

## International Monetary Fund

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Fourth Review Under  
an EFF Arrangement  
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**Portugal:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 27, 2012

The following item is a Letter of Intent of the government of Portugal, which describes the policies that Portugal intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of Portugal, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

## PORTUGAL: LETTER OF INTENT

Lisbon, June 27, 2012

Ms. Christine Lagarde  
Managing Director  
International Monetary Fund  
Washington, DC 20431

Dear Ms. Lagarde:

1. The attached Memorandum of Economic and Financial Policies (MEFP) describes the progress made in recent months towards the objectives laid out in our program supported by the Extended Arrangement. It also updates previous MEFPs and highlights the policy steps to be taken in the months ahead.
2. Our economic and financial program is on track. All quantitative performance criteria and structural benchmarks for the fourth review were met, sometimes with minor delays. Economic activity has been stronger than expected in the past few months, reflecting mainly the dynamism of exports. As a result, external adjustment has continued to proceed at a faster pace than initially envisaged. In spite of this, however, unemployment has increased significantly. Budget execution so far this year has been generally in line with projections. After a large drop in December 2011, domestic arrears have increased again over the past few months, leading to several breaches of the continuous indicative target on the non-accumulation of new domestic arrears. We are confident, however, that the ongoing efforts to strengthen expenditure commitment controls and the recent increase in budgetary allocations to the health sector will help ensure compliance with the target in the months ahead.
3. We have made further strides toward improving our budget monitoring system and strengthening controls over expenditure commitments, and have continued to improve the overall efficiency of our revenue administration. The operational restructuring of SOEs and the strengthening of the PPP framework, key reforms to alleviate risks to the fiscal consolidation process, are on track. Our policy efforts to support financial system stability have continued, and further steps have been taken to increase competitiveness, growth, and employment.
4. Looking ahead, risks to the budgetary outlook are tilted to the downside, reflecting mainly the rise in unemployment and a composition of growth less favourable to tax collection. We will therefore continue to closely monitor fiscal developments in the new few months and assess whether further policy adjustments are necessary to achieve the 2012 target. Building up on the progress made so far on the structural front, we will continue to implement our wide-ranging reform agenda aimed at strengthening fiscal institutions and

boosting competitiveness and growth. We will also continue to monitor the pace and composition of the deleveraging process, which needs to remain consistent with the program's macroeconomic framework, and complete the planned bank capital augmentation exercise according to the program's timeline. The attached MEFP proposes two new structural benchmarks aimed at ensuring that the current system of extending collective wage agreements does not hamper competitiveness and prioritizing PFM reforms for the next three years.

5. On the basis of the strength of the policies defined in this letter, and in light of our performance under the program, we request the completion of the fourth review under the Extended Arrangement, the fifth purchase under the arrangement in the amount of SDR 1197 million, as well as waivers of applicability of the end-June performance criteria.

6. We remain confident that the policies described in the current and previous MEFPs are adequate to achieve the objectives under the program. We stand ready to take additional measures should they may be needed to meet the objectives of the economic program and will consult with the IMF, the European Commission, and the ECB, in advance of any necessary revisions to the policies contained in this letter and attached Memorandum.

7. This letter is copied to Messrs. Juncker, Rehn, and Draghi.

Sincerely yours,

/s/

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Vitor Gaspar  
Minister of State and Finance

/s/

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Carlos da Silva Costa  
Governor of the Banco de Portugal

Attachments: 1. Memorandum of Economic and Financial Policies (MEFP)  
2. Technical Memorandum of Understanding (TMU)

## PORTUGAL: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

June 27, 2012

### I. MACROECONOMIC OUTLOOK

1. **The economic contraction in the first quarter of the year was milder than envisaged in the program.** Preliminary data indicate that real GDP contracted by 0.1 percent over the previous quarter (compared to an expected 1.4 percent), likely reflecting a stronger-than-expected export performance (see below). For the year as a whole, the expected improvement in net exports is expected to more-than-offset the deterioration in domestic demand. Taking this into account, we now expect a decline in output of about 3 percent in 2012 (compared to 3¼ percent at the time of the third review). We are concerned, however, by the sharp increase in unemployment in recent months (see below). Against the backdrop of weaker domestic demand and falling unit labor cost, and consistent with the deceleration since the beginning of the year, we now expect inflation to average 2¾ percent in 2012.
2. **Despite slowing demand in key trade partners, we expect exports to continue to contribute strongly to growth and external adjustment.** Export growth remained robust in the first quarter, at over 8.5 percent year-over-year. Non euro area trade partners have continued to make a strong contribution to export performance; and over the past year, exports have recovered for a wide range of products and services. We expect these trends to continue and, together with the expected fall in imports, to contribute to a further decline in the current account deficit to about 3.9 percent of GDP this year.

### II. ENSURING FISCAL SUSTAINABILITY

3. **We remain committed to achieving its deficit objectives of 4½ percent of GDP in 2012 and 3 percent of GDP in 2013—consistent with debt peaking at 118½ percent of GDP next year.**
  - *Budget execution has been consistent with the 2012 fiscal objectives, but risks are tilted to the downside.* Revenue and expenditure developments have been generally in line with projections, but there are early signs that the sharper-than-expected deterioration in employment and the faster rebalancing of growth away from higher-taxed domestic demand, toward net external demand, is affecting tax revenues and social security accounts. The re-programming of EU funds, lower-than-expected net interest payments, as well as tight budgetary execution will help offset these developments, but downside risks remain. In view of the existing downside risks, we will closely monitor fiscal developments in the months ahead and assess whether further policy adjustments are necessary to achieve the 2012 target.

- *Achieving the 2013 objective will entail a further structural primary adjustment in the order of 1½ percent of GDP.* This will bring the cumulative structural primary adjustment in 2011-13 to over 9 percent of GDP. Measures will be designed with a view to minimizing the negative impact of fiscal consolidation on growth. On the expenditure side, which will account for about two thirds of the measures, adjustment will come mainly from further cost rationalization and efficiency gains in the public administration, the health sector, and SOEs, while limiting cuts in capital spending.

### III. PROMOTING EMPLOYMENT

4. **Unemployment is a priority concern.** The unemployment rate rose to some 15 percent in the first quarter of 2012, and the employment level is now 4¼ percent lower than a year ago. Both structural and cyclical factors have contributed to this deterioration. The former is evident from the pronounced employment losses in labor intensive non-tradable sectors. The cyclical aspects are evident from employment decline across a broad range of sectors reflecting tighter fiscal and financial conditions.
5. **Our structural agenda will deliver long-term job growth, but immediate actions are needed to counter the rise in unemployment, particularly among young workers.** Our strategy to support employment envisages a three pronged approach: active labor market policies with a particular focus on the youth to facilitate transition to work, ways to stimulate employment demand, and continuation of labor market institutions reform.
6. **Active labor market policies:** to sustain labor demand through the downturn and increase the employability of job seekers, we have prepared a package of policies. A plan was launched to revamp the role and functioning of Public Employment Services (PES). We have introduced several new programs, supported by EU funds:
  - *Estimulo 2012* provides a wage subsidy for firms that hire and train unemployed enrolled in PES centers for 6 months or more. The program has the potential to reach approximately 56, 000 unemployed. Since February, it has allowed the creation of 4,000 jobs and the placement of 2,000 high-risk unemployed.
  - *Vida Ativa* is a targeted training initiative, which delivers high-employability training modules on a part-time basis, to allow the unemployed to keep actively searching for a job. The streamlined placement procedure ensures that all newly-registered unemployed will be attending a training module in no more than 45 days after enrolment in a job center. So far, 67,000 unemployed have already been referred to the training centers and 7,000 have already participated in a training module.
  - *Partial accumulation of unemployment benefits and wages* is an initiative to bring into employment those that have been enrolled in PES centers for at least 6 months. It allows cumulating up to 50% of the unemployment benefit (UB), for up to 12 months, when accepting a job offer that pays gross wages below the UB.

- We have established *Impulso Jovem*, specifically to help the unemployed youth—one of the groups most affected by the crisis. We hope to reach 80,000 young unemployed, through : (i) internships, which provide on-the-job training to increase employability; (ii) other programs, which include an incentive for employers through a reimbursement of employers' social security contributions for younger (18-30 years old) unemployed workers and programs aimed at promoting entrepreneurship; and (iii) SME financing activities.

7. **Stimulating employment:** we will assess the budgetary scope for stimulating the demand for labor through tax changes. The positive effects on employment and growth of shifting away from labor taxes can persist even in the long-run, beyond the cyclical downturn. We will explore ways, to design a targeted and deficit-neutral cut in the employers' social security contribution rate. Within a budgetary envelope of around 0.5 percent of GDP, targeting could inter-alia concern younger or lower-income workers. Specific proposals for introducing such a cut in the context of the 2013 budget will be put forward at the next review.

8. **Reforming labor market institutions:**

- *Reforms are needed to allow firms to respond more flexibly to demand conditions.* Comprehensive revisions to the Labor Code, in line with commitments under the program, were approved by the parliament in May. These revisions included measures to facilitate adjusting hours worked rather than cutting jobs, to allow better firm-worker matches, to increase productivity, and to encourage and retain investment in human capital through reducing labor market duality. Further measures will address the convergence of the regime for severance payments to the EU average and their partial financing via a compensation fund.
- *To limit adjustment through job losses, we will reform the wage setting mechanisms.* Affordable wages vary greatly across firms; to reduce job destruction from exit of firms facing wage pressure, we will promote wage developments consistent with firm-level conditions. To that end, we will formalize the criteria for extending collective agreements. The objective will be to ensure that collective agreements subscribed to in sectors where the signatory employer's associations cover less than a 50 percent of the total work force will not be extended to all firms in the sector. In cases where this representativeness threshold is reached, a decision on extension will be based on specific criteria aimed at preventing an undue burden on the competitive position of non-affiliated firms in the sector. The draft legislation defining these criteria and the modalities for their implementation will be submitted to Parliament by end- September (structural benchmark).

## IV. CONTAINING FISCAL RISKS

### A. Public Financial Management

9. **Strengthening our capacity to better manage public resources remains a priority.** We continue to make progress across a range of public financial management reforms. Key steps over the past few months included the adoption of medium-term expenditure ceilings, an estimation of tax expenditures under an internationally accepted methodology, and an assessment of fiscal risks. The tax expenditure report and fiscal risk statements will be further refined ahead of their publication along with the 2013 budget. In addition, program coordinators are now in place to support our strengthened budget monitoring system. Given the wide scope of our PFM reform agenda, we will take stock of the progress achieved in the first year of the program and, in consultation with the EC and the IMF, develop our PFM strategy for the next three years. This will be put forth in a dedicated document, which will be prepared by mid-September (structural benchmark) and attached to the 2013 budget.

10. **In order to reverse the accumulation of arrears, we will rapidly extend new expenditure commitment control procedures and arrear claims verification to all general government entities.** The implementation of the law on expenditure commitment controls is advancing, with most government entities adjusting their systems to the new requirements. However, further efforts are needed at the subnational government level. In order to ensure across-the-board implementation of the new law, we will work with local governments and the Autonomous Region of Madeira with a view to upgrade their systems by end-July. Regarding the arrears clearance process, the Inspectorate General of Finance (IGF) is close to concluding the verification of claims in the health sector, and payments will start soon after the ongoing negotiations with the creditors are concluded. Given the new credit line aimed to settle arrears and short-term debt at the municipal level (see below), IGF will reinforce the verification of the arrear claims and commitment control systems, giving priority to those municipalities under structural rebalancing.

### B. State-Owned Enterprises and Public-Private Partnerships

11. **We are making headway in ensuring state-owned enterprises are financially stable and well managed.** Operational restructuring is proceeding as planned, and we expect SOEs to reach our target of operational balance, on aggregate, by the end of the year. The financial needs of these firms have also remained within the budgeted envelope. In addition, we have approved and will shortly submit to Parliament a law reforming the governance framework for state-owned enterprises (SOEs). The new framework will grant substantially more powers to the Ministry of Finance to ensure that SOEs are financially viable and serve public interests. The creation of a dedicated unit at the Ministry of Finance will also allow detection of potential financial difficulties, so as to encourage early remedial actions.

12. **Tackling fiscal risks stemming from SOEs remains a priority.** Eliminating operational deficits will not be enough to restore financial balance in many firms, and legacy debt needs to be addressed. We have already prepared an initial report presenting options to unwind Parpública (end-April structural benchmark). However, a more comprehensive strategy to deal with all SOEs debt is necessary. We will prepare such a strategy by end-July. It will be based on a principle of full disclosure and transparency. It will also take into account the need to ensure a proper incentive structure, including maintaining a hard budget constraint, so as to avoid a new build up in unsustainable debt in the future.

13. **Our privatization program is proceeding as planned.** The sales of EDP and REN have been completed. We have selected advisors for the privatization of the airline, TAP, and the airport concessionaire, ANA, and the next step is to seek expressions of interest in these two companies; we expect the sales to be completed late this year, with the proceeds benefiting the budget in 2013. The sale of the rail cargo firm CP Carga has been delayed in order to coordinate policies on infrastructure links with Spain and ensure economic benefits can be maximized. Legal and regulatory preconditions and internal restructuring for the sales next year of the postal company CTT and a television channel and radio station belonging to RTP are falling into place. We are also advancing in the reorganization of the water company Águas de Portugal, with a view to assessing the scope for introducing private capital and management, and privatizing waste management areas.

14. **The reform of the PPP framework, which aims at reducing the risks to the public finances, is on track.** A new legal and institutional framework, which aims at ensuring fiscally sound decisions in this area, was enacted in May. The new decree-law strengthens the role of the Ministry of Finance in assessing and monitoring fiscal consequences of PPP contracts, including through the creation of a specialized PPP unit. We will work towards finding a solution to impose similar requirements at the regional level by end-September 2012. At the same time, the study prepared by the independent accounting firm selected earlier this year is advancing, and completion is expected by end-June. For certain PPP and concession contracts, the renegotiation process started before the completion of the study, due to financial or legal imperatives. The negotiations are progressing and are expected to result in significant reductions in outlays for the state. Other than these, final decisions on renegotiation will be taken after the study's conclusion and in consultation with the EC, ECB and the IMF.

### C. Revenue Administration

15. **Revenue administration reforms are proceeding apace, with a strong focus on fighting non-compliance.** We are progressing with implementation of the multi-year Plan to Combat Fraud and Evasion. Amongst other measures, we will (i) enable the tax administration to access information gathered in the context of anti-money laundering and other criminal investigations and (ii) press ahead with a wider adoption of electronic invoicing in Portugal. In particular, an incentive scheme to combat evasion through

encouraging taxpayers to ask for the issuance of invoices, notably in hard-to-tax sectors, will be adopted. We will closely monitor the implementation of this scheme, and consult with the EC, ECB and the IMF on any developments regarding the scheme design. An evaluation report of the scheme will be prepared by end-March, 2013. In addition, our reforms to streamline the local branches network and implement a full-fledged Large Taxpayers Office are on track. A working group has concluded that the merger between the *Autoridade Tributária e Aduaneira* (AT) and the revenue collection function of the Social Security was not feasible in the short-middle term, but stressed the advantages of greater coordination between the two entities. We will, by end-August: i) prepare a draft proposal to enhance the exchange of information between the AT and the Social Security and (ii) study ways of possible implementation of the other working group recommendations to strengthen control and simplifying compliance.

16. **We continue to advance in our efforts to modernize tax appeals at the judicial level.** The task force of judges has increased the pace of its work on high-value tax cases, and we remain committed to clear the remaining such cases in courts. Based on the report already presented, we will draft, by August 20, 2012, an action plan with concrete measures and timelines to resolve the backlog related to the regularization of VAT bad debts. We will further assess the possibility of introducing transitional measures regarding the cases currently filed in courts, taking into account tax fraud and erosion risks. We are committed to improve transparency by publishing quarterly reports on recovery rates, duration and costs of tax cases in courts within four months of the end of each quarter, starting in the fourth quarter of 2012.

#### D. Public Administration

17. **We are committed to reducing wasteful spending in the public sector.** Significant progress is being made in streamlining the public administration and modernizing its governance. We have launched a new public employment information system for central and subnational administrations and enhanced transparency by publishing comprehensive public labor statistics for the first time. Based on the new system, a comprehensive assessment on public pay scales will be prepared by year-end. We have concluded the census of foundations, and the law regulating their creation and functioning has been approved. The final report on the central administration restructuring plan (PREMAC)—which aims at a reduction of 40 percent of administrative units and 27 percent of management positions—will be completed by end-September. Finally, the negotiations with public sector labor unions aimed at facilitating working time flexibility and geographical mobility are well advanced.

#### E. Regional and Local Public Finances

18. **A comprehensive reform aimed at putting the subnational governments' public finances on a sound and sustainable path remains a key objective.** The working group in charge of revising regional and local finance laws has further advanced its work, with

support of EC and IMF technical assistance. As part of this process, and with the goal of reducing systematically over-stated revenue projections in local and regional governments' budgets, we will by end-September: (i) prepare a proposal for common revenue forecasting guidelines for subnational governments, and (ii) define the types of data to be exchanged between the central and subnational governments, striking a balance between tax secrecy protection and effective sharing of information across governmental levels. We have also made progress in streamlining local governments' administrations: (i) the law to reduce the number of parishes has been approved, and these changes will come into effect by the beginning of the next local elections; and (ii) the new regime for local SOEs has been submitted to Parliament.

19. **We have launched a special program to support local governments under financial stress.** We will open a €1 billion credit line to help municipalities clear their arrears and amortize short-term debt. Clearance of arrears under this scheme will be subject to the principles laid out in our Strategy for the Settlement of Arrears. We will ensure that the process of alleviating local debt burdens is consistent with our fiscal consolidation targets. Municipalities in difficulties benefiting from this credit line will be requested to prepare and implement tailored adjustment programs. We will prepare by end-July a document detailing the procedures and responsible units for monitoring, controlling and auditing this program. We will also ensure transparency of the use of the credit line through the monthly publication of the amounts lent, disbursed, and used to settle arrears and other liabilities by municipality.

20. **The Autonomous Region of Madeira completed the first review of its program.** Progress has been made towards fiscal consolidation and the fiscal structural reform program is broadly on track. Nevertheless, increasing risks have been identified and the regional government is bound to adopt corrective measures in case of a deviation vis-à-vis the program targets.

## **V. PROTECTING THE FINANCIAL SYSTEM AMIDST DELEVERAGING AND SOVEREIGN CRISES**

21. **Efforts to secure an orderly deleveraging of the economy are ongoing.** The easing of liquidity pressures and attendant augmentation of banks' capital is helping alleviate risks of an excessive credit contraction. However, with funding strains evident in certain segments, we are taking measures to ensure that the productive sectors of the economy are able to secure continued access to credit as deleveraging proceeds. To this end, the ongoing proposal being prepared to foster the diversification of financing alternatives to the corporate sector is on track to be completed by end-July. In parallel, in the context of its regular supervisory program, the Banco de Portugal (BdP) continues to evaluate banks' impairment levels and to discourage ever-greening of problematic loans. As part of these efforts, it has issued an instruction for banks to identify and report recently restructured loans due to financial difficulties. Also, BdP has launched on-site inspections focusing on those assets that are

more sensitive to current market conditions. If needed, these inspections will be used to develop appropriate policy guidelines.

22. **Adequate bank liquidity remains essential to preserve financial stability.** Under conditions of heightened risks in the euro area, exceptional Eurosystem liquidity support at longer maturities and a broadening of the collateral eligibility criteria are playing a pivotal role in easing liquidity pressures and 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.

23. **The bank capital augmentation exercise is nearing conclusion.** The BdP has reviewed the banks' funding and capital plans for meeting by end-June 2012 the Core Tier 1 program target of 9 percent, taking into account the Special on-site Inspections Programme, the pension fund transfer and the 2011 EBA capital exercise, and has provided the Minister of Finance with a duly motivated opinion on the banks foreseeing to apply, under the relevant legislation, to public investment in order to fulfill their capital needs. Following the publication of the Ministerial Order ("Portaria") on May 17, 2012, agreement has been reached with the relevant banks on the amount, mix and conditionality of public capital support. The banks, in turn, have initiated all the necessary steps to ensure completion of the envisaged capital augmentation measures by the end-June 2012 deadline. Upon completion, these measures are expected to enable the large Portuguese banks to meet the Core Tier 1 program target of 10 percent at end-2012, as well as the end-June 2012 requirements. Banks receiving public capital support were required to draw up comprehensive business plans, aimed at enhancing the banks' resilience, *inter alia* through restructuring measures, better risk control and corporate governance, and cost reduction. BdP is closely monitoring the compliance of the set targets by the relevant deadlines, with a view to promptly take appropriate action in case these are not met.

24. **Resources from the Bank Solvency Support Facility (BSSF) remain available to provide further support to viable banks, if needed.** We remain committed to supporting viable banks in line with state aid rules and subject to strict conditionality in order to avoid that private shareholders are effectively subsidized by the public sector and that private liabilities migrate to the public sector balance sheet. The remaining resources in the BSSF will solely be utilized to provide public support, if needed, to the banking system.

25. **Efforts to streamline the state-owned Caixa Geral de Depósitos (CGD) are continuing.** Plans to augment CGD's capital before end-June 2012 have been finalized, utilizing cash buffers outside of the BSSF. The divestitures of its insurance arm and health sector activities to third parties are on track to be completed before end-2012, and sales of equity stakes are ongoing.

26. **We are implementing the strategy for managing the distressed assets from Banco Português de Negócios (BPN).** Following the completion of the sale of BPN to

Banco BIC Portugues, we have obtained advice from an independent party on the process for recovering the assets currently held by three state-owned SPVs. On the basis thereof, we intend to outsource the management of the assets to a professional third party, with a mandate to gradually recover the assets over time. The party managing the assets will be selected through a competitive bidding process and the mandate will include proper incentives to optimize the recoveries. CGD's state guaranteed claim will be gradually settled in cash, according to the schedule agreed with the EC, ECB and IMF. Any net recoveries realized on the assets will also be applied towards the settlement of CGD's claim.

27. **BdP continues to strengthen its prudential supervision.** The BdP is pursuing multiple initiatives to enhance its supervisory organization, optimize its supervisory processes and develop and implement new supervisory methodologies and tools. Moreover, onsite inspections have been launched at the initiative of BdP that will focus on those assets that are more sensitive to current market conditions. In addition, the BdP is stepping up its monitoring of banks, including via ad hoc audits.

28. **The early intervention, resolution, and deposit guarantee framework has been strengthened.** We are in the process of adopting the implementing measures necessary for completion of the new legislative framework for banking resolution. We will pass regulations relating to the resolution fund and its funding arrangements (end-July 2012) and the BdP will finalize supervisory notices on recovery plans (end-July 2012), bridge banks (end-September 2012), and resolution plans (end-October 2012). In reviewing the banks' recovery and subsequent resolution plans, the BdP intends to give priority to banks that are of systemic importance. Moreover, we will swiftly transpose the new EU Directive on bank resolution as soon as it enters into force.

29. **We have improved the legal framework for corporate debt restructurings.** The corporate insolvency law amendments to support better early rescue of viable firms (mid-June 2012 structural benchmark) became effective on May 20, 2012. We will continue to step up actions to raise public awareness of the new restructuring tools. In addition, we are finalizing the conciliation framework mediated by IAPMEI, a public entity, to facilitate extrajudicial corporate debt restructurings for viable SMEs.

30. **Resolving household sector indebtedness in an orderly fashion remains a key priority.** We continue to monitor the evolution of household indebtedness closely and are establishing a framework for financial institutions to engage in out-of-court debt restructuring for households.

## VI. BOOSTING COMPETITIVENESS AND GROWTH

### A. Goods and Services Market Reforms and Competition Framework

31. **In the electricity sector, we have taken measures that reduce excess rents and will alleviate the pressure they ultimately place on end-user prices.** Both related

structural benchmarks were met in May. First, we eliminated the Power Guarantee incentive for cases where investment decisions had already been taken without the expectation of an additional incentive—i.e. for power plants already licensed prior to the law that established this incentive. Second, to accelerate convergence to market-based pricing for co-generation operators, we published the new reference tariff and the formula for updating tariffs in the transitional regime, during which tariffs will decline gradually. In addition, we are negotiating with stakeholders a reduction in the compensation paid on early termination of PPA contracts and for recouping payment for rights to operate beyond the contract period. The cumulative effect of these and other rent-reducing measures would be to reduce cumulative real price growth in electricity by 4 percentage points baseline in absence of policy change. Further commitments to ensure the sustainability of the national electricity system are described in the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) with the EC.

**32. We remain committed to further correcting the impact of policies that have led to limited competition, high costs, and low productivity.**

- *A landmark revision of the Ports Work Law*, which will be submitted to Parliament shortly, lowers wage costs dramatically for the workers who have traditionally enjoyed an extreme degree of protection. This, together with the early retirement for historical port workers, removes the constraints to optimizing the use of labor, by freeing the use of temporary workers and allowing for more flexibility in contracts for intermittent work periods. To ensure the transmission of substantially lower unit labor costs to the price of services in this sector, we will look to international experience with engendering competitive outcomes within the concession framework—for example in designing performance clauses (see Memorandum of Understanding 5.20).
- The *new Competition Law* was approved by Parliament, published on May 8, and will enter into force in July. Given the expanded scope of roles and responsibilities of the Competition Authority, we will review, in consultation with key stakeholders, the conditions for proper execution of its mandate. We will also monitor the inflow of cases in the specialized Competition Court, which began operations on April 2, with a view to assessing the risk of potential backlogs. Work on the report reviewing and benchmarking the responsibilities, resources, as well as the independence of the main sectoral regulators, has begun. A proposal for policy actions based on key findings will be prepared by end-September 2012 (structural benchmark), to be implemented by end-2012.
- Following a number of corrective measures already taken, we will continue to *monitor the competitive environment in the telecommunications sector*, in particular wholesale and retail broadband access and mobile origination charges, and barriers to entry into the fixed communication market.

- We are preparing a *new horizontal framework law* requiring highly regulated professions (such as lawyers, accountants, architects) to change their bylaws to ease access to these professions and limit anti-competitive practices. We will reform the functioning of the construction and real estate sectors by facilitating cross-border provision and easing establishment conditions.

## **B. Business Environment**

33. **We are pursuing our efforts to facilitate business entry through the Point of Single Contact (PSC) platform.** We have made progress in presenting clear information for already-established and for cross-border service providers, and will seek ways to ensure stronger and faster cooperation from responsible agencies in providing the needed assistance at the local and central administration level. We have also taken a number of important initiatives to cut red tape. We intend to use the PSC platform to provide “zero industrial licensing” services for the majority of industrial firms. A recently approved decree law has committed to simplify licensing procedures where bottlenecks have been identified. In addition, reforms to remove barriers in the areas of building permits, land use, territorial planning and environment are also in the pipeline.

## **C. Judicial Reform**

34. **We continue pushing ahead with targeted measures to reduce the backlogged enforcement cases that slow the judicial process and generate costs across the economy.** An additional 20,000 enforcement cases have been cleared, bringing down the total number by about 70,000 enforcement cases since November 2011, and the inter-agency task force has set quarterly targets for closing enforcement cases by mid-August 2012. We will prepare an initial draft bill to strengthen the legal and institutional framework for enforcement agents and to include a fee structure that incentivizes speedy enforcement by mid-August 2012, which will be further refined by mid-October 2012 based on extensive consultation including IMF/EU technical assistance and informed by cross country experience. We continue overhauling the information system to facilitate the speedy processing of court cases.

35. **We are advancing two major reforms to improve efficiency of the court system.** We have refined the comprehensive judicial roadmap to reduce the number of courts and streamline the court structure with extensive stakeholder consultation. We will prepare an initial draft bill on the judicial roadmap by mid-August 2012, which will then be revised by end-September 2012, in consultation with stakeholders and also informed by IMF/EU technical assistance, and submit the bill to Parliament by end-November 2012 (structural benchmark). We have decided to adopt an entirely new Code of Civil Procedure to speed up the judicial process rather than amending the current Code. An initial draft for the new Code of Civil Procedure will be prepared by July 6, 2012 which will then be further refined by end-September 2012, informed by stakeholder consultation and IMF/EU technical assistance.

We will submit the new Code of Civil Procedure to Parliament by end-November 2012 (structural benchmark).

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

	Performance Criteria (unless indicated otherwise)										Indicative Targets	
	Jun-11		Sep-11		Dec-11		Mar-12		Jun-12	Sep-12		Dec-12
	Program	Actual	Program	Actual	Program	Actual	Program	Actual				
1. Floor on the consolidated General Government cash balance (cumulative)	-5.4	-5.1	-6.7	-5.7	-10.3	-7.1	-1.9	-0.45	-4.4	-5.9	-7.5	
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 1/	...	...	0	0.2	0	Not met	0	Not met	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	171.2	175.0	177.5	177.5	
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	0	

1/ Domestic arrears increased by €236 million in October-November 2011. They decreased by €320 million in December, but increased again during the first three months of 2012 (by €333 million).

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

Measure	Timing	Status
<b>Structural Benchmarks</b>		
<b>A. Strengthen financial stability</b>		
1 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
2 Amend the Insolvency Law to better facilitate effective rescue of viable firms. 1/	End-Dec. 2011	Met with delay
3 Amend the framework (Law No. 63-A/2008) for bank access to public capital	End-Jan. 2012	Met
4 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	Met
5 Prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector.	End-July 2012	
<b>B. Enhance competitiveness and address bottlenecks to growth</b>		
6 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
7 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
8 Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011	Met
9 Take all necessary legal, administrative, and other steps to make arbitration fully operational.	End-Feb. 2012	Met
10 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	Met with Delay 2/
11 Publish the Ministerial Order defining the new reference tariff and formula for updating tariffs in the future for the electricity co-generation regime.	End-April 2012	Met with Delay 2/
12 Submit to Parliament draft legislation defining the criteria for extension of collective agreements (including a majority representation threshold) and the modalities for their implementation.	End-Sept 2012	
13 Prepare a proposal to implement identified best international practices in order to reinforce the independence of the main sectoral regulators.	End-Sept 2012	Reset from mid-Aug 2012
14 Submit to Parliament a new Code of Civil Procedure to streamline and speed up the court procedures.	End-Nov 2012	Reset from end Sept 2012 3/
15 Submit to Parliament the bill to implement the judicial roadmap to improve the court structure.	End-Nov 2012	Reset from end Sept 2012 3/
<b>C. Strengthen fiscal institutions and reduce fiscal risks</b>		
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	Met
19 Develop a PFM strategy covering the next three years, to be attached to the 2013 budget.	Mid-Sept 2012	
20 Revise and submit to Parliament the draft regional and local public finance law.	End-Dec. 2012	Reset from end-March 2012
21 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.

2/ The two executive orders on co-generation remuneration and power guarantee incentives were signed on April 30th, establishing the legal changes to the regime, but publication was delayed to May 14.

3/ Reset to reflect more demanding nature of benchmark (i.e. a new code instead of the previously envisaged changes to the existing code)

**PORTUGAL: TECHNICAL MEMORANDUM OF UNDERSTANDING**

June 27, 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 €1 = 1.483 U.S. dollar, €1 = 116.8390 Japanese yen, €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.<sup>1</sup>

## 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<sup>2</sup> 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-

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<sup>1</sup> 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.

<sup>2</sup> 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.

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 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.** The 2012 quarterly floors on the consolidated general government cash balance will be adjusted for the cumulative amount of arrears settled in the context of the arrears clearance strategy. This includes the health sector arrears settled with the banks' pension funds transfers' resources, as well as local government arrears settled through the €1 billion credit facility created in May 2012.

## **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, accrued liabilities. Arrears are a subset of payables/creditors. For the purposes of the Program domestic arrears are defined as payables/creditors (including foreigner commercial 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, as well as the monthly amounts of (i) health sector arrears settled with the banks' pension funds transfers' resources, and (ii) local government arrears settled through the €1 billion credit facility created in May 2012.

12. **Adjustor.** The monthly change in the stock of arrears will be adjusted for any stock adjustment related to the arrears clearance strategy. This includes the health sector arrears settled with the banks' pension funds transfers' resources, as well as local government arrears settled through the €1 billion credit facility created in May 2012. 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. €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 €5 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.

**PORTUGAL: LETTER OF INTENT TO THE EUROPEAN COMMISSION  
AND THE EUROPEAN CENTRAL BANK**

Lisbon, 27 June 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 attached Memorandum of Understanding (MoU) describes the progress made in recent months towards the objectives laid out in our Programme. It also updates previous MoUs and highlights the additional policy steps to be taken in the months ahead.
2. Our Economic Adjustment Programme is on track. Economic activity has been stronger than expected in the past few months, reflecting mainly the dynamism of exports. As a result, external adjustment has continued to proceed at a faster pace than initially envisaged. In spite of this, however, unemployment has increased significantly. Budget execution so far this year has been generally in line with projections. After a large drop in December 2011, domestic arrears have increased again over the past few months, leading to several breaches of the continuous indicative target on the non-accumulation of new domestic arrears. We are confident, however, that the ongoing efforts to strengthen expenditure commitment controls and the recent increase in budgetary allocations to the health sector will help ensure compliance with the target in the months ahead.
3. We have made further strides toward improving our budget monitoring system and strengthening controls over expenditure commitments, and have continued to improve the overall efficiency of our revenue administration. The operational restructuring of the state-owned enterprises (SOEs) and the strengthening of the private-public partnership (PPP) framework, key reforms to alleviate risks to the fiscal consolidation process, are on track. Our policy efforts to support financial system stability have continued, and further steps have been taken to increase competitiveness, growth, and employment.

4. Looking ahead, risks to the budgetary outlook are tilted to the downside, reflecting mainly the rise in unemployment and a composition of growth less favourable to tax collection. We will therefore continue to closely monitoring fiscal developments in the next few months and assess whether further policy adjustments are necessary to achieve the 2012 target. Building up on the progress made so far on the structural front, we will continue to implement our wide-ranging reform agenda aimed at strengthening fiscal institutions and boosting competitiveness and growth. We will also continue to monitor the pace and composition of the deleveraging process, which needs to remain consistent with the Programme's macroeconomic projections, and complete the planned bank capital augmentation exercise according to the Programme's timeline.

5. On the basis of the strength of the policies defined in this letter, and in light of our performance under the Programme, we request the completion of the fourth review under the Economic Adjustment Programme, the release of the fifth instalment under the Programme in the amount of EUR 2 600 million.

6. We remain confident that the policies described in the current and previous MoUs are adequate to achieve the objectives under the Programme. We stand ready to take additional measures should they 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.

7. This letter is copied to Ms Christine Lagarde.

Sincerely yours,

/s/

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Vítor Gaspar  
Minister of State and Finance

/s/

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Carlos da Silva Costa  
Governor of the Banco de Portugal

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

**PORTUGAL: MEMORANDUM OF UNDERSTANDING ON  
SPECIFIC ECONOMIC POLICY CONDITIONALITY**

Fourth Update – 27 June 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 fourth 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<sup>1</sup>

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 fourth quarterly review was carried out in May 2012. It assessed compliance with the conditions to be met by end-March and the need and scope for additional policy steps. This fourth update of the MoU reflects the findings of the fourth 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.

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<sup>1</sup> On 8 April 2011, Eurogroup and ECOFIN Ministers issued a statement clarifying that financial support of the EU (European Financial Stabilisation Mechanism, EFSM) and the euro-area (European Financial Stability Facility, EFSF) 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 thereunder are subject to the compliance with the conditions of this Memorandum.

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 percent of GDP) in 2012. This should allow to reach a deficit target of 3 percent of GDP by 2013. Second, bring the government 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**

The 2012 general government headline deficit target of 4 ½ per cent of GDP remains valid. Downside risks to the fiscal objectives related to the macro outlook are starting to materialise, with the growth composition tilting more strongly towards net exports and away from domestic demand, as is evidenced by the more pronounced fall in private consumption and the substantial worsening of the labour market situation. However, savings coming from the re-programming of EU funds, lower net interest payments, as well as a tighter budgetary execution will help offset these developments. The government is committed to closely monitor fiscal developments in the months ahead. In view of the existing downside risks, contingency reserves will be included in the 2013 budget to offset possible carry-over effects to 2013.

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.<sup>2</sup> **[Q4-2012]**

1.2. Throughout the year, the government will rigorously implement the Budget Law for 2012, as amended by the Supplementary Budget. 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. **[Q2, Q3 and Q4-2012]**

1.3. The measures listed below, worth 5.4 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, as amended by the Supplementary Budget, unless elsewhere specified. Overall, expenditure reduction accounts for two thirds of that fiscal effort and revenue increases for one third.

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<sup>2</sup> In 2012, operations related to the banking sector support and restructuring strategy under the programme will not be considered for the assessment of compliance with the programme target for the general government deficit. Conversely, if during the fifth review there is an agreement that there are sufficient safeguards to prevent further accumulation of arrears and the implementation of the strategy for the arrears' settlement is on track, the accrual government balance objectives may be adjusted by the amount of settled arrears.

*Expenditure*

1.4. 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 13<sup>th</sup> and 14<sup>th</sup> 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.
- 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'.

1.5. Reduce pension expenditure in gross terms in 2012 by at least EUR 1,140 million by: (i) suspending the 13<sup>th</sup> and 14<sup>th</sup> 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.

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

1.7. 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.

1.8. 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.

1.9. 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.

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

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

1.12. 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, 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.

1.13. 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*

1.14. 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.

1.15. 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.

1.16. 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.

1.17. 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.

1.18. 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.

1.19. 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.

1.20. 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**

1.21. The government will achieve a general government deficit of 3 percent of GDP or below. **[Q4-2013]** The government will assess the budgetary scope for stimulating the demand for labour through tax changes. Aiming at achieving the positive effects in the long-run, beyond the cyclical downturn, the government will explore ways to design a targeted and deficit-neutral cut in the employers' social security contribution rate within a budgetary envelope of around 0.5 percent of GDP. Targeting could inter alia concern younger or lower-income workers. Specific proposals for introducing such a cut in the context of the 2013 budget will be put forward at the **Fifth Review**.

1.22. 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]**

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

#### *Expenditure*

1.24. 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.

1.25. 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*

1.26. 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.

1.27. 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**

1.28. The government will aim at achieving a general government deficit in 2014 in line with the Medium-Term Fiscal Strategy defined in April 2012. The necessary measures will be defined in the 2014 Budget Law. **[Q4-2013]**

1.29. 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; optimise the process for recovering the assets transferred from BPN to the three state-owned SPVs; 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.

*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 BdP will continue to 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. In this context, banks have been instructed to report recently restructured loans due to financial difficulties. Also, BdP has launched on-site inspections on portfolios particularly sensitive to business cycle developments and these inspections will be used to develop appropriate policy guidelines, if needed. These steps will be taken without burdening or posing risks to public resources. The Ministry of Finance, the BdP, and other stakeholders, will complete a proposal for encouraging the diversification of financing alternatives to the corporate sector **by end-July**<sup>3</sup>. 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 deleveraging remain consistent with the macroeconomic framework of the programme. **[Ongoing]**

*Capital buffers*

2.3. Finalise by **30 June 2012** the capital augmentation related to the exercise launched by the European Banking Authority (EBA) aiming at a Core Tier 1 ratio of 9% for the major banks, the partial transfer of banks' pension plans and the special on-site inspections program (SIP). Ensure in parallel that the programme target of a Core Tier 1 ratio of 10 % by end-2012 target is reached.

2.4. Monitor closely compliance with the set deadlines, with a view to promptly take appropriate action in case the deadline is not met. **[Ongoing]**

2.5. Resources from the Bank Solvency Support Facility (BSSF) remain available in line with state aid rules to provide further support to viable banks, if needed. **[Ongoing]**

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<sup>3</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

*Caixa Geral de Depósitos (CGD)*

2.6. Continue to streamline the state-owned CGD group to increase the capital base of its banking arm as needed. The sale of the insurance and health arm is expected to take place **before end-2012** to contribute to meeting that year's additional capital needs, while the sale of non-strategic stakes is ongoing. Provide CGD with government capital support from cash buffers outside of the BSSF subject to EU state aid rules.

*Monitoring of bank solvency*

2.7. 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*

2.8. The BdP will continue to strengthen its supervisory organisation, optimise its supervisory processes and develop and implement new supervisory methodologies and tools. In this context, on-site inspections have been launched, aimed at closely scrutinising banks' portfolios which are particularly sensitive to the business cycle developments. **[Ongoing]**

2.9. In addition, the BdP is stepping up the monitoring of banks, including via ad hoc audits. **[Ongoing]**

2.10. BdP will remain committed to close coordination with home and host country supervisors, both within and outside the EU. **[Ongoing]**

*Banco Português de Negócios*

2.11. Gradually settle CGD's state guaranteed claim on the SPVs in cash, according to the schedule agreed with the EC, ECB and IMF. Any recoveries on the assets held by the state-owned SPVs will also be used to promptly repay CGD. **[Ongoing]**

2.12. Outsource the management of the assets to a professional third party, with a mandate to gradually recover the assets over time. Select the party managing the assets through a competitive bidding process and include proper incentives to optimise the recoveries into the mandate. **[Ongoing]**

*Bank resolution framework*

2.13. The early intervention, resolution and deposit guarantee framework has been strengthened. The authorities are asked to prepare the implementing measures. In particular, the following actions will be taken: (a) setting-up of the resolution fund with a view to ensuring its funding arrangement by **July 2012**; (b) finalize supervisory notices on recovery plans by end-July 2012, (c) adopt resolution plans regulations by **end-October 2012**, taking into account, to the extent possible in view of the deadline, the EBA recommendations and templates; (d) adopt rules applicable to setting-up and operation of bridge banks in line with EU competitions rules by **end-September 2012**. Give priority to the review of the recovery and subsequent resolution plans of the banks that are of systemic importance.

2.14. 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*

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

*Monitoring of corporate and household indebtedness*

2.16. Continue the monitoring of the high indebtedness of the corporate and household sectors through the quarterly reports. 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. Establish a framework for financial institutions to engage in out-of-court debt restructuring for households. In addition, finalise the amendments to the conciliation framework mediated by IAPMEI, a public entity, to facilitate extrajudicial corporate debt restructurings for viable SMEs. **[Ongoing]**

### ***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 including SOEs, PPPs, foundations, associations; re-focus their activities to core public policy objectives and enhance their cost efficiency and fiscal sustainability; streamline the budgetary process, including by adopting new financing laws at regional and local level; 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.

#### **Public Financial Management framework**

*Reporting and Monitoring*

3.1. 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. Technical assistance will be provided if necessary.

3.2. Publish a tax expenditure report **each year as part of the budget**. The report will define a clear methodology to estimate and to evaluate tax expenditures, in line with international best practices. The report will cover central, regional and local administrations.

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

3.4. Prepare, in consultation with the EC and the IMF, a dedicated document, which will accompany the budget report, assessing reform progress in the area of public financial management and delineating next steps over the next three years. [Q3-2012]<sup>4</sup>

#### *Arrears*

3.5. The law on commitments control will be implemented across all general government entities including the regional and local administration and the SOE hospitals; the government will work with these entities so that the necessary changes in the systems are done by **end-July**. The Inspeção Geral de Finanças (IGF) will carry out inspections throughout the process to verify compliance of the commitment control system through a risk based approach. IGF will reinforce the verification of local governments' arrears claims and commitment control systems.

3.6. The stock of domestic arrears will be significantly reduced by the end of the programme period. A significant part of the existing arrears will be reduced as laid down in the strategy for the settlement of arrears. [Q3-2012]

3.7. Prepare a document detailing the procedures and responsible units for monitoring, controlling and auditing the programme agreed between the government and the local authorities for the settlement of arrears ("*Programa de Apoio à Economia Local*") [July-2012]. Transparency of the use of the credit line will be ensured through the monthly publication of the amounts lent, disbursed, and used to settle arrears and other liabilities by municipality [Q3-2012].

#### *Budgetary framework*

3.8. 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.

3.9. Review the Budget Framework Law to take account of the reinforced EU fiscal framework and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (fiscal compact). The revised law will also accommodate the developments in the regional and local financing laws. [Q4-2012]

3.10. Define in detail the 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 after modification of the Budget Framework Law. [April-2013]

#### **Regional and local budgetary frameworks**

3.11. 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.

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<sup>4</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

Adequate structures of monitoring, fiscal reporting, and commitment control will be put into place. **[Ongoing]**

3.12. 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 and the local finance law will be discussed with EC/IMF/ECB by **[Q2-2012]** and submitted to Parliament by **[Q4-2012]**<sup>5</sup>. 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.

3.13. Create a working group with representatives from the Ministry of Finance, the Autonomous Regions and the local authorities to prepare a proposal for common revenue forecasting guidelines for subnational governments. **[Q3-2012]**

3.14. Proceed with identifying data needs to support the revenue projections, balancing the need to preserve tax secrecy and the elaboration of sound forecasts by subnational governments. **[Q3-2012]**

3.15. 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 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 **[Ongoing]**.

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<sup>5</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

### **Public Private Partnerships**

3.16. Complete the study to assess the costs and benefits of renegotiating any PPP contract to reduce the government financial obligations [Q2-2012]. 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. For certain PPP and concession contracts, the renegotiation process started before the completion of the study, due to financial or legal imperatives. Other than these, final decisions on renegotiation will be taken after the study's conclusion and in consultation with the EC, ECB and the IMF. Regions will be encouraged to design a framework for assessing fiscal risks derived from PPP, concessions and other public investments, as well as for monitoring their execution. The requirements will be similar to those put in place at central level. [Q3-2012]

3.17. 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 Banco de Portugal. [Q3-2012]

### **State-owned enterprises**

3.18. 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 before the **Fifth Review**.

3.19. The government will prepare, in consultation with staff from the EC, ECB and IMF, a comprehensive strategy for managing the heavy debt load of all SOEs – including Parpublica. [July-2012]

3.20. Submit to Parliament a draft law 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. [Q2-2012] No additional SOEs will be created until this law is adopted.

3.21. Equivalent measures on operational results, debt, restructuring and governance will be taken at the local and regional levels, while respecting their administrative autonomy as foreseen in the law. The annual and quarterly SOEs reports will assess progress towards

achieving these objectives for central and local SOEs. Each Autonomous Region will provide similar annual reports. These will serve as inputs to the fiscal risks analysis in the budget. **[Q2-2012]**

### **Privatisation**

3.22. 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 programme. 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 concluded by the **second quarter of 2013**. The tender for the privatisation of the national air carrier (TAP) and the airport operator Aeroportos de Portugal (ANA) will be launched in the third quarter, with a view to completing these transactions in **early 2013**. 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.

3.23. 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]**

3.24. The government will work together with the municipalities and regional governments in order to identify the scope for further privatisation, by preparing an inventory of their assets, including real estate. **[Q3-2012]**

### **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**.

3.26. Following the recommendations of the "Study on the potential merger of the collection units of the Tax Authority and the Social Security", the government will by **[end-August]**:

- i. prepare a draft proposal to enhance the exchange of information between the collection units of the Tax Authority and the Social Security, and
- ii. study ways of possible implementation of the other working group recommendations to strengthen control and simplifying compliance.

3.27. 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. based on the report presented, prepare draft action plan with concrete measures and timelines to resolve VAT issues related to backlog enforcement cases and assess the possibility of introducing transitional measures targeting cases currently filed in courts taking into account tax fraud and erosion risks. [**20 August 2012**];
- v. publish quarterly reports on recovery rates, duration and costs of tax cases starting from **Q4-2012** within four months after the end of the relevant quarter.

3.28. 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.

3.29. 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. Based on this proposal, a draft law will be submitted to Parliament by [**Q4-2012**].

3.30. The tax administration has concluded the strategic plan to combat fraud and evasion for 2012-14 and has taken important steps for its implementation. Moreover, the plan to implement e-invoicing in Portugal will be further developed [**Q4-2012**]. Measures to strengthen final consumers' incentives to ask for invoices, notably in hard-to-tax sectors, will be implemented, and EC, ECB and the IMF will be consulted on any developments regarding the scheme design. An evaluation report of the scheme will be prepared [**Q1-2013**].

3.31. The tax administration will develop a modern tax compliance management framework as an important tool to curb non-compliance. A fully-fledged Large Taxpayer Office (LTO) will be operational by [**Q4-2012**]<sup>6</sup>.

### **Public administration**

#### *Central, regional and local administration*

3.32. Conclude the public administration restructuring programme (PREMAC) by the completion of procedures for the preparation, approval and publication of all legal acts by **end-June**. The final report, comprising the internal organisation and the roster of each entity, including the reallocation of human resources, will be presented in [**Q3-2012**].

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<sup>6</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

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 an average of at least 15 per cent by the end of 2012. **[Q2-2012]**

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 and local administrations, facilitating the closure of existing entities when warranted. In addition, the government will promote 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. The government will reorganise and significantly reduce the number of such entities. 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. **[Q3-2012]**

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). **[Q1-2013]** GeRFIP will also be implemented in the Autonomous Region of Madeira and in the Autonomous Region of Azores **[Q4-2013]**;
- 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. The Autonomous Region of Madeira will implement GeRHuP gradually;
- 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 and the regulation on mutual agreement on contract termination, 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 general government, to identify unwarranted differences in remuneration between the public and the private sector for similar types of qualifications. **[Q4-2012]** The comprehensive study of entities classified outside the general government will follow in **Q2-2013**.

### **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 percent 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**.

*Pricing and reimbursement of pharmaceuticals*

3.45. Enact legislation which automatically reduces the prices of medicines when their patent expires to 50 per cent of their previous price. **[Q4-2012]**

3.46. Complete the transfer of the responsibility of pricing medicines to the Ministry of Health (for example to Infarmed). **[Q2-2012]**

3.47. The government implements an annual revision of prices of medicines and of countries of reference in order to achieve cost savings. Second price revision to be published in **January 2013**.

3.48. 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*

3.49. 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]**

3.50. Continue to devise and enforce a system of sanctions and penalties, as a complement to the assessment framework. **[Ongoing]**

3.51. Strictly monitor the implementation of the legislation making it compulsory for physicians at all levels of the system, both public and private, to prescribe by International Non-proprietary Name (INN) to increase the use of generic medicines and the less costly available product. An implementation report will be published by **December 2012**.

3.52. 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]**

3.53. 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]**

3.54. 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*

3.55. Effectively implement the new legislation regulating pharmacies. **[Q2-2012]**

3.56. 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]**.

3.57. 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]**

3.58. 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*

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

3.60. Take further measures to increase competition among private providers and reduce by an additional 10 percent 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]**

3.61. 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]**

3.62. Conduct an analysis of the market characteristics of relevant areas of service provision such as dialysis and the pharmacies sector in view of ensuring competition and fair prices in private markets. **[Q4-2013]**

#### *Primary care services*

3.63. 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*

3.64. Implement the strategy to clear arrears in the health sector, within the overall strategy for settling and avoiding the re-emergence of arrears. Ensure standardised and tight control procedures for all health sector entities to ensure expenditure commitments stay within the budget allocated to each entity and therefore prevent the re-emergence of arrears. **[Q3-2012]**

3.65. 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]**

3.66. 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. **[Q4-2012]**

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

3.68. 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]**

3.69. 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]**

3.70. Continue work to ensure full interoperability of IT systems in hospitals, 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. **[Ongoing]**

3.71. 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 percent 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]

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

3.73. 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]

3.74. 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*

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

#### *Cross services*

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

3.77. 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 (Decree-law 64/2012 and Decree-law 65/2012 of 15 March) - 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 approval by Parliament of draft law n. 46/XII (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. In consultation with social partners, the Government will, submit to Parliament by **Q3-2012** draft legislation aiming at:

- aligning the level of severance payments with 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.

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 **Q3-2013**.

### *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 50 percent 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 **Q3-2012**<sup>7</sup>, with a view to entering into force by **Q1-2013**;
- iv. prepare an independent review by **Q3-2012** on:
  - o how the tripartite concentration 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;
  - o 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**:

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<sup>7</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

- 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. in line with the action plan to improve the quality of secondary education the Government, by **Q3-2012**, will: (i) implement the legislation to promote trust agreements with public schools and report about progress; (ii) define and implement a simple formula-based funding framework comprising performance evaluation criteria and accountability for public schools and schools under autonomy agreements; (iii) present an assessment of the new inspection model;
- iii. in line with action plan on vocational and educational training (VET) the Government will present a progress report on: (i) ways to promote the involvement of businesses in the provisions of traineeships [**Q3-2012**]; (ii) action taken to reorganise modalities for the provision of VET, improve the quality and attractiveness of VET, and to enhance students' orientation and career guidance [**Q4-2012**]; (iii) the establishment of "professional schools of reference". [**Q1-2013**]

## **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 Regulatory 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:

- i. 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**];
- ii. prepare a report analysing and developing options to improve the harmonised mechanism for capacity allocation and congestion management of cross-border flows with Spain, including the introduction of virtual reverse flows and other mechanisms allowing smaller players to make efficient use of the LNG Sines facility [**Q1-2013**];
- iii. 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**]

#### *Ensure sustainability of the national electricity system*

5.4. Implement the measures approved in the Council of Ministers on 17 May 2012 to reduce excessive rents and to address the sustainability of the national electricity system. Cost reduction measures address the following compensation schemes: power guarantee, special regime (renewables - excluding those granted under tender mechanisms – and cogeneration), CAE's (power purchase agreements) and CMECs, and will reduce policy cost by at least

EUR 1275 million in Net Present Value (NPV)<sup>8</sup> [**July-2012**]. The updated estimation of cost reductions that will be achieved as well as progress towards elimination of the tariff debt (defice tarifário) by 2020 will be presented and assessed in the fifth review.

5.5. Implement the announced measures to limit the policy costs embedded in CMECs and PPAs. In particular, as an element in revising the rate of return to bring it in line with the cost of capital at the moment the CMEC compensation was defined plus, if warranted, a risk premium of the assets that the mechanism remunerates: (i) reduce the CMEC annuity discount rate from 7.55% to 5% (yielding a NPV of EUR 120 million); and (ii) set a compensation for the extension of exploitation licences of the power plants in Sines and Pego<sup>9</sup> yielding NPVs of EUR 55-75 million and EUR 30-50 million respectively, providing details on the valuation methodology leading to these figures. The updated estimation of cost reductions that will be achieved will be presented and assessed in the **fifth review**.

5.6. Present a report on the CMEC scheme including the foreseen annual compensation amounts to each beneficiary and past payments since 2007 and the forecast of future payments. The report will also describe the process for the extension of the concession of the public hydro resource by the former CAE hydro power plants, its correspondent economic valuation, and the rationale for the direct award instead of a tender process. The report will assess and consider all the information available within the governmental and the official bodies (General Directorates, Regulator, State representative in the contracts). [**Q3-2012**]

5.7. Implement the announced measures to limit the policy costs of renewables under the special regime - excluding those granted under tender mechanisms, in particular (i) the compensation to be paid by the generators (yielding a NPV of EUR 75 to 150 million); and (ii) the introduction of a maximum duration for the feed in tariff in small hydro plants (yielding an NPV of EUR 200 to 250 million). The updated estimation of cost reductions that will be achieved will be presented and assessed in the **fifth review**.

5.8. Accelerate convergence to market-based pricing for co-generation operators in parallel with electricity market developments under the EU internal electricity and gas market legislation. The remuneration scheme for co-generation will be further revised to improve efficiency of the support system in ensuring continued guaranteed access of operators to electricity networks and markets with the calculation of explicit subsidies based on relevant price factors in the context of a competitive electricity market. The revision should ensure that the design of the support scheme allows a dynamic correlation between electricity market prices and the efficiency premium when the values of avoided externalities are not adequately reflected in electricity and other factor prices. [**Q4-2012**]. Ensure through annual audits that plants not fulfilling the requirements for co-generation do not receive the support, and report on the progress. [**Q2-2012, Q2-2013**]

5.9. Establish the new subsidy regime under the Power Guarantee mechanism, taking into account the principles established in the Executive Order (Portaria 139/2012) of 14 May 2012 that has revoked the former scheme, namely the differentiated approach for thermal and hydro power plants. Incentives to build additional generating capacity in the future will take

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<sup>8</sup> Computed using a discount rate of 7.55% back to June 2012.

<sup>9</sup> Pego power plant compensation will not be included when determining the reduction of the rate of return of the CMEC.

into account adequate security of supply levels and the existence of other mechanisms, such as interruptibility services. This new regime, replacing the one eliminated by Executive Order is estimated to reduce policy costs by about EUR 37 million in 2012, EUR 64 million in 2013 and 2014, EUR 52 million per year in 2015 and 2016, EUR 38 million in 2017, and EUR 25 million per year from 2018 to 2020 [Q2-2012]. The updated estimation of cost reductions that will be achieved with the new Power Guarantee mechanism will be presented and assessed in the **fifth review**.

5.10. 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**.

5.11. 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*

5.12. 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]

### **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*

5.13. 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 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). **[Q2-2012]**

5.14. Following the corrective measures already taken, monitor the competitive situation in the telecommunications sector, in particular wholesale and retail broadband access, mobile origination charges and barriers to entry into the fixed communication market. **[Ongoing]**

### *Postal services*

5.15. Following the transposition of the Third Postal directive, further liberalise the postal sector by 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 (Law 17/2012) transposing the Third 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.

### *Strategic Plan for Transport*

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

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

5.18. 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. continue to implement the plans to bring the infrastructure manager to operational balance, in particular by reducing 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. Reintroduce incentives to REFER to reduce costs and access charges. Provide annual progress reports on the implementation of balancing revenues and expenditures **[Q2-2012, Q2-2013]**;
- iii. analyse the potential for further rationalisation in loss-making and low-demand lines and services **[Q4-2012]**;
- 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 **[Q3-2012]**. 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. extend the performance scheme on infrastructure charges to other operators [Q2-2012];
- vi. review and render more effective the yield management on long-distance passenger ticket prices. [Q1-2013];
- vii. to prepare the privatisation of the freight branch of the state-owned rail operator, carry out an analysis for transferring part or whole of CP Carga's rolling stock to a rolling stock operating company. [Q3-2012];
- viii. 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. [Q3-2012]; Plans will be presented and assessed in the **fifth review**.
- ix. optimise the train driver certification process concerning additional authorisations by shortening lead times, simplifying and making more effective the safety rules in close collaboration with the rail regulator [Q3-2012]

#### *Ports*

5.19. 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] The revised legal framework is expected to come into force by [Q3-2012].

5.20. 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 long-term vision of the transport system to be adopted (measure 5.17). The Ministry of Economy and Employment will deliver and enforce policies that ensure strong integrated policy-making, strategic planning and surveillance functions common to all ports in the country. Moreover, the Port Regulator shall have the capacity to ensure at a National level that the Port Authorities will implement policy decisions so that (i) efficiency gains and cost-savings are passed through to port customers; and (ii) concession-holders of terminals and land facilities in ports respect minimum performance criteria. [August-2012]

#### *Road pricing*

5.21. 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*

5.22. 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]**.

5.23. 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 **[Q2-2012]** in view of approval by **[Q3-2012]**.

#### *Professional qualifications*

5.24. Improve the recognition framework on professional qualifications through adoption by the Parliament of the amendment to Law 9/2009, already submitted, on the recognition of professional qualifications in compliance with the Professional Qualifications Directive **[expected by August-2012]**. Adopt the executive order (portaria) on the services provider prior declaration following the adoption of amendment of Law 9/2009. **[Q3-2012]**

#### *Regulated professions*

5.25. 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 **[July-2012]** in view of approval by **[Q3-2012]**.

5.26. 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 5.24, and 5.25; (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, following the 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*

5.27. Continue the simplification reform effort by:

- i. adapting the content and responsive to the new legislation to be adopted to ensure conformity with the Services Directive (see 5.22 and 5.23 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;
- ii. 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 5.24, 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;
- iii. making available in PSC on-line procedures for the registration of establishments covered by "Zero Authorisation" (DL 48/2011) by [Q4-2012]. Foster collaboration from municipalities in providing the content for the working hours map for the stores and establishments services and advertisement regimes for which they have full competence to make the PSC operational [Q3-2012]; and also for installation, modification and closing up of restaurants, bars and other establishment and occupation of public space regimes [Q4-2012]. 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 [Q1-2013]. The platform will be available to all levels of administration, including all municipalities [Q1-2013];
- iv. extending PSC to services not covered by the Services Directive [Q2-2013];
- v. extending the "Zero Authorisation" project to other services 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.

*Property taxation*

6.1. 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]

6.2. 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]**

*Comprehensive review of the housing market*

6.3. Following the adoption of the amendments to the New Urban Lease Act Law 6/2006 and the Decree Law which simplifies the administrative procedures for renovation, the government will undertake a comprehensive review of the functioning of the housing market with the support of internationally-reputed experts. The review will determine whether the new legal provisions adopted are sufficient to make the housing market more dynamic and, if necessary, will propose new policy measures. **[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 third report to be completed by **15 August 2012**.

7.3. Present the initial draft bill for enforcement agent framework (i) strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, and (ii) to include a fee structure that incentivises speedy enforcement by **mid-August 2012** which will be further refined by extensive consultation including with the IMF/EU technical assistance by **mid-October 2012**.

#### *Management of courts*

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

7.4. Submit an initial draft bill on judicial reform by **mid-August 2012** which will be further refined by extensive consultation including with the IMF/EU technical assistance by **end-**

**September 2012.** Submit a Bill to implement the judicial reform roadmap to Parliament by **end-November 2012**<sup>10</sup>.

*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 **November 2012**.

*Civil law cases in the courts*

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

7.6. Prepare an initial draft of the new Code of Civil Procedure by 6 July 2012 which will be further refined by extensive consultation including with the IMF/EU technical assistance by **end-September 2012**. By **end-November 2012**<sup>11</sup> submit to Parliament the Code of Civil Procedure which addresses 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.

*Budget and allocation of resources*

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

7.7. 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 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*

7.8. 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

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<sup>10</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>11</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

management or control of companies **[Ongoing]**. The Portuguese State will ensure that CGD alienates its participation in Galp. **[Q2-2012]**

7.9. 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]**

7.10. Monitor the inflow of cases and report on the functioning of the specialised court for Competition, Regulation and Supervision, assessing the situation in terms of risk of potential court backlogs. **[Q4-2012]**

7.11. 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 7.12 (i), the financing model of the latter will be re-examined resulting in a technical proposal by **[Q3-2012]** to be implemented by **[Q4-2012]**. Given the enlarged scope of action of the Competition Authority, review with key stakeholders the conditions for the proper execution of its mandate. **[Q3-2012]**

7.12. 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 **[Q3-2012]**<sup>12</sup>.

#### *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:

7.13. Submit a report analysing the effectiveness and impact of the amendments to the revised Public Procurement Code as well as of the enhanced role of the Court of Auditors in ensuring compliance with public procurement rules by **[Q1-2013]**.

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<sup>12</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

*Business environment*

7.14. 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.

7.15. 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 internationalisation of companies, in particular for SMEs (therefore partially responding also to measure 2.16) 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]**

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

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

7.18. The government is also undertaking additional initiatives to simplify substantially the administrative and other legal requirements for the exercise of an economic activity. This includes a revision of the legal frameworks of territorial planning, land use and urban and construction and industry licensing in line with the '*Programa da Indústria Responsável*' and the forthcoming Decree Law on '*Sistema de Indústria Responsável*' which aims at (i) extending the Zero Licensing to the majority of the industrial activities, (ii) creating Special Areas where the firms will benefit from exemptions of administrative and licensing requirements, and (iii) extending the use of the Point of Single Contact for the procedures needed in the start-up or alteration of an industrial activity and for the relations with the Public Administration. **[Ongoing]**