure that incentivises speedy enforcement. In addition, make the oversight body's full access to the enforcement case files including financial data operational by **30 June 2012**. Finalise the above-mentioned Action Plan with concrete measures based on extensive stakeholder consultation and cross-country experience by **mid-May 2012**.

Management of courts

Advance with reforms aimed at improving management efficiency of the court system:

7.4. Building on the end-January 2012 proposal on judicial reform and taking into account stakeholder consultations and cross country experience, prepare a revised roadmap identifying, inter alia, key quarterly milestones to reduce the number of court districts and close down underutilised courts by **June 2012**. Submit a Bill to implement the judicial reform roadmap to Parliament by **end-September 2012**[14].

Alternative dispute resolution for out-of-court settlement

Continue strengthening alternative dispute resolution (ADR) to facilitate out-of-court settlement:

7.5. Submit the Bill to improve the Justices for Peace regime to Parliament by **September 2012**.

Civil law cases in the courts

Further streamline and speed up civil case processing in the courts:

7.6. Make the new courts on Competition and on Intellectual Property Rights fully operational. **[Q1-2012]**

7.7. Prepare by **June 2012** draft amendments to the Code of Civil Procedure, based on the end-2011 proposal which identified the key areas for improvement, including (i) to consolidate legislation for all aspects of enforcement cases before the court, (ii) to give the judge the power to expedite cases, (iii) to restrict the administrative burdens for judges, (iv) to enforce statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases and (v) to establish a single judge procedure for small claims, and taking into account stakeholder consultation and comparative law analysis. Submit the above amendments to the Parliament by **September 2012.** [15]

Budget and allocation of resources

Remain committed to putting in place a more sustainable and transparent budget for the judiciary:

7.8. Publish quarterly reports on recovery rates, duration and costs of corporate insolvency cases starting from **[Q3-2011]**, within four months after the end of the relevant quarter.

Competition, public procurement and business environment

Objectives

Ensure a level playing field and minimise rent-seeking behaviour by strengthening competition and sectoral regulators; eliminate special rights of the state in private companies (golden shares); reduce administrative burdens on companies; ensure fair public procurement processes; improve effectiveness

[14] Structural benchmark in the Memorandum of Economic and Financial Policies.
[15] Structural benchmark in the Memorandum of Economic and Financial Policies.

of existing instruments dealing with export promotion and access to finance and support the reallocation of resources towards the tradable sector.

Competition and sectoral regulators

7.9. The Government shall take the necessary measures to ensure that the Portuguese State or any public bodies do not conclude, in a shareholder capacity, shareholder agreements the intention or effect of which hinder the free movement of capital or which influence the management or control of companies. Concerning the existing shareholder agreement of CGD in Galp, the Portuguese State will ensure that CGD alienates its participation in Galp. **[Q1-2012]**

7.10. Going beyond elimination of special rights of the State, the authorities also commit to ensure that obstacles to free movement of capital will not be created by their action. The authorities acknowledge that the discretion granted under the amended article 13(2) of the Framework Law of Privatisations (Law 11/90 amended by Decree 3/XII of the Parliament of 5 August 2011), if used, shall be restricted solely to the concrete privatisation operation and thus used in such a proportionate manner that privatisation's implementing laws will not set or allow holding or acquisition caps beyond the privatisation transaction**. [Ongoing].**

7.11. Take measures to improve the speed and effectiveness of competition rules' enforcement. In particular, following the already adopted legislation establishing specialised court for Competition, Regulation and Supervision, make it operational in the context of the reforms of the judicial system (see measure 7.6) **[Q1-2012].**

7.12. Following up on the adoption of the executive order (*portaria*) concerning the transfers of payments from regulators to the Competition Authority and the report prepared under measure 7.13 (i), the financial model of the latter will be re-examined. **[Q3-2012]**

7.13. Ensure that the national regulator authorities (NRA) have the necessary independence and resources to exercise their responsibilities by **Q4-2012** for the main NRAs and by **Q1-2013** for the others. In order to achieve this:

i. provide an independent report (by internationally recognised specialists) on the responsibilities, resources and characteristics determining the level of independence of the main NRAs. The report will benchmark nomination practices, responsibilities, independence and resources of each NRA with respect to best international practice. It will also cover scope of operation of sectoral regulators, their powers of intervention, as well as the mechanisms of coordination with the Competition Authority. The report will be completed by **[Q2-2012]**;

ii. based on the report, present a proposal to implement the best international practices identified to reinforce the independence of regulators where necessary, and in full compliance with EU law by **mid-August 2012**[16].

Public procurement

The government will modify the national public procurement legal framework and improve public contracts award practices to ensure a more transparent and competitive business environment and improve efficiency of public spending. In particular, it will:

7.14. Adopt a law revising the Public procurement code by **Q1-2012** in line with the Public Procurement Directives. This revision will amend the provisions on errors and omissions, the award of contracts for additional works/services, eliminate the exemptions regarding public foundations as set out in Law n.º 62/2007 and all other exemptions permitting the direct award of public contracts, and repeal Art. 42 (7) (8) (9).

7.15. Submit a report analysing the effectiveness and impact of the above measures in [7.14] as well as of the enhanced role of the Court of Auditors in ensuring compliance with public procurement rules by **[Q1-2013].**

[16] Structural benchmark in the Memorandum of Economic and Financial Policies.

Business environment

7.16. Make operational the procedures for requesting VAT exemptions for exporting firms and to simplify procedures associated with indirect exports by **Q3-2012** as part of the "Simplex Exports" programme.

7.17. As a follow up to the report delivered in January, draft a report furthering the assessment of the overall consistency, the effectiveness, and the impact of existing financing and non-financing support measures designed to provide access to finance and encourage internationalization of companies, in particular for SMEs (therefore partially responding also to measure 2.20) by **Q2-2012**. Following results of the report, modify or adopt, where necessary, measures to facilitate access to finance and export markets for companies, in particular for SMEs. **[Ongoing]**

7.18. Promote liquidity conditions for business by timely implementing the New Late Payments Directive. **[Q1-2013]**

7.19. Continue reducing administrative burdens by including municipalities and all levels of public administration within the scope of the Simplex Programme. **[Q1-2013]**

ANNEX 6. INDICATIVE TIMELINE

Indicative timeline of financial sector and structural measures in the Memorandum of Understanding on specific economic conditionality[1]

	Actions for the fourth review (to be completed by end Q1-2012)
Fiscal-structural	**[1.2]** Adopt a Supplementary Budget. **[1.4]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[1.15]** Present detailed plans on improving the working of central administration, increasing efficiency, reducing and eliminating services that do not represent a good use of public money. **[1.7]** Define numeric targets for staff reductions per main area of administration. **[3.1]** Publish quarterly cash balance targets for the general government. **[3.2]** Publish the fiscal risks report (April 2012). **[3.3]** Complete the annual report on tax expenditure. **[3.6]** Strategy document for reduction of the arrears to be approved by the Council of Ministers. **[3.9]** Make operational the Fiscal Council. **[3.13]** Sign the service contract by end-March with a top tier international accounting firm. **[3.14]** New legal and institutional framework for analysing PPPs. **[3.25]** Study the costs and benefits of including the revenue collection units of the social security administration in AT. **[3.19]** Draft law to regulate the creation and functioning of SOEs. **[3.25]** Study the costs and benefits of including the revenue collection units of the social security administration in the merge. **[3.29]** Finalise the assessment of the net financial impact on the incentive scheme (5% rebate on VAT paid through electronically transmitted invoices. **[3.33]** Present initiatives needed for each region for the presentation of a plan aiming at reducing the management positions and administrative units by 15%.
Financial sector	**[2.6]** Provide plans on how to meet the capital needs (end-February 2012).
Health care system	**[3.46]** Enact legislation which reduces the prices of medicines **[3.47]** Complete the transfer of the responsibility of pricing medicines to the Ministry of Health. **[3.51]** Devise and enforce a system of sanctions and penalties. **[3.52]** Enact of legislation making compulsory to prescribe by International Nonproprietary Name (INN) to increase the use of generic medicines. **[3.56]** Implement the legislation regulating pharmacies. **[3.63]** Comply with European competition rules of the provision of services in the private healthcare sector. **[3.65]** Put in place a mechanism to ensure strong coordination between Minsitry of Health and Ministry of Finance. **[3.67]** Implement measures aimed at achieving reductions in operational costs of hospitals. **[3.71]** Achieve full interoperability of IT systems in hospital. **[3.74]** Update the inventory of all health staff to identify staff and current/future

[1] Square brackets identify paragraph numbers in the MoU as signed on 15 April 2012. Items that are Structural Benchmarks under the program are flagged with SB, and also identified by the MEFP paragraph number. Items that are Prior Actions under the program are flagged with PA, and also identified by the MEFP paragraph number.

Actions for the fourth review (to be completed by end Q1-2012)	
	needs.
Labour market and education	**[4.4]** Draft legislation on severance payment entitlements for current employees to be submitted to Parliament. **[4.3]** Prepare legislative proposal to: i) align the level of severance payments to the EU average; and ii) allow the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers. **[4.8 ii]** Present an action plan to improve the quality of secondary education services. **[4.8 iii]** Present an action plan on attractiveness and labour market relevance of vocational education and training and enhancing career guidance mechanisms.
Goods and services markets	**[5.2]** Present proposals to harmonise the tariffs for access to the interconnection networks. **[5.4]** Submit to the EC a Risk Assessment report on energy security. **[5.5]** Appoint an independent negotiator in order to help the government achieve its goals (e.g. reduce rents and stabilise the tariff debt). **[5.7]** Report on the efficiency of support schemes for renewable. **(SB, MEFP ¶41)** **[5.12]** Launch a new tender process for designation of universal service provider(s). **[5.13]** Present market analysis in fixed communications and adopt measures to reduce entry barriers. **[5.17 iii]** Implement plans presented in the Strategic Plan for Transport. **[5.17 vi]** Apply yield management on long-distance passenger ticket prices. **[5.22]** Submit to Parliament the amendments in the areas of construction and real estate. **[5.23]** Submit to Parliament an amendment proposal to Law 9/2009 to improve recognition of professional qualifications. **[5.26 i]** Extend on-line procedures in Point of Single Contact (PSC) to all sectors under the Services Directive. Adapt PSC to incorporate new legislation in order to reduce administrative burdens for firms.
Judicial system	**[7.6]** Make the specialised courts on Competition and IPR fully operational.
Competition, public procurement, and business environment	**[7.9]** Ensure that CGD alienates its participation in Galp. **[7.11]** Make operational the adopted legislation establishing specialised court for Competition, Regulation and Supervision. **[7.14]** Adopt a law revising the Public procurement code.

Actions for the fifth review (to be completed by end Q2-2012)	
Fiscal-structural	**[1.6]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[3.4]** Submit a proposal to reduce budgetary fragmentation. **[3.5]** Carry out inspections to verify compliance of the commitment control system. **[3.8]** Define the characteristics of the medium-term budgetary framework. **[3.11]** Submit a proposal to revise the local finance law. **[3.12]** Provide report on the progress of financial arrangement's implementation by RAM. **[3.15]** Enhance annual PPP and concessions report. **[3.16]** Prepare a progress report concerning the implementation of SOEs strategy. **[3.17]** Prepare restructuring plans for SOEs with significant risks of not achieving operational balance. **[3.18]** Develop a strategy for managing the heavy debt load of SOEs. **[3.20]** Prepare a fiscal risk analysis, including all liabilities in preparation for the annual budget. **[3.23]** Prepare a strategy for Parpublica.

Actions for the fifth review (to be completed by end Q2-2012)	
	[3.24] Prepare an asset inventory, including real estate, owned by municipalities and regional government, examining scope for privatisation. **[3.28]** Draft a proposal to strengthen the powers of central tax administration. **[3.32]** Implement a second phase of the administration reform programme (PREMAC). **[3.33]** Municipalities to present plans to reduce management positions and administrative units by at least 15% by the end of 2012. **[3.35]** Define the monitoring and reporting mechanism to be put in place to evaluate performance. **[3.37]** Eliminate inefficiencies and duplicities in the central, local and locally-based central administration. **[3.40]** Reinforce the mobility schemes.
Financial sector	**[2.6]** Provide the capital for the pension plan transfers and the SIP. **[2.7]** Finalise the framework for access to public capital. **[2.18]** Make effective the corporate insolvency law amendments. **[2.20]** Revise the report assessing the impact of existing support mechanism to SMEs.
Health care system	**[3.48]** Publish first price revision for medicines (April 2012). **[3.69]** Improve selection criteria of the members of hospital boards. **[3.73]** Reinforce the centralised monitoring of PPP contracts. **[3.74]** Update the inventory of all health staff and prepare annual reports on HR allocation. **[3.77]** Finalise the system of patient electronic medical records and ensure access to all relevant health care facilities.
Labour market and education	**[4.5 iii]** Submit draft legislative proposal containing criteria and modalities for the extension of collective agreements. **[4.5 iv]** Prepare an independent review on how the tripartite concertation on wages can be reinvigorated and on the desirability of shortening the survival of contracts that are expired but not renewed. **[4.7]** Present an assessment of the activation policies in tacking unemployment, and an action plan for improvements. **[4.8]** Management tool operational by Q3-2012.
Goods and services markets	**[5.1]** Take further steps towards the full transposition of the Third EU Energy. **[5.7]** Publish the Executive Order defining the new reference tariff and the formula of updating tariffs in the future. **[5.10 i]** Eliminate the exemption from the tax on ISP. **[5.10 ii]** Conduct a cost-benefit analysis on the effectiveness of the System for the Management of Energy-Intensive Consumption. **[5.10 iii]** Review the effectiveness of the other exemptions and reduced rates of the tax on ISP. **[5.10 iv]** Take measures to eliminate possible overlaps between PPEC and EEF. **[5.11]** Eliminate the Power Guarantee investment incentive for the set of power plants existing or already licensed at the time of the approval of the 2007 Decree Law 264/2007. **[5.14]** Liberalise the postal sector by amending the law laying down the framework of the concession contracts. **[5.17 ii]** Provide annual progress reports on the implementation of balancing revenues and expenditures. **[5.17 iii]** Provide a detailed breakdown of state contributions for each line under PSO. **[5.17 v]** Make the performance scheme on infrastructure charges fully operational. **[5.17 vi]** Privatise the freight branch of the state-owned rail operator.

Actions for the fifth review (to be completed by end Q2-2012)	
	[5.18] Submit to Parliament a revised legal framework governing port work. **[5.19]** Improve the governance model of the ports system. **[5.21]** Adopt the remaining necessary amendment to the sector specific legislation to fully implement the Services Directive. **[5.22]** Approval by the Parliament of the amendments in the areas of construction and real estate. **[5.23]** Adopt the executive order (*portaria*) on the services provider. **[5.24]** Submit to Parliament the law for professions where regulation does not involve a professional body. **[5.25]** Submit to Parliament the legal framework concerning the remaining requirements in regulated professions and elimination of unjustified ones. **[5.26]** Make available PSC on-line procedures for the registration of establishments covered by "Zero authorisation". **[5.30]** Submit to Parliament the law for professions where regulation does not involve a professional body.
Housing	**[6.1]** Submit to the Parliament the Decree Law which amends the New Urban Lease Act Law 6/2006.
Competition, public procurement, and business environment	**[7.13]** Complete an independent report on the responsibilities, resources and characteristics determining the level of independence of the main NRAs. **[7.17]** Draft a report assessing the impact of financing and non-financing support measures aimed to provide access to finance for companies. **[7.20]** Present an independent report on the independence and resources of the national regulator authorities.
Judicial system	**[7.2]** Prepare reports on implementation status of measures (second report 15 May 2012). **[7.3]** Finalise the Action Plan by mid-May2012. **[7.4]** Prepare a revised roadmap. **[7.7]** Prepare by June 2012 draft amendments to the Code of Civil Procedure. **[7.17]** Draft a report on the assessment of the existing financing and non-financing support measures for companies.

Actions for the sixth review (to be completed by end Q3-2012)	
Fiscal-structural	**[1.4]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[3.15]** Impact assessment on credit allocation and effects to be done in liaison with Banco de Portugal. **[3.20]** Include all SOEs in the MoF report as well as a comprehensive fiscal risk analysis (by July 2012). **[3.34]** Apply the approach on foundation, the compulsory census and subsequent analysis to central, regional and local administration. **[3.36]** Develop by July 2012 a consolidation plan to reduce significantly the number of local authorities, to come into effect by the beginning of the next local election cycle. **[3.37]** Carry out a study to identify inefficiencies between central, local and locally-based central administration services.
Financial sector	**[2.16]** Make fully operational the Resolution Fund. **[2.16]** Adopt the rules applicable to setting-up and operation to bridge banks.
Health sector	**[3.57]** Produce assessment of the savings for wholesale companies and pharmacies.

Labour market	**[4.3]** Draft legislation submitted to Parliament to: i) align the level of severance payments to the EU average; and ii) allow the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers. **[4.8]** Improve the system by having an operational management tool.
Goods and services markets	**[5.2]** Take measures to accelerate the establishment of a functioning Iberian market for natural gas (MIBGAS). **[5.8]** Annual report on new contracts in renewables. **[5.9]** Annual report on new investments in renewables. **[5.16]** Present a list of actions to improve the efficiency of the transport sector. **[5.17]** Analyse the potential for further rationalisation in loss-making and low-demand lines and services. **[5.25]** Approval of the draft horizontal legal framework by the Parliament. **[5.24]** Approve the law for professions where regulation does not involve a professional body. **[5.26 iv]** Make fully operational the "Zero authorisation project" that abolishes licenses on wholesale and retail and restaurants and bars.
Housing	**[6.3]** Rebalance property taxation towards the recurrent real estate tax (IMT), while considering the socially vulnerable.
Competition, public procurement, and business environment	**[7.12]** Re-examine the financial model. **[7.13]** Present a proposal to reinforce the independence of regulators in full compliance with EU law. **[7.16]** Make operational the procedures for requesting VAT exemptions for exporting firms.
Judicial system	**[7.4]** Submit to Parliament Bill to implement the judicial reform roadmap. **[7.5]** Submit to Parliament the Bill to improve the Justices for Peace regime. **[7.7]** Submit draft amendments to the Code of Civil Procedure to Parliament. **[7.16]** Make operational the procedures for requesting VAT exemptions for exporting firms and simplify the procedures associated with indirect exports.

Actions for the seventh review (to be completed by end Q4-2012)	
Fiscal-structural	**[1.4]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[1.26]** Carry out measures with the 2013 Budget Law. **[3.11]** Submit to Parliament the draft proposal to revise the regional finance law. **[3.16]** SOEs to reach operational balance. **[3.22]** Prepare a strategy for Aguas de Portugal (AdP). **[3.25]** Complete the implementation of the new structure that merges tax, customs and DGITA. **[3.26 i]** Assess the need to establish special chambers within the tax tribunals to handle cases above EUR 1 million. **[3.26 ii]** Reduce number of municipal tax offices by 20%. **[3.26 iii]** Increase to 30% the number of auditors in the tax administration. **[3.27]** Clear cases above EUR 1 million with the support of the tax court judges. **[3.28]** Submit to Parliament the draft proposal to strengthen the auditing and enforcement powers of the central tax administration. **[3.30]** Implement a full-fledged Large Taxpayer Office (LTO). **[3.34]** Apply the approach on foundation, the compulsory census and subsequent analysis to association and later to other public and quasi-public entities. **[3.37]** Reform the existing framework of central, local and locally-based administration services. **[3.38 i]** Complete the implementation of the strategy of shared services in the area of

	financial resources (GeRFIP). **[3.38 ii]** Implement fully the strategy of shared services in central administration in the areas financial and human resources. **[3.38 iii]** Implement shared services in IT. **[3.42]** Prepare a comprehensive review of wage scales.
Financial sector	**[2.4]** BdP to follow closely the banks in view of reaching a core Tier 1 capital ratio of 10%. **[2.16]** Prepare the implementing measures in order to rend the new legal framework fully operational.
Health care system	**[3.43]** Additional revenue of EUR 150 million following the revision of NHS moderating fees. **[3.59]** Publish an action plan concerning the reduction of costs and fighting waste. **[3.61]** Take measures to increase competition among private providers and reduce by 10% the overall spending. **[3.66]** Change existing accounting framework and adopt accounting standards in line with the requirements for private companies and other SOEs. **[3.70]** Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators and regular reports. **[3.72]** Reduce by at least 15% hospital operational costs. **[3.72]** Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators – first regular report. **[3.72]** Publish detailed action plan to deliver additional cuts in the hospitals network operating costs of at least 5% in 2013. **[3.75]** Adopt for all staff flexible time arrangements, to reduce by at least 20% spending on overtime compensation in 2012 and another 20% in 2013. **[3.76]** Improve monitoring, internal control and fiscal risks management systems of the Administracaoes Regionais de Saude. **[3.78]** Reduce costs for patient transportation by 1/3.
Labour market	**[4.1]** Prepare an analysis on benefit dependency and long-term unemployment. **[4.3]** Submit draft legislation to Parliament.
Goods and services markets	**[5.3]** Define a way of convergence of the platforms for electricity and natural gas. **[5.15]** Implement the Strategic Plan for Transport for 2011-2015. **[5.17 i]** Strength the capacities of the railway regulator. **[5.17ii]** Reduce operational costs by at least 23%. **[5.17 iv]** Ensure that the awarding authority has the required level of independence and competence. **[5.20]** Adopt the necessary legislative amendments to achieve full compliance with Directive 1999/62/EC and EU Treaty. **[5.25]** Make the necessary changes in the statutes of professional bodies. **[5.26 iv]** Make the "Zero authorisation" platform available to all levels of administration, including municipalities.
Housing market	**[6.2]** Bring value of all property stock close to market value.
Competition, public procurement, and business environment	**[7.13]** Ensure that remaining NRAs have the necessary independence and resources to exercise their responsibilities.

Actions for the eighth review (to be completed by end Q1-2013)	
Fiscal structural	**[1.25]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[3.38 ii]** Fully implement the strategy of shared services (Tax Authority) (end-January 2013).

Actions for the eighth review (to be completed by end Q1-2013)	
Labour market	**[4.1]** Assess if further measures are needed in relation with benefit dependency and long-term unemployment. **[4.5]** Enter the legislative proposal into force. **[4.6]** Assess in a report the effects of the organised decentralisation.
Goods and services markets	**[5.2]** Apply a harmonised congestion management mechanism to all the interconnection capacity between Portugal and Spain. **[5.15 v]** Reform the transport and infrastructure's regulatory framework.
Competition, public procurement, and business environment	**[7.15]** Submit a report analysing the impact of measures included in [7.14]. **[7.18]** Implement the New Late Payments Directive. **[7.19]** Include all municipalities and all levels of public administration within the scope of the Simplex Programme.

Actions for the ninth review (to be completed by end Q2-2013)	
Fiscal structural	**[1.25]** Quarterly ceilings for the consolidated General Government cash balance to be assessed.
Labour market	**[4.4]** Prepare a report on the effects of the changes to the dismissal rules on labour market indicators. **[4.6]** If needed, prepare an action plan to ensure works council can negotiate wages at firm level.
Goods and services markets	**[5.26 v]** Extend the Points of Single Contact reducing administrative burdens for firms to services not covered by the Services Directive.
Housing market	**[6.4]** Review of the impact of all housing market reforms.
Judicial system	**[7.1]** Eliminate the court backlog.

Actions for the tenth review (to be completed by end Q3-2013)	
Fiscal structural	**[1.25]** Quarterly ceilings for the consolidated General Government cash balance to be assessed.
Goods and services markets	**[5.8]** Annual report on new contracts in renewables . **[5.9]** Annual report on new investments in renewables . **[5.26 vi]** Extend the "Zero authorisation project" abolishing licenses to other sectors of the economy.
Health care system	**[3.58]** Introduce a contribution in the form of an average rebate, in case the change in the calculation of profit margin will not produce the expected savings.

Actions for the eleventh review (to be completed by end Q4-2013)	
Fiscal-structural	**[1.24]** Achieve a general government deficit of 3% of GDP. **[1.25]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[1.31]** Define measures in the 2014 Budget Law to achieving a general government deficit in 2014 in line with the Medium-Term Fiscal Strategy defined in August 2011. **[3.25]** Merge the revenue collection units of social security administration, if cost-benefit assessment is favourable. **[3.26 ii]** Reduce number of municipal tax offices by 20%. **[3.39]** Reduce the number of local branches of line ministries.
Goods and services markets	**[5.17 ii]** Bring the infrastructure manager to operational balance.