

Lisboa, 05.02.2016

**M. Valdis Dombrovskis**

Vice-President of the European Commission

**M. Pierre Moscovici**

*Member of the European Commission*

Following your letter on the 26<sup>th</sup> of January our services have worked long hours to clarify some issues you have raised in order to consolidate Portugal's Draft Budgetary Plan (DBP) for 2016. These intensive exchanges have resulted in a more robust DBP which, we are certain, will be in accordance with the goals and objectives of the Stability and Growth Pact.

As you are aware, the Portuguese Government is fully engaged to honour its European commitments. Our DBP has, since its first version, reflected our pledge to honour them, as it is reflected in the Government's Programme approved in the Assembly of the Republic. As such, we embarked on this constructive dialogue to clarify outstanding issues with determination and a transparent stance.

Let me summarize the main structural measures we have added to the DBP during this week, which were already described in detail to your services. These are measures both on the expenditure and on the revenue side:

- Interest savings related to early payments to the IMF – **50M€**;
- Revenues related to changes on vehicle acquisition taxes – **70M€**;  
*This measure aims at curbing the excess of credit consumption.*
- An additional increase in tax revenues related to tobacco – **100M€**;  
*Having in mind the macro-economic scenario the Government will present a 3% update of this tax. This increase also aims to discourage the consumption of a detrimental health product.*
- An additional increase in petroleum tax – **120M€**;  
*Given record low oil prices in international markets this tax increase will constitute a revenue-neutral measure. The measure is also intended to disincentive a further consumption of oil products, thus contributing to fulfil Portugal's commitments to fight Climate Change.*
- Repeal of the local tax exemption for investment funds and pension funds – **50M€**;  
*Investment and pension funds have a partial exemption (50%) on local property taxes – both the local estate tax (IMI) and the tax on estate transactions (IMT). The estate tax is levied yearly on real estate. It varies between municipalities, ranging from 0.3% to 0.8%. The real estate transaction tax is paid by the buyer. The rates vary between 4.1% and 6.5%. Past exemptions mean that a large number of properties are owned by funds.*
- An additional contribution by banks to the Resolution Fund: **50M€**;



- **New civil servants rotation policy – savings worth 100M€;**  
*The policy for human resources in Public Administration will be made more efficient. We will implement a rule of hiring one worker for every two workers that leave the Public Administration.*
- **New system of Monthly Reporting of Remunerations for Social Security – 50M€;**  
*In 2016 the Social Security reporting procedure will be changed with the adoption of a new Monthly Reporting of Remunerations (MRR), which will enhance the reporting efficiency. The new MRR consists of an integrated model within the contributions management, facilitating the provision of information and allowing clearer communication between companies and the social security. There will be greater integration between business flows, reducing the interactions of companies with Social Security. By providing a set of new services, such as pre-filling with data on social security information system and the validation of input to the remuneration statements to ensure the quality of delivered data, you can reduce compensation claims errors, and thereby increase reporting and contribution collection efficiency. The rules and validations underlying the new MRR will be gradually implemented during the first half of 2016.*
- **Corporate tax revenue related to assets' revaluation have an intrinsic structural nature – 125M€;**  
*The measure will be a permanent change in the regime in which companies will be able to periodically revalue their tangible assets already fully depreciated under tax laws, for a new period of depreciation; the revaluation period will be 10-year intervals. In practical terms the measure will consist of taxing at 14% (2/3 of the normal tax rate) the revaluated value. This revaluation allows balance sheets prepared for tax purposes to reflect the assets' accurate value, because legal depreciation may exceed the real deterioration. The incentives for companies to use the new regime lies on its strong impact on the companies' equity and value. Many Portuguese companies for instance do not qualify for European Funds support or are refused bank credit due to the balance sheet situation showing in their tax forms.*
- **Improvement of control mechanisms in sickness benefits – savings of 60M€.**  
*Over the past few years, we observed an increase in expenditure on sickness benefits justified largely by a decrease in the number of grant recipients called to the Disability Verification Service (DVS). The most effective form of fraud detection in social provision of this nature is through a call to attend a medical board, which verifies the eligibility claim of sickness benefits within the first 30 days. Between 2013 and 2015 spending on sickness benefits increased, approximately, 65 million euros (+ 17%). The Government will undertake a strengthening of the notice procedure of DVS estimating a reduction in spending of 60 million euros.*
- **Roll back of the reduction of 1,5pp in the Social Security Contribution previously announced for workers with wages lower than 600 euro – savings of 135M€.**

Additionally, in the final preparation of the 2016 Budget, we received new data from the Central Bank and the Social Security Institute which generate a positive impact on the general Government balance:

- An improvement in the central bank dividends, previously estimated in 200 million euros and now estimated in **240M€;**
- An improvement in the estimated overall balance of the social security accounts of **175M€** based on an updated account that reflects the monthly data for December and (already) the full month of January.





Our services were also able to clarify that some measures should be considered as one-offs. The first one was the European Resolution Fund, due to the resolution of *Novo Banco* and *Banif*, European legislation foresees that the country is exempted from contributing until 2024 (8-year waive). As a consequence, the **130M€** constitute a revenue peak. The second one was the Transmontana PPP. In 2015, *Infraestruturas de Portugal* received EU funds worth **164M€** to finance a PPP, which it did not transfer to the Transmontana subconcession.

Besides all this, as you are aware, Portugal has recently completed an economic adjustment programme. Many reforms were implemented but their impact failed to materialize and potential growth remains subdued, as the programme was short-term oriented and fell short of addressing important bottlenecks in the Portuguese economy. These structural weaknesses are of major relevance as they compromise the long run prospects of the Portuguese economy – the key objective in the Stability and Growth Pact.

The Government's action, based on its Programme, will pay particular attention during next year to promote structural reforms in (i) the modernization of the Public Administration, reducing transaction costs; (ii) fighting labour market segmentation and diversifying Social Security financing sources, thus reinforcing its long-term sustainability; (iii) the support of the capitalization of enterprises and to stimulate the link between universities, innovation research centres and firms; and (iv) review the financial system supervisory framework. These processes will be conducted in a participatory way, working within the Standing Committee for Social Dialogue in order to build a broad-based medium-term consensus on key reforms.

All in all, the consideration of all these new measures result in a **structural effort of 0,3pp** in 2016.

I believe there can be no doubt about the Portuguese Republic's commitment to honour her obligations.

Yours sincerely,

Mário Centeno

Ministro das Finanças