

European Commission

Directorate-General for Economic and Financial Affairs

# The Economic Adjustment Programme for Portugal

## ACKNOWLEDGEMENTS

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# Outline of the Report

Executive summary .....	4
I. Weak economic performance and growing imbalances in the years before the crisis .....	5
II. The run-up to the international financial assistance programme .....	13
III. Programme design and objectives .....	16
III.1. Economic outlook: shrinking domestic demand and rising net exports .....	16
III.2. Putting fiscal policy on a sustainable footing .....	18
III.3. Stabilising the financial sector .....	22
III.4. In-depth structural reforms to support growth and the unwinding of imbalances .....	23
IV. Programme financing .....	28

## Annex

Annex 1: Commission services' macroeconomic projections, 2011-15 .....	31
Annex 2: List of fiscal measures included in the Programme .....	35
Annex 3: Indicative financing needs and sources .....	36
Annex 4: Programme documents .....	37
Letter of Intent .....	38
Portugal—Memorandum Of Economic And Financial Policies .....	41
Memorandum of Understanding on Specific Economic Policy Conditionality .....	58
Portugal - Technical Memorandum Of Understanding (TMU) .....	94
Annex 5: Indicative timeline of financial sector and structural measures in the Memorandum of Understanding on specific economic conditionality .....	100
Annex 6: Provision of data .....	112

## Boxes

Box 1: Decomposition of export performance .....	6
Box 2: The net foreign asset position (NFA) .....	7
Box 3: Public-Private Partnerships (PPPs) in Portugal .....	11
Box 4: The sovereign debt crisis of Portugal - Chronology of events .....	15
Box 5: Government debt and fiscal sustainability in Portugal .....	18
Box 6: Employment protection: moving closer to a single contract? .....	26
Box 7: EFSM and EFSF financing .....	30

## EXECUTIVE SUMMARY

*Portugal has suffered from low GDP and productivity growth for more than a decade before the outbreak of the recent crisis. Potential output growth has been on a steady downward trend, with competitiveness being undermined by rising unit labour costs and deep-rooted structural problems. As a consequence of persistent current account deficits, Portugal has accumulated a high external debt, which is reflected in high household, corporate and fiscal debts. On the positive side, Portugal did not witness a property boom and bust, nor were banks exposed to toxic assets. Therefore, the financial sector has weathered the first phase of the financial crisis relatively well.*

*The period before the request for financial assistance was marked by unfavourable developments in public finances and a worsening economic outlook. This led to a deterioration of confidence and rising market pressures on Portuguese debt, accentuated by the negative developments in euro area sovereign bond markets. Amidst consecutive downgradings by credit rating agencies of Portuguese sovereign bonds, the country became unable to refinance itself at rates compatible with long-term fiscal sustainability. In parallel, the banking sector, which is heavily dependent on external financing, was increasingly cut off from international market funding and had to step up reliance on the Eurosystem for funding.*

*Following a request by Portugal on 7 April 2011, the Troika consisting of the European Commission, ECB and IMF negotiated an Economic Adjustment Programme, aimed at restoring confidence, enabling the return of the economy to sustainable growth, and safeguarding financial stability in Portugal, the euro area and the EU. The Programme was agreed by the European Council on 30 May 2011 and the IMF board on 20 May. It covers the period 2011-2014. Its financial package will cover up to EUR 78 billion for possible fiscal financing needs and support to the banking system. One third (up to EUR 26 billion) will be financed by the European Union under the European Financial Stabilisation Mechanism (EFSM), another third by the European Financial Stability Facility (EFSF), and the final third by the IMF under an Extended Fund Facility. The programme foresees comprehensive action on three fronts.*

*First, a credible and balanced fiscal consolidation strategy, supported by structural fiscal measures and better fiscal control over Public-Private-Partnerships (PPPs) and state-owned enterprises (SOEs), aiming at putting the gross public debt-to-GDP ratio on a firm downward path in the medium term. The authorities are committed to reducing the deficit to 3% of GDP by 2013.*

*Second, efforts to safeguard the financial sector through market-based mechanisms supported by back-up facilities. Central aspects here are measures to foster a gradual and orderly deleveraging, strengthened capitalisation of banks, reinforced banking supervision and the sale or unwinding of the BPN bank.*

*Third, deep and frontloaded structural reforms to boost potential growth, create jobs, and improve competitiveness. In particular, the Programme contains reforms of the labour market, the judicial system, network industries and housing and services sectors, with a view to strengthening the economy's growth potential, improving competitiveness and facilitating economic adjustment.*

*An important feature of the programme is the aim to mitigate negative social impacts, while addressing fiscal, banking and structural imbalances at the same time. In particular, tax increases and benefit reforms are designed such as to minimise the impact on the lowest income groups.*

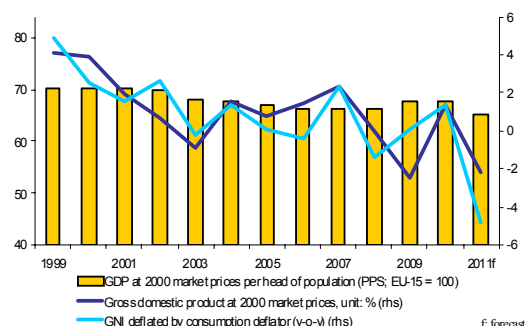
# I. WEAK ECONOMIC PERFORMANCE AND GROWING IMBALANCES IN THE YEARS BEFORE THE CRISIS

## A DECADE OF LOW PRODUCTIVITY GROWTH, DETERIORATING COMPETITIVENESS AND GROWING INDEBTEDNESS

1. **Portugal has suffered from low GDP and productivity growth for more than a decade.** During the years before the financial crisis (2001-08), average annual real GDP growth was only 1 percent. Over the last decade, Portugal's economic growth was the second-lowest of the 27 EU Member States. This is in contrast with the 1991-2000 decade, when the economy grew at rates above 3 percent per year on average. GDP per capita in Purchasing Power Standards (PPS) increased to 70 percent of the EU15 average in 2000, but has been stagnating since. Gross National Income (GNI) deflated by the private consumption deflator, another indicator of prosperity, grew even less than GDP, reflecting the effect of servicing a large and growing stock of external liabilities (see Graph 1).

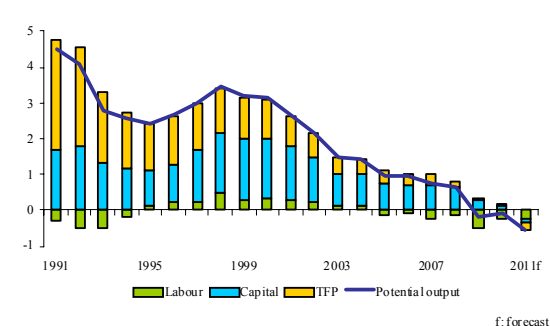
2. **Potential output growth has been on a downward trend since the late 1990s.** Declining potential growth reflected decreasing contributions of capital, labour and total factor productivity (see Graph 2). Latest projections point to stagnating potential GDP, as strongly negative contributions of labour supply are not fully compensated by slightly positive growth contributions of capital and factor productivity. Significant wage increases even during periods of rising unemployment (in 2009-10 compensation per employee increased by 3.3 percent and 1.5 percent, respectively, despite a rise in the unemployment rate from around 8 percent in 2008 to over 11 percent in 2010) point to higher structural unemployment.

Graph 1: GDP per capita (EU15=100), real GDP and GNI growth



Source: Commission services

Graph 2: Potential output growth



Source: Commission services

3. **Deep-rooted structural problems have caused a major loss of competitiveness.** Since the introduction of the euro, Portugal has experienced significant real exchange rate (REER) appreciation vis-à-vis its trading partners, due to wage growth largely outstripping productivity advances (Graph 3). However, the competitiveness problem goes well beyond inadequate price and wage developments. Rigidities and inefficiencies in labour and product markets, weak enforcement of competition rules, a dysfunctional judicial system, malfunctioning housing and rental markets, a lack of adequate human capital and of innovation, have all hampered an efficient use of resources and the dynamism of the economy.

4. **Portugal has been losing export markets shares.** The loss in price competitiveness together with an unfavourable geographical and sectoral export composition translated into a significant loss in

market shares on markets for labour-intensive goods, where Asian and Eastern European competition has been strengthening. Portugal's export concentration in a small number of euro area markets, which have grown less than world trade, has also contributed to its subdued export performance over the past decade. Portugal's export structure is also mostly focused in slow-growing sectors (see Box 1). In spite of some improvement on diversification in the most recent years towards exports with higher technological content, their further expansion is held back by the low skills base. In the services sector, Portugal's share in world trade has increased, but faster-growing sectors represent a very small share of total exports of services.

#### BOX 1: DECOMPOSITION OF EXPORT PERFORMANCE

Portugal's export product mix is problematic with respect to factor intensity and technological content, exposing the tradable sector to fierce competition from emerging economies, especially in Asia. Despite some improvements in the last decade, Portugal's exports are still concentrated in low-technology goods, which are usually associated with lower value-added activities (see Table 1). This is also reflected in the specialisation by factor intensity. Table 1 shows that manufacturing exports are still dominated by labour-intensive goods. Encouragingly, in some medium to fast growing sectors such as road vehicles and plastics (in non-primary forms), Portugal reveals a stronger comparative advantage than the euro area average relative to the world.

Table 1: **Export specialisation (Balassa Index):**

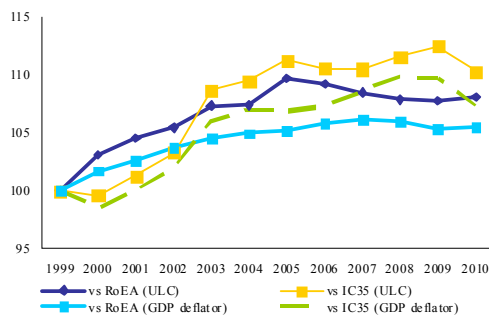
By technological intensity (average 2004-2007)									
	PT	ES	IT	IE	DE	EA16	EU27	Eastern EU	China
High-technology sectors	0.34	0.50	0.47	2.76	0.92	0.95	1.02	0.51	1.04
Medium-high-technology sectors	0.77	1.16	1.05	0.86	1.30	1.13	1.01	1.09	0.63
Medium-low-technology sectors	1.15	1.10	1.11	0.16	0.87	0.92	0.95	1.22	1.04
Low-technology sectors	1.80	0.99	1.21	0.62	0.59	0.87	1.01	1.02	1.64
ICT	0.65	0.26	0.21	1.14	0.54	0.50	0.91	0.77	1.63
By factor intensity (average 2005-2009)									
	PT	ES	IT	IE	DE	EA16	EU27	Eastern EU	China
Raw Material Intensive Goods	0.64	0.87	0.45	0.44	0.34	0.58	0.47	0.57	0.24
Labour Intensive Goods	1.96	1.10	1.79	0.49	0.89	1.05	0.98	1.30	2.07
Capital intensive Goods	1.30	1.92	1.06	0.49	1.48	1.31	1.08	1.45	0.55
Easy Imitable Research Goods	0.54	0.63	0.56	3.54	0.93	1.05	1.06	0.97	1.81
Difficult Imitable Research Goods	0.67	0.77	1.32	0.54	1.35	1.09	1.38	1.01	0.94
By dynamic industries in the manufacturing sector (average 2005-2009)									
	PT	ES	IT	IE	DE	EA16	EU27	Eastern EU	China
Fast-growing sectors	0.83	0.96	0.91	1.22	0.90	1.02	0.97	1.15	1.00
Medium-fast-growing sectors	1.07	1.37	0.75	0.30	1.25	1.00	0.94	1.24	0.61
Medium-slow-growing sectors	0.72	0.84	1.27	1.50	1.10	1.11	1.31	0.74	0.72
Slow-growing sectors	1.56	0.75	1.14	0.96	0.66	0.83	0.70	0.78	1.94

Notes: Technological intensity based on OECD classification. Eastern EU includes Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia. Balassa Index of "revealed comparative advantage" compares the share of one sector in a country's total exports with the share of that sector in the world's total exports. Readings above 1 indicate a country's comparative advantage relative to the world. Dynamic industries in the manufacturing sector based on SITC Revision 3 at a 2-digit level.

Source: Commission services calculations based on Comtrade and Comext data.

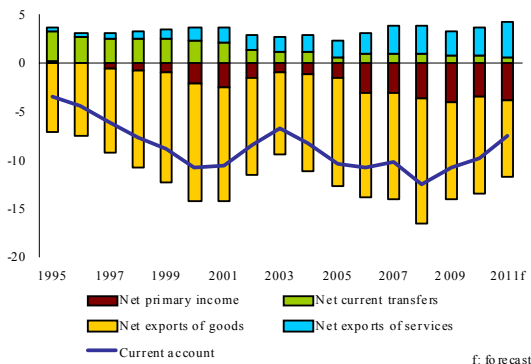
**5. The recent adjustment in the current account deficit is not sufficient to restore external sustainability.** During the last decade, net external borrowing hovered between 6½ and 10½ percent of GDP. Although declining from its peak in 2008, the deficit remained high at 8½ percent of GDP in 2010. In 2010, the goods trade deficit was 10 percent of GDP (Graph 4). The surplus in services trade (2¼ percent of GDP) and positive balances of current and capital transfers were largely offset by large and increasing primary income outflows. The persistent goods trade deficits can partly be explained by the high share of energy in imports. However, in order to significantly reduce the current account deficit in the future, export growth will have to exceed import growth by a wide margin.

Graph 3: REER vs Rest of the Euro area and 35 Industrialised countries 1999=100



Source: Commission services

Graph 4: Current account composition (% of GDP)



Source: Commission services

**6. Portugal's external indebtedness is very high.** The stock of net external liabilities is estimated at around 110 percent of GDP at the end of 2010, from less than 40 percent ten years before. On current projection it would reach 120 percent of GDP in 2012 (see Box 2). As a result of the depreciation of Portuguese liabilities – including government debt owned by foreigners, there has been a small reduction in external debt at market prices. The annual net primary income outflow has meanwhile reached 3½ percent of GDP and is expected to keep on increasing in line with net external debt and interest rates.

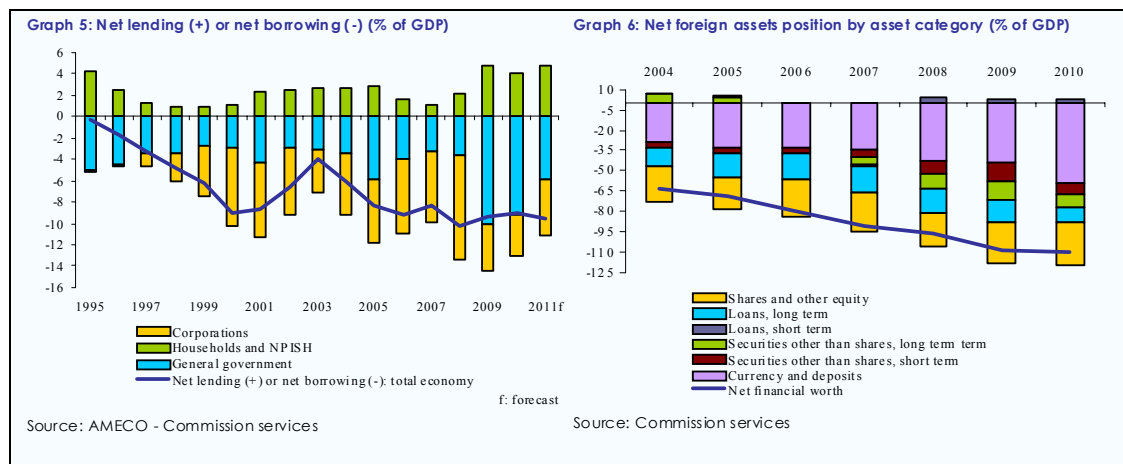
**BOX 2: THE NET FOREIGN ASSET POSITION (NFA)**

The net external borrowing needs of the economy amounted to about 8 percent of GDP on average in the period 2000-2008, compared to 3¼ percent of GDP in the second half of the nineties (see Graph 5). The household sector barely accumulated savings, the corporate sector borrowed heavily and the public sector has been a net borrower in all years. In 2009-2010, despite some deleveraging in the private sector, the net external borrowing needs of the economy have not decreased due to the offsetting increase in general government borrowing. Net external liabilities surpassed 100 percent of GDP already in 2009 (see Graph 6).

The composition of external financing has changed in recent years. In 2006, nearly 40 percent of external financing came from interbank loans, while portfolio investment and direct investment covered around ¼ each of the total deficit. More recently, portfolio investment covered ¾ of the total external deficit, also due to increased government borrowing. Net direct investment was close to nil in 2008-2009, reflecting the netting out of relatively modest inflows and outflows (around 1.2 percent of GDP in 2009, up from around 0.5 percent of GDP on average in 2006-2008).

Deposits remain the main liability category with 43 percent of total net external liabilities. The net stock of securities (other than shares) has recently increased to nearly 20 percent (see Graph 6). The stock of loans and the stock of shares and other equity remained fairly constant during 2003-2009, although their weight in the total net external financial stock nearly halved.

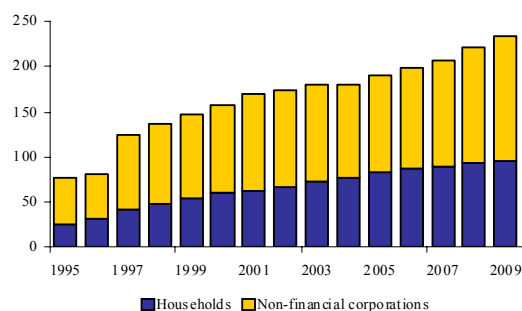
Between 1995 and 2008, negative valuation effects, concentrated in securities other than shares, have contributed to the deterioration of the NFA position. These effects did not reverse during the crisis.



## EMERGING VULNERABILITIES IN THE FINANCIAL SECTOR

7. **The counterpart to the expansion in external debt has been growing household and firm indebtedness.** Total non-financial private sector debt grew to above 200 percent of GDP (see Graph 7). The intermediation of this massive stock of credit occurred mostly through the domestic banking sector, resulting in high leverage ratios and large credit exposures for Portuguese banks.

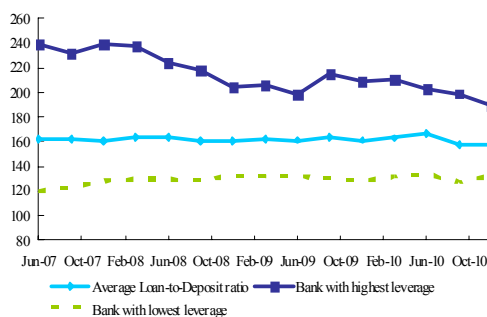
Graph 7: Private indebtedness (% of GDP)



Note: Private indebtedness has been defined as the sum of liabilities in loans and securities other than shares.

Source: AMECO

Graph 8: Loan to deposit ratio



Source: Banco de Portugal

8. **Portuguese banks weathered the first phase of the crisis relatively well due to lacking exposure to toxic assets and the absence of a property boom and bust episode.** Portuguese banks usually operate a rather conservative, traditional financial intermediation business model. In the wake of the fall of Lehman Brothers, Banco de Portugal (BdP) required domestic banks to increase their Tier 1 capital ratio to 8 percent. The new capital requirements were met by private shareholders and no public intervention was necessary. Acting in its capacity as shareholder, the Portuguese government recapitalised Caixa Geral de Depósitos (CGD) following the new capital rules. Banks remained profitable throughout 2008-2010 against the background of increasing non-performing loans (see Table 2) and declining loan growth, whereas private household deposits increased fast in 2009 and 2010. As there was no major real estate price correction, banks did not suffer any major mortgage losses. The stock of mortgage loans kept on increasing through to 2010, albeit at a slower pace.



Table 2: **Soundness indicators of the Portuguese banking system**

%	2007	2008	2009	2010	Quarter
<b>ROE</b>	18	12.7	7.6	8.4	Q4
<b>NPL</b>	1.5	1.9	3.3	4.1	Q4
<b>Coverage ratio</b>	195	144.5	118.3	112.8	Q4
<b>Tier 1 capital</b>	6.5	7.3	7.9	8.2	Q4
<b>CAR</b>	10.3	10.6	10.5	10.2	Q4
<b>Loan-to-deposit ratio</b>	160.1	160.3	161.5	158.4	Q4

Note: The NPL ratio is based on the national definition and reports only the overdue amount

Source: Banco de Portugal

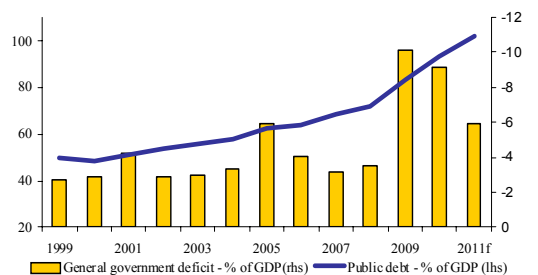
9. **More recently, however, banks have suffered from funding pressures.** The average loan-to-deposit ratio was above 160 percent until mid-2010 and did not decline during the economic and financial crisis (see Graph 8). Along with its significant forthcoming roll-over needs (EUR 30 billion alone for the five biggest banks in 2010-13, according to Bloomberg), the high leverage of the banking system became a major concern, when capital markets shut down following the crisis in the sovereign debt market.

#### **PUBLIC FINANCES ON AN UNSUSTAINABLE TREND**

10. **Public debt has been steadily increasing.** Since joining the euro area, Portugal's government deficit (net of one-off deficit decreasing measures) was almost always above the 3 percent of GDP ceiling. Expenditure growth has outpaced GDP growth implying that the expenditure-to-GDP ratio in 2010 was more than 8 percentage points above the level of 2000. High structural budget deficits and low economic growth put the debt-to-GDP ratio on a steadily increasing path since the beginning of the decade. The government debt-to-GDP ratio, which was below 60 percent in 2004, is projected to approach 100 percent by the end of 2011 and to rise further in the subsequent years (Graph 9).

11. **Foreign investors have recently reduced their holdings of Portuguese government debt.** Reflecting the smaller pool of private sector savings, the share of foreign holders of sovereign debt was structurally high and increasing, reaching 75 percent in mid-2009. By the end of 2010, however, this share had dropped below 60 percent as foreign holdings of government debt have increasingly been replaced by domestic investments (see Graph 10).

Graph 9: Deficits and debt in Portugal

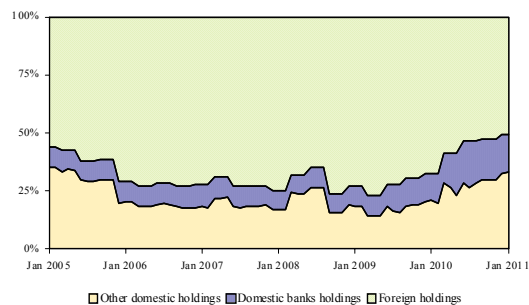


Note: Figures up to 2007 do not include the effect of the reclassification of SOEs

f: forecast

Source: Commission services

Graph 10: Foreign ownership of PT public debt



Source: AMECO, ECB, Bloomberg and Commission services

12. **High government deficits were recorded in both 2009 and 2010.** The fiscal deterioration in 2009 reflected the severity of the recession, the operation of the automatic stabilisers, as well as a discretionary fiscal expansion – a small part of it in the context of the European Economic Recovery Plan. The mild deficit fall in 2010 reflects higher revenue due to some recovery from the sharp revenue falls in 2009 and an increase in tax rates – particularly VAT – adopted in the course of 2010. Furthermore, the headline deficit was also reduced by a large one-off revenue worth 1.6 percent of GDP, linked to the transfer of the pension fund of Portugal Telecom to the government sector. On the opposite side, one-off costs related to the rescue in 2008 of two troubled banks dragged down the balance by 1.3 percent of GDP. Furthermore, following a decision of the statistical authorities, the headline figure for the deficit was affected by changes in the government perimeter to include a number of public-private partnerships (with a deficit increasing impact of 0.5 percent of GDP in 2010). The 2010 execution also included the spending for the purchase of two submarines of 0.6 percent of GDP.

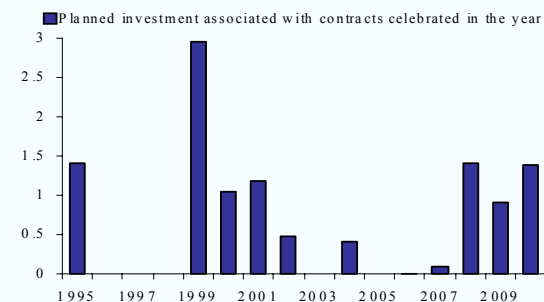
13. **The financial situation of state-owned enterprises (SOEs) entails large fiscal risks.** Several SOEs have been structural loss-makers and have accumulated large debt. In particular transport companies (road management, railway, urban transport), but also hospitals, are a matter of concern. Notwithstanding subsidies, other currents transfers (which are recorded as government deficit-increasing), and capital injections (which in some cases Eurostat rules allow to be recorded below the line), these companies have accumulated very large amounts of debt (SOE gross debt amounts to around 15 percent of GDP), which at some stage might have to be taken over by the government. In addition to posing risks to public finances, SOEs have other negative spill-over effects on the private sector: they absorb a substantial part of bank lending; they are able to impose relatively high prices for their services, and they attract high-skilled workers.

14. **Public Private Partnerships (PPPs) impact on public finances.** PPPs have been used extensively in Portugal to finance mainly transport infrastructure but also other projects, such as hospitals (see Box 3). The implicit government liabilities in relation to PPPs – the net present value of the flow of payments in relation to the contracts already signed – are currently estimated at over 14 percent of GDP. These commitments limit the flexibility of government expenditure in the medium term. There seems to have been a lack of adequate central control for creating public-private partnerships and wrong incentives arising from the fact that they are a way to loosen the budget constraint in the short term as they are recorded, according to existing statistical rules, in the private partners' balance sheets.

### Box 3: PUBLIC-PRIVATE PARTNERSHIPS (PPPs) IN PORTUGAL

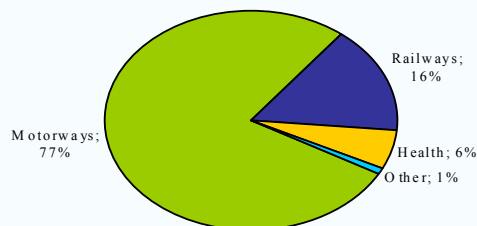
In the case of Portugal, PPPs have become a popular tool to finance investment in infra-structure especially in the early 2000s. Since 2008, they have re-gained importance with a new wave of PPP contracts. They have involved plans for cumulative investments of almost 10 percent of GDP since 1995, which corresponds to an annual average of almost  $\frac{3}{4}$  percent of GDP (see Graph 11). Contracts have been concentrated in motorways and to a lesser extent railways and health care, notably the construction of hospital premises, and in some cases the supply of some hospital services (see Graph 12).

Graph 11: PPPs contracts per year (% of GDP)



Source: Portuguese Finance Ministry and Commission services

Graph 12: PPPs investment per category

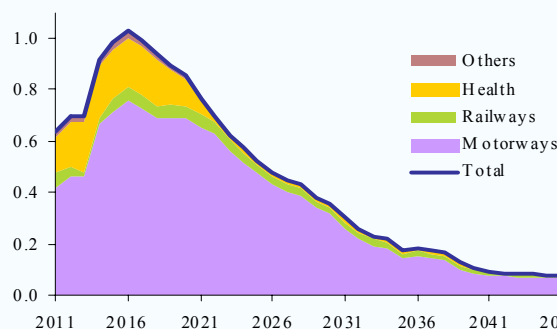


Source: Portuguese Finance Ministry and Commission services

A key feature of PPPs is the payment of rentals by the government over an extended period of time. Graph 13 shows the government's future rental burden due to the existing PPP contracts. It can be observed that such spending is expected to increase in the coming years, peaking in the middle of the decade (2015-2017) at around 1 percent of GDP. Afterwards, it is expected to slowly decline before decreasing more visibly only well into the next decade. In present value terms, these costs are estimated to amount to an implicit debt of 14 percent of GDP.

PPPs will also yield revenues to the government. That is notably the case of PPPs for motorways, where the government is currently charging tolls. In addition, after the end of the contract, the infrastructure becomes property of the government, who can continue operating it. The official projections are that those revenues would increase substantially over the decade of 2030s – when a number of contracts expire – and in that way help the fiscal balance, up to the point of yielding a positive impact to the budget. However, an open question is whether these projections correctly reflect the necessary capital costs to maintain the infrastructure operational after a long period in order to keep it attractive for users willing to pay the due tolls.

Graph 13: Costs of PPPs for annual budgets (% of GDP)



Source: Portuguese Finance Ministry and Commission services

The Programme devotes particular attention to the situation of PPPs – alongside with SOEs – amidst a set of actions to get a full picture of the financial position of the wider public sector. An independent review of PPPs is due by early 2012, which will also assess the feasibility of renegotiating some PPP contracts to reduce government liabilities. In addition, the monitoring framework will be substantially strengthened, with more comprehensive reporting standards, which will include an in-depth analysis of fiscal risks related to PPPs, in

particular via possible contingent liabilities for the State. PPPs will be avoided until the completion of these wide-ranging review and reform process, and subject to very stringent tendering requirements in the future.

## **DAUNTING STRUCTURAL CHALLENGES**

**15. The corporate sector is structurally weak and the public sector oversized.** Mid- to large-sized companies that serve international markets are underrepresented in Portugal's corporate sector, in opposition to predominance of small businesses (some of which with large external trade activity) on the one hand and large companies concentrated in non-tradable and sheltered sectors on the other hand. Companies face large administrative and regulatory burdens, and a complex tax system. By contrast, the State is substantially larger than in countries with comparable levels of per capita income, and there is a sizable number of SOEs and other public bodies at the margins of the government perimeter.

**16. Economic adjustment is held back by limited human resources.** Portugal is still lagging behind in educational achievement. It stands out as having by far the highest share of lower secondary education graduates in the EU, pointing to relatively low aggregate skill levels. Its functional literacy is among the lowest in Europe. Despite recent increases in PISA educational achievement scores, it will still take a long time for the skill level of the overall working population to converge to the European average. This severely limits the flexibility of employers to adjust to new demands. The potential pool of skilled workers in tradable sectors is further reduced by a still relatively high share of university graduates entering the government administration, although this trend has recently reversed. At the same time, the allocation of human capital to tradable sectors has been hampered by the relatively high level of wages in non-tradable sectors and in protected professions, where less intense competition allows higher profit margins to feed into higher wage premia.

**17. Problems in the labour market can be traced back to the second half of the 1990s.** At that time domestic demand increased amid anticipation of euro participation, resulting in high output growth and a steady decrease in unemployment from 7 percent in 1995 to 4 percent in 2001. Low unemployment led to wage increases significantly and persistently above productivity growth (which was almost nil in the first half of this decade), and to a higher nominal unit labour cost growth than in Portugal's main trading partners. The downward rigidity of nominal wages, implying an asymmetric response of unit labour costs to cyclical conditions, is a major reason for the increase in unemployment after 2001.

**18. Labour market reforms are key to improve growth prospects and recover competitiveness.** The most critical are excessive employment protection of permanent contracts, generous unemployment benefits, rigid working-time arrangements and a wage bargaining system that has not been capable to keep wage growth aligned to developments in productivity and external competitiveness. The rules for individual dismissal of permanent workers are strict and the compensation upon dismissal high by international standards. The strong protection of workers on permanent contracts has led to a two-tier labour market. The strict employment protection legislation (EPL) is also responsible for the very low labour turnover and very long duration of unemployment. Restrictive dismissal rules combined with generous severance payments may also have contributed to higher wage outcomes. Furthermore, the rigid working time regulations represent a burden on firms and hamper labour mobility and job creation.

**19. In many branches of the non-tradable sectors competition is lacking.** Portugal has a number of sheltered sectors, notably in services and network industries, which are marked by excess profits. This concerns in particular regulated professions, the distribution sector and pharmacies. In 2000-7, the gross operating rate (value added net of personnel costs, before taxes, divided by turnover) of transport-related sectors increased by 5 percentage points, while it was relatively flat in other sectors.

At 30 percent, the profit rate is particularly high in postal services and telecommunications. The economy experienced a shift of supply from tradables to non-tradables when higher prices in the non-tradable sector attracted labour and capital. Removing distortions in non-tradable sectors (notably services) will be key in promoting competitiveness adjustment.

## II. THE RUN-UP TO THE INTERNATIONAL FINANCIAL ASSISTANCE PROGRAMME

**20. The period before the request for financial assistance was marked by unfavourable developments in public finances and a worsening economic outlook.** This led to a deterioration of confidence and rising pressures on Portuguese debt, accentuated by the negative developments in euro area sovereign bond markets. In parallel, the banking sector, which is heavily dependent on external financing, was increasingly cut off from market funding and had to resort extensively to funding from the Eurosystem. The government stepped out after failing to obtain parliamentary approval for the Stability Programme in late March. The sovereign credit rating of Portugal was lowered several times over this period, and ultimately interest rates reached levels no longer compatible with long-term fiscal sustainability. Box 4 provides the chronology of events during this period.

**21. The international financial crisis had triggered only a marginal adjustment of existing imbalances and weakened public finances further.** In 2010, Portugal's GDP grew at a rate of 1.3 percent. Along with strong export growth, this positive growth performance was also due to exceptional factors that boosted private consumption, namely the anticipatory effects of the VAT increases in January 2011 and the relatively low inflation due to falling energy prices. Notwithstanding the significant growth contribution of external trade, Portugal lost 0.9 percent in export market share in 2010. The adjustment in price and cost competitiveness was too slow to redress the current account deficit, which was still high at 10 percent of GDP last year. The weak economy and the steep increase in unemployment, coupled with a strong countercyclical fiscal stance in 2009, spilled into large government deficits, above 10 percent of GDP in 2009 and 9 percent in 2010, up from 3.5 percent in 2008.

**22. The 2010 government deficit was revised upward to 9.1 percent of GDP on account of statistical revisions governed by Eurostat.** In particular, the losses of the banks Banco Português de Negócios (BPN) and Banco Privado Português (BPP) were to be booked in 2010, lifting the deficit by 1.3 percent of GDP (see Table 3). At the same time, several large public transport companies and PPPs have been re-classified as belonging to the general government sector, increasing the budget deficit in 2010 by an additional 1 percent of GDP. As a further result, gross debt as a share of GDP increased by over 10 percentage points. Even though the statistical revisions were of a technical nature and information on bank losses and public enterprises publicly available, the higher headline figures further dented confidence.

Table 3: 2010 Government Deficit revisions

		% of GDP
2010 deficit (Target set in May 2010)	(1)	7.3
Revision due to bank rescue costs (BPN + BPP) (one-off operations)	(2)	1.3
Revision due to re-classification of PPPs (one-off operation)	(3)	0.5
Revision due to re-classification of SOEs (permanent impact)	(4)	0.5
Residual*	(5)=(6)-(1)-...-(4)	-0.5
<hr/>		
2010 deficit (Notified figure)	(6)	9.1

Note: (+) means deficit-increasing impact; (-) means deficit-reducing impact.

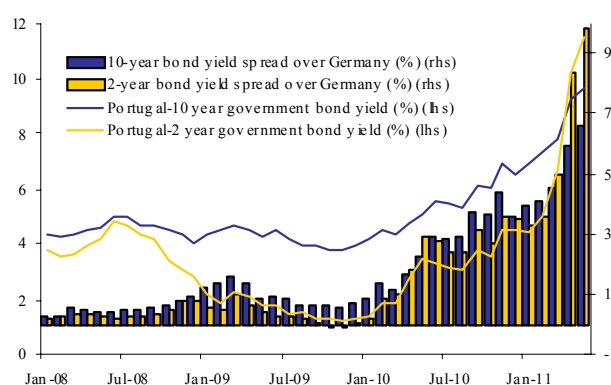
\* Deviations of revenue and expenditure from original plans as well additional measures or operations (permanent and one-offs) decided after May 2010.

Source: Portuguese Finance Ministry and Commission Services

## THE STABILITY PROGRAMME AND POLITICAL CRISIS

23. **The Stability Programme prepared by the government in March 2011 tried to address vulnerabilities and restore confidence.** The Stability Programme spelled out the measures that the Portuguese government had put forward on 11 March to achieve the deficit targets of 4.6 percent of GDP in 2011 and 3 percent in 2012. Those measures were sent in a note to the ECB and European Commission, which assessed them positively. Failure to get parliamentary approval for the Stability Programme triggered the resignation of PM Sócrates' minority government on 24 March. The President of the Republic called for elections on 5 June. Sovereign bond yields surged further, with interest rates for 2-year bonds exceeding 10 percent (see Graph 14), inducing the government to request international financial assistance from the EU and IMF on 7 April 2011 in a complex political environment (see Box 4).

Graph 14: 2-year and 10-year government debt yields



Source: Reuters

24. **Negotiations between the caretaker government and the Troika of European Commission, ECB and IMF mission resulted in an agreement at technical level in early May.** The negotiations on the Economic Adjustment Programme took place in a cooperative environment in consultation with the main opposition parties and other civil society partners. The Programme received public support from the then main opposition parties. This broad-based political support bodes well for the successful implementation of the Programme.

**BOX 4: THE SOVEREIGN DEBT CRISIS OF PORTUGAL - CHRONOLOGY OF EVENTS**

- **2 December 2009:** EU Council addresses recommendations to Portugal in accordance with Article 126(7) TFEU with a view to bringing an end to the situation of an excessive government deficit by 2013.
- **8 May 2010:** Portugal announces a revised target of 7.3 percent of GDP for the 2010 deficit, 2.1 percentage points below the 2009 deficit outturn.
- **13 May 2010:** The 2011 deficit target was revised to 4.6 percent of GDP reflecting the consolidation measures announced on that day.
- **November 2010:** Parliament passes austerity budget aimed at bringing down high public debt levels. The budgetary target for 2011 is set at 4.6 percent of GDP.
- **February 2011:** The Portuguese government announces that it had successfully achieved a 2010 deficit below 7.3 percent of GDP.
- **11 March 2011:** The Portuguese government addresses to European Commission and ECB a note in which it engages to undertake substantial fiscal and structural measures
- **23 March 2011:** Stability Programme spelling out the measures included in the note sent to the Commission and the ECB fails to be approved in Parliament.
- **24 March 2011:** The Portuguese government resigns, but remains as a caretaker government.
- **29 March 2011:** Portugal's statistical office (INE) reports a government deficit of 8.6 percent of GDP for 2010, above the target of 7.3 percent, as a result of the statistical rulings on the booking of two defeasance structures, a guarantee that was called and the inclusion of three state-owned enterprises in the government accounts.
- **31 March 2011:** S&P downgrade Portugal's credit rating to BBB-.
- **6 April 2011:** Interest rates for 2-year bonds exceed 10 percent, while 10-year bonds reach yields of nearly 9 percent.
- **7 April 2011:** Portugal request financial assistance from EFSM/EFSF and IMF.
- **8 April 2011:** The President of the Republic calls general elections for 5 June.
- **11 April 2011:** Technical mission of Troika starts discussions with Portuguese authorities.
- **23 April 2011:** Portugal's statistical office (INE) reports a government deficit of 9.1 percent of GDP for 2010, as a result of the statistical re-classification of three PPP contracts.
- **3 May 2011:** The Programme is agreed at technical level between Troika mission and Portuguese authorities.
- **17 May 2011:** Signature of the Memorandum of Understanding
- **20 May 2011:** The Programme is agreed by the IMF board.
- **30 May 2011:** Council adopts Implementing Decision on Granting Union Financial Assistance amounting to EUR 78 billion.
- **5 June 2011:** National elections



### III. PROGRAMME DESIGN AND OBJECTIVES

25. **The overarching goals of the Economic Adjustment Programme are to underpin economic growth and macro-financial stability and to restore financial market confidence.** The Programme foresees action on three fronts:

- i. **Putting fiscal policy on a sustainable footing.** The fiscal consolidation strategy aims at setting the debt-to-GDP ratio on a downward path from 2013 onwards. It draws on a broad-based mix of revenue-raising and expenditure-reducing measures, with priority given to expenditure in line with the need to reduce the public sector's large claim on resources. Flanking structural-fiscal measures include a stronger budgetary framework (including monitoring and reporting), more efficient administrative structures and containment of fiscal risks from the wider government perimeter (notably from SOEs and PPPs).
- ii. **Stabilisation of the financial sector.** Banking sector vulnerabilities need to be addressed immediately to restore market confidence and reduce reliance on Eurosystem financing, while at the same time ensuring that the deleveraging process is not abrupt and does not undermine economic growth. The Programme foresees measures to strengthen banks' liquidity and solvency, including through higher capital adequacy ratios and a solvency support fund. Additional elements are the unwinding of BPN bank and a reinforcement of the supervisory and regulatory framework.
- iii. **In-depth structural reforms to support an orderly unwinding of external and internal imbalances and to raise potential growth.** The structural reform agenda is comprehensive and frontloaded. It addresses decisively major obstacles to the proper functioning of factor and product markets. The measures include a reform of the labour market, reinforcement of competition, a review of the judicial system, housing and rental market reform, liberalisation in services sector and network industries, reducing the administrative burden on companies, scaling down the direct involvement of government in the economy, strengthening human capital via further reform of the education system. Moreover, the scope for a budgetary neutral reduction in social contributions (a 'fiscal devaluation') will be considered.

26. **Addressing fiscal, banking and structural imbalances at the same time calls for a carefully balanced approach to mitigate negative social impacts.** The Programme contains elements specifically targeted at protecting the weakest. Tax increases are designed in a progressive way, with lowest income groups retaining their levels of income. For instance, minimum wages and lowest pensions remain untouched. Benefit entitlements will be extended to many that are currently excluded. In the longer term, full implementation of the Programme will lead to a better functioning and more competitive economy and to better employment prospects.

#### III.1. ECONOMIC OUTLOOK: SHRINKING DOMESTIC DEMAND AND RISING NET EXPORTS

27. **The economy is forecast to contract by a cumulative 4 percent in 2011-12.** On the basis of conservative assumptions, the Economic Adjustment Programme assumes a fall in real GDP of more than 2 percent in 2011. Private consumption in volume may fall by 4½ percent; public consumption is projected to fall by 6 percent, and fixed investment by about 10 percent (see Annex 1 for detailed macro-fiscal projections). This strong decline in domestic demand is only partly compensated by a significant growth contribution of net exports, which itself is owed to buoyant export growth (+6 percent, assuming a continued recovery of trading partners' economies) as much as to a strong contraction of imports (-5 percent).



**28. The unavoidable fiscal consolidation and deleveraging will continue to weigh on growth in 2012.** Domestic demand dynamics will be shaped by shrinking public consumption and investment. In addition, households and non-financial corporations are expected to accelerate their deleveraging and restrain private consumption and business investment. Real GDP is therefore projected to decline by another 2 percent in 2012, leading to a cumulative output loss of about 4 percent in 2011-12 (with domestic demand decreasing by 1 percent and net exports increasing by about 7 percent). To return to positive trend growth rates, the economy will be highly dependent on exports, driven by the recovery of trading partners and Portugal's ability to increase market shares. Under the Programme scenario, Portugal is expected to return to positive GDP growth in 2013 (1¼ percent), and to growth rates above 2 percent in the years thereafter (see Table 4).

**Table 4: Main GDP components**

y-o-y volume change	2010	2011	2012	2013	2014	2015
Final consumption expenditure (private)	2.2	-4.4	-3.8	-0.4	1.1	1.0
Final consumption expenditure (public)	1.8	-6.1	-4.6	-2.0	-0.3	-0.2
Gross fixed capital formation	-5.0	-9.9	-7.4	2.0	4.2	2.3
Domestic demand (excl. inventories)	0.8	-5.7	-4.6	-0.3	1.4	1.0
Exports of goods and services	8.7	6.2	5.9	6.5	6.5	6.5
Imports of goods and services	5.2	-5.3	-2.8	2.1	3.7	3.6
<b>Gross domestic product</b>	<b>1.3</b>	<b>-2.2</b>	<b>-1.8</b>	<b>1.2</b>	<b>2.5</b>	<b>2.2</b>

Source: Commission Services

**29. Structural reforms are expected to lift potential growth in the medium term.** Although the growth-enhancing reforms entailed in the adjustment Programme are deep and broad in scope, the Programme scenario cautiously assumes that the effects on potential growth will become visible only gradually. Structural reforms and subdued domestic demand will contribute to a strengthening of the external balance. However, due to the low starting base of exports, the reduction of the current account deficit will take time. By 2015, Portugal should have considerably reduced its current account deficit from levels close to 10 percent of GDP in 2010 to close to balance.

**30. Price increases in 2011-12 will be driven by hikes in indirect taxes.** In 2010, HICP increased by 1.5 percent; discounting the impact of indirect taxes, inflation was 1 percent. In 2011-12, indirect taxation will again be a main driver of price developments, together with energy costs. As a result of higher VAT and excise taxes, HICP inflation is expected to reach 3½ percent in 2011. However, in the context of a compressed domestic demand, rising unemployment and substantial structural reforms, second-round effects should be contained, leading to a fall-back in inflation to levels around 1½ percent as of 2013 (see Table 5).

**Table 5: HICP and HICP at constant taxes**

	2010	2011	2012	2013	2014	2015
HICP	1.5	3.4	2.0	1.5	1.5	1.5
HICP at constant taxes	1.0	2.3	1.3	1.5	1.5	1.5

Source: Commission Services

**31. Wage cuts in the public sector are expected to contribute to wage moderation in the private sector.** Average private sector wages are foreseen to decelerate in 2011-12 as a result of cuts in government and SOEs' wages, depressed domestic demand, and labour market reforms. As the economy starts growing again in 2013, the Programme scenario foresees a resumption of moderate growth in wages. Wage moderation will contribute to more dynamic exports and the reduction of the external deficit.

### III.2. PUTTING FISCAL POLICY ON A SUSTAINABLE FOOTING

#### SETTING AMBITIOUS BUDGETARY TARGETS

32. **Portugal will embark on an ambitious but realistic fiscal consolidation programme, which takes into account the need to front-load consolidation while containing growth risks.** As the economic environment deteriorated and the statistical re-classifications shifted the headline deficit up, it became increasingly evident that the government deficit objectives for 2011 and 2012 (4.6 and 3 percent of GDP, respectively) were no longer realistic as they would require too much of an adjustment in a too short a period and, consequently, would have a major negative effect on economic growth. The budgetary targets in the Programme for 2011 to 2013 are 5.9, 4.6 and 3 percent of GDP, respectively. This path is in line with the Council Recommendations under the Excessive Deficit Procedure, which required reducing the deficit to or below 3 percent of GDP by 2013. Without further consolidation efforts, the government deficit may come at 2.3 and 1.9 percent of GDP in 2014 and 2015, respectively. The various consolidation measures are expected to represent a cumulative fiscal effort of around 10 percent of GDP over the years 2011-2013, which is consistent with the plans presented by the Portuguese authorities in March 2011. More than half of this fiscal effort is already needed to achieve the deficit target for 2011. Overall, expenditure-reducing measures account for two thirds of the consolidation effort and revenue increases for the remainder. Government debt is projected to peak at around 108½ percent of GDP in 2013 and gradually decline thereafter (see Box 5).

**Table 6: Public finances targets**

% of GDP	2010	2011	2012	2013	2014	2015*
GDP (% real growth)	1.3	-2.2	-1.8	1.2	2.5	2.2
Fiscal targets	-9.1	-5.9	-4.5	-3.0	-2.3	-1.9
Consolidation measures by year		5.7	3.0	1.9	0.0	0.0
<i>of which temporary</i>		0.5				
Debt	93.0	101.7	107.4	108.6	107.6	105.7

\*For 2015, projection at unchanged policies.

Source: INE, Ministry of Finance and Public Administration, IFM, ECB and Commission Services.

#### BOX 5: GOVERNMENT DEBT AND FISCAL SUSTAINABILITY IN PORTUGAL

In the Programme scenario, government debt continues increasing in 2011 and 2012, peaks at 108½ percent of GDP in 2013 and declines thereafter. This Box presents a debt baseline scenario up to 2030 and a sensitivity analysis to changes in the key assumptions over the period beyond the Programme scenario and up to 2030.

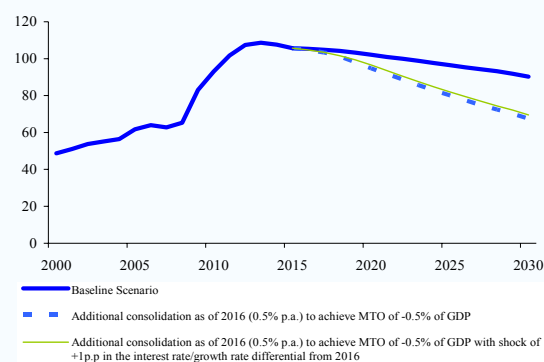
The baseline scenario, depicted in Graph 15, assumes that after 2015 the structural primary fiscal balance (i.e., the government balance adjusted for interest payments and for the effect of the cycle) remains unchanged at a surplus of 2.9 percent of GDP; nominal interest rates are 5 percent; nominal GDP growth stays close to 4 percent (2 percent growth in volume terms plus 2 percent inflation). Ageing costs are taken into account according to the projections in the Commission's 2009 Sustainability Report, and the expected fiscal impacts of PPPs are factored into the analysis. Graph 15 shows that full observance of the Programme plans creates the basis for a gradual decline of the debt ratio over the longer term. However, for a number of years the debt ratio would remain higher than before the current crisis.

Variations in GDP growth or in the interest rate can have a significant impact on the debt ratio.\* For instance, a nominal GDP growth rate of 3 percent, i.e. one percentage point lower than in the baseline scenario, would jeopardise the reduction of the debt ratio. Higher interest rates on debt by 1 percentage point would have the same effect. Conversely, higher GDP growth or lower interest rates would allow a faster debt reduction, and result in a debt-to-GDP ratio some 15 percentage points lower than in the baseline scenario by 2030. Furthermore, the

Programme foresees a bank solvency support facility up to EUR 12 billion. Assuming that banks' recapitalisation requires EUR 10 billion of capital injections and under different 'recovery' scenarios for the government in the longer run, the debt ratio could be about 10 percentage points higher than in the baseline scenario at the end of the period.

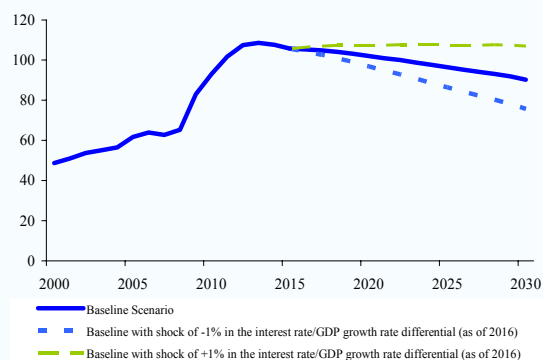
Pursuing fiscal consolidation beyond the Programme horizon can go a long way in reinforcing the decline in the debt ratio (see Graph 16). In particular, further fiscal consolidation towards the Medium-term Objective (MTO) of a structural balance of 0.5 percent of GDP after 2015 would ensure a fall in the debt-to-GDP ratio even under lower economic growth or higher interest rates than in the baseline. Attaining the MTO under the current assumptions would require a cumulative consolidation effort of around 2 percent of GDP between 2016 and 2019 or lower if the efforts are taken earlier.

Graph 15: Developments in the debt ratio - effect of further consolidation (% of GDP)



Source: Commission services

Graph 16: Developments in the debt ratio – scenarios (% of GDP)



Source: Commission services

\* Given the arithmetic of debt dynamics, an increase (decrease) in interest rate is equivalent to a reduction (increase) in GDP growth as far the evolution of the debt ratio is concerned. Similarly, the differential can also be seen as a linear combination of the two factors, e.g.: one 1 increase in the interest-growth differential can result from a ½ point increase in the interest rate and ½ point reduction in GDP growth. Higher interest rates on sovereign debt may also have negative repercussions on GDP growth, especially if they result in higher borrowing costs for the private sector.

### 33. The focus of 2011 is mainly on budgetary execution rather than devising new measures.

Over the remainder of the year, the authorities will rigorously implement the Budget Law for 2011 and some additional measures announced in the note on policy guidelines and measures addressed on 11 March to the ECB and the European Commission, aimed at reducing current expenditure and raising current revenue. In total the measures represent a consolidation effort of over 5½ percent of GDP. The 2011 consolidation effort is broad-based and supported by a wide range of measures to reduce spending and to increase revenue. Measures on the expenditure side include an average cut of 5 percent in government wages, reductions in government payroll lists, cuts in social transfers such as unemployment benefits and family allowances, and a freeze of all other social outlays. Additional measures are targeted at reining in spending in a number of other areas, including, for instance, the health sector, SOEs or public investment. Consolidation efforts on the revenue side consist mainly of an additional rise of 2 percentage points of the standard VAT rate on 1 January 2011. In addition, revenue proceeds will reflect the carry-over effect of the tax hikes of mid-2010. A number of smaller measures are foreseen, notably to broaden the basis for social contributions and especially to increase non-tax revenues, both by charging higher prices and fees and by selling assets, the latter having only a temporary impact on the government deficit.

34. **For 2012-2013, the consolidation measures are broad-based, mostly concentrating on the expenditure side.** Expenditure savings will be achieved notably by:

- lower operating expenditures, to be obtained by improving the working of the central administration, eliminating redundancies, increasing efficiency, redefining the functions carried out by the public sector and reducing and eliminating services that do not represent a cost-effective use of public money, as well as streamlining the education system;
- reduction of the government wage bill through wage and promotion freezes and a gradual reduction in staff;
- lower social transfers by suspending the application of pension indexation rules, freezing of pensions, and a special contribution levied on pensions above €1500. In addition, means-testing of social benefits will be strengthened and cost control of health care expenditures tightened;
- reduction in the duration and generosity of unemployment benefits;
- tightening transfers to local and regional governments;
- lower transfers to state-owned enterprises and cuts in capital spending.

35. **Revenue increases target consumption and non-tradables and aim at reducing tax distortions.** Consumption tax increases avoid a direct increase in production costs and thereby protect the competitive position of the economy. Moreover, tax increases on income are designed in such a way as to protect the most vulnerable segments of the population. The main elements are:

- higher property tax revenues by broadening the base for assessment;
- higher consumption tax revenues by increasing excises rates and broadening the VAT base (by reducing exemptions and moving goods and services from reduced and intermediate to higher VAT rates). In addition, the government will propose amendments to the regional finance law to limit the reduction of tax rates in the autonomous regions to a maximum of 20 percent vis-à-vis the rates applicable in the mainland;
- broadening of the base of corporate and personal income taxes: this leaves the marginal tax rates largely intact, while reducing or freezing deductions for items such as mortgages and rents, education and private health care expenditure;
- higher property tax revenues by reducing exemptions and broadening the base for assessment.

#### **FISCAL STRUCTURAL MEASURES**

36. **Fiscal consolidation will be supported by flanking measures to ensure fiscal targets will be met.** Measures will go beyond mere cost savings and include the strengthening of the fiscal framework, administrative capacity, spending controls and curtailing the risks from the wider public sector, notably stemming from PPPs and SOEs.

37. **The government will step up its budget planning and implementation capacity.** The new budgetary framework law sets up a multi-annual framework with expenditure and budget balance rules, binding the expenses of the State and all entities in the public administration. It also establishes a Fiscal Council as an independent advisory body. The law will improve the existing framework in line with international best practices. In addition, the Ministry of Finance will start publishing quarterly targets for total revenue, tax revenue, total expenditure, total primary expenditure and the

budgetary balance of the central administration, regional and local administration as well as social security. Data reporting requirements will be further extended. These will help the early detection of budgetary slippages.

**38. To remove inefficiencies, administrative bodies will be merged or closed.** Public sector services will be re-arranged, closing or streamlining inefficient and redundant services and agencies while ensuring adequate staffing. Setting up proper procedures and administrative structures will reduce costs. Within the revenue administration, for instance, this concerns the merging of the three tax agencies, to raise the efficiency and effectiveness of the tax administration.

**39. Local government spending will be monitored more closely and government administration reorganised.** The monitoring and budget execution of local and regional governments will be strengthened. Administrative structures are often too fragmented to be efficient. There are currently 308 municipalities and 4,259 parishes, pointing to potential cost savings. The government will prepare a plan to reorganise and reduce the number of local government administrations to enhance service delivery, improve efficiency and reduce costs.

#### **HEALTH CARE REFORM**

**40. Significant cost savings and efficiency gains can be expected from reforms of the health care system.** The government has already started to implement reforms aimed at cost control and higher efficiency. The further reforms included in the Programme are expected to yield additional savings of at least 1¼ percent of GDP by the end of 2012 and a further 1 percent of GDP by 2013.

**41. The reform of the health care sector will not put basic services at risk and is expected to improve safety and quality of care.** Central to the reform strategy is improving the way health services activity and related expenditure are monitored and assessed and feedback is provided to providers. This will be achieved through better use of information technology (e-prescription, electronic medical records) and existing datasets, the publication of clinical guidelines, the use of a comprehensive set of indicators and regular assessment and auditing reports. Cost savings are possible in the area of pharmaceuticals through the reduction of generous mark-ups, the publication of prescription guidelines and more use of generic drugs with benefits for patients who pay a substantial part of the price. Other measures include changes in 'moderating fees' paid by users, improved and more centralised purchasing and procurement systems, reinforcement of primary care services and staff mobility and the reorganisation and rationalisation of the hospital network and medical staff management.

#### **CONTAINING RISKS FROM THE WIDER PUBLIC SECTOR PERIMETER**

**42. Measures will be taken to monitor closely and contain the fiscal risks stemming from the extensive use of PPPs.** Existing PPPs and concessions will undergo a thorough review, involving from external experts. The legal and institutional framework for assessing and entering PPP or concession agreement as well as monitoring and execution will be reviewed and substantially strengthened. The annual report on PPPs will include an in-depth recording of all financial risks. New PPPs will be avoided until the completion of the above reviews.

**43. The significant potential for cost savings in SOEs will be exploited.** SOEs management will be streamlined to reduce costs and limit debt accumulation. The authorities will undertake a thorough analysis of the situation of each company so as to achieve an average reduction in operating costs of 15 percent, based on company-specific measures. A tightening of debt ceilings will be considered in order to bring SOEs debt on a downward path, which is expected to force a better focus of SOEs activities. These measures should lead to stronger balance sheets and make companies more palatable for privatisation.

**44. Privatisation proceeds in the order of EUR 5 billion will contribute to relieving government debt.** The State still holds a relatively large and complex web of companies, either fully or partly. In many of them the involvement of the State is economically not justified. The government plan for privatisation covers a wide range of companies in the transport sector (Aerportos de Portugal, TAP, and freight branch of CP), energy (GALP, EDP, and REN), communications (Correios de Portugal), and insurance (Caixa Seguros), as well as a number of smaller firms. In the framework of the Economic Adjustment Programme, Portugal will go beyond its original plans by pursuing a rapid and full divestment of public sector shares in EDP, REN and TAP by the end of 2011, if market conditions allow. The government will also initiate a process to sell the bank BPN on an accelerated schedule and without minimum price (see below). In addition, an updated privatisation plan will be prepared in the course of 2012 with the aim of identifying further potential privatisation receipts. Privatisation will contribute to reducing government financing needs, stimulate competition and attract foreign capital.

### III.3. STABILISING THE FINANCIAL SECTOR

**45. The Portuguese banking system has weathered the financial crisis rather well but is now facing serious challenges.** Adhering to traditional business models, not holding significant amounts of toxic assets and being spared from a housing bubble, the banks remained overall profitable, posting a return on equity of 8.4 percent in 2010. However, they are highly leveraged and exposed to a highly indebted economy with weak growth prospects. Strengthening the banking system is a key element to the success of the Programme.

**46. The Programme's financial sector strategy aims at maintaining the stability of the financial sector while supporting a balanced and orderly deleveraging of banks.** The deleveraging of Portuguese banks should take place in an orderly fashion within the Eurosystem framework, be consistent with the Economic Adjustment Programme and follow clear, institution-specific target loan-to-deposit ratios. Regular quarterly reviews will be conducted by the Banco de Portugal (BdP) and the ECB in consultation with the European Commission and the IMF. These reviews will evaluate the feasibility of individual banks' medium term funding plans and their implications for leverage ratios for the sector and for the economy. At the same time banks will be encouraged to strengthen their collateral buffers while the BdP together with the ECB will continue monitoring the liquidity situation at system and individual bank level. Portuguese authorities are committed to facilitating the issuance of government guaranteed bank bonds of up to EUR 35 billion, in accordance with EC competition guidelines.

**47. Adequate capitalisation of banks is key to bolster the resilience of the sector in light of the difficult economic adjustment process.** In view of the challenging environment and to further enhance the confidence in the solvency of the banking system, the BdP will direct all banks subject to supervision in Portugal to reach a core Tier 1 capital ratio of 9 percent by end-2011 and 10 percent at the latest by end-2012 and maintain it thereafter. In the event market based solutions fail and banks are unable to reach these targets on schedule, ensuring the higher capital standards might temporarily require public provision of equity for the privately owned banks. The authorities will therefore augment the bank support facility to EUR 12 billion with resources provided by EU and IMF financing. The banks benefitting from such equity injections will be subjected to specific management rules, a restructuring process and restrictions in line with EU competition requirements. Actual funding needs may, however, be lower than this amount, or non-existent, if banks are able to improve their capitalisation through market-based solutions. The CGD group will be streamlined putting in focus its core banking activities, which will benefit from a capital increase to be financed from internal group resources. Some non-core subsidiaries will be sold in view of optimising the group's efficiency and governance.

**48. Banking supervision will be strengthened.** The BdP will boost its supervisory activities by increasing resources for recruitment of specialist banking supervisors and intensifying on-site inspections and data accuracy verification. Systemically important institutions will be required to



prepare contingency resolution plans reviewed on regular basis. The disclosure on non-performing loans will be improved by adding a new ratio aligned with international practices.

**49. Efforts to resolve the case of the nationalised Banco Português de Negócios (BPN) will be intensified.** For BPN, the target is to find a buyer by the end of July 2011 at the latest. BPN is launching another programme of more ambitious cost cutting measures with a view to increase its attractiveness to investors. The re-privatisation of BPN is an important step towards relieving the state-owned Caixa Geral de Depósitos (CGD) of its trustee role assigned by the government in 2008. Programme financing also takes into account the amounts required to cover the losses incurred by the Portuguese Republic from its nationalisation BPN and the repayment of liquidity support provided by CGD to BPN.

**50. An updated bank resolution framework will promote financial stability and protect depositors.** The legislation on early intervention and resolution framework concerning credit institutions will be amended. This will impose on credit institutions new rules on early reporting obligations based on clear triggers and penalties and will allow the BdP to timely and effectively intervene to promote the implementation of recovery plans. The new resolution regime for distressed credit institutions will follow EU developments and international sound practices. Notably, the new framework will be based on clear triggers for its initiation and will encompass a set of tools such as recapitalisation without shareholders pre-emptive rights, transfer of assets and liabilities to other credit institutions and the setting up of a bridge bank.

**51. The legal framework to facilitate orderly and efficient corporate and household debt restructurings will be refined whilst the government will intensify the monitoring of corporate and household sectors indebtedness.** A fast-track court approval procedure for restructuring plans, modification of creditor voting, and provision of legal certainty to pre-insolvency restructuring agreements will be introduced. Action will be taken to authorise the tax and social security administrations to use a wider range of restructuring tools based on clear criteria and review the tax law to identify impediments to debt restructuring. The personal insolvency procedures will be amended to better support rehabilitation of financially responsible individuals. Quarterly reports on corporate and household sectors' funding pressures and debt refinancing activity will be prepared. Finally, a task force will be constituted to prepare contingency plans to efficiently deal with the challenges posed by the corporate and household sectors indebtedness.

#### **III.4. IN-DEPTH STRUCTURAL REFORMS TO SUPPORT GROWTH AND THE UNWINDING OF IMBALANCES**

**52. An overarching objective of the Programme is to raise potential GDP growth, notably by boosting productivity and labour use.** Making fast progress towards this goal is key for employment and welfare, and to underpin long-term fiscal sustainability. The structural reforms in the Programme can be broadly divided into three categories: First, policies to enhance flexibility in the use of production factors, chiefly labour. Second, sector specific-reforms aimed at increasing competition and service quality and eliminating distortions and excess rents out of protected sectors. Third, the Programme contains important measures aimed at improving the business framework conditions, i.e. reforms of the judicial system, the easing of administrative rules, and the enforcement of competition law.

**53. The Programme contains a number of policy strands to facilitate the orderly unwinding of the large external imbalances.** Reducing external indebtedness in a monetary union without hampering growth puts an extra burden on price adjustment. On the fiscal side, the Programme is designed to bring about a relative shift in the tax burden from production factors to consumption. This is complemented by a broad-based approach aimed at trimming down excess profits in sheltered domestic sectors through structural reforms. In addition, the government will promote the tradable sectors by giving support and securing adequate access to funding.

**54. Government revenue increases are designed in a way least disruptive to economic activity.** Revenue-increasing measures mainly target consumption. The increase in VAT revenues through a broader tax base, as well as bringing in line excise duties on tobacco with European averages, will contribute to reducing domestic price distortions and reduce imports of consumption goods. Review of company car taxation will address the subsidy provided to the private use of company cars. This could help to reduce imports of vehicles.

**55. The Programme advocates a significant reduction in social contributions, to be achieved in a budget-neutral way, to boost competitiveness.** This measure will be designed in the summer of 2011, so as to be able to start implementation with the 2012 budget. Lower social security contributions could be offset, thus guaranteeing fiscal neutrality, by changing the structure and rates of VAT, by additional permanent expenditure cuts, and by raising other taxes that would not have an adverse effect on competitiveness. While the economic principle of such fiscal devaluation is appealing, it needs to be carefully calibrated to ensure revenue neutrality. Furthermore, issues of sectoral targeting, timing and total adjustment volume deserve close scrutiny to maximise the positive effects for the economy. The outcome in terms of competitiveness will depend on the extent to which firms will pass the lower labour costs onto producer prices. Thus, its success is very much dependent on a proper and frontloaded implementation of structural reforms that improve competition in product markets and flexibility in the labour market, with a view to boost the needed price and wage flexibility as well as to reduce the possibilities of excessive profits.

**56. Companies will benefit from reforms of product and labour markets and from measures to facilitate access to finance.** The government will implement a strategy to facilitate access to finance and export markets for companies, in particular for SMEs. This will include a review of the overall consistency and effectiveness of existing measures and support mechanisms. The reallocation of resources towards export sectors will be eased by product and labour market reforms.

#### **REFORMING THE LABOUR MARKET**

**57. The Programme foresees comprehensive labour market reforms to reduce duality, enhance incentives to work, and promote a better alignment of working arrangements and wages to specific firm conditions.** Excessively strict employment protection reduces job creation, hinders mobility to dynamic sectors and favours a disproportionate use of temporary contracts. The precarious and uncertain labour market status of most young workers dents their human capital potential and productivity prospects. The generous unemployment benefit system does not promote job search effort and raises the risk that unemployment becomes entrenched. The wage setting system needs to improve the response of wages to labour market conditions and foster wage developments in line with the need to restore competitiveness.

**58. Unemployment benefits will be reformed with a view of avoiding unemployment traps and increasing the fairness of the system.** To reduce the risk of benefit dependence and strengthen job search, the maximum benefit duration will be shortened to no more than 18 months, and benefits reduced over the unemployment spell. The cap to the net benefit replacement rate will also be tightened. Overall, these changes will bring the generosity of the Portuguese system more in line with European averages. In addition, sources of inequity will be removed. A proportion of the unemployed that are currently not entitled to receive benefits, mostly young, will enter the system, as the minimum contributory period will be lowered. Some categories of disguised temporary workers, namely, the self-employed workers whose income heavily depend on the services provided to a single firm, may also benefit from unemployment benefits coverage. The design of active labour market policies will be further geared to strengthen job search efforts by the unemployed, improve the employability of the young and disadvantaged categories, and ease labour market mismatches.



**59. Employment protection legislation (EPL) will be revised to reduce labour market segmentation, foster job creation and facilitate adjustment.** Severance payments are very high in Portugal. This prevents the restructuring of the economy as collective dismissals are expensive and because job-to-job mobility is hindered by the fact that acquired severance payment entitlements would be lost in case of taking up a job elsewhere. The reform in the EPL system builds on several pillars: (i) aligning the severance payment regime of open-ended contracts to that of fixed-term contracts; (ii) bringing the level of severance payments closer to that of other EU countries; (iii) making the definition of fair dismissal for open-ended contracts less restrictive; (iv) easing job-to-job mobility by making part of the severance payments portable via the creation of a fund financing notional individual accounts, in analogy with the Austrian system. The reform, if implemented courageously, will bring the Portuguese system close to a "single contract" (see Box 6) and will contribute to unlock resources and stimulate investment.

**60. Working time arrangements will be made more flexible.** The cost of overtime in Portugal is among the highest in Europe and working time arrangements are not flexible. Apart from weighing on firms' competitiveness, these features reduce the room for adjusting labour on the intensive margin, so that sectoral shocks and economic fluctuations are translated to a greater extent in employment losses. The reforms in the Programme aim both at reducing the cost of overtime and allowing greater room for adjusting flexibly working time.

**61. On wage setting, the government will take commitments to ensure that overall labour cost developments are consistent with improving firms' competitiveness and fostering job creation.** Any future minimum wage increases will have to be compatible with the economic and labour market situation. To promote wage negotiations better tailored to individual firms, the criteria for the extension of collective agreements will be reviewed and the size limits to firm level negotiations made less prohibitive.

**62. The government will tackle low education attainment and improve the efficiency of the school system.** Portugal's education system is relatively expensive, but there is room for improving its effectiveness without imposing additional budgetary costs. The government has already started on substantive reforms. These will be evaluated and properly monitored. In addition, an action plan will be developed with a view to strengthening school autonomy and accountability, improve incentives for teachers and link the financing of private schools to performance criteria. The link between curricula and skill needs in the labour market will also be strengthened.

#### BOX 6: EMPLOYMENT PROTECTION: MOVING CLOSER TO A SINGLE CONTRACT?

Differences in the level of EPL between open-ended and fixed-term contracts have led to increasing labour market segmentation in some European countries. In France, Italy and Spain there were debates on proposals for a single open-ended contract. Although the single open-ended contract was specific to each one of these countries, the common underlying goal of each proposal was to create a new contract of employment to help overcome the legal asymmetry between open-ended and fixed-term contracts. However, these debates have not yet led to the implementation of an open-ended single contract.

The main features of a single contract are: (i) the absence of a clear distinction between a fixed-term and an open-ended contract from the viewpoint of workers' protection and (ii) a gradual continuous increase of rights with tenure. The exact design of the contract may differ across countries. The flexibility of the entry phase encourages job creation on open-ended contracts as the employer is given more time to learn about the quality of the job match. Since workers' entitlements to job protection rise with tenure, they are at a lower risk of precariousness than they would be with a fixed-term contract. A major issue with the implementation of the single contract is its co-existence with the other labour contracts. The suppression of other current contracts is largely opposed. But the single contract will be less effective if it has to co-exist with current contracts.

The asymmetry between open-ended and fixed-term contracts is large in Portugal. A partial approach to reforms of the EPL is at the origin of the problem. While legislation regulating fixed-term contracts was eased, a parsimonious approach was followed to reduce the strictness of open-ended contracts. This led the proportion of employees on temporary contracts to increase from 10 percent in 1995 (below the EU average) to 23 percent in 2010 (the third highest share in the EU). In the current legal framework, two main elements make temporary contracts more attractive to the employer. The first is the level of severance pay that is higher for workers on open-ended contracts. The second is the narrow definition of fair dismissals that increases the risk for employers to enter into open-ended contracts.

The recommendations in the Memorandum of Understanding tackle the issue of labour market segmentation in such a way to create a system closer to the principles of the single contract. In a first stage, building upon the Portuguese March 2011 Tripartite Agreement with social partners, the severance payment of open-ended contracts will be fully aligned with those of fixed-term contracts. In a second stage, the definition of fair dismissal for open-ended contracts will be eased and the level of severance payment will be reduced in line with the EU average. A full and timely implementation of this reform is a key element to redress the critical labour market situation in Portugal.

#### REVIVING THE HOUSING MARKET

**63. Reviving the dysfunctional rental market will improve households' access to housing and foster labour mobility.** Rental regulation is cumbersome, tenant protection is very strong and eviction procedures difficult and slow, hampering the functioning of the rental market. A large number of apartments in city centres remain empty, causing a substantial waste of capital as well as additional costs in terms of welfare, equity, transport, and environment. The lack of a rental market hampers geographical labour mobility and contributes to a high structural unemployment rate. This situation, as well as tax incentives, has encouraged house purchases and the building up of household indebtedness.

**64. The reform programme addresses the many distortions currently in place while safeguarding the most vulnerable social groups.** The strategy aims at easing rental control, strengthening ownership rights, simplifying judicial procedures and construction permits and modernising property taxes. Some of the changes will be phased in only gradually to reduce social disruptions. This is notably the case for adjustments of rents which were not allowed to increase for many decades and where contracts can be passed on to the relatives of the current renters. Others are to be introduced relatively swiftly, like the quickening of judicial procedures in the case of contract breaches and the simplification of renovation procedures. In addition, property taxation will also be made more equitable and less distortive, in particular by accelerating the convergence of valuations

for tax purposes towards market prices. Similarly, the preferential treatment of housing credit in personal income taxation will be phased out.

## **IMPROVING THE FUNCTIONING OF KEY SECTORS**

### *Energy*

65. **There is scope to improve the functioning of energy markets, which are essential for the efficient allocation of resources in the economy.** Important reforms in the electricity sector were introduced in 2006 and good progress has been registered in the creation of an electricity market with Spain (MIBEL). Reforms under the Programme target the further liberalisation of the electricity and gas markets. The remaining regulated tariffs will be phased out by the end of 2012, while ensuring the provision of universal service at reasonable prices to vulnerable costumers. The powers of the Regulatory Authority will also be strengthened. Moreover, plans will be developed to limit the additional costs associated with the production of electricity under the ordinary and special (co-generation and renewables) regimes. Energy policy instruments, including incentives and taxation will also be reviewed to ensure the consistency of the overall energy policy. VAT tax rates on electricity and gas will be increased, as well as excises for electricity.

### *Transport*

66. **An efficient and well-integrated transport system is a crucial element for the functioning of the economy.** Portugal will present in the fall of 2011 a Strategic Plan for Transport. Its aim is to improve the performance of the transport system and ensure a better balance between different modes of transport, including further use of railway and maritime transport and improved interconnections. The Strategic Plan will propose concrete measures based on criteria of cost-effectiveness. The railways will become more market-oriented and less dependent on State intervention. Deficits will be reduced by better management and pricing systems. Competition will be strengthened and parts of the sector privatised. Portugal will also present a strategy by the end of 2011 aimed at better integrating ports into the logistic and transport system and increase their efficiency.

### *Services and telecommunications*

67. **Competition in telecommunication and the postal sector will be strengthened by bringing down entry barriers.** In the telecommunication sector, Portugal will enhance the independence of the regulator, facilitate access to radio spectrum, reduce discrimination in favour of the incumbent, and make it easier for customers to switch suppliers. In the postal sector, the regulatory framework of the EU postal directive will be implemented, bringing further liberalisation of the sector.

68. **Services sectors suffer from numerous restrictions, many of which will be lifted.** High entry barriers tend to lead to inefficiencies and excess profits in protected sectors. The full transposition of the EU Services Directive by the end of 2011 will address this, notably by lifting restrictions on cross-border providers and removing limits to competition on the real estate and construction business. Beyond the mandatory provisions of the Services Directive, the limits to exercising regulated professions (such as accountants, auditors, lawyers and pharmacists) will be reviewed. The recognition of professional qualifications will be facilitated and restrictions on the number of professionals lifted.

## **IMPROVING FRAMEWORK CONDITIONS**

### *Judicial reform*

69. **The inefficient judicial system is a pervasive and major obstacle to doing business in Portugal.** It is cumbersome, extremely protracted, acts as a major deterrent for investment, and negatively impacts on the business environment. Debt claims are the bulk of the approximately 1½ million cases currently pending. The dysfunctions of the judicial system affects the efficient conduct of all economic activities, on account of the uncertainty and extra costs in the legal enforcement of laws and contracts. It is in particular a deterrent to FDI. The judicial system shares with the housing market the characteristic of being exceptionally ill-functioning in comparison to other EU countries.

70. **The government will take measures to increase the efficiency of the justice system and expedite the resolution of the existing backlog.** Measures include in particular new court management models, procedural simplification, specialized courts, use of information technology, and alternative dispute resolution. Speedy implementation of such reforms is of essence. The impact of the reform will be monitored by means of clear performance benchmarks in terms of average resolution speeds and number of outstanding cases.

#### *Stronger enforcement of competition rules*

71. **There is a need to strengthen the enforcement of competition rules to ensure a level-playing field and minimise rent-seeking.** The effectiveness of the competition authority and sectoral regulators will be raised inter alia by revisions in the competition law, the setting up of a specialised court and the implementation of best practices in terms of independence of national regulators.

72. **"Golden shares" will be abolished.** Presently the State holds special rights in private companies in particular in the energy and telecommunications sectors. Abolishing such rights will contribute to a more transparent and market-led functioning of these companies.

#### *Easing the regulatory burden*

73. **The administrative and regulatory burden on businesses will be reduced.** The Programme includes several measures to facilitate the ease of doing business, including the extension of "Points of Single Contact" to services not covered by the Service Directive and the reduction of red tape via a "Zero authorisation" project. Together with more efficient tax structures these measures should also contribute to fighting the informal economy. Moreover, public procurement rules will be amended to ensure a transparent and competitive business environment while improving the efficiency of public spending.

## IV. PROGRAMME FINANCING

74. **In spite of the considerable adjustment planned in the Programme, large financing needs will have to be partly covered by official financial assistance.** The financing gap between June 2011 and September 2014 has been estimated at EUR 78 billion (see Annex 2). Official financial assistance from the EU/euro area and the IMF is planned to amount to some EUR 38 billion in 2011, EUR 25 billion in 2012, EUR 10 billion in 2013, and EUR 5 billion in 2014. Around four-fifths of the Programme amount will be used to cover public sector financing needs, while the rest is aimed at possible banking sector support. The EU contribution amounts to two-thirds of the total (EUR 52 billion) and will be financed through loans from the EFSM and the EFSF (see Box 7). The IMF loans will be provided on the basis of an Extended Fund Facility (EFF).

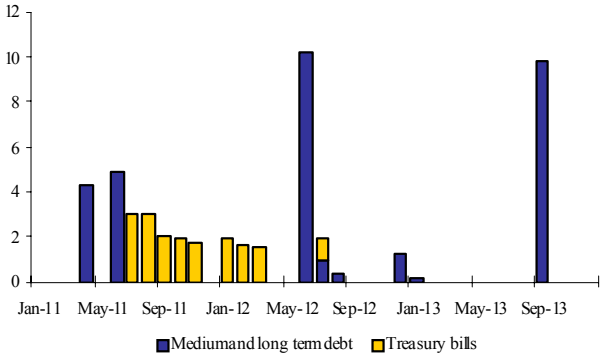
75. **The Portuguese government's access to the medium- and long-term debt market is assumed to be restored only very gradually.** The assistance covers the financing of the government

deficit over the next three years and assumes no roll-over of maturing medium- and long-term public debt between June 2011 and June 2013, and a full roll-over as from the second half of 2013. Until the first quarter of 2012, Portugal is assumed to rollover half of its maturing treasury bills, of which it has a large stock. Privatisation receipts are expected to reduce the financing needs over the Programme period by some EUR 5 billion. The assistance includes a buffer to provide for unexpected deviations from the baseline financing scenario.

76. **The financing needs for the Programme's financial sector strategy primarily consist of a contingency provision to support stronger banking sector capitalisation.** The EUR 12 billion contingency provision gives assurance that banks are able to meet current and future capital requirements. Actual funding needs may, however, be lower than this amount, or even non-existent, if banks are able to raise capital on the markets. The Programme includes a provision to cover the losses incurred by the Portuguese Republic from the nationalisation of BPN and the repayment of liquidity support provided by CGD to BPN.

77. **The disbursement schedule for Portugal is expected to be significantly front-loaded as a result of the country's large financing needs in the first year of the Programme (Graph 17).** At the same time, the disbursement schedule supports the country's continued participation in short-term debt markets and also safeguards the necessary incentives for ensuring implementation of structural reforms along the Programme period.

Graph 17: Maturing debt (EUR billion)



Source: Bloomberg

#### BOX 7: EFSM AND EFSF FINANCING

The EU-share of the Programme (EUR 52 billion) is provided in equal shares by the EFSM and the EFSF. The EFSM borrows directly on behalf of the EU from capital markets to fund the aid. The EFSF is an intergovernmental facility for providing assistance to euro area member states. It is a separate legal entity and obtains funds through borrowing on the capital markets on the strength of guarantees provided by euro area members (excluding Greece, Ireland and Portugal).

Both the EFSM and the EFSF contribute to the Programme financing from the second quarter of 2011. The average maturity of the loans to Portugal will be 7.5 years for both the EFSM and the EFSF. Assistance under the EFSM and EFSF will come through fixed rate bullet loans. This stands in contrast to IMF loans, which are floating rate loans with a gradual repayment of the principal. EFSM and EFSF loans will involve a combination of shorter and longer maturities in the range of 5 to more than 10 years, mainly in standard benchmark maturities of 5, 7 and 10 years. Issuances under the EFSM will be denominated only in euros. The EFSF will also most likely issue in euros, but it does not have any currency limitation for its funding activities and can adapt to market developments.

The EU (EFSM) and the EFSF are rated triple A by the three major rating agencies, Fitch, Moody's and Standard & Poor's. The ratings of the EFSF as a borrower reflect the strong shareholder support and credit enhancements such as an over-guarantee of the amount borrowed by 120 percent and the cash buffer which will be deducted from the cash amount remitted to a borrower from each loan (which implies that to lend EUR 26 billion to Portugal, the EFSF is expected to raise around EUR 31 billion). The cash reserve comprises a margin rate and a one-off service fee. The EFSF's structure requires both the principal and interest to be covered by guarantees. Issuances by the EU are executed by the European Commission's financial operations department located in Luxembourg. They will all be launched through a syndication format. Issuances by the EFSF are executed by the German Debt Management Office on behalf of the EFSF.

The average interest payment on EU funds is close to IMF lending rates. The average interest rate on the EUR 52 billion available from the EU will depend on the prevailing market rates at the time of each drawdown. Simulations based on market interest rates at the end of April 2011 suggest that loans by the EFSM to Portugal throughout the life of the Programme would have had an effective interest rate of about 5.5 percent, and loans by the EFSF an average interest rate of about 6.1 percent. This should be compared to an average interest rate of 5.5 percent for the IMF commitment, once expressed in financially equivalent terms, i.e. when the IMF SDR floating rates are swapped into fixed rates in euro with 7.5 years duration. In contrast to EU loans, IMF loans are subject to currency risk as they are provided in Special Drawing Rights (SDR) whose exchange rate to the euro can change.

Interest rates on the two first EFSM funding transactions in May were lower than the end-April rates used for the simulations. The first transaction was a 10 year bond issue of EUR 4.75 billion, disbursed on 31 May 2011, to finance the first instalment of the EFSM loan to Portugal (EUR 1.75 billion) and the third instalment of the EFSM loan to Ireland (EUR 3 billion). The resulting interest rate applied to the first Portuguese EFSM loan is 5.65 percent, resulting from adding a margin of 2.15 percent (as decided by the Council on 30 May) to the borrowing cost of 3.50 percent. The second transaction was a 5 year bond issue, also of EUR 4.75 billion, disbursed on 1 June 2011. The resulting interest rate of the 5-year loan to Portugal was fixed at 4.90 percent, composed of the cost of borrowing for the EU at 2.75 percent plus the margin. The EFSF is expected to issue during June 2011 to finance its share of the first disbursement to Portugal.

The proceeds from the margin applied on the EFSM operations go to the EU Budget and are distributed to the 27 EU Member States at the end of each financial year. The Commission does not charge any fees nor keeps any margin.

## Annex 1: Commission services' macroeconomic projections, 2011-15

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

<i>Annual % change</i>	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-1.1	2.2	-4.4	-3.8	-0.4	1.1	1.0
2. Government consumption expenditure	3.7	1.8	-6.1	-4.6	-2.0	-0.3	-0.2
3. Gross fixed capital formation	-11.2	-5.0	-9.9	-7.4	2.0	4.2	2.3
<b>4. Final domestic demand</b>	<b>-2.3</b>	<b>0.8</b>	<b>-5.7</b>	<b>-4.6</b>	<b>-0.3</b>	<b>1.4</b>	<b>1.0</b>
5. Change in inventories	--	--	--	--	--	--	--
<b>6. Domestic demand</b>	<b>-2.9</b>	<b>0.7</b>	<b>-5.7</b>	<b>-4.7</b>	<b>-0.4</b>	<b>1.4</b>	<b>1.0</b>
7. Exports of goods and services	-11.6	8.7	6.2	5.9	6.5	6.5	6.5
7a. - of which goods	-13.4	9.7	6.5	6.2	6.6	6.4	6.3
7b. - of which services	-6.5	6.3	5.5	5.3	6.1	6.9	6.8
<b>8. Final demand</b>	<b>-4.9</b>	<b>2.3</b>	<b>-3.1</b>	<b>-2.0</b>	<b>1.4</b>	<b>2.8</b>	<b>2.6</b>
9. Imports of goods and services	-10.6	5.2	-5.3	-2.8	2.1	3.7	3.6
9a. - of which goods	-11.3	5.5	-5.5	-2.8	2.1	3.6	3.5
9b. - of which services	-6.3	3.6	-4.1	-2.3	2.4	4.3	4.4
<b>10. Gross domestic product at market prices</b>	<b>-2.5</b>	<b>1.3</b>	<b>-2.2</b>	<b>-1.8</b>	<b>1.2</b>	<b>2.5</b>	<b>2.2</b>
<i>Contribution to change in GDP</i>							
11. Final domestic demand	-2.5	0.8	-6.1	-4.8	-0.3	1.4	1.0
12. Change in inventories + net acq. of valuables	-0.7	-0.1	0.0	-0.1	-0.1	0.0	0.0
13. External balance of goods and services	0.8	0.6	4.0	3.1	1.6	1.1	1.2

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

<i>Annual % change</i>	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-3.5	3.9	-1.1	-1.8	1.1	2.6	2.5
2. Government consumption expenditure	6.5	0.6	-8.8	-4.7	-1.2	1.2	1.1
3. Gross fixed capital formation	-13.1	-2.5	-7.2	-5.7	3.3	5.6	3.7
<b>4. Final domestic demand</b>	<b>-3.7</b>	<b>2.0</b>	<b>-3.7</b>	<b>-3.1</b>	<b>1.0</b>	<b>2.8</b>	<b>2.5</b>
5. Change in inventories	--	--	--	--	--	--	--
<b>6. Domestic demand</b>	<b>-4.2</b>	<b>2.0</b>	<b>-3.8</b>	<b>-3.2</b>	<b>0.9</b>	<b>2.8</b>	<b>2.5</b>
7. Exports of goods and services	-15.5	13.4	10.4	7.7	7.9	8.1	8.1
<b>8. Final demand</b>	<b>-6.8</b>	<b>4.4</b>	<b>-0.6</b>	<b>-0.5</b>	<b>2.8</b>	<b>4.3</b>	<b>4.1</b>
9. Imports of goods and services	-18.2	10.1	0.9	-0.3	3.6	5.3	5.3
10. Gross national income at market prices	-2.4	3.0	-1.5	-1.0	2.2	3.7	3.4
11. Gross value added at basic prices	-0.2	1.5	-1.7	-0.6	2.8	4.5	4.2
<b>12. Gross domestic product at market prices</b>	<b>-2.0</b>	<b>2.3</b>	<b>-1.2</b>	<b>-0.5</b>	<b>2.5</b>	<b>3.9</b>	<b>3.7</b>

**Table 3: Implicit price deflators**

<i>% change in implicit price deflator</i>	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-2.4	1.6	3.4	2.0	1.5	1.5	1.5
2. Government consumption expenditure	2.7	-1.2	-2.9	-0.2	0.8	1.5	1.3
3. Gross fixed capital formation	-2.1	2.6	3.0	1.8	1.3	1.4	1.4
<b>4. Domestic demand</b>	<b>-1.3</b>	<b>1.3</b>	<b>2.1</b>	<b>1.6</b>	<b>1.3</b>	<b>1.5</b>	<b>1.4</b>
5. Exports of goods and services	-4.5	4.3	4.0	1.6	1.3	1.4	1.5
<b>6. Final demand</b>	<b>-2.0</b>	<b>2.0</b>	<b>2.6</b>	<b>1.6</b>	<b>1.3</b>	<b>1.5</b>	<b>1.5</b>
7. Imports of goods and services	-8.5	4.7	6.6	2.6	1.4	1.5	1.6
<b>8. Gross domestic product at market prices</b>	<b>0.5</b>	<b>1.0</b>	<b>1.1</b>	<b>1.2</b>	<b>1.3</b>	<b>1.4</b>	<b>1.4</b>
<b>HICP</b>	<b>-1.0</b>	<b>1.5</b>	<b>3.4</b>	<b>2.0</b>	<b>1.4</b>	<b>1.5</b>	<b>1.5</b>

**Table 4: Labour market and cost**

<i>Annual % change</i>	2009	2010	2011	2012	2013	2014	2015
1. Labour productivity (GVA per employee)	0.2	2.8	-1.4	-0.9	1.0	1.9	1.4
2. Compensation of employees per head	3.3	1.5	-0.3	0.1	0.8	1.3	1.0
3. Unit labour costs	3.2	0.3	0.7	0.4	-0.4	-0.2	0.0
4. Total population	0.1	0.0	0.0	0.0	0.0	0.0	0.0
5. Population of working age (15-64 years)	-0.1	-0.2	-0.2	-0.1	0.0	0.1	0.2
6. Total employment	-2.5	-1.5	-1.5	-0.9	0.5	1.1	1.3
7. Calculated unemployment rate - Eurostat definiti	9.6	10.9	12.2	12.9	12.4	11.6	10.6

**Table 5: External balance**

<i>levels</i>	2009	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	33.7	38.9	43.2	46.7	50.4	54.5	58.8
2. Imports of goods (fob)	50.7	56.2	56.8	56.7	58.7	61.8	65.0
<b>3. Trade balance (goods, fob/fob) (1-2)</b>	<b>-17.0</b>	<b>-17.2</b>	<b>-13.6</b>	<b>-10.0</b>	<b>-8.3</b>	<b>-7.3</b>	<b>-6.2</b>
<i>3a. p.m. (3) as % of GDP</i>	<i>-10.1</i>	<i>-10.0</i>	<i>-8.0</i>	<i>-5.9</i>	<i>-4.7</i>	<i>-4.0</i>	<i>-3.3</i>
4. Exports of services	13.4	14.5	15.8	16.9	18.1	19.7	21.3
5. Imports of services	9.1	9.6	9.6	9.6	10.0	10.5	11.1
<b>6. Services balance (4-5)</b>	<b>4.3</b>	<b>4.9</b>	<b>6.2</b>	<b>7.3</b>	<b>8.2</b>	<b>9.1</b>	<b>10.2</b>
<i>6a. p.m. 6 as % of GDP</i>	<i>2.6</i>	<i>2.8</i>	<i>3.6</i>	<i>4.3</i>	<i>4.7</i>	<i>5.1</i>	<i>5.4</i>
<b>7. External balance of goods &amp; services (3+6)</b>	<b>-12.6</b>	<b>-12.4</b>	<b>-7.4</b>	<b>-2.7</b>	<b>-0.1</b>	<b>1.8</b>	<b>4.0</b>
<i>7a. p.m. 7 as % of GDP</i>	<i>-7.5</i>	<i>-7.2</i>	<i>-4.3</i>	<i>-1.6</i>	<i>0.0</i>	<i>1.0</i>	<i>2.1</i>
8. Balance of primary incomes and current	-5.5	-4.5	-5.3	-6.1	-6.8	-7.5	-8.2
<i>8a. - of which, balance of primary income</i>	<i>-6.8</i>	<i>-5.8</i>	<i>-6.4</i>	<i>-7.1</i>	<i>-7.7</i>	<i>-8.4</i>	<i>-9.1</i>
<i>8b. - of which, net current Transfers</i>	<i>1.3</i>	<i>1.3</i>	<i>1.1</i>	<i>1.0</i>	<i>0.9</i>	<i>0.9</i>	<i>0.9</i>
<i>8c. p.m. 8 as % of GDP</i>	<i>-3.2</i>	<i>-2.6</i>	<i>-3.1</i>	<i>-3.6</i>	<i>-3.9</i>	<i>-4.1</i>	<i>-4.4</i>
<b>9. Current external balance (7+8)</b>	<b>-18.1</b>	<b>-16.9</b>	<b>-12.7</b>	<b>-8.8</b>	<b>-6.8</b>	<b>-5.7</b>	<b>-4.2</b>
<i>9a. p.m. 9 as % of GDP</i>	<i>-10.7</i>	<i>-9.8</i>	<i>-7.5</i>	<i>-5.2</i>	<i>-3.9</i>	<i>-3.1</i>	<i>-2.2</i>
10. Net capital transactions	1.8	2.3	2.5	2.5	2.6	2.7	2.8
<b>11. Net lending (+)/ net borrowing (-) (9+10)</b>	<b>-16.3</b>	<b>-14.6</b>	<b>-10.2</b>	<b>-6.3</b>	<b>-4.2</b>	<b>-3.0</b>	<b>-1.4</b>
<i>11a. p.m. 11 as % of GDP</i>	<i>-9.7</i>	<i>-8.5</i>	<i>-6.0</i>	<i>-3.7</i>	<i>-2.4</i>	<i>-1.6</i>	<i>-0.8</i>



**Table 6: Fiscal accounts**

	2009	2010	2011	2012	2013	2014	2015
	<i>% of GDP</i>						
Indirect taxes	12.6	13.4	13.9	14.3	14.4	14.5	14.5
Direct taxes	9.0	8.9	9.1	9.3	9.4	9.4	9.4
Social contributions	12.5	12.2	12.5	12.5	12.3	12.3	12.2
Sales and other current revenue	4.6	4.5	5.0	5.0	4.9	5.0	5.0
<b>Total current revenue</b>	<b>38.8</b>	<b>38.9</b>	<b>40.5</b>	<b>41.1</b>	<b>41.1</b>	<b>41.2</b>	<b>41.1</b>
Capital transfers received	0.9	2.6	1.3	1.3	1.3	1.3	1.3
<b>Total revenue</b>	<b>39.7</b>	<b>41.5</b>	<b>41.8</b>	<b>42.4</b>	<b>42.3</b>	<b>42.5</b>	<b>42.3</b>
Compensation of employees	12.6	12.2	11.5	11.2	10.7	10.3	9.9
Intermediate consumption	4.9	5.1	4.3	4.0	3.8	3.8	3.8
Social transfers in kind via market prod	4.9	4.9	4.6	4.3	4.0	4.0	3.9
Social transfers other than in kind	17.0	17.0	17.4	17.6	17.5	17.4	17.3
Interest paid	2.9	3.0	4.2	4.8	5.1	5.1	5.1
Subsidies	0.8	0.7	0.7	0.5	0.5	0.5	0.5
Other current expenditure	2.6	2.5	2.2	1.9	1.7	1.7	1.7
<b>Total current expenditure</b>	<b>45.8</b>	<b>45.5</b>	<b>44.8</b>	<b>44.4</b>	<b>43.3</b>	<b>42.8</b>	<b>42.3</b>
Gross fixed capital formation	2.9	3.3	2.5	2.1	1.7	1.6	1.6
Other capital expenditure	1.1	2.0	0.3	0.4	0.4	0.4	0.3
<b>Total expenditure</b>	<b>49.8</b>	<b>50.7</b>	<b>47.7</b>	<b>46.9</b>	<b>45.3</b>	<b>44.8</b>	<b>44.3</b>
<b>General Government balance (EDP)</b>	<b>-10.1</b>	<b>-9.1</b>	<b>-5.9</b>	<b>-4.5</b>	<b>-3.0</b>	<b>-2.3</b>	<b>-1.9</b>
	<i>% change</i>						
Indirect taxes	-12.0	8.2	2.6	2.2	3.6	4.3	3.6
Direct taxes	-8.5	0.5	1.6	1.4	3.5	4.1	3.7
Social contributions	2.9	-0.4	1.8	-0.5	0.9	3.4	2.8
Sales and other current revenue	-4.2	0.4	9.2	0.1	0.5	6.2	3.1
<b>Total current revenue</b>	<b>-5.8</b>	<b>2.7</b>	<b>2.9</b>	<b>1.0</b>	<b>2.4</b>	<b>4.2</b>	<b>3.3</b>
Capital transfers received	26.1	186.3	-52.0	-0.5	1.5	4.6	3.7
<b>Total revenue</b>	<b>-5.3</b>	<b>7.0</b>	<b>-0.6</b>	<b>0.9</b>	<b>2.3</b>	<b>4.2</b>	<b>3.3</b>
Compensation of employees	3.0	-0.9	-7.2	-2.6	-2.5	-0.4	0.4
Intermediate consumption	9.0	6.4	-17.8	-7.1	-1.7	4.5	2.9
Social transfers in kind via market prod	15.2	1.4	-6.4	-6.7	-4.6	2.0	2.0
Social transfers other than in kind	10.3	2.2	1.1	0.5	1.9	3.4	3.4
Interest paid	-7.7	6.9	36.0	14.2	8.2	5.6	2.6
Subsidies	14.9	-3.6	-8.5	-26.9	-9.0	15.1	2.6
Other current expenditure	15.4	-1.8	-11.5	-12.8	-8.4	3.1	3.7
<b>Total current expenditure</b>	<b>7.5</b>	<b>1.7</b>	<b>-2.6</b>	<b>-1.6</b>	<b>-0.1</b>	<b>2.8</b>	<b>2.4</b>
Gross fixed capital formation	0.9	13.9	-23.2	-19.4	-15.0	-0.1	3.6
Other capital expenditure	698.1	75.5	-85.2	48.0	-15.9	8.7	-3.9
<b>Total expenditure</b>	<b>9.3</b>	<b>4.1</b>	<b>-7.1</b>	<b>-2.2</b>	<b>-0.9</b>	<b>2.7</b>	<b>2.4</b>
Nominal GDP, EUR bn	168.6	172.6	170.6	169.6	173.8	180.7	187.3

**Table 7: Government debt developments**

	2009	2010	2011	2012	2013	2014	2015
<b>EDP deficit (% of GDP)</b>	<b>-10.1</b>	<b>-9.1</b>	<b>-5.9</b>	<b>-4.5</b>	<b>-3.0</b>	<b>-2.3</b>	<b>-1.9</b>
EDP gross debt (% of GDP)	83.0	93.0	101.7	107.4	108.6	107.6	105.7
<i>levels, EUR bn</i>							
<b>EDP deficit</b>	<b>-17.0</b>	<b>-15.8</b>	<b>-10.0</b>	<b>-7.6</b>	<b>-5.2</b>	<b>-4.2</b>	<b>-3.6</b>
Gross debt	139.9	160.5	173.5	182.2	188.7	194.3	198.0
Change in gross debt	16.8	20.5	13.0	8.7	6.5	5.6	3.6
Nominal GDP	168.6	172.6	170.6	169.6	173.8	180.7	187.3
Real GDP	167.7	170.0	166.2	163.3	165.2	169.3	173.0
<b>Real GDP growth (% change)</b>	<b>-2.5</b>	<b>1.3</b>	<b>-2.2</b>	<b>-1.8</b>	<b>1.2</b>	<b>2.5</b>	<b>2.2</b>
Change in gross debt (% of GDP)	10.0	11.9	7.6	5.1	3.8	3.1	1.9
Stock-flow adjustments (% of GDP)	-0.1	2.7	1.7	0.7	0.8	0.7	0.0
<i>% of GDP</i>							
<b>Gross debt ratio</b>	<b>83.0</b>	<b>93.0</b>	<b>101.7</b>	<b>107.4</b>	<b>108.6</b>	<b>107.6</b>	<b>105.7</b>
Change in gross debt ratio	11.4	10.0	8.7	5.7	1.2	-1.0	-1.9
<i>Contribution to change in gross debt</i>							
Primary balance	7.2	6.1	1.7	-0.3	-2.1	-2.8	-3.2
"Snow-ball" effect	4.3	1.1	5.2	5.3	2.4	0.9	1.2
of which							
<i>Interest expenditure</i>	2.9	3.0	4.2	4.8	5.1	5.1	5.1
<i>Real growth effect</i>	1.8	-1.1	2.0	1.8	-1.2	-2.7	-2.4
<i>Inflation effect</i>	-0.4	-0.8	-1.0	-1.3	-1.4	-1.5	-1.5
<b>Stock-flow adjustments</b>	<b>-0.1</b>	<b>2.7</b>	<b>1.7</b>	<b>0.7</b>	<b>0.8</b>	<b>0.7</b>	<b>0.0</b>
<i>Implicit interest rate</i>	4.0	3.7	4.4	4.7	4.8	4.9	4.9

## Annex 2: List of fiscal measures included in the Programme

<b>2011</b>	<b>% of GDP</b>
Expenditure measures in the 2011 Budget Law	3.4
Expenditure measures introduced in March 2011	0.3
Revenue measures in the 2011 Budget Law	2.0
Revenue measures introduced in March 2011	0.0
<b>Total annual impact</b>	<b>5.7</b>
<b>2012</b>	
<b>Expenditure</b>	
Reduction of health expenditure	0.3
Savings in State-owned enterprises	0.3
Reduction of investment	0.3
Public administration savings	0.3
Pensions cut	0.3
Wage bill restraint	0.3
Education spending	0.1
Lower transfers to local and regional authorities	0.1
Reduction of costs in other public bodies and entities	0.1
Lower financing to government sector health insurance	0.1
	<b>2.1</b>
<b>Revenue</b>	
Revision of VAT rates structure	0.2
Higher excises	0.1
Property taxation	0.1
Reduction of tax expenditures - corporations	0.1
Reduction of tax expenditures - households	0.1
Taxation of pensions and social transfers	0.1
Fight of tax evasion	0.1
	<b>0.9</b>
<b>Total annual impact</b>	<b>3.0</b>
<b>2013</b>	
<b>Expenditure</b>	
Public administration operating savings	0.3
Reduction of health expenditure	0.2
Reduction of investment	0.2
Reduction of social transfers	0.2
Wage bill restraint	0.2
Education spending	0.1
Lower transfers to local and regional authorities	0.1
Savings in State-owned enterprises and other public bodies	0.1
Lower financing to government sector health insurance	0.1
	<b>1.4</b>
<b>Revenue</b>	
Higher excises	0.1
Property taxation	0.1
Reduction of tax expenditures - corporations	0.1
Reduction of tax expenditures - households	0.1
Taxation of pensions and social transfers	0.1
	<b>0.5</b>
<b>Total annual impact</b>	<b>1.9</b>

## Annex 3: Indicative financing needs and sources

### General government financing needs and sources (EUR billion) <sup>1</sup>

	2011 Jun-Dec	2012 Year	2013 Year	2014 Jan-Jun	2011-2014 Total
<b>A</b> General government (GG) deficit <sup>2</sup>	5.9	7.6	5.2	3.3	22.0
<b>B</b> Amortization of debt issued by central government (C+D) <sup>3</sup>	27.2	24.0	19.3	10.5	80.9
<b>C</b> of which short-term debt <sup>4</sup>	20.8	9.0	9.0	4.2	42.9
<b>D</b> of which long-term debt <sup>5</sup>	6.4	15.1	10.4	6.3	38.1
<b>E</b> Net redemption of non-traded debt issued by central government	0.9	1.2	0.0	0.0	2.1
<b>F</b> <b>Financing need for GG deficit and debt amortization (A+B+E)</b>	<b>33.9</b>	<b>32.8</b>	<b>24.5</b>	<b>13.7</b>	<b>105.0</b>
<b>G</b> Rollover rate of short-term debt	43%	100%	100%	100%	72%
<b>H</b> Rollover rate of long-term debt	0%	0%	96%	96%	42%
<b>I</b> <b>New general government borrowing (J+K)</b>	<b>9.0</b>	<b>9.0</b>	<b>18.9</b>	<b>10.2</b>	<b>47.0</b>
<b>J</b> of which short-term borrowing (C*G)	9.0	9.0	9.0	4.2	31.0
<b>K</b> of which long-term borrowing (D*H)	0.0	0.0	10.0	6.0	16.0
<b>L</b> <b>Privatisation receipts</b>	<b>2.0</b>	<b>2.0</b>	<b>1.0</b>	<b>0.0</b>	<b>5.0</b>
<b>M</b> <b>Bank Solvency Support Mechanism</b>	<b>3.5</b>	<b>5.5</b>	<b>3.0</b>	<b>0.0</b>	<b>12.0</b>
<b>N</b> <b>Others</b> <sup>6</sup>	<b>11.3</b>	<b>-2.4</b>	<b>2.4</b>	<b>1.6</b>	<b>12.9</b>
<b>O</b> <b>Financing gap (F-I-L+M+N)</b>	<b>37.8</b>	<b>25.0</b>	<b>10.0</b>	<b>5.1</b>	<b>78.0</b>
<b>P</b> <b>Loan disbursements</b>	<b>37.8</b>	<b>25.0</b>	<b>10.0</b>	<b>5.1</b>	<b>78.0</b>
<b>Q</b> of which IMF (%)	12.6	8.3	3.3	1.7	26.0
<b>R</b> of which EU (%)	25.2	16.7	6.7	3.4	52.0

<sup>1</sup> Data in this table are subject to revision. In order to take into account the fact that each quarterly loan disbursement has to anticipate the financing needs of the next quarter, the annual financing gap estimates for 2011-2013 include the amortization of debt and other financing needs accruing in the first quarter of the subsequent year (see also footnote 2 on the general government deficit projections).

<sup>2</sup> The general government deficit refers to the projection on a calendar-year basis (i.e. excluding the deficit accruing in the first quarter of the subsequent year).

<sup>3</sup> The data refers to the amortization of debt owed by the central government and state-owned enterprises classified within the general government. It does not include the debt issued by local and regional governments, non-financial corporations that are not consolidated in the general government, and financial public sector entities.

<sup>4</sup> Tentative schedule based on the assumption that half of the outstanding stock of T-bills will be rolled-over throughout the programme period. The financing need for the amortization of short-term debt in 2011 includes the unwinding of repo operations.

<sup>5</sup> Includes maturing medium and long-term debt owed by state-owned enterprises classified within the general government sector.

<sup>6</sup> Includes change in cash position and bank restructuring costs.

Source : Portuguese authorities and Commission services' estimates.

**Annex 4: Programme documents**

## LETTER OF INTENT

Lisbon, May 13, 2011

Mr Jean-Claude Juncker  
President  
Eurogroup

Mr György Matolcsy  
President  
Council of the European Union (ECOFIN)

Mr Olli Rehn  
Commissioner  
European Commission

Mr Jean-Claude Trichet  
President  
European Central Bank

Dear Sir

1. Against the background of the structural challenges facing the Portuguese economy and contagion from the sovereign debt crisis in other euro area countries, financial conditions facing the Portuguese sovereign and banks have sharply worsened. To restore market confidence and to raise the potential of our economy to generate socially balanced growth and employment we are proposing a far-reaching reform programme, backed by substantial international financing to meet balance of payments needs.

2. Following up on already announced measures, we believe further comprehensive action is required on three fronts: (i) deep structural reforms to boost potential growth, create jobs, and improve competitiveness (including through fiscal devaluation); (ii) a credible and balanced fiscal consolidation strategy, supported by structural fiscal measures and better fiscal control over PPPs and SOEs; and (iii) efforts to safeguard the financial sector against disorderly deleveraging through market-based mechanisms supported by back-up facilities.

As our reform programme is implemented, priority will be given to protecting the most vulnerable groups.

3. To signal our strong commitment to implementing the ambitious reform programme, we request financing assistance from international partners. We estimate that the support needed for our external financing will be around €78 billion over the next three years. We therefore request support from the European Financial Stability Mechanism and the European Financial Stability Facility which could be drawn over a period of 36 months. The overall total of this support will be €52 billion. We are also sending a parallel request for financial assistance to the IMF for a total amount of €26 billion (SDR 23.7 billion). This arrangement will underpin confidence, support market access and help ensure orderly adjustment and the restoration of sustainable growth. We will draw on these resources in parallel throughout the program period, drawing on the EU/euro-area and IMF financing in a ratio of 2 to 1 following programme approval and for each review period (measured at the programme exchange rate).

4. We are confident that the policies described in the attached Memorandum of Economic and Financial Policies (MEFP) are sufficient to achieve the objectives under the programme. An annexed Memorandum of Understanding (MoU) specifies detailed economic policy measures that will be used as benchmarks for assessing policy performance in the context of the quarterly reviews, in coordination with the IMF and the European Commission, under the financial assistance programme. The reviews will assess progress in the programme's implementation and permit understandings on any additional measures that may be needed to achieve its objectives.

5. In particular, progress in the implementation of the policies under this programme will be monitored through quarterly (and continuous) quantitative performance criteria (PCs) and indicative targets, prior actions, structural benchmarks, quarterly programme reviews, and any consultation clauses (these are detailed in Tables 1 and 2; the attached Technical Memorandum of Understanding (TMU) contains definitions), and through the detailed and specific economic policy criteria in the MoU.

6. The conditionality under the programme provides substantial comfort that the programme will be delivered and that the support will be repaid. We will ensure that the financial assistance in the context of the EFSM and EFSF to be provided to Portugal will be subject to the loan terms and conditions that will protect the EU, the euro-area and EU Member States' financial and legal interests in a non discriminatory way as compared to the assistance provided by the euro-area and the EU to other Member States.

7. The Portuguese Government and Banco de Portugal believe that the policies set forth in the attached MoU are adequate to achieve the objectives of our economic programme. We, nonetheless, stand ready to take additional measures that may be needed to meet the

objectives set. We will maintain a close policy dialogue and will consult with the European Commission, the ECB and the IMF prior to the adoption of any such measures and in advance of any necessary revisions to the policies included in the MEFP and the MoU. All available information requested by the European Commission, the ECB and the IMF to assess implementation of the programme will be provided.

8. We are confident that resolute implementation of our economic programme will help our economy recover and bolster market sentiment. If fiscal consolidation proceeds faster than expected or if market conditions improve significantly during the programme period, we would refrain *pari passu* from drawing on the financing assistance.

9. This letter is copied to Mr. Strauss-Kahn.

Sincerely yours,

/s/

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Fernando Teixeira dos Santos  
Minister of State and Finance

/s/

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Carlos da Silva Costa  
Governor of Banco de Portugal

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



## PORTUGAL—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

### A. Introduction and Macroeconomic Outlook

1. **The Portuguese economy faces considerable challenges.** Competitiveness indicators have suffered, economic growth has been anemic, and the current account deficit is at 10 percent of GDP. The global crisis exposed Portugal's weak fiscal and financial position with public debt at around 90 percent of GDP at end-2010 and private sector debt about 260 percent of GDP. Banks that financed this build-up in debt now have the highest loan-to-deposit ratio in Europe.

2. **To address these challenges we have embarked on a balanced and focused reform to correct external and internal imbalances and boost potential growth and employment.** Our strategy envisions bold and upfront structural reforms to improve competitiveness, an ambitious but credible pace of fiscal adjustment, and measures to ensure a stable and dynamic financial system. Large support from the international community will help reduce the social costs of adjustment. It will also allow us sufficient breathing space to establish a strong record of policy implementation before going back to markets.

3. **Growth is expected to recover only gradually over the next three years.** Output is expected to contract around 2 percent in 2011 and 2012 on account of needed fiscal consolidation, general confidence effects that led to the request for international financial support, and adjustments in the banking system. In addition, general market concerns for Euro area periphery countries are also likely to weigh on sentiment in the near term. Nevertheless, as markets regain confidence in the economy and structural reforms begin to deliver, activity is expected to start recovering in 2013 onwards.

### B. Reducing Public Debt and Deficit

4. **Our fiscal targets are ambitious but realistic.** We will target a deficit of 5.9 percent of GDP in 2011, 4.5 percent of GDP in 2012 and—consistent with the Excessive Deficit Procedure deadline agreed with the EU—3 percent of GDP in 2013. This will stabilize public sector debt by 2013. This deficit path reflects an appropriate trade-off between the need to take decisive and frontloaded actions to restore market confidence while ensuring that the pace of adjustment does not take an excessive toll on growth and employment.

5. **Our program is fully specified and carefully balanced between expenditure and revenue measures.** The 2011 budget already entails a significant effort, with discretionary fiscal measures amounting to some 5.4 percent of GDP. The deficit target for 2011 takes into account that the recession is now expected to be deeper and that some SOEs have been reclassified and included in the general government. To reach our target for 2011, we will compress some spending (0.3 percent of GDP) relative to the 2011 budget, particularly in subsidies to SOEs and health spending. Additionally, to reach the

targets for 2012–13, we need to take measures of about 5 percent of GDP in 2012–13. These measures are fully specified in this MEFP at the outset. As to the policy mix, expenditure measures account for 3.5 percent of GDP and revenue measures for 1.4 percent of GDP. The priority given to expenditure measures is in line with the need to reduce the public sector’s large claim on resources. The fiscal adjustment will be supported by well-specified structural reforms.

**6. Our program entails cuts in expenditures:**

- Following the 5 percent average cut in public sector wages this year, wages and pensions will be frozen through 2013, except, in the case of pensions, for those in the lowest categories. In addition, a special contribution levied on pensions above €1,500 will be introduced in 2012 but will exempt those in the lowest categories. Through a policy of only partly replacing separating staff, we will reduce the number of civil servants at the central government by 1 percent in both 2012 and 2013. The rationalization of the public administration at local and regional governments will provide further reduction in costs, including a reduction in employment by 2 percent annually.
- Better means-testing procedures will protect lower income families while making savings in social security non-contributory benefits. Rationalization of curricula and creation of school clusters, without damaging access, will cut costs in education. In addition, savings will be made through curtailing transfers to local and regional governments, other public bodies and entities, and SOEs.
- Our strategy depends also on improving decisions regarding capital expenditures. We will suspend the implementation of all new PPPs and large infrastructure projects until a thorough feasibility assessment is completed. No public funds or guarantees will be provided for the construction of the New Airport in Lisbon, and the high speed train project to Porto will remain suspended for the duration of the program. In addition, stronger controls will be put in place to rationalize new capital expenditures. Finally, line ministries will be required to request a pre-authorization of the Ministry of Finance (MoF) before engaging in new capital expenditure contracts.
- We will streamline spending on defense, SOEs, regional, and local governments. We will (i) submit a draft law by end-2011 revising the Military Funding Law to impose expenditures ceilings and enforce a zero-new-spending commitments rule; and (ii) reduce defense personnel and compensation by at least 10 percent during 2011–2014. In addition to measures detailed below (¶23) we will reduce SOE fringe benefits by at least 5 percent per year over 2011-2014 and will align wage compensation policies to those of the general government.

**7. On the revenue side, the focus is on increasing the share of consumption taxes and reducing tax privileges:**

- The higher VAT, PIT, and CIT rates in the 2011 budget will remain in effect through 2013. The list of goods and services subject to reduced VAT rates will be revised in 2011. The recurrent property tax (IMI) will be enhanced by a reassessment of the property values starting in the second half of 2011 and by rate increases from 2012 which will help compensate for a reduction of property transfer tax (IMT). Excise taxes on vehicles and tobacco will be raised. Electricity taxation will be introduced from January 2012. The convergence of deduction treatment of wages and pensions for tax purposes will be concluded by end-2013.
- A comprehensive revision of tax exemptions will yield 0.5 percent of GDP. We will freeze all existing tax benefits and incentives, and roll back some of them. On personal income tax, we will set a global cap on health, education and housing allowances, differentiated according to tax bracket; and phase out the allowance on mortgage expenses and rents through legislation to be approved by end-2011. On corporate income tax, we will by end-2011 (i) eliminate exemptions—including those subject to the sunset clause of the Tax Benefit Code—and all reduced rates; (ii) limit the deduction of losses; and (iii) limit the carryover period to 3 years. The temporary exemption of the annual property tax will be considerably reduced by end-2011.

8. **In choosing fiscal measures, we have taken care to protect vulnerable groups.** The 5 percent cut in nominal public sector wages and the freezing of pensions in 2011 exempt those earning the lowest wages and pensions. The special contribution on pensions will be levied only above a monthly threshold of €1,500. The means-testing program is being enhanced by applying unified and consistent selection criteria throughout the transfers system. In the health sector, an exemption threshold will be introduced to protect the more vulnerable from the proposed “moderating fees” (for health care) increases and the reduction in exemptions. The exemption threshold based on the value of the property will be kept.

### C. Streamlining the Public Sector

#### Public Financial Management (PFM)

9. **The strategic focus of the budget will be sharpened.** A fiscal strategy for the general government will be published by end-August 2011, and thereafter in April annually, specifying 4-year medium-term economic and fiscal forecasts. This will include supporting analysis and underlying assumptions and 4-year costings of new policy decisions (structural benchmark). Starting with the budget for 2012, budgets will be prepared within the context of the fiscal strategy and will report information to allow for an assessment of performance against this strategy. An independent fiscal council will be established by end-September 2011 to assess the government’s performance against the fiscal strategy.

10. **The budget process will be further integrated.** SOE, PPP, and social security decisions with fiscal implications will be integrated with the budget process to reduce fragmentation. Capital expenditure decisions will be taken in a medium-term context,

with enhanced monitoring and control, through the implementation of a public investment information system, as announced in the 2011 budget. Top-down budgeting with indicative expenditure ceilings and a medium-term budget framework for the central government budget will be introduced in the 2012 Budget and will be put into full effect with the 2013 budget. A new budget framework law incorporating some of these reforms has been approved by Parliament and is awaiting Presidential assent. A proposal to revise the local and regional financial laws will be submitted to parliament by end-2011 in order to fully adapt them to the principles and rules of the new budgetary framework law. We stand ready to refine further the budget framework based on inputs from EC and IMF staff.

11. **Expenditure control will be strictly enforced and arrears will be monitored and reported regularly.** Standard definitions of arrears and commitments will be approved by May 2011 (prior action). Any changes to the budget execution procedures necessary to align with these definitions will be implemented by end-2011, aided by technical assistance from the EC and IMF. Until then, existing commitment control procedures will be enforced to prevent the creation of new arrears. We will conduct and publish by end-August 2011 (structural benchmark) a comprehensive survey of arrears as at end-June 2011 covering all general government entities, as well as SOEs classified outside the general government sector. Following the survey, arrears of general government, will be monitored and published monthly.

12. **Fiscal reporting will be strengthened.** Consolidated general government cash-based reports will be developed and initially reported to the EC and IMF, before moving to external publication by end-December 2011. We will adopt a standard double entry-based chart of accounts and accounting policies consistent with International Public Sector Accounting Standards by end-2012. We will prepare a comprehensive inventory of the existing tax expenditures (including all types of exemptions, deductions, and reduced rates), by type of tax, along with their costing estimates (prior action). Starting with the 2012 budget, we will enhance our annual tax expenditure reports following international standards so that they (a) cover central, regional, and local governments; (b) use a more comprehensive concept of tax expenditures; and (c) include the methodology used for estimating such expenditures.

13. **We will start publishing a comprehensive report on fiscal risks as part of the annual budget.** This will commence with the 2012 Budget and will be consistent with international best practices. The report will take into account risks, including those related to forecast expenditure and revenue, contingent liabilities, the debt composition, the banking system, all PPPs, all SOEs, and natural disasters.

#### **Public-Private Partnerships (PPPs)**

14. **We will undertake a comprehensive review of PPPs and concessions to reduce the government's financial exposure.** The PPPs have exposed the government to significant financial obligations, and exposed weaknesses in its capacity to effectively manage these arrangements. The review will comprise two parts:

- We will request technical assistance from the EC and the IMF to undertake an assessment by end-August 2011 of at least the 20 most significant PPP and concession contracts, including the major *Estradas de Portugal* PPPs. The technical assistance report will identify the key areas of concern and prepare the terms of reference for a more detailed study described below.
- Based on this assessment, we will recruit a top tier international accounting firm by end-December 2011 (structural benchmark) to complete a more detailed study of PPPs and concessions by end-March 2012. It will assess the scope to renegotiate any PPP or concession contracts to reduce financial obligations without expropriating investors. The review will identify and, where practicable, quantify major contingent liabilities and any amounts that may be payable by the government. All PPP and concession contracts will be made available for these reviews.

15. **We will substantially enhance the annual report on PPPs to strengthen reporting and approval mechanisms.** Starting with the July 2012 report, the annual reports will detail all future cash flows and include a discussion of the government's obligations on an ongoing basis. The legal and institutional framework for assessing and entering into PPP or concession agreements as well as monitoring its execution will also be reviewed and strengthened under the supervision of the MoF and in consultation with EC and IMF staff by end-2012. We will not enter into any new PPPs or concessions at the central or local government levels until at least the completion of these reviews and legal and institutional reforms.

#### **State-Owned Enterprises (SOEs)**

16. **The MoF's central role in the financial governance of SOEs will be enhanced to cut operating costs and streamline the sector.** We will prepare a comprehensive report on ten SOEs posing the largest potential fiscal risks to the state (prior action). We will expand the coverage of this report by end-July 2011 to include all large central government SOEs to (i) complete concrete plans to reduce their overall operating costs by at least 15 percent over 2009 levels; (ii) review tariff structures to reduce subsidization; and (iii) apply tighter debt ceilings for 2012 onwards. In consultation with EC and IMF staff, we will review the level of service provision of SOEs by end-September 2011 as an input into the budget. A report will be prepared by end-February 2012 (structural benchmark) that reviews the operations and finances of SOEs at all levels of government. It will also include a systematic assessment of SOEs' future financial prospects, the potential exposure of the government, and scope for orderly privatization. We will not create any additional SOEs at the central or local government levels at least until the completion of these reviews and will prepare a plan by end-2011 to strengthen governance of SOEs.

#### **Privatization**

17. **We plan to accelerate our privatization program.** The existing plan, elaborated through 2013, covers transport (Aeroportos de Portugal, TAP, and freight branch of CP),

energy (GALP, EDP, and REN), communications (Correios de Portugal), and insurance (Caixa Seguros), as well as a number of smaller firms. The plan targets front-loaded proceeds of about €5 billion through the end of the program, with only partial divestment envisaged for all large firms. However, we are committed to go even further, by pursuing a rapid full divestment of public sector shares in EDP and REN, and are hopeful that market conditions will permit sale of these two companies, as well as of TAP, by the end of the 2011. We will identify, by the time of the second review, two additional large enterprises for privatization by end-2012. An updated privatization plan will be prepared by end-March 2012.

## **Health Sector**

18. **A comprehensive reform will improve efficiency and effectiveness in the health care system.** Amongst other reforms, moderating fees will be increased by September 2011, indexed to inflation by end-2011, and exemptions will be substantially reduced by September 2011. In order to protect the more vulnerable, means-testing mechanisms will be put in place.

## **Revenue Administration**

19. **The revenue administration will be modernised.** The domestic tax administration, customs administration, and the information technology service will be unified. We will complete a study by end-September 2011 to assess the feasibility of the new structure taking over the collection function of the social security administration. The structure, to be designed in consultation with EC and IMF staff, will be organized around core business functions and complemented by a taxpayer segmentation approach, mainly through the adoption of a Large Taxpayer Unit. The design of the new structure will be completed by end-2011 and fully implemented by end-2012. The structure will streamline local branches, closing down at least 20 percent of local offices in both 2011 and 2012.

20. **A revenue administration strategic plan for 2012-14 will be prepared by end-October 2011.** This will include concrete actions to combat tax fraud and evasion. We will also prepare a report by end-2011 assessing the current state of our tax information systems, and propose the next steps to strengthen the information technology function. We will submit to Parliament by end- 2011 a law to reinforce the auditing and enforcement powers of the central revenue administration to exercise control over the whole territory of Portugal, including currently exempt tax regimes. The law will also give to the central tax administration the exclusive power to issue interpretative rulings on taxes with national scope, in order to ensure its uniform application.

21. **The operational capacity of the revenue administration will be strengthened.** The audit workforce will be increased to 30 percent of total employees of the tax administration by the end of 2012, mostly through reallocation of staff in the public sector and within the tax administration, and adopting a clear risk management approach for taxpayer selection. We will enhance third-party information to support audit.

22. **We will facilitate an orderly and efficient resolution of tax cases.** Tax tribunals will be specialized in large cases and will be assisted by independent tax specialists similar to the pool used for tax arbitration by end-January 2012. A temporary task force of judges will be established to clear cases worth above €1 million by end-2012 (prior action). The new tax arbitration law will be implemented by end-July 2011. We will include the application of above-market interest charges on the outstanding debt over the entire court proceeding, and impose a special statutory interest on non-compliance with a tax court decision. We will conduct a review of audit performance by end-September 2011 incorporating qualitative indicators in the current quantitative model. An integrated information system between the revenue administration and the tax tribunals will be adopted by end-2011.

### **Public Administration and its Perimeter**

23. **The structure of public administration will be streamlined.** A second phase of the public administration restructuring program (PRACE 2007) will be implemented for central government by end-2011. A similar program for local governments will be launched by April 2012. The objective will be to improve efficiency, and reduce the size of public administration across all levels. We will reduce the number of central government employees by at least 1 percent a year over the duration of the program, with at least 2 percent reduction at the local level, through a policy of only partly replacing separating staff, while at the same time increasing mobility across the administration. As part of these reforms, we will reduce management positions and administrative units by at least 15 percent (on average, over end-2010 levels) by end-2011 for central government and end-June 2012 for local governments, and reduce the number of local branches of line ministries.

24. **The creation of new public and quasi-public entities will be controlled more strictly and the existing number entities will be streamlined.** In conjunction with the SOE review, a comprehensive survey of public and quasi-public entities, including associations, foundations and other bodies, across all levels of government will be published by end-2011. Based on this survey, the administration responsible for public entities will decide to close or maintain them. A new set of public administration laws regulating the creation of SOEs, foundations, associations, and similar bodies at the central and local levels will be adopted by July 2012. We will move immediately to make any legal changes required to enhance monitoring, reduce operating costs and temporarily stop the creation of any new public or quasi-public bodies (including SOEs) at the local level.

25. **We will work with the regional government to bring about similar changes at their level of government.** These efforts will cover preventing creation of SOEs, PPPs, concessions, and any other quasi public entities. We will work to reduce management positions and administrative units by at least 15 percent and put in place a new set of public administration framework laws. We will also work with regional governments to reduce the number of their employees by at least 2 percent a year over the duration of the program.

26. **Local government administration will be reorganized.** There are currently around 308 municipalities and 4,259 parishes. By July 2012, the government will develop a consolidation plan to reorganize and significantly reduce the number of such entities. We will implement these plans based on agreement with the EC and the IMF. 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.

#### **D. Protecting the Financial System amidst Deleveraging**

27. **While the Portuguese banking system has weathered the crisis well so far, bank liquidity remains under pressure.** 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. Banks will be encouraged to take actions to strengthen their collateral buffers. Subject to approval under EC competition rules, the authorities are committed to facilitating the issuance of government guaranteed bank bonds in an amount of up to €35 billion, including the existing package of support measures.

28. **We see a balanced and orderly deleveraging of the banking sector as critical to eliminating its funding imbalances on a permanent basis.** The process should take place in an orderly manner within the Eurosystem framework and consistent with the IMF/EU adjustment program, taking into account the need to reduce reliance on Eurosystem funding and to continue to support the more productive sectors of the domestic economy, not least SMEs. The BdP and the ECB, in consultation with EC and IMF staff, will include clear periodic target leverage ratios and will ask banks to devise by end-June 2011 institution-specific medium-term funding plans to achieve a stable market-based funding position. To smooth the deleveraging process, we will encourage private investors to maintain their exposure. Quarterly reviews will be conducted in consultation with EC and IMF staff, and will examine the feasibility of individual banks' plans and their implications for leverage ratios, as well as the impact on credit aggregates and the economy as a whole, and the BdP will then request adjustments in the plans as needed.

29. **To bolster the resilience of the banking sector, we are asking banks to further strengthen their capital buffer, while augmenting the bank solvency support mechanism.** The BdP had already required banks to raise their core Tier 1 capital level to 8 percent and significant progress has been achieved in reaching this level. However, the environment has become more challenging lately, and to further enhance confidence in the solvency of the banking system, the BdP will now direct all banking groups subject to supervision in Portugal to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent at the latest by end-2012 (prior action) and maintain it thereafter. If needed, using its Pillar 2 powers, the BdP will also require some banks, based on their specific risk profile, to reach these higher capital levels on an accelerated schedule, taking into account the indications of the solvency assessment framework described in paragraph 31. Banks will be required to present plans to the BdP by end-June 2011 on how they intend to reach the new capital requirements through market solutions. However, in the event that they



cannot reach the targets on time, ensuring higher capital standards may temporarily require public provision of equity for the private banks. We are thus augmenting the bank solvency support facility in line with EU state aid rules. Taking into account the overall resources available to us, including the EU-IMF financing, we will have adequate funds to provide €12 billion to the facility. This will be done in a way that preserves the control of the management of the banks by their non-state owners during a first phase and allow them the option of buying back the government's stake. The banks benefitting from equity injections will be subjected to specific management rules and restrictions, and to a restructuring process in line with EU competition and state aid requirements, that will provide the incentive to give priority to market-based solutions.

30. **We will streamline the state-owned CGD group to increase the capital base of its core banking arm as needed.** With 23 percent of the system's assets, this bank plays a central role in the financial system and we realize that its balance sheet should be optimized. The CGD bank is expected to raise its capital to the new required levels from internal group resources and improve the group's governance. This will include a more ambitious schedule towards the already announced sale of the insurance arm of the group, a program for the gradual disposal of all non-core subsidiaries, and, if needed, a reduction of activities abroad.

31. **The BdP is further intensifying its monitoring of the banking sector.** It is stepping-up its solvency and deleveraging assessment framework for the system as a whole and for each of the eight largest banks, and will seek an evaluation of the enhanced assessment framework by end-September 2011 (structural benchmark) by a joint team of experts from the EC, the ECB and the IMF. By end-June 2011, the BdP will also design a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment (structural benchmark). This program will be part of a capacity building technical cooperation project put in place with the support of the EC, the ECB, and the IMF that will bring together Portuguese supervisors, cooperating central banks and/or supervisory agencies, external auditors and other experts as needed. The BdP will provide quarterly updates of banks' potential capital needs going forward and check that their deleveraging process remains on track and properly balanced. Whenever the assessment framework will indicate that a bank's core Tier 1 ratio might fall under 6 percent under a stress scenario over the course of the program, the BdP, using its Pillar 2 powers, will ask it to take measures to strengthen its capital base.

32. **The BdP has kept a watchful eye on the banking sector and will continue to strengthen banking regulation and supervision.** The efficacy of the supervisory function is being permanently improved. This has included the reorganization of the function into three more focused departments last year and the setting-up of an interdepartmental committee for the purpose of financial stability monitoring and macro-prudential supervision. An internal bank evaluation system is currently being developed and is being fine-tuned. Disclosure on non-performing loans will be improved by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments by end-September 2011 (structural benchmark). Still more focus will be put on on-site inspections and verification of data accuracy with technical

assistance from the IMF, in the context of the data verification exercise for the new solvency assessment framework. New resources will be allocated for the recruitment of additional specialist banking supervisors. Close coordination will be maintained with home and host country supervisors, within the EU framework for cross-border banking supervision and with relevant non-EU host supervisors of branches and subsidiaries of Portuguese banks.

33. **We are stepping-up our efforts to bring closure to the case of Banco Português de Negócios (BPN).** Following the unsuccessful privatization of the bank in 2010, and taking into account the recent deterioration of economic conditions, we are now launching a process to sell the bank on an accelerated schedule and without a minimum price. To this end, we will submit a new plan to the EC for approval under competition rules. Our target is to find a buyer by end-July 2011 at the latest. To facilitate the sale, the 3 existing special purpose vehicles holding its non-performing and non-core assets have been separated from BPN, and more assets could be transferred into these vehicles as part of the negotiations with prospective buyers. BPN is also undertaking additional cost-cutting measures to increase its attractiveness to investors. Once a solution has been found, CGD's state-guaranteed claims on BPN and all related special purpose vehicles will be taken over by the state according to a timetable to be defined at that time.

34. **We will strengthen the early intervention and resolution framework.** This will allow timely and effective intervention and resolution in line with EU developments and international sound practices. Legislation concerning credit institutions will be amended, in consultation with EC, ECB, and IMF staff, by end-November 2011 (structural benchmark) to, inter alia, impose early reporting obligations based on clear triggers and penalties; empower the BdP with remedial measures to promote implementation of a recovery plan; and require credit institutions with systemic risks to prepare contingency resolution plans subject to regular review. The amendments will also introduce a resolution regime for distressed credit institutions as a going concern under official control to promote financial stability and protect depositors. There will be clear triggers for its initiation, and restructuring tools for the resolution authorities shall include (i) recapitalization without shareholder pre-emptive rights in accordance with the relevant EU framework; (ii) transfer of assets and liabilities to other credit institutions; and (iii) a bridge bank.

35. **We will strengthen the legislation on the Deposit Guarantee Fund (FGD) and on the Guarantee Fund for Mutual Agricultural Credit Institutions (FGCAM).** This will be done in consultation with EC, ECB and IMF staff, by end-2011 (structural benchmark). These funds' functions will be re-examined to strengthen protection of guaranteed depositors. These funds should retain the ability to fund the resolution of distressed credit institutions and in particular the transfer of guaranteed deposits to another credit institution but not to recapitalize them. Such financial assistance shall be capped at the amount of guaranteed deposits that would have to be paid out in liquidation. This should be permissible only if it does not prejudice the ability of these funds to perform their primary function. Further, the Insolvency Law will be amended by end-November 2011 to provide that guaranteed depositors and/or the funds (directly or

through subrogation) will be granted a priority ranking over unsecured creditors in the credit institution's insolvent estate.

36. **The legal framework will be refined to facilitate orderly and efficient corporate and household debt restructurings.** The Insolvency Law will be amended to better support effective rescue of viable firms (end-November 2011 structural benchmark), with technical assistance from the IMF, to, inter alia, introduce fast track court approval procedures for restructuring plans. General principles on voluntary out of court restructuring in line with international best practices will be issued by end-September 2011. We will also take the necessary actions to authorize the tax and social security administrations to use a wider range of restructuring tools based on clear criteria and review the tax law to identify impediments to debt restructuring. The amendments to the Insolvency Law will also include improvements of personal insolvency procedures to better support rehabilitation of financially responsible individuals. Finally, we will launch a campaign to raise awareness of the restructuring tools available for early rescue of viable firms through, e.g., training and new information means.

37. **The government will intensify the monitoring of the corporate and household sectors, and prepare contingency plans for a large debt overhang in these sectors.** Starting quarterly, reports on corporate and household sectors will be prepared, to include an assessment of their funding pressures and debt refinancing activity. An assessment of the guarantees programs currently place and an evaluation of market-based financing alternatives will also be performed. Finally, a task force will be constituted to prepare contingency plans to efficiently deal with the challenges posed by corporate and household sectors indebtedness. These enhanced monitoring actions will put be in place by end-September 2011 in consultation with EC, IMF, and ECB staff.

## **E. Enhancing Competitiveness through Structural Reforms**

### **Labor markets**

38. **Reforms will focus on creating new jobs, not least for the young.** We must address the fundamental problems that impede the efficient transition of workers across occupations, firms and sectors and create socially unfair privileges. To this end, in consultation with our social partners, we will adopt the following measures:

- **Reform employment protection legislation to foster flexibility and improve equity.** We will align severance payments for open-ended and fixed-term hires, submit legislation by end-July 2011 (structural benchmark) reducing severance payments for all new contracts to 10 days per year of tenure, with an additional 10 days financed out of employers' financed fund, and present a proposal to revise severance payment entitlements for current employees in line with the reform for new hires by end-2011, without reducing accrued-to-date entitlements. As a further step, by end-March 2012, we will prepare a proposal to align the level of severance payments to the EU average, while at the same time amending the dismissal fund in a way that allows the portability of worker's entitlement to

severance pay. We will prepare by end-December 2011 a proposal aimed at introducing adjustments to the cases for fair individual dismissals.

- **Revise the unemployment insurance system to change incentives, increase employment, and strengthen social safety nets.** We will reduce the maximum duration of unemployment insurance benefits to no more than 18 months, and cap unemployment benefits at 2.5 times the social support index and introduce a declining profile of benefits after six months of unemployment (a reduction of at least 10 percent in benefits), without reducing accrued-to-date entitlements. To extend social safety nets, we will reduce the necessary contributory period to access unemployment insurance from 15 to 12 months, and present a proposal to extend eligibility for clearly-defined categories of self-employed. Training opportunities will be strengthened, especially for the low-skilled.
- **Ensure that labor costs support job creation and competitiveness.** Over the program period, any increase in the minimum wage will take place only if justified by economic conditions and agreed in the context of regular program reviews.
- **Define clear criteria for the extension of collective agreements,** including the representativeness of the negotiating organizations and the implications of the extension for the competitive position of non-affiliated firms. To promote wage adjustments in line with productivity at the firm level we will (i) allow works councils to negotiate mobility conditions and working time arrangements; (ii) reduce the threshold below which works councils or other workers organizations cannot conclude firm-level agreements to 250 employees per firm; and (iii) include in sectoral collective agreements conditions under which works councils can independently conclude firm-level agreements.

### **Fiscal devaluation**

**39. A critical goal of our program is to boost competitiveness.** This will involve a major reduction in employer's social security contributions. This measure will be fully calibrated by the time of the first review (end-July 2011, structural benchmark). The offsetting measures needed to ensure fiscal neutrality may include changing the structure and rates of VAT, additional permanent expenditure cuts, and raising other taxes that would not have an adverse effect on competitiveness. In calibrating this measure, we will take measures to: (i) mitigate the social impact of higher consumption taxes; (ii) ensure that changes to social security contributions are compensated by allocating equivalent revenues in order not to jeopardize the sustainability of the pension system; and (iii) ensure that tax changes are passed through to lower prices. While the proposal might be implemented in two steps, the bold first step will be implemented in the context of the 2012 budget. A structural benchmark for October 2011 will be set at the time of the first review.

## Competition Framework

40. **To rebalance growth toward the tradable sector, we need to foster competition in the non-tradable sector.** State involvement in private sector activities will be reduced, and the independence of sectoral regulators reinforced. We will eliminate “golden shares” and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state (structural benchmark, end-July 2011).

41. **We will take bold steps to address excessive profits and reduce the scope for rent-seeking behavior.**

- In electricity, we will review the efficiency of support schemes for co-generation and renewables, assessing their rationale, levels, and other relevant design elements, including options for reducing the implicit production subsidy (structural benchmark, end-December 2011). We will reassess legacy support measures associated with the production of electricity under the ordinary regime, and, where possible, revise downwards the guaranteed compensation mechanism (CMEC) paid to producers and the remaining long-term power-purchase agreements (PPAs).
- In telecommunications, we will facilitate the entry in the market of new players awarding the right to use new radio frequencies for broadband wireless access and lowering mobile termination rates, alleviate restrictions on mobility of consumers and ensure that the provision on universal service designation and the incumbent’s concession contract are non-discriminatory.
- We will review and reduce the number of regulated professions (by end-September 2011 for professions not regulated by Parliament and by end-March 2012 for all others); eliminate the restriction on the use of advertising in regulated professions (end-September 2011); improve the recognition framework on professional qualifications, ease the requirements related to the establishment of foreign service providers in Portugal; and reduce the number of requirements to which cross-border service providers are subject (end-December 2011).
- We will (i) submit to Parliament a law revising the Competition Law, clearly separating rules on competition enforcement procedures and penal procedures, and (ii) establish a new Court on Competition Matters and introduce greater specialization of judicial functions (structural benchmark).

42. **We commit to a number of additional measures to enhance the flexibility and productive capacity of the economy.** In particular, we will undertake a comprehensive reform of the housing market which aims at facilitating labor mobility and reducing incentives for private sector over-borrowing. We also commit to tackle low educational attainment and improve the quality of secondary and vocational education, and continue reducing the administrative burden for firms in all sectors and facilitate access to export

markets by end-March 2012. The joint EC-ECB Memorandum of Understanding further specifies these and other structural policies recommended in the MEFP.

## **Judicial Reforms**

43. **Immediate priority will be given to improve the efficiency of the judicial process.** The current tedious judicial process coupled with a severe backlog of cases impede effective market functioning across a number of sectors. We are committed to implement the announced Judicial Reform Map without delay and take additional steps to make the judicial system efficient and effective.

44. **We aim to resolve the backlog of cases in the courts within 24 months.** An audit of the backlog cases including debt enforcement, insolvency, and tax and labor cases will be completed by end-June 2011. Based on this audit, additional measures will be developed by end-September 2011 to expedite the resolution of the backlog, including (i) establishing separate Chambers or Teams involving all agencies solely for resolving the backlog; (ii) restructuring court record-keeping to take cases off the books; (iii) merging similar small debt enforcement cases; (iv) strengthening and enforcing existing regulations allowing dormant cases to be removed from the court register; (v) imposing additional costs and penalties against non-cooperative debtors in enforcement cases; and (vi) assigning special court managers to allow judges to focus on the cases.

45. **The court system will be restructured to improve management efficiency.** Thirty-nine court units, with added management support for each unit, will be established by end- 2012. This restructuring will be entirely financed through expenditure savings and gains of efficiency and is part of the rationalization effort, in order to improve efficiency in the management of infrastructure and public services. We will develop a roadmap for this reform, identifying key quarterly milestones by end-September 2011. A new internal management system will be implemented for two county courts (including Lisbon) by end-2011. The new Courts on Competition Matters and Intellectual Property Rights will become operational by end-January 2012; and we will assess the need for separate Chambers within the Commercial Courts with specialized judges for insolvency cases by end-2011. A new personnel management plan will be developed to support judicial specialization and mobility of court officials by end-2011.

46. **We will further improve the efficiency of civil case processing in the courts.** The new experimental civil procedure regime which has been applied to seven courts will be extended to four courts by end-September 2011. A report will be prepared by end-2011 on whether such regime should be applied to all courts. Finally, we will review the Code of Civil Procedure and prepare a proposal by end-2011 (structural benchmark) addressing the key areas for refinement, including (i) consolidating legislation for all enforcement cases before the court, (ii) giving judges the power to expedite cases, (iii) reducing administrative burdens on judges, and (iv) enforcing statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases.

47. **A more sustainable and transparent budget for the judiciary is crucial to the success of the judicial reform.** We will standardize the court fees and introduce special court fees for certain cases and procedures by end-September 2011. The Ministry of Justice will develop and publish an annual plan on the allocation of resources based on court by court performance data. A workload/staffing assessment will be completed for the six pilot courts under the Judicial Reform Map and the specialized courts by end-March 2012. In addition, quarterly reports on recovery rates, duration and costs of corporate insolvency and tax cases will be published starting from the third quarter of 2011.

48. **Alternative dispute resolution (ADR) needs to be strengthened to better facilitate out-of-court settlement.** We will adopt the Law on Arbitration by end-September 2011. We will take all necessary legal, administrative, and other steps to make arbitration for debt enforcement cases fully operational by end-February 2012 to facilitate resolution of backlog cases and out-of-court settlement (structural benchmark). The Justices for Peace regime will be optimized by increasing its capacity to handle small claim cases by end-March 2012. To bolster the ADR regime, we will adopt measures to give priority to the ADR enforcement cases in the courts by end-2011.

#### **F. Program Matters**

49. **In the context of the arrangement, the BdP will undergo a safeguards assessment in accordance with the IMF safeguards policy.** In this regard, and to facilitate a timely completion of the assessment, the authorities have provided the information requested for the assessment to commence, and have also authorized the external auditors to provide information to and hold discussions with IMF staff. A memorandum of understanding between the government and the BdP will establish a clear framework on the modalities for the repayment of IMF financing and the servicing of interest payments and other charges. As part of these arrangements, Fund disbursements will be deposited into the government's account at the BdP pending their use.

Table 1. Portugal: Quantitative Performance Criteria and Indicative Targets  
(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
1. Floor on the consolidated General Government cash balance (cumulative) 1/	-5.4	-6.7	-10.3	-1.7	-3.8	-5.9	-7.6
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 2/	...	0	0	0	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	175.9	175.9	189.4	189.4	189.4	189.4
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government 3/	0	0	0	0	0	0	0

1/ Corresponds to an overall deficit of the General Government of €10,042 million on ESA 95 basis. Cumulative from January 1, 2011 for 2011, and cumulative from January 1, 2012 for 2012.

2/ Applies on a continuous basis from September 15, 2011 onwards. Insufficient information for application in June.

3/ Applies on a continuous basis from June 15, 2011 onwards.



<b>Table 2. Portugal: Structural Conditionality</b>	
<b>Measure</b>	<b>Status / Timing</b>
<b>Prior Actions</b>	
1 Direct all banking groups subject to supervision in Portugal to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent by end-2012 and maintain it thereafter, with banks required to present by end-June 2011 plans on how they intend to comply with these requirements.	Met
2 Prepare a comprehensive report on 10 SOEs posing the largest potential fiscal risks to the state. The report would cover (i) concrete plans, per enterprise, for reducing its operational costs, consistent with an average cut of at least 15 percent in the sector over 2009 levels; (ii) a planned revision of the tariffs.	Met
3 Prepare a comprehensive inventory of the existing tax expenditures (including all types of exemptions, deductions, and reduced rates), by type of tax, along with their costing estimates.	Met
4 Approve a standard definition of arrears and commitments	Met
5 Establish a temporary task force of judges to clear tax cases worth above €1 million	Met
<b>Structural Benchmarks</b>	
<b>A. Strengthen financial stability and enhance banking sector monitoring:</b>	
6 Design a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment.	End-Jun. 2011
7 Seek evaluation of the enhanced solvency and deleveraging assessment framework by a joint team of experts from the EC, the ECB and the IMF.	End-Sep. 2011
8 Improve disclosure on non-performing loans by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments.	End-Sep. 2011
9 Amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework and introduce a regime for restructuring of banks as a going concern under official control.	End-Nov. 2011
10 Amend the Insolvency Law to better facilitate effective rescue of viable firms and support rehabilitation of financially responsible individuals.	End-Nov. 2011
11 Amend the relevant legislation to strengthen deposit insurance framework by authorizing bank resolution financing and introducing depositor preference.	End-Dec. 2011
<b>B. Enhance competitiveness:</b>	
12 Eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state.	End-Jul. 2011
13 Submit to Parliament a law, already agreed with social partners, to align and reduce severance payments on all new contracts (fixed term and open-ended).	End-Jul. 2011
14 Finalize calibration of fiscal reform to reduce unit labor costs via deficit-neutral reduction in labor taxes.	End-Jul. 2011
15 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-Dec. 2011
16 Review the efficiency of support schemes for co-generation and renewables and propose possible options for reducing the implicit subsidy.	End-Dec. 2011
17 Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011
18 Take all necessary legal, administrative, and other steps to make arbitration for debt enforcement cases fully operational.	End-Feb. 2012
<b>C. Strengthen public financial management and reduce fiscal risks:</b>	
19 Publish a fiscal strategy document for the general government which will specify 4-year medium-term economic and fiscal forecasts, supporting analysis and underlying assumptions, and 4-year costings of new policy decisions.	End-Aug. 2011
20 Conduct and publish the results of a survey of arrears of general government entities and SOEs for all categories of expenditure as at end-June 2011.	End-Aug. 2011
21 Based on assessment from EU/IMF technical assistance on the budgetary implications of main PPP programs, recruit a top tier international accounting firm to complete a more detailed study of PPPs and identify areas for deeper analysis by an international consulting firm.	End-Dec. 2011
22 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

**PORTUGAL**

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

17 May 2011

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, this Memorandum of Understanding details the general economic policy conditions as embedded in Council Implementing Decision [...] of [...] on granting Union financial assistance to Portugal.<sup>1</sup>

The Council Implementing Decision specifies that the first disbursement of financial assistance from the EFSM shall be released subject to the entry into force of this Memorandum of Understanding on specific economic policy conditionality (MoU) and of the Loan Agreement. Before the signature of this MoU, Portugal has completed the prior actions set out in the Memorandum of Economic and Financial Policies (MEFP) and which are also included in this MoU.

The Decision also makes the release of further instalments 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 MEFP and in this MoU, as well as Council Recommendations in the context of the Excessive Deficit Procedure. The first quarterly review will be carried out in the third quarter of 2011 and will assess compliance with the conditions to be met by end-July. 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.

If targets are missed or expected to be missed, additional action will be taken. The authorities commit to consult with the European Commission, the ECB and the IMF on the adoption of policies that are not consistent with this Memorandum. They will also provide the European Commission, the ECB and the IMF with all information requested that is available to monitor progress during programme implementation and to track the economic and financial situation. Prior to the release of the instalments, the authorities shall provide a compliance report on the fulfilment of the conditionality.

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

## **1. Fiscal policy**

### **Objectives**

Reduce the Government deficit to below EUR 10,068 million (equivalent to 5.9% of GDP based on current projections) in 2011, EUR 7,645 million (4.5% of GDP) in 2012 and EUR 5,224 million (3.0% of GDP) in 2013 by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups; bring the government debt-to-GDP ratio on a downward path as of 2013; maintain fiscal consolidation over the medium term up to a balanced budgetary position, notably by containing expenditure growth; support competitiveness by means of a budget-neutral adjustment of the tax structure.

### **Fiscal policy in 2011**

1.1. The Government achieves a general government deficit of no more than EUR 10,068 millions in 2011. **[Q4-2011]**

1.2. Over the remainder of the year, the government will rigorously implement the Budget Law for 2011 and the additional fiscal consolidation measures introduced before May 2011. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). **[Q3 and Q4-2011]**

### **Fiscal policy in 2012**

1.3. On the basis of a proposal developed by the time of the first review **[end-July 2011]**,<sup>2</sup> the 2012 Budget will include a budget neutral recalibration of the tax system with a view to lower labour costs and boost competitiveness **[October 2011]**.

1.4. The government will achieve a general government deficit of no more than EUR 7,645 millions in 2012. **[Q4-2012]**

1.5. Throughout the year, the government will rigorously implement the Budget Law for 2012. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). **[Q1, Q2, Q3 and Q4-2012]**

1.6. The following measures will be carried out with the 2012 Budget Law **[Q4-2011]**, unless otherwise specified:

### *Expenditure*

1.7. Improve the working of the central administration by eliminating redundancies, 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 500 million. Detailed plans will be presented by the Portuguese authorities and will be

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<sup>2</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

assessed by **Q1-2012**; the budgetary impacts will spread to 2014. To this end, the government will:

- i. reduce the number of services while maintaining quality of provision;
- ii. create a single tax office and promoting services' sharing between different parts of the general government;
- iii. reorganise local governments and the provision of central administration services at local level;
- iv. regularly assess the value for money of the various public services that are part of the government sector as defined for national accounts purposes;
- v. promote mobility of staff in central, regional and local administrations;
- vi. reduce transfers from the State to public bodies and other entities;
- vii. revise compensation schemes and fringe benefits in public bodies and entities that independently set their own remuneration schemes;
- viii. reduce subsidies to private producers of goods and services.

1.8. Reduce costs in the area of education, with the aim of saving EUR 195 million by rationalising the school network by creating school clusters; lowering staff needs; centralising procurement; and reducing and rationalising transfers to private schools in association agreements.

1.9. Ensure that the aggregate public sector wage bill as a share of GDP decreases in 2012 and 2013 [**Q2-2012** for assessment; **Q2-2013** to complete process]:

- i. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 1% per year in the staff of central administration and 2% in local and regional administration. [**Q3-2011**]
- ii. Freeze wages in the government sector in nominal terms in 2012 and 2013 and constrain promotions.
- iii. Reduce the overall budgetary cost of health benefits schemes for government employees schemes (ADSE, ADM and SAD) lowering the employer's contribution and adjusting the scope of health benefits, with savings of EUR 100 million in 2012.

1.10. Control costs in health sector on the basis of detailed measures listed below under 'Health-care system', achieving savings worth EUR 550 million.

1.11. Reduce pensions above EUR 1,500 according to the progressive rates applied to the wages of the public sector as of January 2011, with the aim of yielding savings of at least EUR 445 million.

1.12. Suspend application of pension indexation rules and freeze pensions, except for the lowest pensions, in 2012.

1.13. Reform unemployment insurance on the basis of detailed measures listed below under 'Labour market and education', yielding medium-term savings of around EUR 150 million.

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

1.15. Reduce costs in other public bodies and entities by at least EUR 110 million.

1.16. Reduce costs in State-owned enterprises (SOEs) with the aim of saving at least EUR 515 million by means of:

- i. sustaining an average permanent reduction in operating costs by at least 15%;
- ii. tightening compensation schemes and fringe benefits;
- iii. rationalisation of investment plans for the medium term;
- iv. increase their revenues from market activities.

1.17. Permanently reduce capital expenditure by EUR 500 millions by prioritising investment projects. Make more intensive use of funding opportunities provided by EU structural funds, while preserving the basic competitiveness approach agreed with the European Commission in the context of the current National Strategic Reference Framework (NSRF).

### *Revenue*

1.18. 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.

1.19. Reduction of *corporate* tax deductions and special regimes, with a yield of at least EUR 150 million in 2012. Measures include:

- i. abolishing all reduced corporate income tax rates;
- ii. limiting the deductions of losses in previous years according to taxable matter and reducing the carry-forward period to three years;
- iii. reducing tax allowances and revoking subjective tax exemptions;
- iv. curbing tax benefits, namely those subject to the sunset clause of the Tax Benefit Code, and strengthening company car taxation rules;
- v. proposing amendments to the regional finance law to limit the reduction of corporate income tax in autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

1.20. Reduction of *personal income tax* benefits and deductions, with a yield of at least EUR 150 million in 2012. Measures include:

- i. capping the maximum deductible tax allowances according to tax bracket with lower caps applied to higher incomes and a zero cap for the highest income brackets;
- ii. applying separate caps on individual categories by (a) introducing a cap on health expenses; (b) eliminating the deductibility of mortgage principal and phasing out the deductibility of rents and of mortgage interest payments for owner-occupied housing; eliminate interest income deductibility for new mortgages (c) reducing the items eligible for tax deductions and revising the taxation of income in kind;
- iii. proposing amendments to the regional finance law to limit the reduction of personal income tax in autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

1.21. Apply personal income taxes to all types of cash social transfers and ensure convergence of personal income tax deductions applied to pensions and labour income with the aim of raising at least EUR 150 million in 2012.

1.22. Changes in property taxation to raise revenue by at least EUR 250 million by reducing substantially the temporary exemptions for owner-occupied dwellings. Transfers from the central to local governments will be reviewed to ensure that the additional revenues are fully used for fiscal consolidation.

1.23. Raise VAT revenues to achieve a yield of at least EUR 410 million for a full year by:

- i. reducing VAT exemptions;
- ii. moving categories of goods and services from the reduced and intermediate VAT tax rates to higher ones;
- iii. proposing amendments to the regional finance law to limit the reduction of VAT in the autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

1.24. Increase excise taxes to raise at least EUR 250 million in 2012. In particular by:

- i. raising car sales tax and cutting car tax exemptions;
- ii. raising taxes on tobacco products;
- iii. indexing excise taxes to core inflation;
- iv. introducing electricity excise taxes in compliance with EU Directive 2003/96.

1.25. Increase efforts to fight tax evasion, fraud and informality to raise revenue by at least EUR 175 million in 2012.

### **Fiscal policy in 2013**

1.26. The government achieves a general government deficit of no more than EUR 5,224 million in 2013. **[Q4-2013]**

1.27. Throughout the year, the government will rigorously implement the Budget Law for 2013. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). **[Q1, Q2, Q3 and Q4-2013]**

1.28. The following measures will be carried out with the 2013 Budget Law **[Q4-2012]**, unless otherwise specified:

#### *Expenditure*

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

- i. central administration functioning: EUR 500 million. Detailed plans will be presented and assessed before Q3-2012;
- ii. education and school network rationalization: EUR 175 million;

- iii. wage bill: annual decreases of 1% per year in headcounts of central administration and 2% in local and regional administrations;
- iv. health benefits schemes for government employees: EUR 100 million.
- v. health sector: EUR 375 million;
- vi. transfers to local and regional authorities: EUR 175 million;
- vii. costs in other public bodies and entities, and in SOEs: EUR 175 million;
- viii. capital expenditure: EUR 350 million;
- ix. maintain the suspension of pension indexation rules except for the lowest pensions in 2013.

1.30. 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 350 million.

### *Revenue*

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

- i. corporate tax bases and reduce tax benefits and tax deductions: EUR 150 million;
- ii. personal income tax benefits and tax deductions: EUR 175 million;
- iii. taxation of all types of cash social transfers and convergence of personal income tax deductions for pensions and labour income: EUR 150 million;
- iv. excise taxes: EUR 150 million.

1.32. Update the notional property value of real estate assets for tax purposes to raise revenue by at least EUR 150 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**

1.33. The government will aim at achieving a general government deficit of no more than EUR 4,521 millions in 2014. The necessary measures will be defined in the 2014 Budget Law. **[Q4-2013]**

1.34. Throughout the year, the Government will rigorously implement the Budget Law for 2014. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). **[Q1 and Q2-2014]**

1.35. 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***

### **Objectives**

Preserve financial sector stability; maintain liquidity and support a balanced and orderly deleveraging in the banking sector; strengthen banking regulation and supervision; bring closure to the Banco Português de Negócios case and streamline state-owned Caixa Geral de Depósitos; strengthen the bank resolution framework and reinforce the Deposit Guarantee Fund and the Guarantee Fund for Mutual Agricultural Credit Institutions; reinforce the corporate and household insolvency frameworks.

### *Maintaining liquidity in the banking sector*

2.1. Subject to approval under EU competition rules, the authorities are committed to facilitate the issuance of government guaranteed bank bonds for an amount of up to EUR 35 billion, including the existing package of support measures.

### *Deleveraging in the banking sector*

2.2. Banco de Portugal (BdP) and the ECB, in consultation with the European Commission (EC) and the IMF, will include clear periodic target leverage ratios and will ask banks to devise by **end-June 2011** institution-specific medium-term funding plans to achieve a stable market-based funding position. To smooth the deleveraging process, the authorities will encourage private investors to maintain their exposure. Quarterly reviews will be conducted in consultation with the EC and the IMF, and will examine the feasibility of individual banks' plans and their implications for leverage ratios, as well as the impact on credit aggregates and the economy as a whole, and the BdP will then request adjustments in the plans as needed.

### *Capital buffers*

2.3. BdP will direct all banking groups supervised by BdP to reach a core Tier 1 capital ratio of 9 percent by **end-2011** and 10 percent at the latest by **end-2012** and maintain it thereafter.<sup>3</sup> If needed, using its Pillar 2 powers, the BdP will also require some banks, based on their specific risk profile, to reach these higher capital levels on an accelerated schedule, taking into account the indications of the solvency assessment framework described below. Banks will be required to present plans to BdP by **end-June 2011** on how they intend to reach the new capital requirements through market solutions.

2.4. In the event that banks cannot reach the new capital requirements on time, ensuring higher capital standards might temporarily require public provision of equity for the private banks. To that effect, the authorities will augment the bank solvency support facility, in line with EU state aid rules, with resources of up to EUR 12 billion provided under the programme. The facility will be designed in a way that preserves the control of the management of the banks by their non-state owners during an initial phase and allows them the option of buying back the government's stake. The banks benefitting from equity injections will be subjected to specific management rules and restrictions, and to a restructuring process in line with EU competition and state aid requirements, that will provide the incentive to give priority to market-based solutions.

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<sup>3</sup> Prior action in the Memorandum of Economic and Financial Policies.



### *Caixa Geral de Depósitos (CGD)*

2.5. The state-owned CGD group will be streamlined to increase the capital base of its core banking arm as needed. The CGD bank is expected to raise its capital to the new required level from internal group resources, and improve the group's governance. This will include a more ambitious schedule toward the already announced sale of the insurance arm of the group, a program for the gradual disposal of all non-core subsidiaries, and, if needed a reduction of activities abroad.

### *Monitoring of bank solvency and liquidity*

2.6. The BdP is stepping up its solvency and deleveraging assessment framework for the system as a whole and for each of the eight largest banks, and will seek an evaluation of the enhanced assessment framework by **end-September 2011** by a joint team of experts from the EC, the ECB and the IMF.<sup>4</sup>

2.7. By **end-June 2011**, the BdP will also design a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment. This program will be part of a capacity building technical cooperation project put in place with the support of the EC, the ECB, and the IMF that will bring together Portuguese supervisors, cooperating central banks and/or supervisory agencies, external auditors and other experts as needed.<sup>5</sup>

2.8. The BdP will provide quarterly updates of banks' potential capital needs going forward and check that their deleveraging process remains on track and properly balanced. Whenever the assessment framework will indicate that a bank's core Tier 1 ratio might fall under 6 percent under a stress scenario over the course of the program, the BdP, using its Pillar 2 powers, will ask it to take measures to strengthen its capital base.

### *Banking regulation and supervision*

2.9. BdP will ensure by **end-September 2011** that the disclosure of non-performing loans will be improved by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments.<sup>6</sup> BdP will intensify on-site inspections and verification of data accuracy with technical assistance from the IMF, in the context of the data verification exercise for the new solvency assessment framework. BdP will allocate new resources to the recruitment of additional specialist banking supervisors. Close coordination will be maintained between home and host country supervisors within the EU framework for cross-border banking supervision and with relevant non-EU host supervisors of branches and subsidiaries of Portuguese banks.

### *Banco Português de Negócios*

2.10. The authorities are launching a process to sell Banco Português de Negócios (BPN) on an accelerated schedule and without a minimum price. To this end, a new plan is submitted to the EC for approval under competition rules. The target is to find a buyer **by end-July 2011** at the latest.

2.11. To facilitate the sale, the three existing special purpose vehicles holding its non-performing and non-core assets have been separated from BPN, and more assets could be

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

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

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

transferred into these vehicles as part of the negotiations with prospective buyers. BPN is also launching another program of more ambitious cost cutting measures with a view to increase its attractiveness to investors

2.12. Once a solution has been found, CGD's state guaranteed claims on BPN and all related special purpose vehicles will be taken over by the state according to a timetable to be defined at that time.

### *Bank resolution framework*

2.13. The authorities will amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF by **end-November 2011** to, inter alia, impose early reporting obligations based on clear triggers and penalties. BdP will be authorised to take remedial measures to promote implementation of a recovery plan. Credit institutions with systemic risks will be required to prepare contingency resolution plans) subject to regular review.<sup>7</sup>

2.14. The amendments will introduce a regime for the resolution of distressed credit institutions as a going concern under official control to promote financial stability and protect depositors. The regime will set out clear triggers for its initiation, and restructuring tools for the resolution authorities shall include recapitalization without shareholder pre-emptive rights in accordance with the relevant EU framework, transfer of assets and liabilities to other credit institutions and a bridge bank.

### *The Deposit Guarantee Fund*

2.15. The authorities will strengthen the legislation on the Deposit Guarantee Fund (FGD) and on the Guarantee Fund for Mutual Agricultural Credit Institutions (FGCAM), in consultation with EC, the ECB and the IMF, **by end-2011**.<sup>8</sup> These funds' functions will be re-examined to strengthen protection of guaranteed depositors. These funds should however retain the ability to fund the resolution of distressed credit institutions and in particular the transfer of guaranteed deposits to another credit institution but not to recapitalise them. Such financial assistance shall be capped at the amount of guaranteed deposits that would have to be paid out in liquidation. This should be permissible only if it does not prejudice their ability to perform their primary function.

2.16. The Insolvency Law will be amended **by end-November 2011** to provide that guaranteed depositors and/or the funds (either directly or through subrogation) will be granted a higher priority ranking over unsecured creditors in the insolvent state of a credit institution.

### *Corporate and household debt restructuring framework*

2.17. To better facilitate effective rescue of viable firms, the Insolvency Law will be amended by **end-November 2011** with technical assistance from the IMF, to, inter alia, introduce fast track court approval procedures for restructuring plans.<sup>9</sup>

2.18. General principles on voluntary out of court restructuring in line with international best practices will be issued by **end-September 2011**.

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

<sup>8</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>9</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

2.19. The authorities will also take the necessary actions to authorise the tax and social security administrations to use a wider range of restructuring tools based on clearly defined criteria in cases where other creditors also agree to restructure their claims, and review the tax law with a view to removing impediments to voluntary debt restructuring.

2.20. The personal insolvency procedures will be amended to better support rehabilitation of financially responsible individuals, which will balance the interests of creditors and debtors.

2.21. The authorities will launch a campaign to raise public and stakeholder awareness of the restructuring tools available for early rescue of viable firms through, e.g., training and new information means.

### *Monitoring of corporate and household indebtedness*

2.22. The authorities will prepare quarterly reports on corporate and household sectors including an assessment of their funding pressures and debt refinancing activities. The authorities will assess guarantee programmes currently in place and evaluate market-based financing alternatives. A task force will be constituted to prepare contingency plans to efficiently deal with the challenges posed by high corporate and household sectors indebtedness. These enhanced monitoring actions will put be in place by **end-September 2011** in consultation with the EC, the IMF and the ECB.

## **3. Fiscal-structural measures**

### **Objectives**

Improve the efficiency of the public administration by eliminating redundancies, simplifying procedures and reorganising services; regulate the creation and functioning of all public entities (e.g. enterprises, foundations, associations); streamline the budgetary process through the newly approved legal framework, including by adapting accordingly the local and regional financial legal frameworks; strengthen risk management, accountability, reporting and monitoring.

### **Public Financial Management framework**

To strengthen the public financial management framework the Government will take the following measures:

#### *Reporting*

3.1. Approve a standard definition of arrears and commitments.<sup>10</sup> [Q2-2011]

3.2. Conduct and publish a comprehensive survey of arrears by **end-August 2011** covering all categories of expenditure payables as at the end of June 2011. All general government entities and SOEs classified outside the general government will be covered by this survey.<sup>11</sup>

3.3. Enhance the existing monthly reporting on budgetary execution on a cash basis for the general government, including on a consolidated basis. The monthly reporting perimeter currently includes the State, Other public bodies and entities, Social Security,

<sup>10</sup> Prior action in the Memorandum of Economic and Financial Policies.

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

regional and local governments and it will be progressively expanded to include all SOEs and PPPs reclassified within the general government and local governments. [Q3-2011]

3.4. The existing annual report on tax expenditures will be improved, starting with the 2012 budget, in line with international best practices. The report will cover central, regional and local administrations. Technical assistance may be provided if necessary. [Q3-2011] A comprehensive inventory of the existing tax expenditures, by type of tax, along with their policy costs estimates will be prepared by Q2-2011.<sup>12</sup>

3.5. Develop intra-annual targets, and corrective measures in case of deviation from targets, for [Q3-2011]:

- i. internal monthly cash balance, expenditure, revenue targets for the general government as defined in national accounts;
- ii. public quarterly balance targets for the general government as defined in national accounts.

3.6. Implement any changes to the budget execution rules and procedures necessary to align with the standard definition of arrears and commitments. Meanwhile, existing commitment control procedures will be enforced for all types of expenditure across the general government. Technical assistance may be provided if necessary. [Q4-2011]

3.7. Following the survey, prepare a consolidated monthly report on arrears for the general government sector. The general government perimeter will be defined as in national accounts. [Q3-2011]

3.8. Publish quarterly accounts for State-Owned Enterprises (SOEs) at the latest 45 days after the end of the quarter. It should start with the 30 largest SOEs that are consolidated in the general government but as a general rule all SOEs should follow the same reporting standards. [Q4-2011]

3.9. Publish information on: number of general government staff on a quarterly basis (no later than 30 days after the end of the quarter); Stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. [Q1-2012]

### *Monitoring*

3.10. Approve a standard definition of contingent liabilities. [Q2-2011]

3.11. Publish a comprehensive report on fiscal risks each year as part of the budget, starting with the 2012 budget. The report will outline general fiscal risks and specific contingent liabilities to which the Government may be exposed, including those arising from Public-Private Partnerships (PPPs), SOEs and explicit guarantees to the banks. [Q3-2011]

### **Budgetary framework**

3.12. Publish a fiscal strategy document for the general government by **end-August 2011** and annually thereafter in April for the Stability Programme. The document will specify 4-year medium-term economic and fiscal forecasts and 4-year costs of new policy

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<sup>12</sup> Prior action in the Memorandum of Economic and Financial Policies.

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.<sup>13</sup>

3.13. Ensure full implementation of the Budgetary Framework Law adopting the necessary legal changes, including to the regional and local finance laws: **[Q3-2011]**

- i. The general government perimeter will cover the State, Other public bodies and entities, Social Security, SOEs and PPPs reclassified within the general government and local and regional administrations.
- ii. Define in detail the proposed characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry over rules, commitment controls; and appropriate contingency reserves and related access rules. **[Q3-2011]**

3.14. A proposal to revise the local and regional finance laws will be submitted to Parliament in order to fully adapt the local and regional financing framework to the principles and rules adopted by the recently 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. **[Q4-2011]**

3.15. The forecast underpinning the preparation of the budget and of the fiscal strategy document will be published, including supporting analysis and underlying assumptions. **[Q3-2011]**

3.16. Adopt the Statutes of the Fiscal Council, based on the working group report of 6 April 2011. The Council will be operational in time for the 2012 budget. **[Q3-2011]**

## **Public Private Partnerships**

The Government will:

3.17. Avoid engaging in any new PPP agreement before the completion of the reviews on existing PPPs and the legal and institutional reforms proposed (see below). **[Ongoing]**

3.18. Perform with the technical assistance from EC and the IMF, an initial assessment of at least the 20 most significant PPP contracts, including the major *Estradas de Portugal* PPPs, covering a wide range of sectors. **[end-August 2011]**

3.19. The Government will recruit a top tier international accounting firm to undertake a more detailed study of PPPs in consultation with INE and the Ministry of Finance.<sup>14</sup> The review will identify and, where practicable, quantify major contingent liabilities and any related amounts that may be payable by the Government. It will assess the probability of any payments by Government in relation to the contingent liabilities and quantify such amounts. The study, to be completed by **end-March 2012**, will assess the feasibility to renegotiate any PPP or concession contract to reduce the Government financial obligations. All PPPs and concession contracts will be available for these reviews. **[Q4-2011]**

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<sup>13</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>14</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

3.20. Put in place a strengthened legal and institutional framework, within the Ministry of Finance, for assessing fiscal risks *ex-ante* of engaging into PPP, concessions and other public investments, as well as for monitoring their execution. The Court of Auditors must be informed of this ex-ante risk assessment. Technical assistance may be provided if necessary. [Q1-2012]

3.21. Enhance the annual PPP and concessions report prepared by the Ministry of Finance in July with a comprehensive assessment of the fiscal risks stemming from PPPs and concessions. The report will provide information and analysis at sectoral level. The annual review of PPPs and concessions will be accompanied by an analysis of credit flows channelled to PPPs through banks (loans and securities other than shares) by industry and an impact assessment on credit allocation and crowding out effects. This particular element will be done in liaison with the Bank of Portugal. [Q2-2012]

### **State-owned enterprises**<sup>15</sup>

3.22. Report on concrete plans to reduce the overall operating costs of central government 10 State-owned enterprises (SOEs) posing the largest potential fiscal risks to the State by at least 15% over the 2009 levels and on a planned review of the tariff structure.<sup>16</sup>

3.23. Prepare a comprehensive assessment of the tariff structure of State-owned enterprises (SOEs) to reduce the degree of subsidisation. For the central government SOEs, the assessment will be done by **end-July 2011**, for local and regional government SOEs by **end-September 2011**. Review the level of service provisions of all SOEs. [Q3-2011]

3.24. Review ongoing plans to reduce operational costs by the end of 2011 by at least 15% on average compared with 2009, proposing company specific cuts that are consistent with a realistic economic and financial assessment. For the central government SOEs, the review will be carried out by **end-July 2011**, for local and regional government SOEs by **end-September 2011**.

3.25. Apply tighter debt ceilings to SOEs from 2012 onwards. For the central government SOEs, the plans will be announced by **end-July 2011**, for local and regional government SOEs by **end-September 2011**.

3.26. Prepare a plan to strengthen governance of SOEs in accordance with international best practices. The plan will review the existing shareholder approach, giving the Ministry of Finance a decisive role in financial matters of the enterprises. [Q4-2011]

3.27. Prepare a report reviewing the operations and finances of SOEs at central, regional and local government levels. The report will assess these companies' business financial prospects, the potential exposure of the government and scope for orderly privatisation. The Government will adopt the necessary legal changes to fulfil this requirement. Technical assistance will be provided.<sup>17</sup> [Q1-2012]

3.28. No additional SOEs at central government level will be created until this review is completed. Given the financial impact of these decisions, the Government will submit to Parliament a draft law so that this limitation will also be applicable to local authorities.

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<sup>15</sup> State-owned enterprises comprise those pertaining to central, local and regional administration.

<sup>16</sup> Prior action in the Memorandum of Economic and Financial Policies.

<sup>17</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

The Government will promote the initiatives needed so that the same objective is achieved by the regions. [Q1-2012]

3.29. The Government will submit to Parliament a draft law to regulate the creation and the functioning of SOEs at the central and local levels. The law 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. The Government will promote the initiatives needed so that the same objective is achieved by the regions. [Q1-2012]

3.30. The annual SOEs report prepared by the MoF in **July 2011** will include a comprehensive fiscal risk report detailing and analysing all liabilities (explicit and implicit) of SOEs.

### **Privatisation**

3.31. The Government will accelerate its privatisation programme. The existing plan, elaborated through 2013, covers transport (Aeroportos de Portugal, TAP, and freight branch of CP), energy (GALP, EDP, and REN), communications (Correios de Portugal), and insurance (Caixa Seguros), as well as a number of smaller firms. The plan targets front-loaded proceeds of about €5.5 billion through the end of the program, with only partial divestment envisaged for all large firms. The Government commits to go even further, by pursuing a rapid full divestment of public sector shares in EDP and REN, and is hopeful that market conditions will permit sale of these two companies, as well as of TAP, by the **end of 2011**. The Government will identify, by the time of the **second review**, two additional large enterprises for privatisation by end-2012. An updated privatisation plan will be prepared by **March 2012**.

3.32. Prepare an inventory of assets, including real estate, owned by municipalities and regional governments, examining the scope for privatisation. [Q2-2012]

### **Revenue administration**

3.33. The Government will merge the tax administration, customs administration and the information technology service DGITA in a single entity [**complete design of the new structure by Q4-2011 and implement it by Q4-2012**] and study the costs and benefits of including the revenue collection units of the social security administration in the merge. [Q3-2011] It will proceed with the broader merge if the assessment is favourable [Q1-2012];

3.34. Further comprehensive reform plans will be prepared by **October 2011**, including the following elements: [Q4-2011]

- i. Establishing special chambers within the tax tribunals, specialised to handle large cases and assisted by a specialised technical staff pool; [Q1-2012]
- ii. Reducing the number of municipal offices by at least 20% 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% 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**.

3.35. The Government will address the bottlenecks in the tax appeal system by:

- i. Reviewing the assessment of audit performance based on both qualitative and quantitative indicators; **[Q3-2011]**
- ii. Applying interest charges on the outstanding debt over the whole appeal period using an interest rate above market levels. Impose a special statutory interest on non-compliance with a tax court decision; **[Q3-2011]**
- iii. Implement the new tax arbitration law by **Q3-2011**;
- iv. Establishing an integrated IT system between the revenue administration and the tax courts; **[Q4-2011]**
- v. Setting up a temporary task force of judges by **Q2-2011**<sup>18</sup> to clear cases worth above EUR 1 million by **Q4-2012**.

3.36. The Government will submit to Parliament a law to strengthen the auditing and enforcement powers of the central tax administration to exercise control over the whole territory of the Republic of Portugal including currently exempt tax regimes and to reserve to the central administration the power to issue interpretative rulings on taxes with national scope in order to ensure its uniform application. **[Q4-2011]**

3.37. Prepare a report assessing the current state of the information systems in the tax administration and proposing reforms. **[Q3-2011]**

3.38. The tax administration will prepare a comprehensive strategic plan for 2012-2014. The plan will include concrete actions to combat tax fraud and evasion, to strengthen audit and enforce collection based on risk management techniques. **[end-October 2011]**

## **Public administration**

The Government will take the following measures to increase the efficiency and cost-effectiveness of the public administration:

### *Central, regional and local administration*

3.39. Reduce management positions and administrative units by at least 15% in the central administration. **[Q4-2011]**

3.40. In view of improving the efficiency of the central administration and rationalising the use of resources, implement a second phase of the public administration restructuring programme (PRACE 2007). **[Q4-2011]**

3.41. In view of improving the efficiency of local administration and rationalising the use of resources, the Government will submit to Parliament a draft law by **Q4-2011** so that each municipality will have to present its plan to attain the target of reducing their management positions and administrative units by at least 15% by the end of 2012. **[Q2-2012]** In what concerns regions, the Government will promote the initiatives needed **[Q4-2011]** so that each region will present its plan to attain the same target.

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<sup>18</sup> Prior action in the Memorandum of Economic and Financial Policies.



3.42. In conjunction with the review of SOEs (see above), prepare a detailed cost/benefit analysis of all public and quasi-public entities, including foundations, associations and other bodies, across all levels of government. [Q4-2011] Based on the results of this analysis, the administration (central, regional or local) responsible for the public entity will decide to close or to maintain it in respect of the law (see below). [Q2-2012]

3.43. Regulate by law the creation and the functioning of foundations, associations, and similar bodies by the central and local administration. This law, which will also facilitate the closure of existing entities when warranted, will be prepared in coordination with a similar framework to be defined for SOEs. The law will define the monitoring and reporting mechanisms and evaluation performance. In addition, the Government will promote the initiatives needed [Q4-2011] so that the same objective is achieved by the regions.

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

3.45. 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. [Q4-2011] Based on this analysis, reform the existing framework to eliminate the identified inefficiencies. [Q2-2012]

### *Shared services*

3.46. 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. Fully implement the strategy of shared services in the area of financial (GeRFIP) and human resources (GeRHup). [Q2-2012]
- ii. 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. [Q4-2012]

3.47. 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*

3.48. Prepare a comprehensive plan to promote flexibility, adaptability and mobility of human resources across the administration, including by providing training where appropriate. [Q4-2011]

3.49. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 1% per year in the staff of central administration and 2% in local and regional administrations. The Government will submit to Parliament a draft law to implement 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. [Q3-2011]

## **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 public spending on pharmaceutical to 1.25 per cent of GDP by end 2012 and to about 1 per cent of GDP in 2013 (in line with EU average); generate additional savings in hospital operating costs.

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

### *Financing*

3.50. Review and increase overall NHS moderating fees (*taxas moderadoras*) through:

- i. a substantial revision of existing exemption categories, including stricter means-testing in cooperation with Minister of labour and social affairs; **[by September-2011]**
- ii. increase of moderating fees in certain services while ensuring that primary care moderating fees are lower than those for outpatient specialist care visits and lower than emergency visits; **[by September-2011]**
- iii. legislate automatic indexation to inflation of NHS moderating fees. **[Q4-2011]**

3.51. Cut substantially (by two thirds overall) tax allowances for healthcare, including private insurance. **[Q3-2011]**

3.52. To achieve a self sustainable model for health-benefits schemes for civil servants, the overall budgetary cost of existing schemes – ADSE, ADM (Armed Forces) and SAD (Police Services) - will be reduced by 30% in 2012 and a further 20% in 2013, at all levels of general government. Further reductions at a similar pace will follow in the subsequent years towards having them self-financed by 2016. The budgetary costs of these schemes will be reduced by lowering the employer's contribution and adjusting the scope of health benefits. **[Q4-2011]**

3.53. Produce a health sector strategic plan, in the context of and consistent with the medium-term budget framework. **[Q4-2011]**

### *Pricing and reimbursement of pharmaceuticals*

3.54. Set the maximum price of the first generic introduced in the market to 60% of the branded product with similar active substance. **[Q3-2011]**

3.55. Revise the existing reference-pricing system based on international prices by changing the countries of reference to the three EU countries with the lowest price levels or countries with comparable GDP per capita levels. **[Q4-2011]**

### *Prescription and monitoring of prescription*

3.56. Make electronic prescription for medicines and diagnostic covered by public reimbursement fully compulsory for physicians in both the public and private sector. **[Q3-2011]**

3.57. Improve the monitoring system of prescription of medicines and diagnostic and set in place a systematic assessment by individual doctor in terms of volume and value, vis-à-vis prescription guidelines and peers. Feedback is to be provided to each physician on a regular basis (e.g. quarterly), in particular on prescription of costliest and most used medicines, starting from **Q4-2011**. The assessment will be done through a dedicated unit under the Ministry of Health such as the Centro de Conferência de Facturas. Sanctions and penalties will be envisaged and enforced as a follow up to the assessment. **[Q3-2011]**

3.58. Induce physicians at all levels of the system, both public and private, to prescribe generic medicines and the less costly available branded product. **[Q3-2011]**

3.59. Establish clear rules for the prescription of drugs and the realisation of complementary diagnostic exams (prescription guidelines for physicians) on the basis of international prescription guidelines. **[Q4-2011]**

3.60. Remove all effective entry barriers for generic medicines, in particular by reducing administrative/legal hurdles in order to speed up the use reimbursement of generics. **[Q4-2011]**

### *Pharmacies sector*

3.61. Effectively implement the existing legislation regulating pharmacies. **[Q4-2011]**

3.62. Change the calculation of profit margin into a regressive mark-up and a flat fee for wholesale companies and pharmacies on the basis of the experience in other Member States. The new system should ensure a reduction in public spending on pharmaceuticals and encourage the sales of less expensive pharmaceuticals. The aim is that lower profits will contribute at least EUR 50 million to the reduction in public expense with drugs distribution. **[Q4-2011]**

3.63. If the new system of calculation of profit margin will not produce the expected savings in the distribution profits, introduce a contribution in the form of an average rebate (pay-back) which will be calculated on the mark-up. The rebate will reduce the mark-up by at least 3 percentage points. The rebate will be collected by the Government on a monthly basis through Centro de Conferência de Facturas, preserving the profitability of small pharmacies in remote areas with low turnover. **[Q1 -2012]**

### *Centralised purchasing and procurement*

3.64. Set up the legislative and administrative framework for a centralised procurement system for the purchase of medical goods in the NHS (equipments, appliances, pharmaceuticals), through the recently created Central Purchasing Authority (SPMS), in order to reduce costs through price-volume agreements and fight waste. **[Q3-2011]**

3.65. Finalise the uniform coding system and a common registry for medical supplies developed by the INFARMED and SPMS based on international experience. Regularly update the registry. **[Q4-2011]**

3.66. Take measures to increase competition among private providers and reduce by at least 10 per cent the overall spending (including fees) of the NHS with private providers delivering diagnostic and therapeutical services to the NHS by end 2011 and by an additional 10% by end 2012. **[Q4-2011]**

3.67. 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. **[Q1-2012]**

3.68. Introduce a regular revision (at least every two years) of the fees paid to private providers with the aim of reducing the cost of more mature diagnostic and therapeutical services. **[Q1-2012]**

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

### *Primary care services*

3.70. The Government proceeds with the reinforcement of primary care services so as to further reduce unnecessary visits to specialists and emergencies and to improve care coordination through:

- i. increasing the number of USF (*Unidades de Saúde Familiares*) units contracting with regional authorities (ARSSs) using a mix of salary and performance-related payments as currently the case. Make sure that the new system leads to reduction in costs and more effective provision; **[Q3-2011]**
- ii. set-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. **[Q4-2011]**

### *Hospital services*

3.71. Set out a binding and ambitious timetable to clear all arrears (accounts payable to domestic suppliers past due date by 90 days) and introduce standardised commitment control procedures for all entities to prevent the re-emergence of arrears. **[Q3-2011]**

3.72. Provide detailed description of measures aimed at achieving a reduction of EUR 200 million in the operational costs of hospitals in 2012 (EUR 100 million in 2012 in addition to savings of over EUR 100 million already in 2011), including reduction in the number of management staff, as a result of concentration and rationalisation in state hospitals and health centres. **[Q3-2011]**

3.73. Continue the publication of clinical guidelines and set in place an auditing system of their implementation. **[Q3-2011]**

3.74. 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. **[Q4-2011]**

3.75. Set up a system for comparing hospital performance (benchmarking) on the basis of a comprehensive set of indicators and produce regular annual reports, the first one to be published by end 2012. **[Q1-2012]**

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

3.77. Continue with the reorganisation and rationalisation of the hospital network through specialisation and concentration of hospital and emergency services and joint management (building on the Decree-Law 30/2011) joint operation of hospitals. These improvements will deliver additional cuts in operating costs by at least 5 per cent in 2013.

A detailed action plan is published by 30 November 2012 and its implementation is finalised by the first quarter 2013. [Q2-2012]

3.78. Move some hospital outpatient services to primary care units (USF). [Q2-2012]

3.79. Annually update the inventory of all practising doctors by specialty, age, region, health centre and hospital, public and private sector so as to be able to identify practising, professional and licensed physicians and current and future staff needs by the above categories. [Q3-2011]

3.80. Prepare regular annual reports, the first to be published by the end of March 2012, 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. [Q3-2011]

3.81. Introduce rules to increase mobility of healthcare staff (including doctors) within and across health regions. Adopt for all staff (including doctors) flexible time arrangements, with a view of reducing by at least 10% spending on overtime compensation in 2012 and another 10% in 2013. Implement a stricter control of working hours and activities of staff in the hospital. [Q1-2012]

#### *Cross services*

3.82. Finalise the set-up of a system of patient electronic medical records. [Q2-2012]

3.83. Reduce costs for patient transportation by one third. [Q3-2011]

## **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 raise the quality of human capital and facilitate labour market matching.

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

### *Unemployment benefits*

4.1. The Government will prepare by **Q4-2011** an action plan to reform along the following lines the unemployment insurance system, with a view to reduce the risk of long-term unemployment and strengthen social safety nets:

- i. reducing the maximum duration of unemployment insurance benefits to no more than 18 months. The reform will not concern those currently unemployed and will not reduce accrued-to-date rights of employees;
- ii. capping unemployment benefits at 2.5 times the social support index (IAS) and introducing a declining profile of benefits over the unemployment spell after six months of unemployment (a reduction of at least 10% in the benefit amount). The reform will concern those becoming unemployed after the reform;
- iii. reducing the necessary contributory period to access unemployment insurance from 15 to 12 months;
- iv. presenting a proposal for extending eligibility to unemployment insurance to clearly-defined categories of self-employed workers providing their services to a single firm on a regular basis. The proposal will take into account the risks of possible abuses and will contain an assessment of the fiscal impact of extending benefits under several scenarios concerning eligibility criteria (namely the involuntary character of unemployment) and requirements for increased social security contributions for firms making use of these arrangements.

4.2. This plan will lead to draft legislation to be adopted by the Government by **Q1-2012**.

### *Employment protection legislation*

4.3. 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:

4.4. Severance payments.

- i. The Government will submit **by end-July 2011** legislation to Parliament to implement a reform in the severance payments for new hires in line with the March 2011 Tripartite Agreement.<sup>19</sup> Severance payments of open-ended contracts will be aligned with those of fixed-term contracts. The reform will re-design the system for severance payment entitlements as follows:
  - o total severance payments for new open-ended contracts will be reduced from 30 to 10 days per year of tenure (with 10 additional days to be paid by an employers' financed fund) with a cap of 12 months and elimination of the 3 months of pay irrespective of tenure;
  - o total severance payments for fixed-term contracts will be reduced from 36 to 10 days per year of tenure for contracts shorter than 6 months and from 24 to 10 days for longer contracts (with 10 additional days to be paid by an employers' financed fund);

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<sup>19</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

- implementation of the fund agreed in the March Tripartite Agreement to partly finance the cost of dismissals for new hires.
- ii. By **Q4-2011**, the Government will present a proposal to align severance payment entitlements for current employees in line with the reform for new hires, (taking into account the revised link between entitlement and seniority and the cap to total entitlements) without reducing accrued-to-date entitlements. This plan will lead to draft legislation to be submitted to Parliament by [**Q1-2012**].
- iii. By **Q1-2012**, the Government will prepare a proposal aiming at:
  - aligning the level of severance payments to that prevailing on average in the EU;
  - allowing the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers by means of the creation of notional individual accounts.
 On the basis of this proposal, draft legislation will be submitted to Parliament no later than **Q3-2012**.

4.5. Definition of dismissals. The Government will prepare by **Q4-2011** a reform proposal aimed at introducing adjustments to the cases for fair individual dismissals contemplated in the Labour Code with a view to fighting labour market segmentation and raise the use of open-ended contracts. This proposal will lead to draft legislation to be submitted to Parliament by **Q1-2012**.

- i. Individual dismissals linked to unsuitability of the worker should become possible even without the introduction of new technologies or other changes to the workplace (art. 373-380, 385 Labour Code). Inter alia, a new reason can be added regarding situations where the worker has agreed with the employer specific delivery objectives and does not fulfil them, for reasons deriving exclusively from the workers' responsibility;
- ii. Individual dismissals linked to the extinction of work positions should not necessarily follow a pre-defined seniority order if more than one worker is assigned to identical functions (art. 368 Labour Code). The predefined seniority order is not necessary provided that the employer establishes a relevant and non- discriminatory alternative criteria (in line with what already happens in the case of collective dismissals);
- iii. Individual dismissals for the above reasons should not be subject to the obligation to attempt a transfer for a possible suitable position (art. 368, 375 Labour Code). As a rule, whenever there are work positions available that match the qualifications of the worker, dismissals should be avoided.

### *Working time arrangements*

4.6. The Government will carry out reforms in working time arrangements with a view to contain employment fluctuations over the cycle, better accommodate differences in work patterns across sectors and firms, and enhance firms' competitiveness.

- i. The Government will prepare an assessment regarding the use made of increased flexibility elements by the social partners associated with the 2009 Labour Code revision and prepare an action plan to promote the use of flexible working time arrangements, including on modalities for

permitting the adoption of “bank of hours” working arrangement by mutual agreement of employers and employees negotiated at plant level. [Q4-2011]

- ii. Draft legislation will be submitted to Parliament **by Q1-2012** on the following aspects:
  - o implementation of the commitments agreed in the March Tripartite Agreement regarding working time arrangements and short-time working schemes in cases of industrial crisis, by easing the requirements employers have to fulfil to introduce and renew these measures;
  - o revision of the minimum additional pay for overtime established in the Labour Code: (i) reduction to maximum 50% (from current 50% for the first overtime hour worked, 75% for additional hours, 100% for overtime during holydays); (ii) elimination of the compensatory time off equal to 25% of overtime hours worked. These norms can be revised, upwards or downwards, by collective agreement.

### *Wage setting and competitiveness*

4.7. The Government will promote wage developments consistent with the objectives of fostering job creation and improving firms’ competitiveness with a view to correct 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;
- ii. 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 both quantitative and qualitative indicators. To that purpose, the Government will charge the national statistical authority to do a survey to collect data on the representativeness of social partners on both sides of industry. Draft legislation defining criteria for extension and modalities for their implementation will be prepared by **Q2-2012**;
- iii. prepare an independent review by **Q2-2012** on:
  - o how the tripartite concertation on wages can be reinvigorated with the view to define 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).

4.8. The Government will promote wage adjustments in line with productivity at the firm level. To that purpose, it will:

- i. implement the commitments in the Tripartite Agreement of March 2011 concerning the "organised decentralisation", notably concerning: (i) the possibility for works councils to negotiate functional and geographical mobility conditions and working time arrangements; (ii) the creation of a



Labour Relations Centre supporting social dialogue with improved information and providing technical assistance to parties involved in negotiations; (iii) the lowering of the firm size threshold above which works councils can conclude firm-level agreements to 250 employees. Action for the implementation of these measures will have to be taken **by Q4-2011**;

- ii. promote the inclusion in sectoral collective agreements of conditions under which works councils can conclude firm-level agreements without the delegation of unions. An action plan will have to be produced **by Q4-2011**.
- iii. **By Q1-2012**, present a proposal to reduce the firm size threshold for works councils to conclude agreements below 250 employees, with a view to adoption **by Q2-2012**.

Draft legislation will be submitted to Parliament by **Q1-2012**.

### *Active labour market policies*

4.9. 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. The Government will present by **Q4-2011**:

- i. a report on 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**

4.10. 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). **[Q4-2011]**
- ii. Present an action plan to improve the quality of secondary education services including via: (i) the generalization of trust agreements between the Government and public schools, establishing wide autonomy, a simple formula-based funding framework comprising performance evolution criteria, and accountability; (ii) a simple result-oriented financing framework for professional and private schools in association agreements

based on fixed per-class funding plus incentives linked to performance criteria; (iv) a reinforced supervisory role of the General Inspectorate. [Q1-2012]

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

## **5. Goods and services markets**

### **Energy markets**

#### **Objectives**

Complete the liberalisation of the electricity and gas markets; 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. Regulated electricity tariffs will be phased out **by January 1, 2013** at the latest. Present a roadmap for the phasing out following a stepwise approach by **end-July 2011**. The provisions will specify:

- i. The timeline and criteria to liberalise the remaining regulated segments, such as pre-determined conditions relating to the degree of effective competition in the relevant market;
- ii. The methods to ensure that during the phasing-out period market prices and regulated tariffs will not diverge significantly and to avoid cross-subsidisation between consumers segments;
- iii. The definition of vulnerable consumers and the mechanism to protect them.

5.2. Transpose the Third EU Energy Package by the **end of June 2011**. This will ensure the National Regulator Authority's independence and all powers foreseen in the package.

5.3. In the gas market, the Government will take measures to accelerate the establishment of a functioning Iberian market for natural gas (MIBGAS), in particular through regulatory convergence. Take up political initiatives with Spanish authorities with the aim of eliminating the double tariff. [Q3-2011]

5.4. Regulated gas tariffs are to be phased out by **January 1, 2013** at the latest.

5.5. Review in a report the reasons for lack of entry in the gas market, despite the availability of spare capacity, and the reasons for the lack of diversification of gas

sources. The report will also propose possible measures to address the identified problems. [Q4-2011]

### *Additional costs associated with electricity production under the ordinary regime*

5.6. Take measures in order to limit the additional cost associated with the production of electricity under the ordinary regime, in particular through renegotiation or downward revision of the guaranteed compensation mechanism (CMEC) paid to producers under the ordinary regime and the remaining long-term power-purchase agreements (PPAs). [Q4-2011]

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

5.7. Review the efficiency of support schemes for co-generation and propose possible options for adjusting downward the feed-in tariff used in co-generation (reduce the implicit subsidy).<sup>20</sup> [Q4-2011]

5.8. Review in a report the efficiency of support schemes for renewables, covering their rationale, their levels, and other relevant design elements.<sup>21</sup> [Q4-2011]

5.9. For existing contracts in renewables, assess in a report the possibility of agreeing a renegotiation of the contracts in view of a lower feed-in tariff.<sup>22</sup> [Q4-2011]

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 Q3-2011, 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 Q3-2011, Q3-2012 and Q3-2013.

5.12. Reduce the delays and uncertainty surrounding planning, authorisation and certification procedures and improve the transparency of administrative requirements and charges for renewable energy producers (in line with Article 13 and 14 of EU Directive 2009/28/EC). Provide evidence of the measures taken to this end. [Q4-2011]

### *Energy policy instruments and taxation*

5.13. Review existing energy related instruments, including taxation and energy efficiency incentives. In particular, evaluate the risk of overlapping or inconsistent instruments [Q3-2011].

5.14. Based on the results of the review, modify energy policy instruments to ensure that they provide incentives for rational use, energy savings and emission reductions. [Q4-2011]

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<sup>20</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>21</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>22</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

5.15. Increase VAT tax rate in electricity and gas (presently at 6%) as well as excises for electricity (presently below the minima required by EU legislation). [Q4-2011]

## **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:*

The Government will:

5.16. Ensure more effective competition in the sector by implementing the new Directive on EU electronic communications regulatory framework (“Better Regulation Directive”), which will (among others) enhance independence of the National Regulator Authority. [Q2-2011]

5.17. Facilitate market-entry by auctioning ‘new’ radio frequencies (i.e. auction of spectrum) for broadband wireless access [Q3-2011] and lowering mobile termination rates [Q3-2011].

5.18. Ensure that the provision on universal service designation and the incumbent’s concession contract are non-discriminatory: re-negotiate the concession contract with the undertaking currently providing the universal service and launch a new tender for designation of universal service providers. [Q3-2011]

5.19. Adopt measures to increase competition in the fixed communications market by: i) alleviating restrictions on mobility of consumers by reducing costs faced when deciding on provider along the lines proposed by the Competition Authority (such as standardized contracts, explicit right to free cancellation and facilitating price comparison) [Q3-2011]; ii) reviewing barriers on entry and adopting measures to reduce them. [Q1-2012]

### *Postal services*

The Government will:

5.20. Further liberalise the postal sector by transposing the Third Postal Directive ensuring that powers and independence of the National Regulator Authority are appropriate in view of its increased role in monitoring prices and costs [Q3-2011].

5.21. Eliminate VAT exemption for products within the universal service [Q3-2011]

## **Transport**

### **Objectives**

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

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

### *Strategic Plan for Transport:*

5.22. Present a Strategic Plan for Transport, which will specifically include [Q3-2011]

- i. An in-depth analysis of the transport system including an assessment of existing capacity, forecast demand, and projected traffic flows;
- ii. Measures to integrate rail, port and air transport services into the overall logistic and transport system, notably by improving competition in these transport modes;
- iii. Measures to facilitate entry for low-cost airline companies, making use of the existing infrastructure;
- iv. A set of priorities for investment with an estimate of the financial needs and the foreseen sources of financing as well as of energy savings.

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*

5.23. Transpose the EU Railway Packages and in particular: [Q3-2011]

- i. Strengthen the rail regulator independence and competences including by strengthening its administrative capacity in terms of decision and execution powers and staffing;
- ii. Ensure full independence of the state-owned railway operator CP from the State;
- iii. Balance the infrastructure manager's revenues and expenditures on the basis of a multi-annual contract with the infrastructure manager of a duration of at least three years and concrete commitments on State finance and performance;
- iv. Carry-out a rationalisation of the network and effective incentives for the infrastructure manager to reduce its costs, whereby the regulatory body will be given a monitoring role;
- v. Revise the existing Public Service Obligations (PSOs) on rail passenger transport, including the legal basis and administrative capacity for stepwise introduction of competitive tendering for PSOs;
- vi. Revise the infrastructure charging scheme to introduce a performance scheme, permitting operators to introduce yield management of tickets, in particular to raise ticket prices;
- vii. Privatisise the freight branch of the state-owned rail operator and some suburban lines.

### *Ports [Q4-2011]*

5.24. Define a strategy to integrate ports into the overall logistic and transport system. Specify the objectives, scope and priorities of the strategy, and the link to the overall Strategic Plan for the Transport sector.

5.25. Develop a legal framework to facilitate the implementation of the strategy and to improve the governance model of the ports system. In particular, define the necessary measures to ensure the separation of regulatory activity, port management and commercial activities.

5.26. Specify in a report the objectives, the instruments and the estimated efficiency gains of initiatives such as the interconnection between CP Cargo and Ex-Port, the Port Single Window and Logistic Single Window.

5.27. Revise the 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.

## **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*

5.28. 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. Amendments will be presented to the Parliament [Q3-2011] and adopted by [Q4-2011].

5.29. In case unjustified restrictions remain following the notification to the Commission of the recently adopted sector-specific amendments in the areas of construction and real estate, review and modify them accordingly. 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). [Q4-2011]

### *Professional qualifications*

5.30. Improve the recognition framework on professional qualifications by adopting the remaining legislation complementing the Portuguese Law 9/2009 on the recognition of professional qualifications in compliance with the qualifications directive. Adopt the law concerning professions not regulated by Parliament [Q3-2011] and present to Parliament the law for those regulated by Parliament [Q3-2011] to be approved by [Q1-2012].

### *Regulated professions*

5.31. Eliminate restrictions to the use of commercial communication (advertising) in regulated professions, as required by the Services Directive [Q3-2011].

5.32. Review and reduce the number of regulated professions and in particular eliminate reserves of activities on regulated professions that are no longer justified. Adopt the law for professions not regulated by Parliament [Q3-2011] and present to Parliament the law for those regulated by Parliament [Q3-2011] to be approved by [Q1-2012].

5.33. Adopt measures to liberalize the access and exercise of regulated professions by professionals qualified and established in the European Union. Adopt the law for professions not regulated by Parliament [Q3-2011] and present to Parliament the law for those regulated by Parliament [Q3-2011] to be approved by [Q1-2012].

5.34. Further improve the functioning of the regulated professions sector (such as accountants, lawyers, notaries) by carrying out a comprehensive review of requirements affecting the exercise of activity and eliminate those not justified or proportional. [Q4-2011]

### *Administrative burden*

5.35. Continue the simplification reform effort by:

- i. making the Points of Single Contact (PSC) more user-friendly and responsive to SMEs needs, extending on-line procedures to all sectors covered by the Services Directive [Q4-2011] and adapt the content and information available at the PSC to the new legislation to be adopted [Q1-2012];
- ii. making fully operational the “Zero authorisation” project that abolish authorisations/licensing and substitute them with a declaration to the PSC for the wholesale and retail sector and restaurants and bars [Q4-2011]. The project shall include all levels of administration, including all municipalities [Q2-2012];
- iii. extending PSC to services not covered by the Services Directive [Q1-2013];
- iv. extending the Zero authorisation project to other sectors of the economy [Q1-2013].

## **6. Housing market**

### **Objectives**

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

### *Rental market*

6.1. The Government will present measures to amend the New Urban Lease Act Law 6/2006 to ensure balanced rights and obligations of landlords and tenants, considering the socially vulnerable. [Q3-2011] This plan will lead to draft legislation to be submitted to Parliament by [Q4-2011]. In particular, the reform plan will introduce measures to: i) broaden the conditions under which renegotiation of open-ended residential leases can take place, including to limit the possibility of transmitting the contract to first degree relatives; ii) introduce a framework to improve households' access to housing by phasing out rent control mechanisms, considering the socially vulnerable; iii) reduce the prior notice for termination of leases for landlords; iv) provide for an extrajudicial eviction procedure for breach of contract, aiming at shortening the eviction time to three months;

and v) strengthen the use of the existing extrajudicial procedures for cases of division of inherited property.

### *Administrative procedures for renovation*

6.2. The Government will adopt legislation to simplify administrative procedures for renovation. [Q3-2011] In particular, the specific measures will: i) simplify administrative procedures for renovation works, safety requirements, authorisation to use and formalities for innovations that benefit and enhance the building's quality and value (such as energy savings measures). The majority of apartment owners will be defined as representing the majority of the total value of the building; ii) simplify rules for the temporary relocation of tenants of building subject to rehabilitation works with due regard of tenants needs and respect of their living conditions; iii) grant landlords the possibility to ask for termination of the lease contract for major renovation works (affecting the structure and stability of the building) with a maximum 6 months of prior notice; iv) standardise the rules determining the level of conservation status of property and the conditions for the demolition of buildings in ruin.

### *Property taxation*

6.3. The Government will review the framework for the valuation of the housing stock and land for tax purposes and present measures to (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). These measures could include enabling municipal officers, in addition to tax officers, to evaluate the taxable value of property and the use of statistical methods to monitor and update valuations. [Q3-2011]

6.4. The Government will modify property taxation with a view to level incentives for renting versus acquiring housing. [Q4-2011] In particular, the Government will: i) limit income tax deductibility of rents and mortgage interest payments as of 01.01.2012, except for low income households. Principal payments will not be deductible as of 01.01.2012; ii) rebalance gradually property taxation towards the recurrent real estate tax (IMI) and away from the transfer tax (IMT), while considering the socially vulnerable. Temporary exemptions of IMI for owner-occupied dwellings will be considerably reduced and the opportunity cost of vacant or non-rented property will be significantly increased.

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

## **7. Framework conditions**

### **Judicial system**

#### **Objectives**

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



system by eliminating backlog of courts cases and by facilitating out-of-court settlement mechanisms.

The Government will:

### *Court backlog*

7.1. Intensify implementation of proposed measures under the Judicial Reform Map. Conduct an audit of the backlog cases in order to better target measures [**end-June 2011**]. Eliminate court backlogs by **Q2-2013**.

7.2. Based on the audit, better target existing measures and assess the need for additional measures to expedite the resolution of the backlog [**Q2-2011**]. Additional measures to be considered include, among others: (i) establishing separate Chambers or Teams (solely) directed towards resolving the backlog, (ii) restructuring court record-keeping so that cases can be taken off the books; (iii) merging similar small debt enforcement cases; (iv) strengthening and enforcing existing regulations allowing dormant cases to be removed from the court register; (v) imposing additional costs and penalties against non-cooperative debtors in enforcement cases; (vi) introducing a staggered court fee structure for extended litigation prompted by litigating parties without manifest cause; and (vii) assigning special court managers to manage the court agenda/hearings allowing judges to focus on the cases.

### *Management of courts*

7.3. Expedite the implementation of the Judicial Reform Map creating 39 court units, with added management support for each unit, entirely financed through expenditure savings and gains of efficiency [**Q4-2012**]. This measure is part of the rationalisation effort, in order to improve efficiency in the management of infrastructures and public services. Prepare a roadmap on this reform identifying key quarterly milestones. [**Q3-2011**]

7.4. Adopt new court management methods for two county courts, including Lisbon. [**Q4-2011**]

7.5. Develop a personnel management plan that permits judicial specialisation and mobility of court officials. [**Q4-2011**]

### *Alternative dispute resolution for out-of-court settlement*

7.6. The Government will present a Law on Arbitration by **end-September 2011** and make arbitration for debt enforcement cases fully operational by **end-February 2012** to facilitate resolution of backlog cases and out of court settlement.<sup>23</sup>

7.7. Optimize the regime for Justices for the Peace to increase its capacity to handle small claim cases. [**Q1-2012**]

7.8. Adopt measures to give priority to alternative dispute resolution enforcement cases in the courts. [**Q4-2011**]

### *Civil cases in the courts*

7.9. Extend the new experimental civil procedure regime to 4 courts. [**Q3-2011**]

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<sup>23</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

7.10. Assess in a report whether the experimental civil procedure regime will be applied to all courts. [Q4-2011]

7.11. Make specialised courts on Competition and on Intellectual Property Rights fully operational. [Q1-2012]

7.12. Assess the need for separate Chambers within the Commercial Courts with specialised judges for insolvency cases. [Q4-2011]

7.13. The Government will review the Code of Civil Procedure and prepare a proposal **by end-2011** addressing the key areas for refinement, including (i) consolidating legislation for all enforcement cases before the court, (ii) giving judges the power to expedite cases, (iii) reducing administrative burdens on judges, and (iv) enforcing statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases.<sup>24</sup>

7.14. Adopt specific measures for an orderly and efficient resolution of outstanding tax cases including (also covered under revenue administration):

- i. taking necessary steps to implement the Tax Arbitration Law (to enable an effective out of court resolution of tax claims); [Q3-2011]
- ii. assessing measures to expedite the resolution of tax cases such as: i) creating a special procedure for high value cases; ii) establishing criteria for prioritizing; iii) extending statutory interests for the entire the court proceeding; iv) imposing a special statutory interest payment on late compliance with a tax court decision. [Q4-2011]

### *Budget and allocation of resources*

7.15. Standardize court fees and introduce special court fees for certain categories of cases and procedures with the aim of boosting revenue and disincentivizing spurious civil litigation. [Q3-2011]

7.16. Develop an annual workplan on the allocation of resources based on court by court performance data, which will be published annually on the internet.

7.17. Conduct a workload/staffing assessment for the six pilot courts under the Judicial Reform Map, as well as for the specialist courts. [Q1-2012]

7.18. Publish quarterly reports on recovery rates, duration and costs of corporate insolvency and tax cases, publishing the first report by Q3-2011.

## **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.

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<sup>24</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

### *Competition and sectoral regulators*

7.19. The Government will eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state (**end-July 2011**).<sup>25</sup>

7.20. Take measures to improve the speed and effectiveness of competition rules' enforcement. In particular:

- i. Establish a specialised court in the context of the reforms of the judicial system [**Q1-2012**].
- ii. Propose a revision of 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, in particular:<sup>26</sup> [**Q4-2011**]
  - simplify the law, separating clearly the rules on competition enforcement procedures from the rules on penal procedures with a view to ensure effective enforcement of competition law;
  - rationalize the conditions that determine the opening of investigations, allowing the competition authority to make an assessment of the relevance of the claims;
  - establish the necessary procedures for a greater alignment between Portuguese law on merger control and the EU Merger Regulation, namely with regard to the criteria to make compulsory the ex ante notification of a concentration operation.;
  - ensure more clarity and legal certainty in the application of Procedural Administrative law in merger control.
  - evaluate the appeal process and adjust it where necessary to increase fairness and efficiency in terms of due process and timeliness of proceedings.
- iii. Ensure that the Portuguese Competition Authority has sufficient and stable financial means to guarantee its effective and sustained operation. [**Q4-2011**]

7.21. Ensure that the national regulator authorities (NRA) have the necessary independence and resources to exercise their responsibilities. [**Q1-2012**] 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. [**Q4-2011**]

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<sup>25</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>26</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

- 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. **[Q4-2011]**

### *Public procurement*

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

7.22. Eliminate, with regard to public foundations as set out in Law n.º 62/2007, all exemptions permitting the direct award of public contracts above the Public Procurement Directives thresholds to ensure full compliance with the Directives **[Q4-2011]**

7.23. Eliminate all special, permanent or temporary exemptions, permitting the direct award of public contracts below the Public Procurement Directives thresholds to ensure full compliance with the principles of the TFEU by the end of **Q3-2011** wherever this does not entail amending the Public Procurement Code, and by the end of **Q4-2011** otherwise.

7.24. Amend the Portuguese Public Procurement Code provisions on errors and omissions and additional works/services in accordance with the Public Procurement Directives. **[Q4-2011]**

7.25. Implement appropriate measures to address the currently existing problems with regard to direct awards for additional works/services and to ensure that such awards occur exclusively under strict conditions foreseen by the Directives. **[Q4-2011]**

7.26. Take measures to render contracting authorities' administrators financially responsible for lack of compliance with public procurement rules as recommended by the Portuguese Court of Auditors. **[Q4-2011]**

7.27. Ensure ex-ante auditing/checks on public procurement by the appropriate national bodies (most notably the Portuguese Court of Auditors) as a tool to prevent and counteract the practice of illegal award of additional works/services and increase transparency. **[Q3-2011]**

7.28. Upgrade the national Public Procurement Portal (Base) based on Resolution nº 17/2010 of the National Parliament in order to improve transparency of award procedures **[Q4-2011]**

7.29. Modify Art. 42 (7) (8) (9) of the Public Procurement Code, which sets out a requirement for investment in R&D projects on all public contracts worth more than EUR 25 million, to ensure full compliance with the Public Procurement directives, in particular by: i) eliminating the condition for the R&D project to be carried out in national territory; ii) requiring the R&D investments to be directly relevant for the performance of the contract; and iii) ensuring that all amounts to be spent on R&D projects are linked and justified by the subject-matter of the contract. **[Q4-2011]**

### *Business environment*

7.30. Adopt the “Simplex Exports” programme, including measures to accelerate the procedures for requesting VAT exemption for exporting firms and simplify procedures associated with indirect exports. **[Q4-2011]**

7.31. Reinforce measures to facilitate access to finance and export markets for companies, in particular for SMEs. This will include a review of the overall consistency and effectiveness of existing measures. **[Q4-2011]**

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

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

## PORTUGAL - TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

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  $\text{€}1 = 1.483$ , U.S. dollar,  $\text{€}1 = 116.8390$  Japanese yen,  $\text{€}1.09512 = 1$  SDR.

3. For reporting purposes, the transmission of the data covered by this TMU will begin having as a reference the month of June 2011, being the Ministry of Finance (MoF), by the Direcção-Geral do Orçamento (DGO), and the Banco de Portugal (BdP), responsible for the transmission.

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 MTU, 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 includes:

- The Central Government. This includes:
  - The entities covered under the State Budget, as defined in the current Budget Framework Law, Law No. 91/2001 of August 20, amended by Law 48/2004 of August 24, 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), including Caixa Geral de Aposentações (CGA) and National Health Service (NHS) entities, and other entities belonging to the budgetary Central Government classified by the National Statistical Authority (INE) as part of the Central Government.

- Other entities 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 Authority (INE) as part of the Central Government.
- State-owned enterprises (SOE) which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as part of the Central Government (ISOE).
- Regional and Local Governments (*Administrações Regionais and Locais*), including 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.
- 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 2011, shall not include entities nor operations that are re-classified into General Government during the remainder of 2011.

#### 5. **Supporting material:**

- 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.
- Data on the cash balances of the other parts of General Government as defined in paragraph 4 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 called guarantees and PPP-related revenues and expenditures.
- Data on domestic and foreign debt redemptions, new domestic and foreign debt issuance, change in the domestic and foreign cash balances of the Central Government at the BdP and other financial institutions, and all other sources of

financing including capital transactions, and arrears of the General Government will be provided to the EC, the ECB, and the IMF by the DGO in the MoF within seven weeks after the closing of each month.

- 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.

#### **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. 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.

- **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 non-recurrent 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; EU expenses, and called guarantees (excluding those related to the banking sector support and restructuring strategy) where the Central Government makes payments on behalf of entities that are not part of the General Government.
- **The cash balance of the Regional and Local Governments, Social Security Funds and 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 MoF will make this specification available by end-May 2011. The reporting by Local Government will be phased as set out in paragraph 8 below.



- **The change in the stock of arrears of all entities of the General Government.** The stock of arrears, defined according to the definition below, as at June 30, 2011 will be measured through a survey and the results of the survey will be published by end-August 2011. From September 2011 onwards monthly report of arrears of the General Government will be published reconciling the stock at the beginning and end of the month and identifying repayments and other movements during the month. Data will be in line with the monthly publications of State Budget arrears, published on the MoF website.

### **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. Transactions that are excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchases of troubled assets. 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. Production of the consolidated General Government budget execution report for internal, EC, ECB, and IMF monitoring will begin in July 2011. The reports will be published externally from end-December 2011. The larger municipalities (defined as those with a population of 100,000 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, 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 quarterly 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.**

- Data on cash balances of the State Government, SEO 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 MoF will submit by end-July and end-January, 2012 a full reconciliation of the cumulative monthly cash deficit up to, respectively, end-March and end-September with the corresponding cumulative accrual deficits determined by the INE in accordance with ESA 95 rules. 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 Domestic Arrears by the General Government (Continuous Indicative Target)**

10. **Definition.** For the purpose of the Program, domestic arrears are defined as invoices 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 in the supplier contract, arrears are defined as invoices that have remained unpaid for 90 days or more after the date of the invoice. Data on arrears will be provided within six weeks after the end of each month. The continuous target of non-accumulation of domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the beginning of the month. Furthermore, in line with quantitative targets to be established at the time of the first review, the existing stock of arrears will be settled or otherwise reduced. This also includes arrears that are being accumulated by the NHS and SOE, which are, otherwise, to a degree excluded from the General Government under ESA95 and ESA95 Manual on Government Deficit and Debt rules classification.

11. Commitment is defined as an explicit or implicit agreement 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.

12. **Supporting material.** Starting in September 2011, 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.

## **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 ceiling on the stock of General Government debt will exclude debt arising from payments for bank restructuring, when carried out under the Program's banking sector support and restructuring strategy. This includes loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by the central government to support banks, including the issuance of guarantees or provision of liquidity will be immediately reported to the EC, ECB and IMF.

14. **Adjusters.** For 2011, 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 2010 general government debt of EUR160.47 billion.

15. **Supporting material.** Quarterly data on the total stock of General Government debt as defined in paragraph 13 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, an external debt payments arrear will be defined as a payment on debt to non-residents 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.** The stock of external debt payment arrears of the General Government will be provided by the MoF with a lag of not more than seven days after the test date.

#### **E. Bank Solvency Support Facility**

18. EUR 1 billion will be provided in cash and be made available in a separate dedicated account to be set up at the Bank of Portugal by end-June 2011. The remainder of the EUR 12 billion foreseen for the bank support fund will be deposited into the dedicated account consistent with the need for bank capital determined by Program reviews.

#### **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.

20. Concerning the Central Administration, and Regional and Local Administrations owned companies not classified by INE within the General Government, the MoF will provide by end-September 2011 data on the 2010 financial statements reported under the Simplified Business Information framework, to be reported by end-June 2011.

**Annex 5: Indicative timeline of financial sector and structural measures in the Memorandum of Understanding on specific economic conditionality<sup>27</sup>**

<b>Actions to be completed before signature of the Memorandum of Understanding<sup>28</sup></b>	
<b>Financial sector</b>	Announce increases in minimum core Tier 1 capital adequacy ratio to 9 percent by end-2011 and 10 percent by end-2012, with banks required to present by end-June 2011 plans on how they intend to comply with these requirements.
<b>Fiscal-structural</b>	<p>Approve a standard definition of arrears and commitments.</p> <p>Prepare a comprehensive report on 10 SOEs posing the largest potential fiscal risks to the state, covering (i) concrete plans, per enterprise, for reducing its operational costs, consistent with an average cut by of at least 15 percent in the sector over 2009 levels; (ii) a planned revision of the tariffs.</p> <p>Establish a temporary task force of judges to clear the stock of tax appeal cases above EUR 1 million.</p> <p>Make a comprehensive tax inventory of the existing tax expenditures by type of tax, along with other policy costs estimates.</p>
<b>Actions for the first review (to be completed by end-July 2011)</b>	
<b>Financial sector</b>	<p>Design by end-June 2011 a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment. (*)</p> <p>Request banks to devise by end-June 2011 medium-term funding plans to achieve a stable market-based funding position.</p> <p>Request banks to present plans by end-June 2011 on how they intend to reach the new capital requirements through market solutions.</p> <p>Launch a process to sell Banco Português de Negócios (BPN) on an accelerated schedule and without a minimum price. The target is to find a buyer and submit the new plan to the EC for approval under competition rules by end-July.</p>
<b>Fiscal-structural</b>	<p>Finalise a proposal for a budget neutral recalibration of the tax system with a view to reduce labour costs. (*)</p> <p>Approve definition of contingent liabilities.</p> <p>Review the tariff structure of central government SOEs to reduce the degree of subsidisation.</p>

1 This table has been prepared by the Commission services. It provides a summary of the main financial sector and structural measures in the Memorandum of Understanding on specific economic policy conditionality (MoU) for each review. The table is indicative both as regards specification of the measures and dates: the assessment of conditionality will take place against the measures and dates as spelled out in the main text of the MoU.

<sup>28</sup> These measures are prior actions in the Memorandum of Economic and Financial Policies.

(\*) Measures that are structural benchmarks in the Memorandum of Economic and Financial Policies.

	<b>Actions for the first review (to be completed by end-July 2011)</b>
	Apply tighter debt ceilings to central government SOEs from 2012 onwards. Complete concrete plans to reduce central government SOEs operational costs by at least 15% on average.
<b>Labour market</b>	Send legislation to Parliament to implement a reform in the severance payments for new hires in line with the March 2001 Tripartite Agreement. (*)
<b>Goods and services markets</b>	Draft law ensuring the implementation of the new Directive on "Better Regulation" to increase competition in telecommunications sector. Transpose Third EU Energy Package. Adopt roadmap for the elimination of regulated tariffs in electricity.
<b>Judicial system</b>	Intensify the implementation of the Judicial Reform Map. Audit of the backlog cases, including debt enforcement, insolvency, tax and labour cases and additional measures to expedite the resolution of the backlog.
<b>Competition, public procurement, and business environment</b>	Eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state. (*)

	<b>Actions for the second review (to be completed by end Q3-2011)</b>
<b>Financial sector</b>	Seek evaluation of the enhanced solvency and deleveraging assessment framework by a joint team of experts from the EC, the ECB and the IMF. (*) Improve disclosure on non-performing loans by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments. (*) Issue general principles on voluntary out of court restructuring in line with international best practices. Provide updates on banks' potential capital needs and evaluates their deleveraging process (to be repeated quarterly). Report on corporate and household sectors indebtedness, their funding pressures and debt refinancing activity (to be repeated quarterly).
<b>Fiscal-structural</b>	Conduct and publish a comprehensive survey of arrears by end-August 2011 covering all categories of expenditure payables as at the end of June 2011. (*) Report the consolidated monthly arrears for the general government. Report the key areas of concern and prepare terms of reference for a more detailed study on the 20 most significant PPP and concession contracts. (*) Enhance monthly reporting on budget execution on cash basis for the general government, including on a consolidated basis. Improve the annual report on tax expenditures. Establish intra-annual fiscal targets. Publish report on fiscal risks (annual). Publish a medium-term fiscal strategy document for the general government by end-August (to be published every April thereafter). (*)

	<b>Actions for the second review (to be completed by end Q3-2011)</b>
	<p>Fully implement the Budgetary Framework Law.</p> <p>Publish forecasts underpinning the budget.</p> <p>Adopt the Statutes of the Fiscal Council.</p> <p>Perform with the technical assistance from EC and the IMF, an initial assessment of at least the 20 most significant PPP and concession contracts, including the major <i>Estradas de Portugal</i> PPPs, by end-August 2011.</p> <p>Prepare a comprehensive assessment of the tariff structure of SOEs (local and regional levels) to reduce the degree of subsidisation.</p> <p>Apply tighter debt ceilings to SOEs from 2012 onwards (local and regional levels).</p> <p>Complete concrete plans to reduce SOEs operational costs by at least 15% on average over 2009 levels (local and regional levels).</p> <p>Review the level of service provision of SOEs at all levels (central, local and regional).</p> <p>Study to assess costs and benefits of merging the social security administration with tax, customs and DGITA.</p> <p>Make a new assessment of audit performance in the revenue administration.</p> <p>Apply interest charges on outstanding debt over the court appeal period.</p> <p>Implement new tax arbitration law.</p> <p>Report on the state of IT in the revenue administration.</p> <p>Draft law and other initiatives to ensure annual decreases of at least 1% per year in the number of central administration employees in 2012-14 and of at least 2% at regional and local levels.</p> <p>Introduction of a standstill rule to all tax expenditure, blocking the creation of new items of tax expenditure and the enlargement of existing items.</p>
<b>Health care system</b>	<p>Draft legislative acts to: i) substantially revise existing exemption categories from NHS moderating fees and ii) increase moderating fees in certain services.</p> <p>Reduce tax allowances for healthcare by two thirds.</p> <p>Revise the pricing of the first generic.</p> <p>Make compulsory the electronic prescription for medicines and diagnostic.</p> <p>Establish the monitoring system of prescription and assessment by individual doctor with future regular feedback.</p> <p>Measures to induce physicians to prescribe generic medicines and less costly available branded product (regulation or guidelines to doctors).</p> <p>Legislative and administrative framework for a centralised procurement system for the purchase of medical goods in the NHS.</p> <p>Increase in the number of USF units contracting with regional authorities.</p> <p>Present timetable to clear arrears in the health system.</p>

	<b>Actions for the second review (to be completed by end Q3-2011)</b>
	<p>Present detailed description of measures aimed to achieve a reduction of EUR 200 millions in the operational costs of hospitals in 2012.</p> <p>Publish clinical guidelines and setting up of an auditing system of their implementation.</p> <p>Update annually the inventory of all practising doctors by speciality, age, region, health centre and hospital, public and private sector.</p> <p>Envisage regular annual reports, first to be published in Q1-2012, on the allocation of human resources in the period up to 2014.</p> <p>Reduce costs for patient transportation by one third.</p>
<b>Goods and services markets</b>	<p>Take measures to improve functioning of Iberian gas market through regulatory convergence.</p> <p>Report on consistency and possible overlapping of energy policy instruments.</p> <p>Report annually on action taken to improve the compensation schemes of new contracts in renewables (if any).</p> <p>Report annually on the cost and benefits of new investments in renewables, including the consequences for energy prices.</p> <p>Auction new radio frequencies (i.e. auction of spectrum) and decrease mobile termination rates.</p> <p>Introduce standardized contracts, make explicit the right to free cancellation, and facilitate price comparison, in order to increase consumers' mobility in fixed communications.</p> <p>Renegotiate existing contract with current provider and launch a new (non-discriminatory) tender for the designation of providers of universal services in telecommunications.</p> <p>Transpose the Third Postal Directive to liberalize Postal Services.</p> <p>Strategic Plan for Transport to rationalize, better integrate and increase competition in the sector.</p> <p>Transpose EU Railway Package law and privatise the freight branch of CP and suburban lines.</p> <p>Present to the Parliament the amendments to sector-specific legislation under the Services Directive in order to further liberalise the sector.</p> <p>Law to improve recognition of professional qualifications: adopted (for professions not regulated by Parliament); presented to Parliament for the other professions.</p> <p>Adjust the legislative framework in order to liberalise access and exercise of regulated professions: to be adopted for professions not regulated by Parliament; to be presented to Parliament for the other professions.</p> <p>Make adjustments to the legislative framework in order to reduce the number of regulated professions and eliminate unjustified reserves of activity and restrictions to advertising: adopted for professions not regulated by Parliament; presented to Parliament for the other professions.</p>
<b>Housing market</b>	<p>Present measures amending the New Urban Lease Act Law.</p> <p>Adopt legislation to simplify administrative procedures for renovation.</p> <p>Review the framework for the valuation of housing.</p>
<b>Judicial system</b>	<p>Adopt roadmap for the implementation of the Judicial Reform Map.</p>

	<b>Actions for the second review (to be completed by end Q3-2011)</b>
	<p>Adopt new law on Arbitration.</p> <p>Extend the new experimental civil procedure regime to 4 courts.</p> <p>Implement the Tax Arbitration Law.</p> <p>Introduce standardised court fee and special court fees for certain categories of cases to disincentivise spurious litigation.</p> <p>Regular reports to be published on recovery rates, duration and costs of corporate insolvency and tax cases.</p>
<b>Competition, public procurement, and business environment</b>	<p>Eliminate exemptions permitting direct award of public contracts below the Public Procurement Directives thresholds wherever this does not entail amending the Public Procurement Code.</p> <p>Establish rules ensuring ex-ante auditing/checks on public procurements by appropriate body.</p>
	<b>Actions for the third review (to be completed by end Q4-2011)</b>
<b>Financial sector</b>	<p>Amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework and introduce a regime for restructuring of banks as a going concern under official control. (*)</p> <p>Amend the Insolvency Law to provide that guaranteed depositors and/or funds will be granted a higher priority ranking over unsecured creditors in the insolvent state of the credit institution.</p> <p>Amend the Insolvency Law to better facilitate effective rescue of viable firms and support rehabilitation of financially responsible individuals. (*)</p> <p>Amend the legislation on the Deposit Guarantee Fund and the Guarantee Fund for Mutual Agricultural Credit Institutions to cap the amount of financial assistance to a distressed bank. (*)</p>
<b>Fiscal-structural</b>	<p>Change budget execution rules to align with the definition of arrears and commitments.</p> <p>Implement first steps of a budget neutral recalibration of the tax system with a view to reduce labour costs, in the 2012 Budget (October 2011).</p> <p>Publish quarterly accounts for SOEs 45 days after end of quarter.</p> <p>Draft law proposal to Parliament to reform local and regional finance laws.</p> <p>Complete a preliminary review of budgetary implications of main PPP programs and recruit a top tier international accounting firm to complete a more detailed study of PPPs and identify areas for deeper analysis by March 2012. (*)</p> <p>Prepare a plan to strengthen the governance of SOEs (at central, local and regional level).</p> <p>Frontload privatisation plans and identify two additional companies for privatisation.</p> <p>Complete the design, in consultation with the EC and IMF staff, of the new structure that merges tax, customs and DGITA..</p> <p>Prepare comprehensive reform plans to reform the revenue administration (including special chambers, reduction of number municipal tax offices, increase in auditing staff).</p>



	<b>Actions for the third review (to be completed by end Q4-2011)</b>
	<p>Prepare a strategic plan 2012-2014 for the revenue administration, including concrete actions to combat tax fraud and evasion, to strengthen audit and enforce collection based on risk management techniques.</p> <p>Integrate the IT systems between the revenue administration and tax tribunals.</p> <p>Submit law to Parliament to strengthen the auditing and enforcement powers of the central tax administration.</p> <p>Reduce management positions and administrative units by at least 15% in central government.</p> <p>Implement a second phase of the administration reform programme (PRACE).</p> <p>Submit law to Parliament to reduce management positions and administrative units in local administration.</p> <p>Take initiative to reduce management positions and administrative units in regional administration.</p> <p>Carry out a cost/benefit analysis of public entities (foundations, institutes, etc).</p> <p>Draft law on creation and functioning of public entities (foundations, institutes, etc) in central and local administration.</p> <p>Take initiative to regulate the creation and functioning of public entities in regional administration.</p> <p>Identify inefficiencies and duplications between the central, local and locally based central administration.</p> <p>Prepare plan of mobility of human resources within the administration.</p>
<b>Health care system</b>	<p>Legislation on automatic indexation to inflation of NHS co-payments.</p> <p>Reduce the public expenditure on public health-benefits schemes by 30% in 2012, by 20% in 2013. Ensure further similar reductions in subsequent years with a view to have the health-benefits schemes self-financed by 2016.</p> <p>Prepare the medium-term health care budgetary framework.</p> <p>Revise the existing pricing system for medicines based on external prices.</p> <p>Carry out the first quarterly feedback on prescription to each physician.</p> <p>Establish rules for the prescription of drugs and complementary diagnostic exams (prescription guidelines).</p> <p>Reduce the administrative/legal hurdles in generic medicines market.</p> <p>Effectively implement the existing legislation regulating pharmacies.</p> <p>Change the calculation of profit margins for wholesale companies and pharmacies to ensure that at least EUR 50 million in savings in public expense comes from reduction in profits of pharmaceutical sector.</p> <p>Finalise the uniform coding system and the common registry for medical supplies.</p> <p>Reduce by 10 percent in the overall spending (including fees) of the NHS with private providers delivering services to NHS – increase competition among private providers.</p> <p>Establish the mechanism to guarantee the presence of family doctors in needed areas.</p> <p>Improve selection criteria and adopt measures to ensure a more transparent selection of the chairs and members of hospital boards.</p>

<b>Actions for the third review (to be completed by end Q4-2011)</b>	
<b>Labour market and education</b>	<p>Adopt an action plan to reform the unemployment benefits system.</p> <p>Prepare legislative proposal to revise severance payment entitlements for current employees in line with the reform for new hires.</p> <p>Prepare legislative proposal to revise the cases for fair individual dismissals.</p> <p>Prepare plan to promote the use of flexible working time arrangements.</p> <p>Implement commitments in the Tripartite Agreement on "organised decentralisation".</p> <p>Adopt an action plan to allow works councils to conclude firm-level agreements.</p> <p>Report on current activation policies and other active labour market policies (ALMP).</p> <p>Adopt an action plan to improve further activation policies and other ALMPs.</p> <p>Prepare a monitoring, assessment and reporting system to evaluate education and training policies.</p>
<b>Goods and services markets</b>	<p>Report on lack of entry in gas market (reasons and measures).</p> <p>Revise downwards payment to electricity producers under guarantee compensation mechanism and long-term power-purchase agreements.</p> <p>Report on the efficiency of support schemes for co-generation and renewables and on the options for adjusting downwards the feed-in tariff used in co-generation (reduce the implicit subsidy) and renewables. (*)</p> <p>Streamline administrative procedures and increase transparency of charges for renewable energy producers.</p> <p>Take measures to modify energy policy instruments to ensure consistency and eliminate possible overlapping of energy policy instruments.</p> <p>Increase in VAT tax rate in electricity and gas and in excise duties in electricity.</p> <p>Prepare the Port Strategy and a proposal for legal framework to implement the Port Strategy for integration of ports into overall logistic and transport system and for improvement of governance.</p> <p>Report on (objectives, instruments and efficiency gains) on-going and planned initiatives in the port sector.</p> <p>Revise the legal framework governing port work (more flexible) in place.</p> <p>Adopt amendments to sector-specific legislation under the Services Directive.</p> <p>Eliminate unjustified restrictions to free establishment and to cross-border provision for construction and real estate, when transposing sector-specific regulation in accordance with the Services Directive.</p> <p>Report of remaining requirements in regulated professions and elimination of unjustified ones.</p> <p>Extend on-line procedures in Points of Single Contact to all sectors under the Services Directive.</p> <p>Implement the "Zero authorisation project" abolishing licenses on wholesale, retail and bars and restaurants.</p>
<b>Housing market</b>	<p>Draft legislation amending the New Urban Lease Act Law 6/2006 to be submitted to Parliament.</p> <p>Modify property taxation with a view to i) level incentives for renting versus acquiring housing and ii) shift the tax burden towards the</p>

<b>Actions for the third review (to be completed by end Q4-2011)</b>	
	recurrent real estate tax.
<b>Judicial system</b>	<p>Establish new court management methods, including in Lisbon and present courts personnel management plan.</p> <p>Take measures to give priority to alternative dispute resolution enforcement.</p> <p>Report on the experimental civil procedure regime and the possibility of extension to all courts.</p> <p>Assess the need for separate Chambers within the Commercial Courts with specialised judges for insolvency cases.</p> <p>Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement. (*)</p> <p>Prepare measures to expedite the resolution of tax cases.</p> <p>Annual work plan on the allocation of resources based on court by court performance data.</p>
<b>Competition, public procurement, and business environment</b>	<p>Revise the Competition Law to make it more autonomous from administrative and penal procedural laws and more in line with the EU legal framework. (*)</p> <p>Present an independent report on the independence and resources of the national regulator authorities and the proposal to reinforce it where necessary.</p> <p>Take measures to ensure the Competition Authority has the necessary and stable resources to guarantee its effective operation.</p> <p>Eliminate exemptions permitting direct award of public contracts above the Public Procurement Directives thresholds.</p> <p>Amend the Public Procurement Code provisions on errors and omissions and additional works/services, and to eliminate the remaining exemptions permitting direct award of public contracts below the Public Procurement Directives thresholds.</p> <p>Implement measures regarding irregular direct awards for additional works/services.</p> <p>Adopt measures making financially responsible contracting authorities for non-compliance with public procurement rules.</p> <p>Upgrade the national Public Procurement Portal (Base) based on Resolution 17/2010 of the National Parliament.</p> <p>Modify Art 42 of the Public Procurement Code concerning R&amp;D projects for large public contracts.</p> <p>Adopt the "Simplex Exports" programme.</p> <p>Implement the strategy to facilitate access to finance and export markets for companies, in particular SMEs.</p>
<b>Actions for the fourth review (to be completed by end Q1-2012)</b>	
<b>Fiscal-structural</b>	<p>Present detailed plans on improving the working of central administration, increasing efficiency, reducing and eliminating services that do not represent a good use of public money.</p> <p>Publish additional information on general government staff on a quarterly basis.</p> <p>Finalisation of detailed study on PPPs and concessions by the top tier international accounting firm.</p>

	<b>Actions for the fourth review (to be completed by end Q1-2012)</b>
	<p>New legal and institutional framework for analysing PPPs.</p> <p>Report on operations and finances of SOEs (at central, regional and local levels). (*)</p> <p>Draft law to regulate the creation and functioning of SOEs.</p> <p>Merge the revenue collection units of social security administration, if cost-benefit assessment is favourable.</p> <p>Establish specialised large tax cases courts and technical staff group.</p> <p>Updated privatisation plan.</p>
<b>Health care system</b>	<p>Implement the centralised purchasing of medical goods through the recently created Central Purchasing Authority.</p> <p>Introduce a regular revision of the fees paid to private providers.</p> <p>Comply with European competition rules of the provision of services in the private healthcare sector.</p> <p>Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators and regular reports.</p> <p>Achieve full interoperability of IT systems in hospital.</p> <p>Adopt rules to increase mobility of healthcare staff including doctors within and across regions.</p> <p>Adopt for all staff flexible time arrangements, aiming at reducing by at least 10% spending on overtime compensation in 2012 and another 10% in 2013.</p> <p>Implement a stricter control of working hours and activities of staff of hospital.</p>
<b>Labour market and education</b>	<p>Draft legislation on unemployment benefits system to be adopted by the government.</p> <p>Draft legislation on severance payment entitlements for current employees to be submitted to Parliament.</p> <p>Draft legislation on the cases for fair individual dismissals to be submitted to Parliament.</p> <p>Draft legislation on the use of flexible working time arrangements to be submitted to Parliament.</p> <p>Draft legislation on firm-level agreements concluded by works councils to be submitted to Parliament.</p> <p>Draft proposal to reduce the firm size threshold for works councils to conclude agreements below 250 employees, with a view to adoption by Q2-2012.</p> <p>Adopt an action plan to improve the quality of secondary education.</p> <p>Adopt an action plan on attractiveness and labour market relevance of vocational education and training and enhancing career guidance mechanisms.</p>
<b>Goods and services markets</b>	<p>Present market analysis in fixed communications and adopt measures to reduce entry barriers.</p> <p>Law to improve recognition of professional qualifications framework approved by Parliament.</p> <p>Law to reduce the number of regulated professions and eliminate unjustified reserves of activity approved by Parliament.</p> <p>Law to liberalise access and exercise of regulated professions approved by the Parliament.</p>

<b>Actions for the fourth review (to be completed by end Q1-2012)</b>	
	Adapt Points of Single Contact to incorporate new legislation in order to reduce administrative burdens for firms.
<b>Judicial system</b>	<p>Make the specialised courts on Competition and IPR fully operational.</p> <p>Make arbitration for debt enforcement cases fully operational. (*)</p> <p>Increase capacity of Justices for the Peace regimes to handled small claims.</p> <p>Assess workload/staffing for the six pilot courts under the Judicial Reform Map.</p>
<b>Competition, public procurement, and business environment</b>	Implement the proposal on reinforcing the independence and resources of the national regulator authorities.

<b>Actions for the fifth review (to be completed by end Q2-2012)</b>	
<b>Fiscal-structural</b>	<p>Prepare the plan ensuring that the aggregate public sector wage bill as a share of GDP decreases in 2012 and 2013.</p> <p>Annual PPP and concessions report (see Q2-2011).</p> <p>Improve the SOE report by including a comprehensive fiscal risk report.</p> <p>Prepare an asset inventory, including real estate, owned by municipalities and regional government, examining scope for privatisation.</p> <p>Close the public entities with an unfavourable cost/benefit analysis.</p> <p>Eliminate inefficiencies and duplicities in the central, local and locally-based central administration.</p> <p>Implement fully the strategy of shared services in central administration in the areas financial and human resources.</p> <p>Municipalities to present plans to reduce management positions and administrative units by at least 15% by the end of 2012.</p>
<b>Health care system</b>	<p>Reorganise and rationalise the hospital network continued through specialisation and concentration of hospital and emergency services and joint management.</p> <p>Move some outpatient services to primary care units (USF).</p> <p>Finalise the system of patient electronic medical records.</p>
<b>Labour market and education</b>	<p>Prepare draft legislative proposal containing criteria and modalities for the extension of collective agreements.</p> <p>Prepare an independent review on how the tripartite concertation on wages can be reinvigorated.</p> <p>Adopt the proposal to reduce the firm size threshold for works councils to conclude agreements below 250 employees.</p>
<b>Goods and services markets</b>	Extend the "Zero authorisation project" abolishing licenses on wholesale and retail and restaurants and bars to all levels of administration.

<b>Actions for the sixth review (to be completed by end Q3-2012)</b>	
<b>Fiscal-structural</b>	<p>Publish the annual report on fiscal risks.</p> <p>Apply tighter debt ceilings for SOEs from 2012 onwards.</p>

<b>Actions for the sixth review (to be completed by end Q3-2012)</b>	
	Develop by July 2012 a consolidation plan to reduce significantly the number of local authorities, to come into effect by the beginning of the next local election cycle.
<b>Goods and services markets</b>	Annual report on new investments in renewables (see Q3-2011). Annual report on new contracts in renewables (see Q3-2011)
<b>Actions for the seventh review (to be completed by end Q4-2012)</b>	
<b>Fiscal-structural</b>	Reduce number of municipal tax offices by 20%. Complete the implementation of the new structure that merges tax, customs and DGITA. Increase to 30% the number of auditors in the tax administration. End of temporary task force to clear stock of appeal cases above EUR 1 million. Implement shared services in IT. Reduce the number of central administration employees by at least 1% per year, with larger reductions at regional and local level of 2%.
<b>Health care system</b>	Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators – first regular report. Further reduce public expenditure on public health-benefit schemes by 30% in 2012.
<b>Goods and services markets</b>	Eliminate regulated tariffs in electricity and gas (Jan 1).
<b>Housing market</b>	Bring value of all property stock close to market value.
<b>Judicial system</b>	Create 39 court units, entirely financed through expenditure savings and gains of efficiency (implementation of the Judicial Reform Map).
<b>Actions for the eighth review (to be completed by end Q1-2013)</b>	
<b>Goods and services markets</b>	Extend the Points of Single Contact reducing administrative burdens for firms to all sectors. Extend the "Zero authorisation project" abolishing licenses to other sectors of the economy.
<b>Competition, public procurement, and business environment</b>	Implement the New Late Payments Directive. Include all municipalities and all levels of public administration within the scope of the Simplex Programme.
<b>Actions for the ninth review (to be completed by end Q2-2013)</b>	
<b>Fiscal structural</b>	Complete the plan that ensures that the aggregate public sector wage bill as a share of GDP decreases in 2012 and 2013.
<b>Housing market</b>	Review of the impact of all housing market reforms.
<b>Judicial system</b>	Eliminate the court backlog.

<b>Actions for the tenth review (to be completed by end Q3-2013)</b>	
<b>Fiscal structural</b>	Publish the annual report on fiscal risks.
<b>Goods and services markets</b>	Annual report on new investments in renewables (see Q3-2011). Annual report on new contracts in renewables (see Q3-2011).
<b>Actions for the eleventh review (to be completed by end Q4-2013)<sup>29</sup></b>	
<b>Fiscal-structural</b>	Reduce number of municipal tax offices by 20%. Reduce the number of local branches of line ministries. Reduce the number of central administration employees by at least 1% per year, with larger reductions at regional and local level of 2%.
<b>Health care system</b>	Further reduce public expenditure on public health-benefit schemes of 20% in 2013.

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<sup>29</sup> There is no structural conditionality foreseen at this stage for the 12<sup>th</sup> quarterly review.

## Annex 6: Provision of data

During the programme, the following indicators and reports shall be shared with the European Commission, the ECB and the IMF by the authorities on the agreed periodic basis. Other indicators may also be requested to and reported by the Portuguese Authorities.

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### To be provided by the Ministry of Finance

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|----|---|---|
| 1. | Data on cash balances of the State Budget. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published by the MoF.   | Monthly, 3 weeks after the end of the month   |
| 2. | Data on the cash balances of the other parts of General Government ( <i>Other entities 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 Authority (INE) as part of the Central Government; State-owned enterprises (SOE) which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as part of the Central Government (ISOE); Regional and Local Governments (Administrações Regionais and Locais), including 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> ). Data will include detailed information on revenue and expenditure items | Monthly, as soon as the data are available and no later than 7 weeks after the end of the month |
| 3. | Detailed information on called guarantees   | Monthly, 7 weeks after the end of the month   |
| 4. | Detailed information on PPP related revenues and expenditures   | Monthly, 7 weeks after the end of the month   |
| 5. | Data on domestic and foreign debt redemptions, new domestic and foreign debt issuance, change in the domestic and foreign cash balances of the Central Government at the BDP and other financial institutions and all other sources of financing including capital transactions and arrears of the General Government.  | Monthly, 7 weeks after the end of the month   |
| 6. | A full reconciliation of the cumulative monthly cash deficit up to, respectively, end-March and end-September with the corresponding cumulative accrual deficits determined by INE in accordance with ESA95 rules. 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.  | End-January and End-July, 2012  |
| 7. | Number of general government staff.   | No later than 30 days after the end of the quarter (from Q1-2012 onwards)                       |
| 8. | Data on the financial statements, reported under the Simplified Business Information framework, of the Central Administration, Regional and Local Administration owned companies not  | End September 2011  |
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classified by INE within the General Government.

9. Report on progress with fulfilment of economic policy conditionality on a quarterly basis. It should include updated estimates of the direct budgetary impact of the measures taken where relevant. In addition, a short summary report should be sent on a monthly basis.
- Quarterly (report), 2 weeks after the end of each quarter. Monthly (short summary report) 2 weeks after the end of each month for which a report is not due.

### **To be provided by the Ministry of Labour**

1. Data on labour market as follows:
- a. layoffs by type
  - b. collective agreements by type and number of collective agreements that are extended by the Ministry of Labour to non-signatory firms
  - c. number of collective agreements that regulate the use of the Bank of Hours working time arrangement
  - d. proportion of unemployed receiving unemployment benefits
  - e. distribution of the unemployed in terms of amount of benefits received (mean of benefits received, median, number of unemployed receiving an unemployment benefit amount equal to the IAS and number of unemployed receiving the maximum amount of unemployment benefits allowed)
  - f. unemployment duration
- Every six months, 6 weeks after the end of each semester.

### **To be provided by the Ministry of Health**

1. Data on health expenditure as follows:
- a. hospital expenditure for the different hospitals and by sub-category of hospital expenditure (e.g., pharmaceuticals, medical supplies, other supplies, services contracted to private providers such as diagnostic tests and treatments, staff)
  - b. outpatient pharmaceutical expenditure
  - c. remuneration costs for staff, by type of staff and specifying remuneration costs related with overtime work
- Quarterly, 30 days after the end of each quarter.

### **To be provided by the Banco de Portugal**

1. Assets and liabilities of Banco de Portugal
- Monthly, 10 days after the end of each month
2. Detailed monthly data on the financing of the General Government
- Monthly, 7 weeks after the end of each month
3. Data on stock of General Government debt
- Quarterly, 90 days after the end of the quarter;
- Monthly estimates, 7 weeks after the end of the month.
4. Assets and liabilities of the Portuguese banking system – aggregate monetary balance sheet of credit institutions
- Monthly, 40 days after the end of each month
5. Report on banking sector liquidity situation, including collateral
- Weekly on Friday, reporting on the previous Friday
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6.	Report on financial stability indicators for the banking sector as whole and for individual systemic important banks	Quarterly, 60 days after the end of each quarter
7.	Report on results from the regular quarterly solvency and deleveraging assessment	Quarterly, 60 days after the end of each quarter depending on data availability.
8.	Detailed report on the dedicated account, on which the funding for Bank Support Facility is held with indication of changes in the amounts	Weekly on Monday, reporting on the previous Friday
9.	Government debt (Portuguese and foreign) held by banks	Monthly, 40 days after the end of each month

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