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The Economic Adjustment Programme for Portugal Second review - Autumn 2011

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The Economic Adjustment Programme for Portugal

Second Review - Autumn 2011

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OUTLINE OF THE REPORT

EXECUTIVE SUMMARY

A joint EC/ECB/IMF mission met with the Portuguese authorities in Lisbon during 7-16 November to assess compliance with the terms and conditions of the Second Review under the Economic Adjustment Programme. *The objectives of the Programme are to restore sound public finances, improve competitiveness and to put Portugal's economy back on the path of sustainable growth and job creation. This report provides an assessment of compliance and summarises the findings of the mission.*

The contraction of economic activity in 2012 is likely to be more pronounced than foreseen in the Programme, outweighing the better performance of the economy in 2011. *Output is now forecast to drop by 3.0 per cent in 2012, with the balance of risks tilted to the downside, as domestic demand is compressed amid sharply falling household income, tightening credit and financial market conditions and weakening confidence. Exports which have recently shown signs of strengthening will be hampered by global headwinds. The economy is expected to stabilise towards the end of 2012 and return to positive growth in 2013. The decline in the current account deficit is projected to continue, driven by a rapidly shrinking trade deficit. The expected rebalancing of the economy is also reflected in a gradual reduction of relative labour costs. While inflation at constant taxes should be declining, a hike in indirect taxes and administered prices will keep headline inflation elevated in the short term.*

Budgetary execution in 2011 has come under strain with both expenditure and revenue projected to be off target. *Additional revenue measures adopted in the summer (a one-off surcharge on personal income taxes and bringing forward the increase in VAT on energy originally planned for 2012), whilst significant, were not sufficient to close the fiscal gap, also in view of further slippages during the autumn. Overall, the fiscal gap in 2011 is estimated to be about 1½ per cent of GDP, a significant part of which will carry over into 2012. The government seeks to close the gap in 2011 through a large one-off transaction, notably the partial transfer of banks' pension funds to the state social security system. This transfer will allow the government to respect the deficit target of 5.9 per cent of GDP although at the cost of future pension payments to the beneficiaries of these pension funds.*

The 2012 budget targets a general government deficit of 4.5 per cent of GDP, in line with the Programme. *To this effect, it contains bold consolidation measures, totalling 6 per cent of GDP, of which two thirds are on the expenditure side. Key measures include significant nominal cuts in public sector wages and pension entitlements and the shift of a large number of goods and services to higher VAT rates. The cuts in wages and entitlements are implemented in a socially compatible way, with lower incomes being less or not affected. The measures are appropriate in view of the need to switch from a consumption-based to a more export-led growth model. While the budgetary yield of the measures has been correctly assessed by the government there are nevertheless risks to the achievement of the target related in particular to the economic outlook and to fiscal risks associated with the performance of state-owned enterprises (SOEs) and regional and local governments. This calls for a determined implementation of the budget as well as flanking structural measures to improve the budgetary control over entities in the wider public sector.*

The government is undertaking a number of reforms to improve fiscal management and expenditure control, including improved reporting at all levels of government, and is committed to a deep restructuring of SOEs. *Efforts are underway, in particular, to improve the fiscal framework through the introduction of a medium-term fiscal strategy, reinforcing commitment controls and regular and comprehensive reporting on arrears. The government has also prepared a strategic plan on SOEs which specifies how to enhance the efficiency of the sector, restore its financial sustainability, and re-focus its activities on core public policy objectives. In view of the substantial fiscal risks posed by this sector, particularly with regard to its high and rapidly rising level of indebtedness, a swift implementation of the strategy should ensure operational balance of these companies by end-2012. This needs to be urgently complemented by a plan spelling out options on* *how to reduce the high stock of arrears, especially in the hospital sector where the problem is particularly severe. The government has also prepared a report on the fiscal risks stemming from Public-Private Partnerships (PPPs), and is launching, with a short delay, a study assessing whether and how the projected high spending pressures from PPPs in coming years can be alleviated.*

A revision of the fiscal frameworks for the regional and local governments is under preparation, although somewhat behind schedule. *Measures limiting the indebtedness of local governments have been included in the budget plan for 2012. But a more profound revision, possibly benefiting from technical assistance, of legislation governing the finances of local and regional governments is necessary with a view to enhancing accountability. Recent developments in the Autonomous Region of Madeira have dramatically demonstrated the fiscal risks related to a lack of transparency and budgetary control. With debt sustainability of the region seriously in doubt, the central government is preparing an arrangement that will include quantitative criteria on fiscal performance and structural reforms. Until this arrangement is in place, the government will ensure enhanced monitoring of Madeira's budget execution.*

The government is pursing its privatisation plans, with the sale of its major stakes in EDP and REN being imminent. *The Programme frontloads estimated total proceeds of some EUR 5 billion, with estimated revenues of EUR 600 million in 2011 and EUR 4 billion in 2012. The sale of stakes in EDP (the dominant electricity company) and REN (the energy network operator) are in an advanced stage, and other privatisation projects mainly in the transport sector are projected to materialise in the course of 2012. The government also considers winding down* Parpublica*, the public holding company, but net revenues will be small, if any, as the proceeds from the sale of its assets will be balanced by substantial liabilities held by the company.*

While deleveraging is ongoing, Portugal's banks face fresh challenges to strengthen their capital positions. *The deleveraging process of Portuguese banks has been facilitated by a reduction in their foreign activities. Going forward, it will be important that the pace and composition of deleveraging allows banks to address their funding imbalances with a view to reducing their high dependence on the Eurosystem liquidity, while safeguarding adequate credit to the productive sectors of the economy. Banks are on track to meet the capital requirements under the Programme at year-end, but capital positions have to improve further in 2012 in line with Programme requirements and as a result of the European Banking Authority's requirement to cater for sovereign exposures, the special on-site inspection programme and the planned transfer of banks' private pension plans. Additional capital requirements will be first sought from private sources but, if insufficient, banks will be able to use the bank solvency support facility included in the financing envelop of the Programme. To this effect, the authorities are finalising the legislation governing the provision of capital from public sources to banks.*

The success of the Programme depends crucially on the implementation of a wide range of structural reforms that will remove the rigidities and bottlenecks behind the economy's decade-long stagnation. *In order to improve cost competitiveness, the Programme envisages measures to reduce dismissal costs and increase wage flexibility at the firm-level, including by suspending the automatic extension of collective agreements while the features of the extension mechanism are redesigned. Housing market regulations will be amended shortly with a view to reducing obstacles to labour mobility. As for tackling entrenched practices distorting competition, a strengthening of the competition framework is underway and progress has been made in liberalising telecommunication markets. Nevertheless, more decisive action is needed to curb rent-seeking in sheltered sectors, particularly in services and regulated professions. The government has also committed to prepare a proposal with a view to correcting excessive rents in the electricity sector and putting the system on a financially sound footing.*

Overall, Portugal has made good progress on a number of fronts, but significant challenges remain. *Achieving the fiscal targets remains essential for the government to regain full market access within the Programme period. To limit the risks to the 2012 fiscal targets a rapid and determined* *implementation of the structural-fiscal measures of the Programme is paramount. At the same time, the government needs to focus on reforms that address Portugal's competitiveness challenges. The 2012 budget does not pursue earlier plans of a 'fiscal devaluation'. This makes it all the more important to adopt rapidly structural reforms in labour and product markets with a view to reducing labour cost, increasing flexibility, lowering entry barriers and tackling rent-seeking. Perseverance and resolve of the government will be required to overcome strong vested interests that stand in the way of reforms.*

The breadth and scope of the reform Programme is testing the administrative capacity of the public sector. *Technical assistance has already been provided in a number of areas. The recently set up Support Group steps up the Commission's involvement in this regard. The Support Group will complement ongoing technical assistance in the fiscal domain by focusing on structural policies and the most effective use of EU structural funds.*

A reassessment of the financing envelope has shown that the Programme projections continue to be valid and that financing is sufficient to cater for the needs of the Portuguese government over the Programme period. *The government's Programme is supported by loans from the European Union amounting to EUR 52 billion and a EUR 26 billion Extended Fund Facility with the IMF. Approval of the conclusion of this review will allow the disbursement of EUR 8.1 billion*[1] *(EUR 5.3 billion by the EU, and EUR 2.8 billion by the IMF) between December 2011 and January 2012.*

[1] The actual amount of the third disbursement is expected to be EUR 100 million higher due to a higher payment by the IMF in euro currency as a result of changes in the euro/SDR exchange rate.

I. INTRODUCTION

1. The report assesses compliance with the conditions of the Second Review of the Portuguese Economic Adjustment Programme. The assessment is based on the findings of a joint European Commission (EC)/European Central Bank (ECB)/International Monetary Fund (IMF) staff mission to Lisbon from 7 to 16 November 2011. In accordance with the Council Implementing Decision amending Implementing Decision 2011/344/EU on granting EU financial assistance to Portugal[2], the mission assessed compliance with the conditionality associated with the third disbursement and progress towards the key objectives of the Programme of sound public finances, restoring competitiveness and putting Portugal's economy back on the path of sustainable growth and job creation.[3]

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

3. Following a positive First Review, 40 per cent of the Programme financing have already been disbursed. In the First Review, the three institutions concluded that the Programme was on track.[4] The new government that took office on 21 June showed a strong commitment to the Programme agreed in May 2011 by reacting swiftly to evidence of fiscal pressures and by pressing ahead with important structural reforms. This allowed the disbursement of EUR 11.5 billion (EUR 7.6 billion by the European Union and EUR 3.9 billion by the IMF), bringing the total disbursement so far to EUR 30.2 billion (of which EUR 19.9 billion by the European Union and EUR 10.3 billion by IMF). The frontloading of the payments is warranted by the Portuguese government's tight cash position and upcoming financing needs.

4. The decisions taken by the Euro area summit on 21 July provide support to the Portuguese adjustment Programme. Euro area Heads of State and Government decided to lower interest rates to close to the EFSF's funding rate, significantly extend maturities, and stand ready to provide financing until market access has normalised. The lending rate margins on the EFSM have since been eliminated and maturities extended, which is estimated to result in savings of EUR 5.2 billion (or 3.0% of 2010 GDP) over the lifetime of the EFSM loans. Discussions on the pricing of the EFSF loans are ongoing and similarly large savings are expected from this source of funding as well.

[2] OJ L 269 of 14.10.2011
[3] The cut-off date for the information included in this report is 25 November 2011.
[4] http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/op83_en.htm

II. ECONOMIC DEVELOPMENTS AND OUTLOOK

MACROECONOMIC OUTLOOK

5. **Real GDP growth in 2011 is likely to be higher than previously anticipated**. Domestic demand showed some resilience in the first semester helped by an unexpected but probably short-lived stabilisation in employment in the second quarter and lower than expected savings on the part of private households. At the same time, imports recorded a sharper fall than previously expected while exports kept their momentum. According to the flash estimate released by Portugal's Statistical Office (INE) on 14 November, real GDP fell by 0.4 per cent in the third quarter over the previous quarter due to a deceleration of export growth and decreases in investment and private consumption. However, recent indicators suggest that better than expected economic developments for the year to date will not carry over to Q4-2011. In particular, the weakening global economic outlook and accelerated fiscal consolidation efforts are likely to act as a drag on growth in the final quarter of this year and beyond. Yet this should not eclipse the better than expected developments to date and real GDP growth in this year is now forecast at -1.6 per cent, which implies an upward revision by 0.6 percentage points compared with the First Programme Review (see Table 1).

Table 1: Projections of main macroeconomic aggregates

	Nov 2011 (2nd review)			Aug 2011 (1st review)			Difference		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
	year-on-year volume change (in per cent)								
Gross domestic product	-1.6	-3.0	0.7	-2.2	-1.8	1.2	*0.6*	*-1.2*	*-0.5*
Private consumption	-3.8	-5.8	-1.1	-4.4	-3.7	-0.5	*0.6*	*-2.1*	*-0.6*
Public consumption	-3.7	-4.1	-2.4	-4.1	-4.6	-3.0	*0.4*	*0.5*	*0.6*
Fixed investment	-11.3	-10.3	0.6	-11.4	-9.0	2.2	*0.1*	*-1.3*	*-1.6*
Exports of goods and services	6.8	3.8	5.5	6.6	6.5	6.5	*0.2*	*-2.7*	*-1.0*
Imports of goods and services	-4.8	-5.0	1.2	-4.9	-2.0	2.2	*0.1*	*-3.0*	*-1.0*
	contributions to real GDP growth (in percentage points)								
Domestic demand excl. inventories	-5.5	-6.5	-1.1	-6.1	-4.8	-0.3	*0.6*	*-1.7*	*-0.8*
Change in inventories	-0.1	0.1	0.1	-0.1	0.1	0.1	*0.0*	*0.0*	*0.0*
Net trade	3.9	3.3	1.6	4.0	3.1	1.6	*-0.1*	*0.2*	*0.0*
Employment (y-o-y change)	-1.0	-1.6	0.2	-1.4	-1.1	0.3	*0.5*	*-0.5*	*-0.1*
Unemployment rate (level)	12.7	13.8	13.6	12.1	12.9	12.6	*0.6*	*0.9*	*1.0*
HICP (y-o-y change)	3.6	3.3	1.3	3.4	2.0	1.4	*0.2*	*1.3*	*-0.1*

Source: Commission services

6. **Economic developments in 2012 will be driven by accelerated fiscal consolidation and a marked further deceleration in exports.** Private consumption is expected to be affected by two countervailing forces: ongoing debt reduction efforts by private households and consumption smoothing amid a sharp drop in real disposable income. The latter is projected to fall by about 6 per cent in real terms due to higher income taxes, lower transfers and the price effects of increases in VAT and excises. As private households are projected to maintain their savings rate at 2011 levels, private consumption should fall in line with disposable income. Fixed investment is forecast to continue its downward trend reflecting the strong decline in domestic consumption and tightening credit supply conditions. Exports are set to continue losing their momentum in the first semester of 2012 and, despite an expected re-acceleration thereafter, will fall to about 4 per cent for the year as a whole. Imports should decline sharply in line with domestic demand. In sum, real GDP is forecast to drop by 3 per cent in 2012, with domestic demand subtracting 6½ percentage points and net external trade contributing 3¼ percentage points to growth. The reduction of the current account deficit should continue at an accelerated pace, with a rapidly shrinking trade deficit being partly offset by a still increasing primary income deficit. The projections of moderate growth in 2013 remain broadly unchanged, with the annual growth rate being dampened by a negative carry-over from 2012.

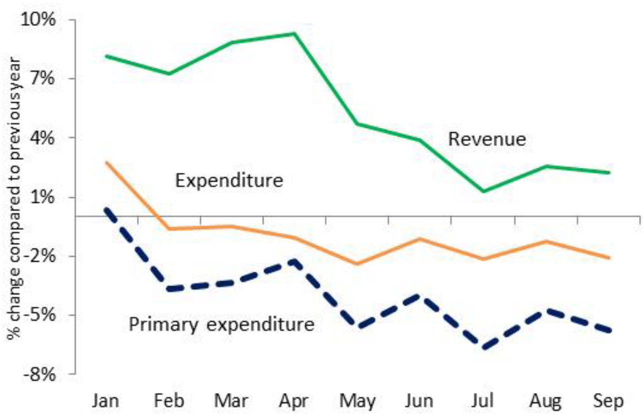
7. Price inflation is being shaped by high energy prices and indirect taxation. Headline inflation in 2011 is developing in line with the Programme projections. HICP decelerated during the summer but rose again to 4.0 per cent in October on account of increases in VAT for natural gas and electricity. Inflation is expected to stay at elevated levels in 2012 following another round of VAT rate hikes on 1 January 2012 but to decelerate markedly thereafter amid continued mark-up compression and downward wage pressure in the context of relatively weak domestic demand and fiscal consolidation. When measured at constant taxes, HICP inflation has been below the euro area average over the past years though this gap has recently narrowed. The short-term outlook for the labour market remains bleak with a recovery in employment projected to take hold only in 2013.

FISCAL DEVELOPMENTS IN 2011

8. The Programme sets a government deficit target of 5.9 per cent of GDP for 2011. Consolidation measures on the expenditure side include an average cut of 5 per cent in government wages, reductions in government payroll lists, cuts in social transfers such as unemployment benefits and family allowances, and a freeze of other social outlays, including old-age pensions. Additional measures were targeted at curtailing spending in the health sector, state-owned enterprises (SOEs) and public investment. Consolidation efforts on the revenue side consisted mainly of an additional increase by 2 percentage points of the standard VAT rate as of 1 January 2011. In addition, revenue projections reflected the carry-over effect of tax hikes introduced in mid-2010. An increase in non-tax revenues through higher prices and fees for services and asset sales was also planned.

9. In cash terms, budgetary execution resulted in a shrinking deficit until September. Revenue has grown at solid rates throughout the year due to the tax hikes referred to above (see Graph 1). Yet that dynamism has declined for several months now on account of declining economic activity and the dissipation of some base effects, notably the tax hikes implemented in mid-2010. At the same time, spending has been declining in nominal terms from the previous year's level, with the decline becoming more pronounced over recent months. The dynamics of falling expenditure is especially noteworthy when primary spending is taken into account since interest payments have grown considerably in recent months. The fall in primary spending is broad-based with cuts in personnel costs and spending on goods and services being important drivers. Cash social transfers have been largely flat after many years of continued high growth. Preliminary data for October suggest a continuation of these trends.[5]

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



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

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

10. The large stock of arrears has continued to increase in recent months.[6] At the end of September, the combined stock of arrears for the general government sector and SOEs classified outside the general government has been estimated at about EUR 5½ billion or 3.2 per cent of GDP (see Table 2). The health sector accounts for almost half of the stock, mostly from incorporated hospitals classified outside the general government sector. Local and regional governments account for another large share. In Q3-2011, arrears increased by EUR 517 million or 0.3 per cent of GDP, again mainly in the health sector and in regional governments.

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

Subsector of the General Government	(1) Jun	Jul	Aug	(2) Sep	(3)=(2)-(1) Δ Sep - June	% total (Sept)
Central Government excluding NHS	312	308	273	313	*1*	6%
NHS classified in General Government	346	407	362	385	*39*	7%
Reclassified entities	58	86	94	99	*40*	2%
Local Government	1 720	1 716	1 720	1 715	*-5*	32%
Regional Government	929	966	983	1 052	*122*	19%
Total	3 366	3 482	3 432	3 563	*197*	65%
Total Consolidated	3 192	3 286	3 275	3 380	*188*	62%
Other entities outside General Government						
Enterprises excluding NHS	13	11	11	8	*-4*	0%
NHS incorporated hospitals	1 718	1 941	1 988	2 051	*333*	38%
p.m.: health sector inside + outside GG	*2 064*	*2 348*	*2 350*	*2 436*	*372*	*45%*
TOTAL	4 923	5 239	5 274	5 440	*517*	
p.m.: percent of GDP	*2.9*	*3.0*	*3.1*	*3.2*		

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

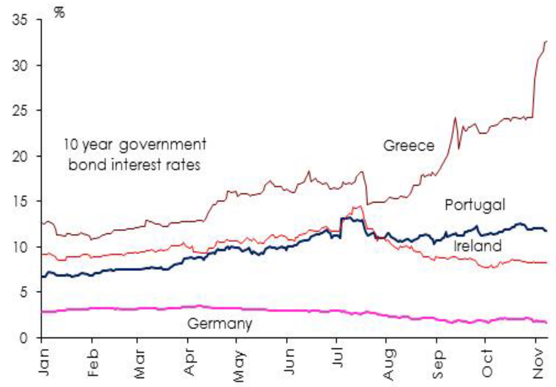
11. In national accounts terms, the government deficit in the first half of 2011 was worse than cash data suggested. The government deficit for the first half of 2011 is estimated at 8.3 per cent of GDP in national accounts terms. The discrepancy with public accounts cash data is due to some standard factors such as time adjustments in the recording of taxes and interest expenditure and the fact that cash accounts cover a smaller public sector perimeter than national accounts (notably, public enterprises are not considered in cash accounts). Among the major factors accounting for this difference were deficits of entities that are not considered in the cash data (around 1 per cent of GDP), unexpected non-recurrent events, namely the recording of the debt of a SOE and of an aborted Public Private Partnership (PPP) agreement both in the remit of the regional government of Madeira by a total amount of 0.7 per cent of GDP, and an increase in the stock of payables. Even taking into account temporary factors, such an outturn pointed to risks of missing the deficit target for the year as a whole.

FINANCIAL MARKETS AND FINANCIAL SECTOR DEVELOPMENTS

12. Portuguese sovereign yields remain at elevated levels while the euro area struggles to contain the debt crisis. Market sentiment towards peripheral economies remains negative with so far limited impact from the European Summits of 21 July and 26 October to solve the sovereign debt crisis. The sovereign debt crisis in the euro area as a whole has spill-over effects on Portugal reflected in continuously high interest rates (Graph 2). At around 12 per cent, long-term interest rates are somewhat below the peaks observed in July 2011 but Portugal has yet to convince international investors, indicating the need for a rigorous Programme implementation.

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

Graph 2: Yields in euro area Programme countries and Germany in 2011

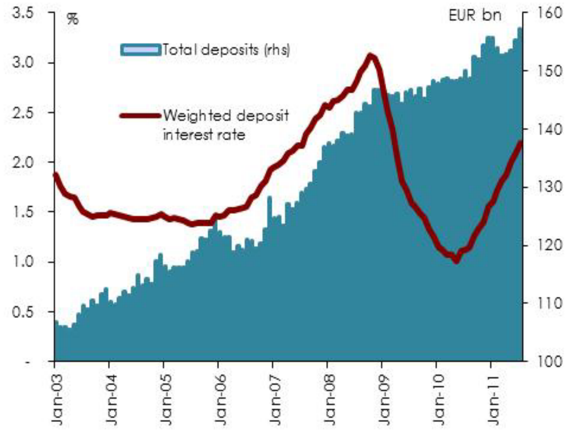


Source: Reuters

13. Banks' tight liquidity situation leads to fierce competition for deposits. Portuguese banks are virtually shut out of the wholesale funding market given the situation of the sovereign. Borrowing from the ECB has stabilised at around EUR 45 billion between June and September 2011, slightly below the peak of EUR 48 billion in April 2011 (Graph 3). Currently there are about EUR 15 billion of unused collateral buffer in the system, unevenly distributed across banks. The search for funds coupled with the aim to lower the loan-to-deposit ratio by increasing the deposit base prompted higher deposit interest rates. The Banco de Portugal, in an attempt to limit competition through deposit rates, has recently introduced restrictions for a remuneration of deposits above 300 basis points of the comparable euribor rate.

Graph 3: ECB Borrowing and deposit developments

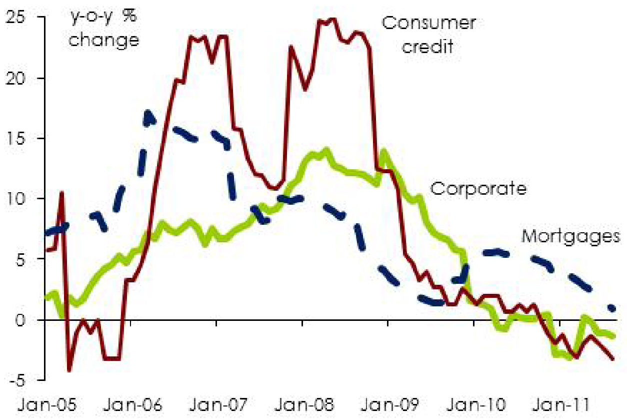
Source: Bank of Portugal, Reuters



Source: Bank of Portugal, Reuters

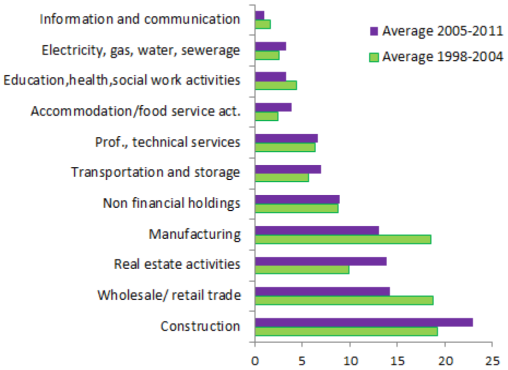
14. Credit to the non-financial sector is stalling. Against the recessionary economic background and banks' tightening credit standards, loans to the non-financial corporate sector of the economy have continued their downward trend (Graph 4). In September, consumer credit has decreased by 5.7 per cent year-on year, which is comparable with the decline in private consumption expenditure. Loans to self-employed have declined by 10.3 per cent on an annual basis, in line with the strong fall in the number of self-employed. Mortgages decreased only slightly in the year to September. This is in stark contrast with the acceleration in bank lending to SOEs, following the strong increase in SOE indebtedness (18.7 per cent in annual terms in August). With external lenders unwilling to expand their exposure to Portugal in nominal terms, this has been increasingly financed through lending by domestic banks. All in all, there are currently no signs of a credit crunch. Subdued bank lending appears to reflect the slowdown in economic activity. However, in view of Portuguese banks' balance sheet constraints, the disproportionate increase in SOEs' borrowing risks crowding out loanable funds to the private sector, especially to SMEs.

15. Credit allocation to the manufacturing sector is a matter of concern. The loans accumulated by non-financial corporations have been directed mainly into construction and real estate activities sectors over the last seven years, while the much more productive manufacturing sector has been able to attract only a relatively low share of total credit. The decrease in the share of the manufacturing sector in total credit has been significant, falling from 19% on average over 1998-2004 to 13% on average over 2005-2011 (Graph 5). The disproportionate increase in the share of credit extended to less productive sectors is puzzling, and it cannot be explained by credit quality. On the contrary, during the crisis, the share of non-performing loans (NPLs) in the construction and real estate activities has increased significantly, while NPLs in the manufacturing sector have not registered such an increase (Graph 6). It appears that the necessary structural shift towards the tradable sectors, away from construction and real estate activities, is a prerequisite for any recovery of bank lending to manufacturing.



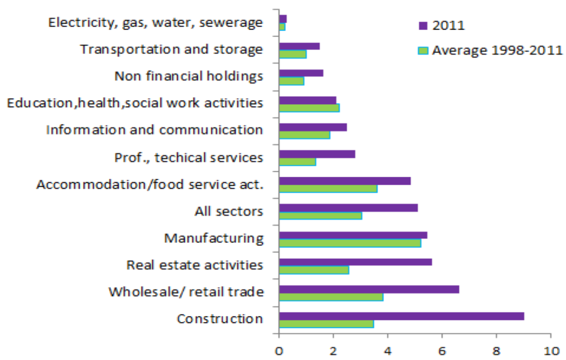
Source: ECB

Graph 5: Loans to non-financial corporations by sector (as a share of total loans, in %)



Source: Commission services, Banco de Portugal

Graph 6: Loans to non-financial corporations by sector – Non-performing loans (as % of total loans in the corresponding sector)



Source: Commission services, Banco de Portugal

16. Low business and consumer confidence weighs on the banks' activity and performance. Net profits in the second quarter have dropped by almost half compared with last year. Profitability continues to be pressured and the return on equity has sharply declined to 4.7 per cent in Q2-2011 (see Table 3) as banks face deteriorating quality of their loan books associated with high impairment charges. Furthermore, the need to meet the deleveraging targets pushes them to remunerate deposits with higher interest rates, weighing on the intermediation margin. Non-performing loans (NPL) edged up in the second quarter by another 50 basis points to reach 4 per cent of total loans according to the national definition, which considers as impaired the overdue amount of the loan. Portugal adjusted its regulation on NPL and published it in its November Financial Stability Report, along with the figures based on the national definition, the NPL statistics according to international best practices. Core Tier 1 own funds continue their ascent towards the key 9 per cent level to be reached by year-end with all banks taking measures to satisfy the new capital requirement.

Table 3: Soundness indicators for the Portuguese banking sector

%	2009Q4	2010QI	2010Q2	2010Q3	2010Q4	2011Q1	2011 Q2
Return on Equity	6.0	7.3	7.6	7.2	6.8	6.4	4.7
Gross Income on Assets	2.8	2.5	2.6	2.6	2.6	2.4	2.4
Cost to Income Ratio	56.8	57.7	57.1	57.2	57.6	59.1	58.1
Non-Performing Loans	3.2	3.4	3.6	3.9	3.2	3.5	4.0
Coverage Ratio	110.1	103.4	98.7	95.6	100.3	94.3	95.9
Capital Adequacy Ratio	10.5	10.3	10.1	9.8	10.3	10.5	10.1
Core Tier 1 Ratio	7.9	8.0	7.8	8.0	8.1	8.4	8.6
Loan-to-deposit ratio	161.5	163.4	166.6	158.4	157.8	156.7	149.2

Source: Banco de Portugal

Note: The Core Tier 1 ratio excludes banks in resolution. The NPL ratio is based on the national definition and reports only the overdue amount

17. The transfer of employee pension funds to the state social security system may represent a significant challenge for the Portuguese banks. Historically, all major Portuguese banks have been responsible for the pension benefits of their employees. Due to the high amounts under management (about EUR 14 billion) of these defined benefit schemes[7] they have been an important source of risk and volatility for the sponsoring banks. The last three years have been particularly disruptive due to the devaluation of assets resulting in major actuarial losses. The ongoing discussion on the banks' pension funds transfer is based on the assumption that the asset transfers will only concern cash and a limited amount of Portuguese government bonds implying numerous asset sales by the banks. The transfer needs to simultaneously achieve a budgetary improvement in national accounts, be compatible with state aid rules and fair in actuarial terms both to the taxpayer and the banking community. Depending on the on the assets to be transferred and their pricing as well as the applied discount rate and mortality tables for liabilities, the tripartite (government, banks and labour unions) technical discussions resulted in a range of estimates of the amount of assets and liabilities to be transferred to the state and the impact on the banks' Core Tier 1 ratio.

18. Banks capital base is under pressure. In addition to the potential impact of a transfer of the banks' pension funds to the social security system, banks' capital needs will be affected by the recessionary environment biting into profits, by the Special on-site Inspections Programme (SIP) which reviews the book value of banks' assets and risk weighted assets, as well as by banks' stress test models. Furthermore, following the decision by the European Council to strengthen the capital buffers of larger banks in the European Union, the re-evaluation of sovereign debt based on market prices under the supervision of the European Banking Authority (EBA) will lead to additional capital needs to be respected by June 2012.

[7] Defined benefit pension plans promising a fixed payment imply that all risks arising from the management of such schemes are borne by the banks. The actuarial risk is the most important whereby benefits will have a higher final cost than the expected return on the pension funds' assets.

III. PROGRAMME IMPLEMENTATION

19. The joint EC/ECB/IMF mission concluded that implementation of the Programme is broadly on track. While budgetary slippages in 2011 are substantial and are being addressed by resorting to one-off measures, this is compensated by a bold and ambitious budget plan for 2012 aiming at achieving a deficit in line with Programme targets by means of solid structural measures, predominantly on the expenditure side. At the same time, the Public Financial Management framework is being strengthened. The need for tackling the lack of budgetary discipline and control of the Autonomous Region of Madeira, which manifested itself dramatically, is now being addressed. The stabilisation of the banking system is proceeding. Banks are taking steps towards meeting the enhanced capital requirements, but might need to resort to the Bank Solvency Support Facility. Improvements in the supervisory and regulatory framework are put in place. Noticeable progress has been made in the area of structural reforms but deadlines have not always been met. Advances are well on track in the labour market, health care, the housing market, judicial reform, and telecommunications. By contrast, reforms in the energy, transport and service sectors are proceeding at a more uneven pace and in a number of cases deadlines in the Memorandum of Understanding (MoU) have been extended. The authorities are fully cooperative with EC, ECB and IMF staff, even though administrative resources are strained. An annex to this report provides a detailed list of the measures taken to meet the conditionality requirement for this Second Review.

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

	Status
Fiscal policy	While the quarterly quantitative performance criterion on the general government cash balance and debt for Q3-2011 were met, structural consolidation measures are insufficient to achieve the budgetary target of 5.9 per cent of GDP in 2011. The target is however planned to be achieved via a one-off operation using banks' pension funds at a larger scale than previously agreed, which would reduce the deficit in national accounts terms. The 2012 budget makes up for the slippages in 2011 and contains bold and ambitious consolidation measures, the bulk of which are on the expenditure side.
Financial sector	Banks have presented funding plans and capital plans on time. Preliminary results of the programme of special on-site inspections to validate banks data on assets were available by mid-October. A buyer has been selected for Banco Português de Negócios (BPN). The acquisition plan has not yet been transmitted to the EU competition authorities.
Fiscal-structural	Public finance management. Implementation of the amended 2011 Budgetary Framework Law is on track, including progress towards medium-term budgeting and the transition to accruals accounting, and a Fiscal Council will be established as planned. The authorities published the Medium Term Fiscal Strategy Document and monthly surveys on arrears. However, the indicative target of non-accumulation of arrears has not been met. Stronger legislation on commitment control will be adopted by the end of 2011. The reports on tax expenditure and fiscal risks still need to be improved. Progress has been made in modernising and merging the tax and customs authorities and a strategic plan to combat tax and customs fraud and evasion for 2012-14 has been completed. An IMF technical assistance mission (the EC also participated in the mission) on streamlining revenue administration took place in September 2011 at the request of the authorities. SOEs. Plans are drawn up to achieve operational balance of all SOEs by end-2012 (with the exception of the railway network operator – REFER). A strategy on how to restructure the SOE sector (excluding the health sector) has been presented inNovember. Additional efforts are necessary to stabilise debt. The strategy expects SOEs' debt to increase by much more than the trajectory set in the 2010 Stability Programme. A particular concern is the long-term debt projection for *Estradas de*

	Portugal. To attain the cost savings targets for 2012, the significant measures already taken must be complemented by reinforcing primary care services and a hospital reorganisation. A clear strategy on how to reduce arrears has not yet been developed, in particular in the SOEs from the health sector which account for a large part of the stock. PPPs. A report on all 36 PPPs and 24 concessions, projecting future cash flows and assessing possible risks, has been completed by the authorities. The deadline for the launch of a study assessing the costs and benefits of renegotiating these PPPs and concession contracts has been postponed by one quarter. Health. Tax allowances for health care were reduce by two thirds. Electronic prescription was made compulsory. The law on compulsory prescription by active substance has been approved by Parliament in generality. Measures aimed at reducing the operational cost of hospitals by EUR 200 million have been presented.
Reform of goods and services markets	Labour market. A preliminary law proposal to revise the Labour Code was presented. The proposal fully meets the requirements of the MoU. Preliminary draft legislation on a fund to finance part of workers dismissals based on individual accounts has been presented. Energy. Steps to improve the function of the Iberian gas market have been taken. A report reviewing consistency and possible overlapping of energy policy instruments has been presented. Telecommunications. Mobile termination rates have been decreased. Plans for a further decrease in 2012 were announced in September. The requirement to introduce standardised contracts, making explicit the right to free cancellation, in fixed communications was not observed Transport. A strategic transport plan to rationalise, better integrate and increase competition in the sector has been presented, but important elements are missing. The rail regulator has been established but its independence and staffing need to be reinforced. Plans for network rationalisation and achieving the operational balance of the infrastructure manager have been presented. Services and professions. Measures to liberalise access and exercise of regulated professions, to reduce their numbers and eliminate unjustified reserves of activity have been postponed. A roadmap for the introduction of Points of Single Contact (PSC) has been prepared and information is now is available online but further work is needed to improve clarity of information and to ensure that procedures are available online.
Reform of framework conditions	Housing market. Guidelines on the urban rental reform and draft legislation on simplifying administrative procedures for renovation works were adopted by the Council of Ministers. A study to review the framework for the valuation of housing has been presented and changes to the current legislation will be adopted by end-December. Judicial system. Measures to expedite the resolution of the court backlogs have been completed. The law on Arbitration has been approved by Parliament.
Data submission	Requirements under the Programme have been observed. Work is ongoing to improve further data submission.

FISCAL POLICY

Budgetary execution in 2011

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

21. The Second Review mission reconfirmed the finding of the preceding mission that in the absence of additional measures the 2011 budget deficit would exceed the Programme target of 5.9 per cent of GDP. Already in August, deviations from the Programme plans had been found due to expenditure overruns and non-tax revenue underperformance. Furthermore, non-recurrent deficit-increasing factors were identified, namely the recording of the debts of a financially-troubled SOE and of a failed PPP agreement both in the remit of the Madeira regional government. Additional and previously non-accounted costs related to the planned sale of troubled bank BPN increased the budgetary shortfall further (see Table 5).

22. The authorities had reacted to the early signs of budgetary slippages and adopted additional measures. In late June, when the data for the first quarter pointed to a higher-than-expected deficit, a one-time tax surcharge on personal income was introduced, which is expected to yield 0.5 per cent of GDP in 2011. Moreover, the authorities increased the VAT rate on electricity and natural gas from 6 to 23 per cent with effect from 1 October, which is expected to yield revenues of 0.1 per cent of GDP in 2011. Efforts to offset slippages that became known later were much more limited.

23. The information provided during the Second Review mission points to an underlying shortfall, i.e. before any correcting measures, of the order of 2¼ per cent of GDP on an ESA95 basis and 2 per cent when the cost of selling BPN is excluded.[8] This represents a major revision compared with the First Review, when the equivalent figures were found to be 1.3 and 1.1 per cent, respectively. A number of factors contributed to the further worsening, notably additional slippage in capital spending and higher interest expenditure. Capital revenues have been revised downwards and the costs related to the SOE and the PPP in the remit of the regional government of Madeira and the sale of BPN mentioned above have been revised upwards. Sales of concessions that had been planned in the original 2011 budget have been downward revised after the First Review mission. A plan for additional sales of concessions that was proposed in August as a stopgap has been abandoned. Furthermore, a number of offsetting factors and corrective measures that had been put forward at the time of the First Review mission are now estimated to have a lower impact. In particular, tax revenue is no longer projected to exceed the Programme projections. Finally, the projected under-execution of investment plans is no longer expected.

24. The government plans to achieve the 2011 target by means of a large pension fund transfers from banks to the government sector. No consolidation measure of a permanent nature has been taken such as the frontloading into 2011 of consolidation measures planned for 2012. Whereas a limited use of pension funds to exceptionally cover the remaining fiscal gap was already announced at the time of the earlier review, these transfers are now expected to be much larger in order to close the fiscal gap.

[8] The budgetary costs of bank support measures under the Programme are accounted for in the budget deficit under ESA 95 rules but are not taken into account in the definition of the budget deficit to be considered for the fulfilment of Programme's targets, following the provisions of the TMU. This exclusion applies to the costs related to the sale of the troubled bank BPN.

Table 5 - Projected 2011 budget shortfall

				EUR bn	% of GDP
First review	**Budget deviation**		(1)	**-2.3**	**-1.3**
	of which: short-falls	Current non-tax revenue	(2)	-0.7	-0.4
		Primary expenditure overruns	(3)	-1.1	-0.6
		Other capital spending, incl. costs with SOEs	(4)	-0.2	-0.1
		Debt assumptions of SOE and PPP by Madeira gvt	(5)	-0.5	-0.3
		Gross costs of selling BPN	(6)	-0.5	-0.3
	windfalls	Tax revenue over performance	(7)	0.4	0.3
		Lower investment	(8)	0.2	0.1
	Offsetting measures		(9)	**1.7**	**1.0**
	of which:	PIT surcharge	(10)	0.8	0.5
		VAT increase on energy	(11)	0.1	0.1
		Transfer of pension fund of BPN	(12)	0.1	0.1
		Sales of concessions	(13)	0.6	0.4
	Fiscal gap identified in 1st Review		(14)=(1)+(9)	**-0.6**	**-0.3**
Second review	**Additional budget deviation compared with first review**		(15)	**-1.6**	**-1.0**
	of which:	Interest expenditure overruns	(16)	-0.2	-0.1
		Capital revenue	(17)	-0.2	-0.1
		Lower sales of real estate assets	(18)	-0.3	-0.2
		Revisions of shortfalls already foreseen in 1st Review	(19)	-0.3	-0.2
		Revision costs of selling BPN (line 6)	(20)	0.0	0.0
		Reversal of Tax revenue over performance	(22)	-0.5	-0.3
		Reversal of Lower investment	(23)	-0.2	-0.1
	Adjustments in offsetting measures		(24)	**-0.9**	**-0.5**
	of which:	Downward revision of concession revenues	(25)	-0.9	-0.5
		Revision of transfer of pension fund of BPN (line 12)	(26)	0.0	0.0
	Additional gap identified in 2nd Review		(27)=(15)+(24)	**-2.6**	**-1.5**
Total	**Total budget Shortfall before corrective measures 1st and 2nd Review**		(28)=(1)+(15)	**-3.9**	**-2.3**
	Total budget Shortfall excluding BPN costs		(29)=(28)-(6)-(20)	**-3.5**	**-2.0**
	Total offsetting measures		(30)=(9)+(24)	**0.7**	**0.5**
	Total fiscal gap at the end of the 2nd Review		(30)=(14)+(27)	**-3.2**	**-1.8**
	p.m.: Total fiscal gap at the end of 2nd Review excl.BPN costs		(31)=(30)-(6)-(20)	**-2.7**	**-1.6**

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

25. A significant part of the slippage in 2011 is of a recurrent nature, which will carry over into 2012, whereas the pension funds transfer does not constitute a structural consolidation measure. Offsetting these effects will therefore require stronger consolidation efforts in 2012. It is particularly important that the primary spending slippages recorded in 2011 do not become permanent and that the carry-over of negative developments in 2011 is offset by permanent measures.

Budgetary execution in 2012 and beyond

26. The 2012 Budget aims at a government deficit of 4.5 per cent of GDP as set in the Programme and includes consolidation measures worth 5¼ per cent of GDP when compared

with 2011 (and over 6 per cent of GDP when compared with a no-policy-change scenario)[9]. This compares with an effort of 3 per cent of GDP agreed under the EU/ECB/IMF Programme. The substantially stepped-up consolidation efforts for 2012 are the consequence of the worse-than-expected underlying fiscal position resulting from budgetary execution in 2011 and the projected sharper contraction of economic activity (see also Table 6). Expenditure-reducing measures account for most of the effort (mainly from wage and pension cuts), with additional contributions from revenue-raising measures (higher indirect taxes). The main consolidation measures are the following:

- **Public wages and employment:** public sector wages will be reduced by suspending the 13th and 14th monthly salary payments for those workers with monthly salaries of EUR 1,000 or more, and suspending on average and in a progressive way the equivalent of one of these two salaries for those workers with monthly salaries between the minimum wage of EUR 485 and EUR 1,000.[10] In addition, permanent staff will be reduced by 2 per cent (full-time equivalents) and the number of temporary positions will be cut. To support these objectives, binding quantitative targets for staff reductions per main area of the administration will be defined by December 2011. No promotions will take place, the costs of health benefits schemes will decline and some additional savings are projected to come from the public administration restructuring.
- **Pensions and other transfers:** expenditure will be cut by reducing pensions along the rules applied to public wages.[11] Eligibility criteria for other cash social transfers will be tightened.
- **Health:** budgetary costs in this area will be reduced thanks to a broad range of measures.
- **SOEs:** savings will come from reducing operating costs by 15 per cent relative to 2009 levels; tightening compensation schemes and fringe benefits and rationalising investment plans for the medium term. Transfers and subsidies to SOEs classified outside the perimeter of the general government will also decline and SOEs will increase their revenue from market activities, including by raising tariffs and prices.[12]
- **Education:** reducing costs by rationalising the school network; centralising procurement; reducing and rationalising transfers to private schools in association agreements and making a more intensive use of EU funds to finance activities in the area of education.
- **Capital expenditure:** prioritising investment projects and making more intensive use of funding opportunities provided by EU structural funds. The increase in EU co-financing rates for countries under an Economic Adjustment Programme and a re-programming of EU funds in the context of the current National Strategic Reference Framework (NSRF) will give an important contribution to this end.
- **Local and regional governments:** transfers to this subsector will be reduced.
- **Central administration and other public bodies:** increasing efficiency, reducing and eliminating services that do not represent a cost-effective use of public money. Costs in other public bodies and entities will also be reduced.

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

[10] The discussion in Parliament of the 2012 Budget Law has led to a change in the salary threshold to EUR 1,100, for workers with monthly salaries between EUR 600 and EUR 1,100. The change has been done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital gains and investment income (e.g. dividends and interest payments) from 21.5% to 25%.

[11] The discussion in Parliament of the 2012 Budget Law has led to a change in the pension threshold to EUR 1,100 for suspending both the 13th and 14th monthly payments, and to between EUR 600 and EUR 1,100 for implementing the progressive suspension. The change has been done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital gains and investment income (e.g. dividends and interest payments) from 21.5% to 25%.

[12] This was not included in the budget as an explicit measure, but it was agreed during the review mission to treat it as such.

- **Indirect taxes:** VAT revenues will increase by shifting goods and services to higher VAT rates. An important carry-over will come from the increase in the VAT rate applied to natural gas and electricity introduced in October 2011. In addition, excise taxes will be raised on electricity, car sales, tobacco and alcohol products.
- **Personal income taxes:** capping and cutting substantially tax allowances, notably for health expenditure, mortgages and rents; harmonising personal income tax deductions applied to pensions and labour income; introducing a surcharge on the income of the top tax bracket and increasing the tax rate on capital gains. However, personal income tax revenues will decline in 2012 given the loss of revenues as a result of the reductions in public wages and pension incomes and the dissipation of the one-time surcharge on personal income introduced in 2011.
- **Corporate taxes**: abolishing all reduced corporate income tax rates and curbing tax benefits; limiting the carry forward of deductions of losses in previous years; increasing the surcharge on corporate profits.
- **Property taxes:** reducing substantially the temporary exemptions for owner-occupied dwellings acquired as of 2012 and increasing rates.

27. The pace of deficit reduction in 2012 is somewhat curbed by a number of factors. In particular, large deficit-reducing one-off measures taken in 2011 such as the transfer of pension funds from banks to the government, the large increase in interest expenditure and the fall in economic activity all work to mitigate the impact of the sizeable consolidation package put forward with the 2012 budget (see Table 6).

28. The authorities presented at the end of August a 4-year fiscal strategy (2012-15) which confirms the Programme commitments to reduce the deficit to 3 per cent of GDP by 2013 and further to 0.5 per cent of GDP by 2015. In addition, the strategy aims at the needed deepening of fiscal consolidation beyond the Programme horizon leading to a government deficit close to balance and a declining government debt ratio. However, details of the fiscal consolidation plans for 2014 and 2015 are still to be disclosed. Moreover, a strategy to deal with the large stock of arrears has not yet been finalised (see below).

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

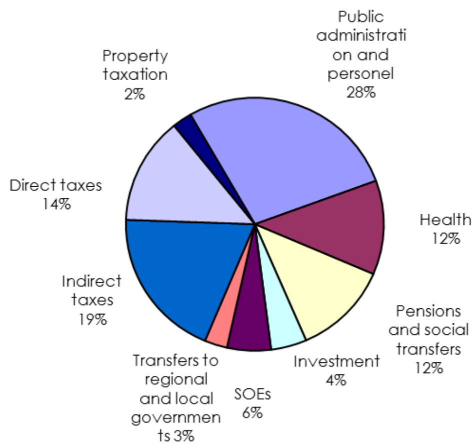
(+) means balance-improving impact; (-) means balance-reducing impact	% of GDP
2011 balance (estimate)	**-5.9**
Primary balance drift in 2012	-1.2
Change in interest expenditure	-0.7
Dissipation of one-offs and non-recurrent effects from previous year	-2.0
New consolidation measures	5.3
2012 balance (target)	**-4.5**
Primary balance drift in 2013	-0.1
Change in interest expenditure	-0.3
Dissipation of one-offs and non-recurrent effects from previous year	-0.1
New consolidation measures	2.0
2013 balance (target)	**-3.0**

Note: Balance in year t equals balance in year t-1 plus nominal primary balance drift in year t, plus the impact of the change in interest expenditure in year t, plus the impact of the dissipation of the one-offs and non-recurrent measures from year t, plus the impact of new consolidation measures in year t.
The Primary Balance Drift includes the change in the balance level that would take place without discretionary measures. It includes the impact of economic activity on the balance and the structural increase in expenditure in real terms, e.g., the increase in pension expenditure.

29. The fiscal target of 3 per cent of GDP for 2013 remains valid. The large consolidation effort in 2012 constitutes a good basis for the achievement of a deficit of 3 per cent by 2013. In addition, measures of some 2 per cent of GDP as envisaged in the original Programme will be taken. To a large extent, they are the continuation and deepening of the consolidation measures already considered for 2012, notably with a view to broadening tax bases and reducing primary expenditure. Whereas part of the additional effort in 2012 described before is a frontloading of measures originally foreseen for 2013, the commitment to stick to the 2 per cent of GDP consolidation effort in 2013 remains in place (Graph 7).

30. The mission concluded that, overall, fiscal consolidation is proceeding. The government is reacting effectively to the slippages that occurred earlier in the year. While the response is based to a large extent on a one-off measure, there is a clear determination to base future consolidation on structural measures, as witnessed by the large consolidation package included in the 2012 Budget plan. The budgetary targets in the Programme for 2012 and 2013 are confirmed at 4.5 per cent and 3 per cent of GDP, as is the commitment to move towards a balanced budget position in the period after the Programme. This path is in line with the Council Recommendations under the ongoing Excessive Deficit Procedure.

Graph 7: Consolidation measures in 2012 and 2013 per area (per cent of GDP)



Source: Commission services

31. Debt projections point to a stabilisation of the debt ratio by 2013 and a fall afterwards. Government debt is projected to peak at around 118 per cent of GDP in 2013 and gradually decline thereafter. The spikes in the debt ratio in 2011 and 2012 are due to accumulation of reserves under the Programme's Bank Solvency Support Facility in case the government plays an active role in augmenting banks' capital (see Box 1).

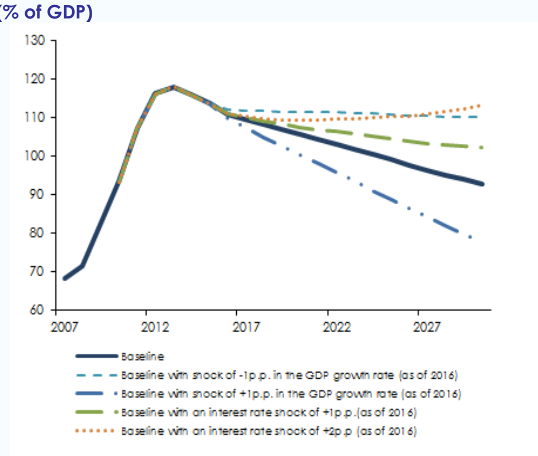
FISCAL DEVALUATION

32. The 2012 budget does not contain an explicit fiscal devaluation, but government plans provide substitutes. Due to the large fiscal consolidation for 2012 an additional substantial tax shift in the same year would have carried substantial risks in terms of implementation and budgetary planning. Nevertheless, efforts to restore competitiveness remain at the centre of the Economic Programme. The ongoing labour market reform measures, specifically on the wage bargaining framework, the increase in the weekly working time and the reduction in bank holidays, more flexible working time arrangement or the reduction in severance pay, are likely to bring about a substantial reduction in unit labour costs over time (Box 3). This is complemented by the efficiency impact of the significant legislative changes in the regulatory framework that facilitate market entry and increase efficiency in the economy. Both structural reforms in labour and product markets and improvements in the regulatory framework will help attract investment from abroad, which in turn is likely to have a positive impact on productivity. Depending on developments in the economy, the issue of fiscal devaluation might need to be revisited in the context of the 2013 budget.

Box 1: Government debt and fiscal sustainability in Portugal

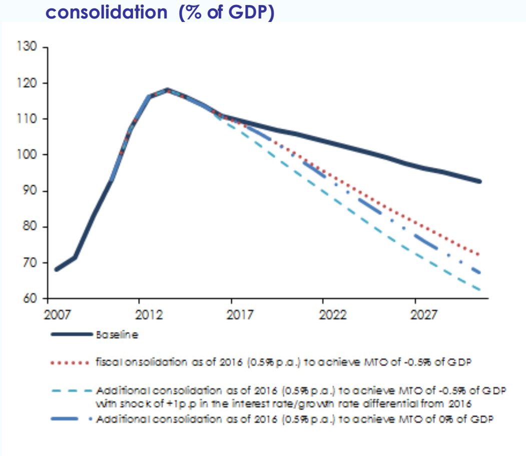
Under the Programme scenario, government debt is projected to peak at 118 percent of GDP in 2013 before starting a gradual decline. The baseline long-term calculations shown below incorporate the Programme scenario up to 2015. Thereafter, it is assumed that: (i) the structural primary fiscal balance (i.e., the government balance adjusted for interest payments and for the effect of the cycle) remains unchanged at a surplus of 3.5 percent of GDP; (ii) nominal interest rates are 5 percent; (iii) nominal GDP growth stays close to 4 percent (2 percent growth in volume terms plus 2 percent inflation); (iv) ageing costs are taken into account according to the projections in the Commission's 2012 Ageing Report; (v) the expected fiscal impacts of PPPs and bank recapitalisation costs of EUR 12 billion over the Programme period are factored into the analysis.

Developments in the debt ratio – macroeconomic risks (% of GDP)



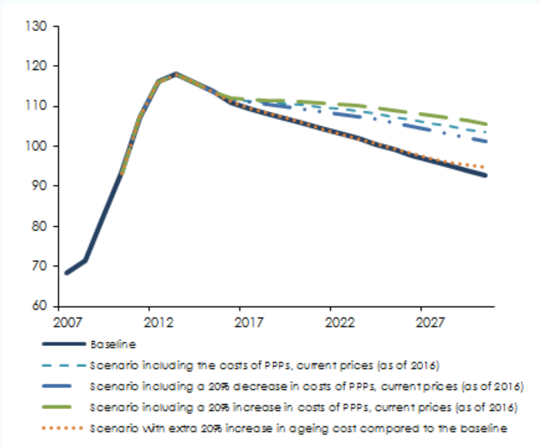
Source: Commission services

Developments in debt ratio – additional fiscal consolidation (% of GDP)



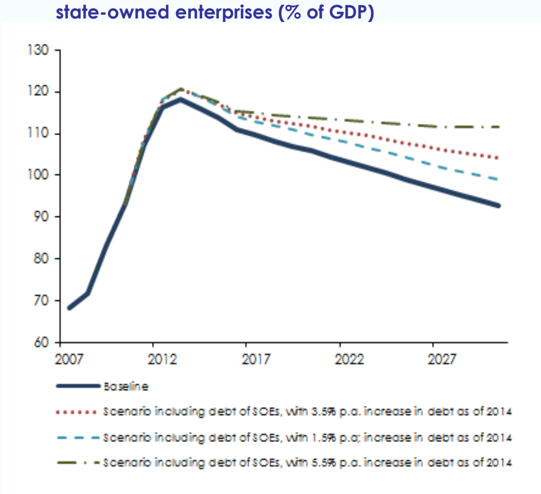
Source: Commission service

Developments in the debt ratio – fiscal risks related to ageing and PPPs costs (% of GDP)



Source: Commission services

Developments in debt ratio – fiscal risks related to state-owned enterprises (% of GDP)



Source: Commission service

Full observance of the Programme plans ensures a gradual decline of the debt ratio over the longer term. However, for a large number of years the debt ratio would remain higher than before the current crisis. The graphs above also present a sensitivity analysis. A lower GDP growth rate or a higher interest rate on maturing and new debt by one percentage point would essentially jeopardise the reduction of the debt ratio. Conversely, higher GDP growth or continued fiscal consolidation beyond the Programme horizon can result in visibly lower debt-to-GDP ratios. Higher ageing costs do not seem to affect the Programme scenario for the debt reduction, while higher PPPs costs would slow significantly the debt reduction rate. Fiscal risks stemming from state-owned enterprises (SOEs) outside the general government are still a matter of concern. An increase in SOEs debt of 5.5% p.a. from 2014 would significantly slow down the decrease in debt.

FISCAL STRUCTURAL REFORMS

Fiscal policy framework

33. The authorities have implemented reforms aimed at improving fiscal reporting and strengthening the budgetary process. The authorities published the Medium-Term Fiscal Strategy Document and monthly surveys on arrears, thus observing two structural benchmarks under the Programme. However, given the 2011 slippages, stronger commitment controls are needed. To this aim, by end-2011, draft legislation will be adopted to review the methodology for ensuring a tight monitoring of the 2012 budget execution, notably by starting to control commitments against the availability of funds.

34. The results of the survey of arrears of the government sector and of SOEs classified outside the government sector have been published. However, the strategy to settle arrears has not been completed. The completion of the strategy for the validation and settlement of arrears for the entities inside the general government as well as for SOEs classified outside the general government has been postponed for the last quarter of 2011. The authorities have committed to include, in this strategy, a roadmap setting out how and when the stock of arrears will be stabilised. Moreover, various options of settling arrears will be explored, providing appropriate incentive mechanisms including the potential of rebates for early settlements and rewarding entities that no longer accumulate new arrears. Given that the indicative target of non-accumulation of arrears was missed in the third quarter of 2011 an expeditious implementation of the strategy needs to be a priority.

35. Although the authorities have completed an inventory of tax expenditures, the tax expenditures report has not been delivered for the 2012 Budget. Exceptionally this year, the annual report on tax expenditures will be completed by Q1-2012 in cooperation with EC and IMF staff. This tax expenditure report will be published from 2012 each year as part of the budget, in line with international best practices. The report will cover central, regional and local administrations.

36. The fiscal risks report included in the 2012 Budget needs to be improved. The authorities committed to publish an enhanced version by Q1-2012 in coordination with EC/IMF. Thereafter, the fiscal risk report will be submitted annually together with the budget proposal. Moreover, fiscal transparency will be enhanced by publishing the level of State guarantees in the monthly budget execution bulletin. Consolidated general government cash-based reports will be published starting February 2012.

Revenue Administration

37. The authorities have made progress in modernising the tax administration and preparing the merger with the customs administrations. Plans to create a new tax authority – Autoridade Aduaneira e Tributaria - are advancing well and the new entity will be operational on 1 January 2012.

In 2012, central and support functions will be merged and a full-fledged large taxpayers unit will be established. The number of branches will be reduced by 20 per cent. The reform will continue to be deepened in 2013 by introducing a business function-type structure and by reducing the number of offices by an additional 20 per cent. At the request of the authorities an IMF/EC technical assistance mission took place in September 2011 to provide advice on streamlining revenue administration and strengthening taxpayer compliance management. A comprehensive assessment of the IT systems has been presented. Based on this assessment, the authorities will prepare an IT Strategic Plan for the new tax authority by December 2011 to address weaknesses.

38. The strategic plan to combat tax and customs fraud and evasion for 2012-14 has been completed. Additional efforts will be made to curb non-compliance, focusing attention on high-evasion sectors and taxpayers. E-invoicing mechanisms to facilitate compliance and improve control will be adopted in 2012.

PPPs, SOEs and privatisation

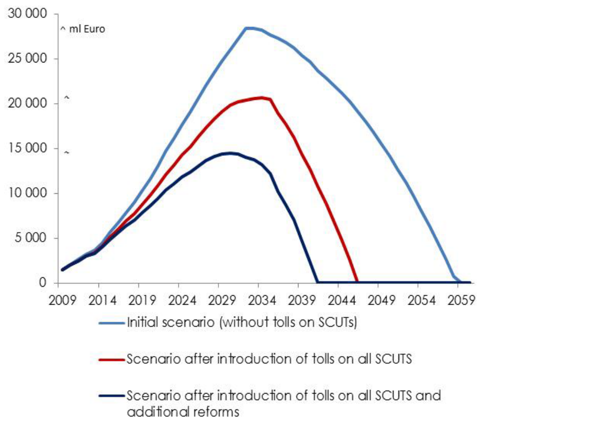
39. Public-Private Partnerships (PPPs) in Portugal are projected to impose a significant fiscal burden in the next 20 years. Going beyond the Programme obligation to assess the 20 most significant PPP contracts, the authorities provided a report of all 36 PPPs and of 24 concessions that are under the responsibility of the central government, projecting future cash flows and assessing possible risks. The report shows that annual net spending pressures are rapidly increasing from EUR 475 million in 2008 to EUR 1.5 billion in 2011. PPP-related expenditure is expected to peak at more than EUR 1.4 billion between 2014 and 2017 and to fall gradually thereafter, reaching levels of below EUR 1 billion only after 2021. Most of these costs arise from 22 PPPs in road transport and 10 PPPs in the health sector. Regarding road transport PPPs, some measures have already been taken to strengthen their revenues (see below).

40. The authorities have postponed by one quarter the deadline for recruiting an international accounting firm assessing the costs and benefits of renegotiating these PPP or concession contracts. The government now plans to launch a tender for this study by end-2011. The authorities remain committed, at all administrative levels, not to enter into any new PPP agreements before the results of this study are available. In addition, the government is putting in place a strengthened legal and institutional framework to be able to assess fiscal risks before engaging in PPPs, concessions and other public investments, as well as for monitoring their execution. Moreover, the 36 PPP contracts will be published on the internet and the annual PPP and concessions report further enhanced.

41. State-owned companies (SOEs) remain a serious concern for the success of the Programme, but plans are drawn up to achieve operational balance by end-2012. Many SOEs have been persistent loss-makers and contributed negatively to public sector finances. SOEs have accumulated large stocks of debt, which is often explicitly or implicitly guaranteed by the government. In addition, SOEs, particularly those in the hospital sector, account for a large part of the stock of arrears. In November 2011, two months later than foreseen in the Programme, the government presented a comprehensive strategy on how to restructure the SOE sector under the responsibility of the central government[13] with the aim to (i) bring SOEs with commercial activities to operational balance by end 2012 (with the notable exception of the railway network operator - REFER); (ii) close or privatise firms providing non-essential services or producing goods; and (iii) deal with the specific problems of the heavily indebted transport sector companies. More detailed plans on strengthening revenues and cutting operational costs were presented for the transport sector (see below on transport).

[13] The authorities have prepared a separate report for SOEs in the health sector.

Graph 8: Scenarios on the debt of Estradas de Portugal



Source: IMF

Note: 'SCUTs' are motorways on which the user does not pay a toll, while the government pays an amount to the private investor depending i.a. on the number of users

42. Growth in SOE indebtedness has been excessive and additional efforts are necessary. In 2010, the debt of SOEs within general government increased by 12.6 per cent (from EUR 18.5 to 20.3 billion) and of SOEs outside general government by 9.7 per cent (from EUR 13.8 to 15.5 billion). The strategy report expects SOEs' debt to continue to increase by 10.4 per cent in 2011, and sets targets of 8.5 per cent in 2012 and 4.5 per cent in 2013 to take into account the costs of debt service, severance payments related to restructuring and the conclusion of ongoing investment projects. This deviates significantly from the ceilings set in the 2010 Stability Programme of 5 per cent in 2012 and 4 per cent in 2013. A particular concern is the long-term debt projection for Estradas de Portugal which, if not addressed by additional measures to increase revenues and reduce costs, could peak at more than EUR 20 billion in 2035 (Graph 8).

43. The large financing needs of SOEs risk crowding out private sector credit in a context of deleveraging by banks. Many SOEs are unable to roll over debt with private banks, with foreign banks in particular withdrawing their funding, so that financing is being granted by the government. As the government issues T-bills for this purpose, which are mostly bought by domestic banks, this increases the T-bills exposure of the banking sector. On the other hand, this provides an opportunity for the government to get better control of SOEs' debt management within the limits set by the 2012 budget.

44. The government is pursuing its privatisation programme. In November 2011, four bidders out of a shortlist of 6 were selected for the electricity company (EDP), and the second phase will be completed before end-2011. Even if the financial closing of this privatisation may only occur in January 2012, the authorities expect some down-payment from the preferred EDP bidder still in 2011. As for the energy network company (REN), the bidders will be selected and the second phase of the privatisation initiated before end-2011 so that the transaction can be completed by early 2012. Bidders for both privatisations include large international strategic investors. The sale of GALP and the small remaining stake in REN on the free market have been delayed until market conditions improve. The complete sale of the railway freight branch (CP Carga) will be launched by mid-2012. The privatisation process for Aeroportos de Portugal (ANA) and the national air carrier (TAP) will be completed in late 2012. The privatisation of Correios de Portugal (CTT) will be launched in the second half of 2012 in order to complete the sale in early 2013. The partial sale of a public television channel (RTP) and Águas de Portugal (AdP), and concessions for transport operators in Lisbon and Porto upon completion of restructuring of the public transport firms in these cities are being considered. The direct sale of Caixa Geral de Depósitos' (CGD) insurance arm (Caixa Seguros) to a final buyer is expected to take place in 2012.

45. The withdrawal of government intervention in company management must be permanent. It is important to guarantee that recent steps taken to liberate the functioning of markets from undue interference of the State by eliminating Golden Shares and special rights by the State are not reversed through other means. The government will therefore have to ensure that a forthcoming Decree Law implementing article 27A of the privatisation framework law dealing with strategic assets fully complies with Community law and the MoU.

46. Overall, the privatisation plan targets frontloaded proceeds of about EUR 5 billion until the end of the program, with revenues of EUR 600 million expected in 2011 and EUR 4 billion in 2012. While these amounts may seem to indicate a lack of ambition, they partly reflect the limited amount of net assets remaining in the hands of the State that can be sold without prior restructuring following significant privatisations in the last 15 years (see Table 7). Moreover, *Parpública,* the state holding company that owns many of the assets foreseen for privatisation, holds at the same time significant liabilities in its books. Hence, while the government is currently preparing a strategy for this company, which includes the possibility of winding it down or consolidating it with the general government, net revenues from the sale of its assets will be small, if any.

Table 7: Proceeds from privatisation 1995-2010

%	1995-1999	2000-2005	2006-2010	1995-2010
total in billion EUR	14.018	5.926	3.799	23.743
average in % of GDP	**2.7**	**0.7**	**0.5**	**1.1**

Source: Ministry of Economy

Regional and local finance

47. More comprehensive information on local and regional SOEs only became available during the review mission. The Programme had required regional and local SOEs to be included in the comprehensive SOE strategy document. A report prepared for the government by an external Working Group on local SOEs identified 466 entities concentrated in cultural and sports activities (16.5 per cent), water distribution and treatment (13.7 per cent), and scientific and technical activities (10.7 per cent). These local SOEs have more than 14,000 employees and total liabilities of EUR 2.5 billion. In November 2011 a law was adopted which defines the information obligations of local SOEs and suspends the right to create new SOEs or the acquisition of company stakes by local governments. The Autonomous Region of Azores (RAA) participates in 53 SOEs, mainly in energy, transport and health, of which in 27 as a majority stakeholder. They have about 5,900 employees and close to EUR 1 billion of financial liabilities. The RAA government has launched a process of restructuring, i.a. to reduce its stake in 20 SOEs.The SOE sector of the Autonomous Region of Madeira (RAM) consists of 51 entities, of which three are highway concessions. These 48 firms with more than 9,100 employees are important players in nearly all main economic activities in RAM, including real estate, sports, and regional development firms. In mid-2011, these 48 firms reported a debt of close to EUR 2.5 billion (of which EUR 1.2 million guaranteed by RAM).

48. The Autonomous Region of Madeira (RAM) has caused a significant drag on the Portuguese public finances that needs to be urgently addressed. Unforeseen losses of a health SOE and a road PPP contribute by more than EUR 500 million (0.3 per cent of GDP) to the general government deficit of Portugal in 2011. Unreported liabilities assumed but not paid of EUR 1.1 billion, which surfaced in the form of debt rescheduling agreements, caused a measurable upward revision of Portugal's general government deficit in 2010. The total debt of the RAM public sector (including SOEs) is around EUR 6 billion (varying according to definition) which exceeds Madeira's GDP and will be difficult to service in the next years, as it amounts to about six times RAM's budget revenues in 2010. This is the result of extremely weak public finance management, a lack of commitment control s, practices to conceal the adoption of new debt, and an excessive provision of public service at prices far below cost recovery levels. The central government is preparing a financial arrangement with RAM which should be finalised by the end of the year. The responsibility for compliance with the measures and objectives laid down under the arrangement will be on RAM. This arrangement will comprise a debt sustainability analysis and will be designed similarly, and consistent with, the financial assistance program between the Republic of Portugal and the EC/ECB/IMF. As a

BOX 2: RISKS FROM MADEIRA'S PUBLIC FINANCES

Madeira's budget provided several negative surprises over the year which contributed to Portugal's difficulties in meeting the deficit target for 2011. The IGF report points to the following problems:

(1) A weak budget process: The budget is cash-based and has no multi-annual planning. There is a systematic overestimation of revenues by up to 30% with the effect that budget outturn mostly remains far below the planned budget. Expenditure plans are based on a bottom-up aggregation of needs rather than on a proper assessment of affordability and prioritisation. The absence of adequate commitment control resulted in the build-up of arrears (i.e. overdue liabilities) which is estimated at EUR 918 million in November 2011. EUR 1.1 billion of 'liabilities assumed but not paid' ('encargos assumidos e não pagos') that had been subject to rescheduling (suppliers cashed them in with banks as 'factoring' or agreed directly with the government to reschedule) had not been reported as debt, even though there is a legal obligation to report liabilities for statistical purposes. The National Statistical Institute (INE) and the Bank of Portugal (BdP) in September 2011 reported the impact on the general government deficit of these liabilities to Eurostat as given in the table below. In an ad hoc visit to Portugal, Eurostat confirmed the assessment of INE and BdP on the underestimation of expenditures and liabilities in recent years. This proved to be at the origin of important data revisions for Portugal in the EDP notification on 30 September 2011.

Increase in Portugal's deficit due to revisions in the accounts of Madeira

	2008	2009	2010
EUR millions	139.7	58.3	915.3
as a percentage of GDP	0.08	0.03	0.53

Source: INE

(2) A significant build-up of debt and other liabilities: According to the Regional Finance Law the debt service must not be higher than 22.5 per cent of the current revenue of the previous year less State transfers (for Madeira the limit was increased to 25 per cent from 2010-2013 because of damages caused by a storm in early 2010). However, the central government can set a debt limit which supersedes this debt rule; it was set to a zero increase in 2011. The government of RAM circumvented this rule, which applies only to 'direct' debt, by increasing instead the debt of SOEs or giving government guarantees. Some of the SOEs, particularly the concession-holders, the four regional development corporations, and the property management company (PATRIRAM) initially helped the government in obtaining advance revenues and thus in avoiding the legally imposed borrowing limits for the region. Now they represent a significant burden on the RAM budget. In the two important sectors water distribution and waste treatment (the IGSERV group) and health care (SESARAM) there are major operating deficits and a high level of financial and commercial debt. The administration of RAM does not have a structure that centralises and adequately monitors the management of its SOEs on a continuous basis, particularly in terms of debt management and control of their operational activity. The IGF report estimates the debt stock of the RAM administration at about EUR 3 billion, that of its SOEs at another EUR 3 billion (including RAM-guaranteed debt), and that of local government and local SOEs at nearly EUR 300 million.

(3) An excessive size of the public sector: The public sector of RAM has 251 entities and 28,710 employees generating an income of EUR 2.9 billion (57 per cent of RAM's GDP). Activities of the 51 SOEs include sport, transport, energy, telecommunications, cement, highway concessions, water supply, waste treatment, property management, health, and regional development. Two highways (ViaLitoral and ViaExpresso, both toll-free) were turned into concession arrangements. The concessionaries paid EUR 574 million for taking over all assets and liabilities; in return the government pays a fee, revised every 5 years, of currently EUR 110-115 million per year until 2029 for debt service, maintenance and operating costs, and a rate of return of 10-11 per cent. A third highway (ViaMadeira), planned as a public private partnership, was never legally ratified. When it was terminated mid-2011 the government took over all its assets and liabilities. As the government had not recorded the invoices as payables before, this increased the general government deficit and debt by EUR 273 million. government guarantees to SOEs amount to EUR 1.17 billion. Some of the guarantees can be called at any time, because they have a trigger linked to a rating downgrade (which already happened). SESARAM, a health SOE (hospitals) outside general government, permanently accumulates losses, covered by government programme contracts, arrears, and loans. In the first quarter of 2011 the government granted a guarantee of EUR 20 million related to a loan which raised the overall guarantees to more than half of the company's debt. According to ESA95 rules the total guaranteed debt of EUR 295 million was therefore reclassified by INE in the calculation of general government deficit and debt.

pre-condition for signing the arrangement, the RAM will present a Statement of Affairs and the Portuguese government will closely monitor the execution of the RAM budget while keeping its transfers to the RAM government suspended.

49. The government is running behind schedule on presenting proposals for the revision of the regional and local finance laws to strengthen fiscal accountability. These were initially required by the Programme by the end of 2011, but have been postponed by one and two quarters, respectively. Instead, a document setting out a roadmap and the main elements and options for the revision of the laws will be presented by the end of 2011. The laws should ensure that the changes in the Budgetary Framework Law will be fully implemented at regional and local level. They should also take into account the lessons from Madeira so as to exclude a repetition of such control failures at regional or local level in the future.

Public administration

50. The government has adopted steps to rationalise the public administration. Several measures, in particular the freeze in wages and promotions as well as the annual decreases in 2012-2014 of 2 per cent per year in the staff (full-time equivalents) of central, regional and local administration, are implemented through the 2012 State budget (see above). Furthermore, the measures set out in the 'Plan for the Reduction and Modernisation of the Central Administration of the Government' (PREMAC) of September 2011 are being implemented. In particular, the reduction of management positions and administrative units by 27 per cent and 40 per cent, respectively, was decided and is going significantly beyond the initial Programme condition of reductions of at least 15 per cent. Following the organic laws of the individual Ministries, the legislation on the specific entities remains to be finalised. A 'Green Paper for Local Administration Reform' was presented in October with a view to submitting related draft laws to Parliament by July 2012. Among other measures, the Green Paper proposes options for inter-municipal communities among the 308 municipalities and criteria for a reduction of the currently 4,259 parishes by about 1,500.

Healthcare sector

51. A substantial amount of technical work has taken place in the health care sector, which allows swift progress towards adoption of the legal documents. Legislation has been enacted which makes e-prescription of medicines and diagnostic tests compulsory for both the private and public sector and reduces the price of generics and entry barriers to generic medicines. The legislative provision aimed at making it compulsory for physicians to prescribe by active substance is expected to be enacted soon. The government also approved a law on 'moderating fees' (taxas moderadoras) setting exemption criteria, updates of fees, inflation indexation, and increased the number of services subject to which they apply. Furthermore, the government has approved the legislative framework for conducting centralised purchasing in the sector which is due to start by Q4 2011. All these legal acts must now be implemented swiftly.

52. Monitoring and assessment mechanisms continue to improve. E-prescription covers now about 97 per cent of prescriptions (of medicines) in the public sector, but much less in the private sector. E-prescription allows tight monitoring of prescription behaviour and the detection of possible fraud and misbehaviour. Clinical guidelines are being developed which will cover about 80 per cent of all prescriptions for medicines and diagnostic tests in 2012. Authorities are exploring ways to introduce guidelines in e-prescription, initiated tighter and regular monitoring of hospitals and are setting up an inventory of physicians by specialty, age and region. Efforts must now be placed on extending tight monitoring and feedback to the private sector and to prescription of diagnostic tests. The government also needs to improve further the coordination between Ministries (Ministries of Health, Finance and Economy).

53. To attain the cost saving targets in 2012 the already substantial cost savings measures must be complemented by reinforcing primary care services and a hospital reorganisation. Substantial cost savings will come from a reduction in overtime expenditure and the cuts in the 13th and 14th month salaries. The revision of fees paid to private providers is ongoing and has led to a 12.5 per cent price reduction in 2011. A further 10 per cent price reduction should be achieved in 2012. However, a substantial reorganisation of hospitals and hospital departments is still needed. Several task forces are developing plans for hospital, primary, and emergency care. Concentrating expensive and specialised services, merging departments within groups of hospitals and reorganising emergency care should release human resources, which are better deployed in primary care services, which are only growing at a slow pace.

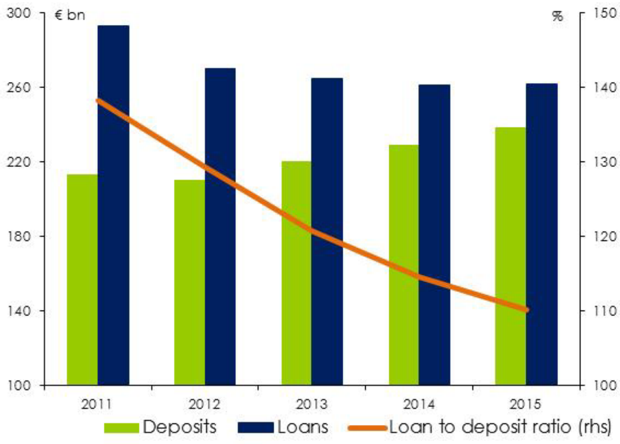
54. Authorities are still working on how to reduce arrears in the sector but a clear strategy and binding timetable is not yet developed. There is a danger that, due to the reduction in funding, further arrears will be accumulated in 2012 if appropriate cost-cutting measures do not materialise. This calls for effective monitoring and tightening of control procedures. The authorities still need some more time to properly assess information and define exemption categories in order to achieve the necessary additional financing from moderating fees. Finally, authorities have approved legislation in the Council of Ministers to revise downward profit margins and update the reference price system. However, the final proposal is not fully satisfactory and further revisions may be required.

FINANCIAL SECTOR

55. Transition towards a less leveraged banking system is on-going. Given the high levels of indebtedness in the public and private sector the adjustment process necessarily implies a deleveraging of the overall economy, which will also be reflected in corresponding adjustments in banks' balance sheets. Moreover, banks will have to adjust their business models and reduce their current high dependence on wholesale funding, implying a reduction in the loan-to-deposit ratio. The top eight banks have presented a revised set of their funding and capital plans by end-September, confirming the serious challenges the sector is facing. Banks plan to reduce the gap between loans and deposits to around 120% over the Programme horizon (Graph 9). It is important that the pace and composition of the deleveraging process is consistent with the macroeconomic scenario and does not jeopardise the provision of appropriate credit to finance productive investment and working capital in the private sector. In this context, the increasing exposure of domestic banks to the public sector and, in particular, to the state-owned enterprises that have seen their foreign funding lines withdrawn needs to be monitored as it entails the risk of crowding out credit to the private corporate sector and renders the task of a de-coupling of the banking sector from the sovereign more difficult. Furthermore, it implies a higher exposure to Treasury Bills through which the government finances the state-owned enterprises in its perimeter, a more intensive reliance on borrowing from the Eurosystem and a higher dependence on deposits growth coming at the price of sluggish net interest income. Overall, the funding plans are surrounded by significant uncertainty and will be repeated on a quarterly basis throughout the Programme.

56. Reinforcing banks' capital ratio requirements is a fundamental dimension of the Programme. All banking groups supervised by the Banco de Portugal move towards higher solvency ratios. With an array of actions, such as liability management, loan book deleveraging, asset sales and new capital issues, banks are aiming at reaching 9 per cent Core Tier 1 ratio (CT1) at year-end. The 2011 CT1 requirement will, however, not take into account the results of the Special on-site Inspections Programme (SIP) nor those stemming from the planned transfer of banks' pensions plans to the general social security system. These capital implications will be combined with the one resulting from the EBA-led exercise based on the valuation of sovereign exposures according to end-September market prices, which set June 2012 as a deadline for additional temporary capital buffers. In the event there are no private market-based solutions available, private banks can draw on the bank solvency support facility of EUR 12 billion included in the Programme. In preparation, the dedicated account of the facility has already been credited by EUR 1 billion and will be further augmented if needed. As regards the potential capital impact of the planned pension funds transfer, the government plans to make part of the transferred funds available for banks as a capital increase in form of common equity.

Graph 9: The loan to deposit ratio (plans)



Source: Banco de Portugal

57. The resilience of Portuguese banks is being assessed in the quarterly stress tests. In case a bank was to fall under 6 per cent core tier 1 ratio, the Banco de Portugal would use its regulatory powers (under pillar II of the Basel accords) to encourage the bank to take remedial actions.

58. The strategy for the streamlining of the balance sheet of the state-owned Caixa Geral de Depósitos (CGD) is being reconsidered. As requested, an independent assessment of its insurance arm was performed before the Second Review. There are, however, questions about the evaluation made and the intended sale procedure, namely the transfer of the insurance arm to the government entity *Parpública* before it is sold on the market. With these concerns in mind and noting that CGD is only a few basis point away from the 9 per cent Core Tier 1 capital ratio to be achieved at the end of 2011, the sale of the insurance arm is on hold and the capital requirement targets in 2011 will be met through other own resources. The sale may resume in 2012 to contribute to meeting the capital needs in that year. If these additional capital requirements cannot be met from internal resources, CGD can call on the State, but remains barred from accessing the Bank Solvency Support Facility.

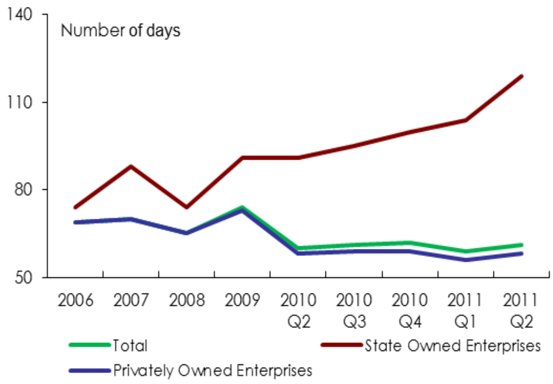
59. The sale of Banco Português de Negócios (BPN) is ongoing. The European Commission opened an investigation to check the compatibility of certain aspects of the deal with EU competition and state aid rules. Before the transaction can be finalised, a decision on this investigation is needed.

60. The Special On-site Inspection Programme (SIP) is on track to meet ambitious deadlines. The SIP is being performed on the eight largest Portuguese banking groups on a consolidated basis included in the solvency and deleveraging assessment exercise. The SIP aims to review the book value of banks' assets and risk-weighted assets. These work streams have significantly progressed and the validation of data on assets will be concluded by end of November. The assets sample includes those that will be put for sale by banks in the context of their deleveraging process and loans to PPPs and SOEs. Work on a comprehensive assessment of the stress test parameters and methodologies has been internally launched and will continue throughout December-January. A Steering Committee including international experts reviews the progress of the tasks performed at its upcoming meeting in early-December 2011. A final report is to be presented by mid-February 2012.

61. The recapitalisation law and related secondary legislation is expected to be adopted in January 2012. The purpose of the legislation is to provide temporary public support to viable banks, under strict conditions and with strong protection of the interests of the taxpayer. The draft law that has already been submitted to Parliament has been criticised as unbalanced by representatives of the banking sector. Receiving also comments by the review mission, the Portuguese authorities will amend the draft. Sensitive issues are the entry and exit modalities of the state in the capital of the banks. New shares acquired by the government (up to certain threshold) should have limited voting rights, leaving time for banks to regain market access and to buy back the shares. The issue price should provide a safety margin for the taxpayer through a sizeable discount and encompass an incentive for early buy-back. The repurchase price has the issue price as reference plus an accrued remuneration and a fair share of any rise in market value.

62. Preventive and corrective actions regarding resolution in the banking sector continue. Legislation to strengthen the framework in these areas is well advanced. The enabling law has already been passed by the Parliament, but still needs to be signed by the President. Subsequently the decree law will need to be adopted by the government and signed by the President. The end-November 2011 deadline for finalisation will be met by end-year. Further amendments may be necessary in view of the forthcoming legal developments at the EU level and will be undertaken without any delay.

Graph 10: Corporate sector: accounts payables



Source: Banco de Portugal

63. The first report monitoring corporate and household indebtedness has been released. The report will be produced on a quarterly basis with publication due in January, April, July and October each year. It reflects the importance of accurately monitoring the private and the State owned segments of the corporate sector as well as the households throughout the duration of the Programme. The first report highlights, among other, the worrying developments concerning arrears by SOEs (Graph 10), which often tend to impact inter-company transactions in the private sector. Furthermore, a task force led by ESAME[14] has been constituted with participants from the ministries and Banco de Portugal to assess the currently available guarantee programmes for enterprises and reflect on alternative market based financing options, in particular for SMEs and microenterprises. This working group will also prepare a forward looking report on the financing of the corporate sector.

STRUCTURAL REFORMS

Labour market

64. The government plans to set up a fund based on individual accounts to partly finance dismissal costs. This was originally foreseen to be introduced in two phases but now the government plans to introduce the scheme in one step. This justifies a slight delay in the introduction of the fund and the plan takes on board the comments by the review mission. Draft legislation for the constitution of the fund must be submitted to Parliament by Q3 2012, with a view to having the fund operating at the latest in early 2013.

65. A preliminary law proposal to revise the Labour Code was discussed by the review mission. The proposal fully meets the requirements of the MoU in substance and speed of implementation.

[14] ESAME or Estrutura de Acompanhamento dos Memorandos is a dedicated team supervised by the office of the Prime Minister overseeing the compliance of measures with the MoU.

Many of the elements of the proposal still need to be discussed with the social partners. The authorities committed to consider a number of changes proposed by the review mission on the preliminary draft law. The authorities plan to submit a draft law to Parliament by January 2012 for the package excluding the third round of severance payments, and by Q3 2012 for the new level of severance payments. Further modifications in the Labour Code to come at a later stage concern the wage setting system, notably the criteria for extending collective agreements.

Box 3: Improving Competitiveness: The Role of Labour Market Reforms

Portugal needs a significant improvement in price competitiveness to bring the current account in positive territory and stabilise the net foreign assets over the medium term. The labour market reforms agreed in the MoU play a central role in facilitating labour cost savings and improving labour market adjustment.

The MoU requires the wage bargaining framework to shift from a system where extension of collective agreements is generally granted in all sectors to a system in which the extension is granted only in sectors where employers' organisations are sufficiently representative and where the extension is not excessively distortive on firms not represented in negotiations. The reform will lead to a higher degree of wage decentralisation and allow wages to react to firm-level conditions. In addition, agreements at firm level, concluded either by unions or works councils, could contribute to wage moderation and reduce nominal downward wage rigidity in a period of weak labour demand.

Considerable changes are expected to occur in working time arrangements, which will mainly contribute to reducing labour costs relating to overtime.(1)

- The overtime premium will be reduced by 50 per cent and the additional 25 per cent time off per each hour of overtime will be eliminated.
- "Bank of hours" arrangements are expected to be introduced also by individual agreements, which implies a further reduction in cost of overtime (which will be compensated to a larger extent via hours off) and facilitates a more efficient use of labour.
- The government announced an increase by 30 minutes per day in the normal working time in the private sector, which will last over the Programme period. A more permanent change concerns the government's plans to eliminate four bank holidays.

Reforms in employment protection legislation will also have relevant implications for labour costs. Severance payments are expected to be reduced from 30 days to around 10 days per year of work. Assuming that 4 per cent of the labour force, on average, is dismissed every year - a figure consistent with evidence on job market flows into unemployment in Portugal before the crisis period - the reform would reduce effective labour costs by at least 3 per cent.(2)

The reduction in the generosity of the unemployment benefits system is likely to contribute to wage moderation and increase labour utilisation. Improvements in the effectiveness of ALMP can reduce labour market mismatches and reforms in vocational training and education can contribute to improving the supply of skilled labour and thereby help increasing productivity.

Overall these measures, if effectively implemented, could lead to a substantial reduction in unit labour costs. Additional wage moderation will result from subdued economic activity and from planned cuts in public sector wages. The labour market reforms are being implemented together with the reforms in product markets to increase competition in the economy and raise productivity.

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(1) In the current depressed demand conditions one cannot expect major increase in total labour inputs, hence the room for productivity gains is probably limited, while gains are expected mostly in a reduction in the cost of broadly unchanged labour inputs thanks to reduced cost of overtime and overtime use.

(2) The computation is as follows: $\frac{\Delta LC}{LC} = \frac{SP' - SP}{LC} = \frac{0.7nw\Delta L - nw\Delta L}{NwL} = 0.7\frac{n}{N}\frac{\Delta L}{L}$, where *LC* stands for total annual labour costs, *SP* are labour costs due to severance payments, w is the average wage, *n* is the average number of wage days paid per worker dismissed, *N* is the total number of work days in one year, ΔL is the average number of workers dismissed in one year. Assuming n=300 (average seniority of dismissed workers=10 years), *N*=250, and $\Delta L/L$=4%, the result indicates $\Delta LC/LC$=3.4. Note that the flows into unemployment as a share of labour force before the crisis are estimated to be close to 6%. A lower figure seems needed in the simulation to take into account the fact that some quits might be voluntary, even if leading to unemployment.

66. Plans to revise the unemployment insurance system closely follow the MoU and authorities consider strengthening the length of the contributory careers vis-à-vis the workers age in determining benefits. The authorities plan to have the new system of unemployment insurance operational by Q1-2012 (decree law by Q4 2011).

67. The authorities started work on assessing the effectiveness of activation and other Active Labour Market Policies (ALMPs). A descriptive study will be ready by Q4 2011. A full study aimed at assessing the impact of ALMPs will be ready by Q2 2012. The authorities are preparing an action plan on ALMPs in line with the MoU. In this framework, the government has prepared a draft Resolution to reinforce the role of the Public Employment Services. The authorities have also prepared a draft proposal for a wage subsidy scheme targeted at the long-term unemployed to be co-financed by the European Social Fund. The authorities plan to continue to be developingalso taking into consideration the results of the reports on effectiveness of ALMPs.

Education

68. The authorities presented a preliminary draft on the implementation of a monitoring system to evaluate education policies. However it appears necessary to deepen the level of detail of the system, starting by focusing on key areas (such as early school leaving) and then enlarge the monitoring system to other areas. The authorities will submit by the next quarter, as requested in the MoU, preliminary action plans on improving the quality of secondary education and on education and vocational training.

Housing market

69. The authorities have taken the first steps in liberalising the rental market by adopting the guidelines for the urban rental reform. The guidelines identify the main measures needed to improve access to housing for both households and firms in line with the MoU. However, some aspects and parameters of the forthcoming legislation still need to be defined, in particular: i) the duration and the possibility of termination of leases; and ii) the design of the mechanism to bring rents up to date for leases signed under the different rental regimes. The proposed mechanism seems at first sight very cumbersome as several regimes and phasing out periods are envisaged according to criteria based on income, age and situation of the property. The period for phasing out is very long for the purpose of the reform (for certain contracts the phasing-out period goes up to 15 years). There seems to be a need for streamlining the proposal and making the mechanism simpler to implement. The draft legislation needs to ensure balanced rights and obligations of landlords and tenants and the phasing out of rent control, considering the socially vulnerable, with a positive impact on the functioning of the housing market. The first draft will be presented by end-November 2011, and submitted to Parliament by end-2011.

70. Draft legislation for renovation works was adopted, simplifying administrative procedures, safety requirements, authorisation to use and formalities for innovation that benefit and enhance quality and value of buildings. The rules determining the level of conservation status of property and the conditions for the demolition of buildings in ruin were standardised. However, the authorities only partially complied with the MoU requirements as the measures regarding renovation works in rented buildings are not addressed in the forthcoming legislation and have been postponed to end-2011 to be dealt with together with the rental market reform.

71. The authorities have completed the study to review the framework for the valuation of the housing stock and land for tax purposes with a view to ensuring by end 2012 that the taxable value of all property is close to the market value. A roadmap and the necessary administrative and financial resources to carry out such a general assessment of the large stock of undervalued houses have been identified. The necessary changes in the legislation have been prepared and are to be adopted by end-November. The general assessment process will already start in December 2011. Safeguard clauses have been considered for the socially vulnerable.

Judicial system

72. Portugal is making progress in the complex task of reforming its judicial system. A top priority is to resolve the backlog of cases in the courts within two years. To achieve this goal, the Portuguese government completed in time an audit with targeted measures to expedite the resolution of the backlog. Given the huge backlog in the debt enforcement process and the pivotal role of enforcement agents in this process, Portugal is adopting measures to strengthen the legal and institutional framework in line with international practice with a particular focus on the financing structure and authority of the oversight body and to ensure the oversight body's full access to the enforcement case files.

73. The Portuguese government is advancing with reforms aimed at improving management efficiency of the court system and is preparing a roadmap by end-January 2012. It will, inter alia, identify key quarterly milestones to reduce the number of court districts and close down underutilised courts. The development of a new personnel management plan to support judicial specialisation and mobility of court officials is under way. Preparations for new Courts on Competition Matters and Intellectual Property Rights to become operational by end-March 2012 and for assessing the need for separate Chambers within the Commercial Courts with specialized judges for insolvency cases by January 2012 are in the process of realisation. Complementary measures are also progressing well. The Portuguese government will continue strengthening alternative dispute resolution (ADR) to facilitate out-of-court settlement, with a law on arbitration just adopted. Court fees are being standardised, which should help to put in place a more sustainable and transparent budget for the judiciary. The development of an annual plan for 2012 on the allocation of resources based on court by court performance data is in preparation, and the first quarterly report on recovery rates, duration and costs of corporate insolvency has been published

Energy and Transport

74. The authorities need to set out a long-term strategic vision for transport policy. The Strategic Plan for Transport adopted by the government in September concentrates on the urgently needed restructuring of the heavily indebted SOEs in the transport sector. However, it fails to provide a long-term vision of how to improve the efficiency and the sustainability of the transport system. A complementary report should tackle the outstanding issues, in particular how to improve competition in each transport mode, to better integrate them and to reduce the dependence on road transport and to better connect key nodes to the EU-wide Transeuropean Network.

75. Despite some progress, the transposition of the "first EU Railways Package" is still incomplete. The railway regulator has been established, but its independence and staffing will have to be reinforced in the context of a general overhaul of national regulatory authorities. The legal framework of the state-owned passenger railway operator, CP, has been amended to guarantee its independence from the State. Plans to bring the infrastructure manager, REFER, to operational balance by 2014, including through a rationalisation of the rail network and cuts in staff costs, have been presented; their effective implementation will need to be ensured. Preparatory work to revise the Public Service Obligations (PSOs) on rail passenger transport has started, and a revised PSO contract between the State and CP– or potentially several contracts – will be concluded in 2012. At the same time, the administrative capacity for a stepwise introduction of tendering of PSOs will be developed, starting with the tendering of some suburban services in 2012. The infrastructure manager has recently introduced a performance scheme on track access charges, through which rail operators are due to pay fines for network disruptions, but no payment has yet been collected from operators. Meanwhile, CP plans to apply yield management on its long-distance passenger ticket prices as of January 2012. Preparations to privatise the state-owned freight railway service operator, CP Carga, are ongoing and the privatisation process is due to be completed in the course of 2012.

76. Further progress has been made towards the liberalisation of electricity and gas markets. The authorities prepared two draft decree-laws on the phasing-out of the remaining regulated tariffs for electricity and gas. In line with the MoU and the roadmap set by the Council of Ministers' resolution of 28 July 2011, regulated tariffs for large consumers and for small consumers will be phased out by 1st July 2012 and 1st January 2013, respectively. Also, in line with the MoU, the draft decree-laws establish a transitory period of maximum three years and transitory tariffs designed so as to encourage consumers to switch to the liberalised market. To complement the legal framework for the liberalisation of regulated tariffs, a decree-law establishing a social tariff for natural gas has been adopted. Moreover, the authorities have launched an information campaign to raise the awareness of both consumers and suppliers about the liberalisation of the market. The authorities have taken steps to further integrate the Iberian gas market (MIBGAS). The Portuguese and the Spanish governments have signed a joint memorandum of understanding, whereby they commit to accelerate the development of MIBGAS through regulatory convergence and the harmonisation of the tariff structures in the two countries. In parallel, the two energy regulators have adopted a roadmap setting out the actions to be taken. Work will continue at technical level but concrete progress will ultimately depend on the cooperation of the Spanish government.

Sustainability of national electricity system

77. The Portuguese authorities accepted a new commitment to adopt measures leading to the elimination of the tariff debt (*déficit tarifário*) by 2020 and ensuring that it will stabilise by 2013 (the latter date is to be reviewed after the presentation of the government's plans in early 2012). The electricity system has accumulated a large tariff debt that in 2011 has reached EUR 1.8 billion with an estimated extra EUR 1 billion created over 2012. The debt is expected to rise steadily, potentially posing risks to cash flows for electricity companies or crowding out credit as the debt is securitised with banks. At the root of this are certain production costs (the so-called policy costs originated by government decisions) that are not fully recovered through the price charged to the electricity end users. Policy costs occur under the standard regime (e.g. thermo-electric and hydro-electric) and under the special regime production (e.g. co-generation and renewables), which give rise to excessive rents given the high rates of return granted. By January the authorities will present a proposal to set the system on a sustainable path and correct these excessive rents in both production regimes. This would also diminish pressure on future electricity price increases and would thus have a positive impact on competitiveness across all sectors.

Telecommunications

78. The authorities have taken clear action to open up telecom markets to competition. Decisive steps have been taken for the transposition into national legislation of the EU Regulatory Framework for Electronic Communications by transposing the Better Regulation Directive. The new regulatory framework aims at facilitating the establishment of telecom operators and cross-border communication services, and at strengthening the role of an independent sectoral regulator to supervise the functioning of the market and guarantee competition and a level playing field. Decisive action has been taken by the national regulatory authority (ANACOM) to lower mobile termination rates with a view to improving market functioning in compliance with the MoU. Further reductions are foreseen and will be followed under the EU framework (Commission Recommendation on the regulatory treatment of termination rates). Following the recommendations of the Competition Authority, measures have been adopted to increase competition in the fixed communications market by improving the mobility of consumers thus complying with the objective of the measure set in the MoU. Progress is also on-going towards complying with the Court of Justice ruling and the objectives set in the MoU, which mandates that the universal service provider(s) must be designated through an efficient, objective, transparent and non-discriminatory mechanism. Currently, steps are being taken to renegotiate the concession contract with the undertaking currently providing the universal service by reducing the scope of the services covered so as to exclude the universal service. Concrete actions have been taken towards launching a new tender process, which is due by end-2011.

79. The spectrum auction has been launched ahead of the Q4 deadline under rules designed to respond to the objective of facilitating market entry and increase competition as set in the MoU.

Following completion of the spectrum auction process, the Portuguese national regulatory authority will carry out an ex-post competitive assessment and address identified competitive distortions. The regulator will also ensure an adequate monitoring and enforcement concerning network access obligations, which are critical for new entrants. Also ahead of the Q4 deadline, the government has lowered the spectrum utilisation fees, thus increasing incentives to entry but still avoiding underutilisation of the spectrum.

Postal services

80. The government is finalising the legislation to transpose the Third Postal Directive. A previous draft law was considerably revised following a public consultation. Given the need for Parliament approval the deadline has been postponed to Q4 2011 and the measure now includes also the re-negotiation of the concession contract for the provision of universal service shortening the designation period in order to further liberalise the sector.

Other services sector

81. Liberalisation of other service sectors is advancing at a slow pace. Some progress has been made in the adoption of the remaining necessary sector-specific legislation to fully implement the Services Directive. Concerning reforms of the construction and real estate legal frameworks (for which a Pilot case has been launched by the Commission in parallel to the MoU monitoring) a revision of the legislative texts is underway and the authorities should make sure that the texts can be adopted by the Q4 deadline. The further liberalisation of the access and exercise of regulated profession for other Member States in Portugal is slow, despite some efforts and progress towards reducing the number of regulated professions. Action has been taken by liberalising access to a large number of professions not regulated by the Parliament. Nevertheless plans concerning professions regulated by Parliament are delayed and the Q3 deadline (to present law to Parliament) has been missed. Particularly problematic seems the lack of progress in 18 highly regulated professions ruled by professional bodies which are of high economic importance. The delay also affects pending legislation on the recognition of professional qualifications.

82. The government remains committed to simplifying procedures necessary to provide a service activity. Relevant information concerning establishment, cross-border provision and required professional qualifications for the exercise of a services activity is now available through the Point of Single Contact in three languages but further actions remain necessary. The MoU measures have been redrafted to specify further actions (for online establishment registration covered by "Zero Authorization" procedures will be available in Q1 2012 and single electronic forms should be available for two procedures at local level by February 2012). In addition, the difference between the various regimes applicable to established and cross-border service providers will be laid down in a sufficiently clear way by January 2012.

Competition and sectoral regulators

83. Effective action has been taken to eliminate obstacles to the free movement of capital, although important steps still need to be taken. The privatisation's implementing laws of EDP and REN are in line with the MoU measure aiming at avoiding obstacles to free movement of capital (such as acquisition or holding caps). The special rights that the State indirectly has in GALP through a shareholding agreement involving the state-owned CGD bank, which holds 1 per cent of GALP, will have to be eliminated through alienation by CGD of this participation by Q4-2011.

84. Important steps have been taken to increase the speed and effectiveness of competition rules enforcement. A draft new Competition Law is under preparation and will be submitted to the Parliament in January 2012, following the on-going public consultation. This law is expected to provide a greater alignment with EU competition legal framework and increase autonomy from administrative and penal code law. As part of the response to ensure sustainable and stable means to the Competition Authority's functioning, an Executive Order was approved, authorising the transfer of contributions from seven sectoral regulators that constitutes the major part of its financing. The government will ensure the administrative conditions for these transfers by the end of 2011. Additional actions such as hiring within the constraints of the competition authority overall budget may have to be allowed to guarantee the human resources for the Authority's effective and sustained operation. The call for tender for a report on the functioning of the National Regulatory Authorities expected in October will be substituted by a direct award in November and the delivery of the study is delayed by one month to April 2012.

IV. PROGRAMME FINANCING

85. The first and second EU-IMF disbursements to Portugal, covering financing needs for the period between June and December 2011, totalled EUR 30.4 billion[15]. The latter is equivalent to almost two-fifths of the total Programme envelope. The second disbursement, in anticipation of the financing needs in Q4-2011, amounted to EUR11.6 billion. The IMF disbursed EUR 4.0 billion to Portugal between 14 and 16 September, while the EFSM disbursed a total of EUR 7.6 billion through three tranches on 21 September, 29 September, and 6 October.

86. The government's cash position in Q4-2011 has improved compared with the previous quarter. Projections by the Portuguese Debt Management Office (DMO) indicate that, in the absence of financial operations additional to those currently planned the government's cash position to the end of the year will be comfortable. The current projections do not take into account *net* cash inflows from the planned partial transfer of bank's pension funds to the State. The projections are based on prudent assumptions on privatisation proceeds by the end of 2011 (Graph 11).

87. The issuance of treasury bills in the second half of 2011 has been consistent with Programme expectations. The stock of treasury bills at end-2011 is expected to amount to EUR 13 billion. While this is EUR 6 billion less than the stock of treasury bills outstanding at end-May 2011, it is well in line with Programme projections. Since September 2011, most of the treasury bills have been issued with a maturity period of just 3 months in order to contain interest costs. Portugal pays an interest rate on 3-month paper of just under 5 per cent and by the end of 2011 the share of outstanding bills with a maturity of just 3 months will reach 60 per cent of the total stock (Graph 11). Tense market conditions in the euro area debt markets since the summer have also contributed to a reduction in foreign interest in short-term Portuguese debt.

88. The financing needs of state-owned enterprises (SOEs) remain an important challenge. Between June and December 2011 the total amount of money provided by the government to SOEs is projected to amount to around EUR 3.0 billion more than had been envisaged in the Programme. SOEs have repaid several maturing credits with the banking sector and received instead financing from the Treasury.

89. The redemption of saving certificates[16] by households has accelerated. In October 2011, the net redemption of saving certificates amounted to EUR 320 million, compared with EUR 250 million per month in August and September. The total redemption of saving certificates between June and December 2011 could reach EUR 2.5 billion, almost EUR 2.0 billion higher than envisaged in the Programme. The increase in redemptions appears to be driven by the higher interest rates offered on bank deposits.

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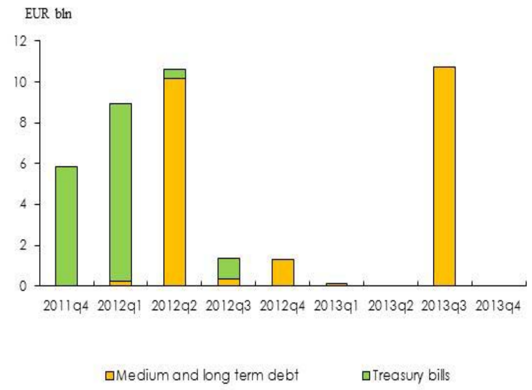
[15] The total amount paid was €0.5 billion higher than originally planned in the Programme due to a higher payment by the IMF in euro currency as a result of changes in the euro/SDR exchange rate.

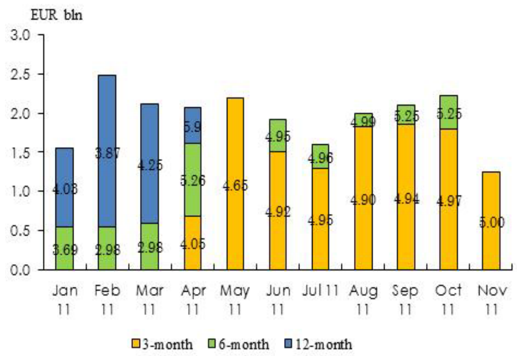
[16] Saving certificates are issued by the government to household investors through the postal branch network. They are non-tradable financial instruments that have small minimum subscription amounts. The amounts reported for redemptions of saving certificates are net of treasury certificates.

Graph 11: Portugal – Maturing debt



Source: Bloomberg, IGCP

Graph 12: Short-term auctions (amount and yield at issue)



Source: IGCP

90. Subject to the successful completion of the Second Review, the third disbursement, covering the financing needs for Q1-2012, is estimated to amount to EUR 8.1 billion[17], of which EUR 5.3 billion from the EU. The latter will increase the total amount disbursed to Portugal to just under one-half the total Programme envelope. On the basis of current projections by the Commission, the payments to the bank solvency support fund might have to be made at a faster pace than originally envisaged in the Programme.

91. The Programme's policies are crucial to reducing financing needs and/or increase financing sources. Fiscal targets should be strictly adhered to. The restructuring of SOEs should also proceed at a rapid pace, which would help to reduce further build-up of their financing needs and also help improve their access to foreign funding sources. A reduction in the banking sector's exposure to public sector would also support the orderly de-leveraging of the banking sector.

[17] The size of the third disbursement is expected to be EUR 100 million higher than originally planned in the Programme due to a higher payment by the IMF in euro currency as a result of changes in the euro/SDR exchange rate

ANNEXES

Specific economic policy conditionality - Financial sector and structural measures[1]

Actions for the Second Review (to be completed by end Q3-2011)	*Status*
Financial sector	
[2.2] BdP and ECB will ask banks to revise their funding plans by end-September.	**Observed:** Plans were submitted end October. Currently BdP discusses deviations from June's plans with banks.
[2.5] Transfer of CGD insurance arm to a state entity as fist step towards its eventual sale, with a new independent evaluation of its market value performed to be completed by the time of the Second Review.	**Ongoing:** A valuation of the insurance arm of CGD took place. The privatisation of the insurance arm planned for 2011 is on hold. The sale is expected to take place in 2012 directly to a final buyer.
[2.6] Implementation by BdP of most recommendations on its solvency and deleveraging Assessment Framework (SDAF). **(SB, MEFP ¶31)**	**Ongoing:** BdP will henceforth carry out its stress tests using a methodology altered in the light of the recommendations.
[2.8] Monitor quarterly banks' potential capital needs.	**Ongoing:** The BdP runs quarterly stress test.
[2.9] Adding a new ratio aligned with inter-national practices to the current ratio that covers only overdue loan payments. **(SB, MEFP ¶32)**	**Ongoing:** BdP has sent the new calculation methodology to banks. New ratio's methodology will be presented in BdP's November financial stability report. Currently the banks are working out their new ratios and BdP performs consistency checks.

[1] Square brackets identify paragraph numbers in the MoU. Items that are Structural Benchmarks under the program are flagged with SB, and also identified by the MEFP paragraph number.

[2.14] Conclude the BPN sale.	**Ongoing:** The EU Competition authorities examine the deal. Once a decision is taken, the state will take over CGD's claims on BPN and all related special purpose vehicles.
[2.17] Issue general principles on voluntary out-of-court restructuring in line with international best practices.	**Observed:** The principles were issued by means of a Council of Ministers statement on 29 September 2011.
Fiscal-structural	
[1.20] Introduction of a standstill rule to all tax expenditure, blocking the creation of new items of tax expenditure and the enlargement of existing items.	**Observed:** In the draft 2012 Budget Law.
[3.2] Conduct and publish a comprehensive survey of arrears by end-August 2011 covering all categories of expenditure payables at the end of June 2011. Prepare a strategy for the settlement of arrears for the entities of general government. **(SB, MEFP ¶11)**	**Partially observed:** The results of the survey of arrears of the government sector and of SOEs classified outside the government sector have been published. The strategy to settle arrears due by end-September has been presented with a delay of one and a half month. The document presents some preliminary ideas, the design of the strategy is still incomplete.
[3.3] Enhance monthly reporting on budget execution on cash basis for the general government, including on a consolidated basis.	**Observed:** Data on budgetary execution of regional governments is now being published on a monthly basis in the Budget Office monthly bulletin.
[3.4] Improve the annual report on tax expenditures.	**Not observed:** The report on tax expenditures has been postponed to Q1-2012.
[3.5] Establish intra-annual fiscal targets.	**Not observed.**
[3.6] Issue an instruction for commitments control to general government units against available funds recorded in the accounting system and set up procedures to ensure compliance. Non-compliance will be subject to specified penalties in accordance with the budget framework law. **(PA, MEFP ¶1,2)**	**Observed:** The commitments control system will be further enhanced by draft legislation due end-2011.

[3.7] Report the consolidated monthly arrears for the general government.	**Observed:** Monthly reports have been submitted to EC/ECB/IMF
[3.11] Publish report on fiscal risks (annual).	**Partially observed:** The report on fiscal risks attached to the draft 2012 Budget Law (submitted to Parliament on 17 October) is incomplete in that it does not quantify risks and does not consider risks emanating from variant macroeconomic scenarios, contingent liabilities and the tariff deficits in the energy and water sectors. Further work on numeric scenarios is needed.
[3.12] Publish a medium-term fiscal strategy document for the general government by end-August. **(SB, MEFP ¶9)**	**Observed:** The Medium Term Fiscal Strategy was published by late August.
[3.13] Fully implement the Budgetary Framework Law.	**Ongoing:** Full implementation is foreseen by end-2011.
[3.15] Publish forecasts underpinning the budget.	**Observed:** Published in the draft 2012 Budget Law.
[3.16] Adopt the Statutes of the Fiscal Council.	**Observed:** The statutes of the Fiscal Council were approved on 8 September and entered into force on 20 October (Law 54/2011 of 19 October). Fiscal Council will be operational by end of the year as stipulated by the MoU.
[3.18] Perform, with the technical assistance from EC and the IMF, an initial assessment of at least the 20 most significant PPPs and concession contracts, including the *Estradas de Portugal* PPPs, by end-August 2011.	**Observed:** Results of the assessment were conveyed in a report for 36 PPPs and 26 concessions.
[3.23] Present operating cost reduction plans for local and regional government SOEs.	**Not observed:** Cost reduction plans for local and regional government SOEs have not been presented by end-September. A White Paper on the Local Business Sector was presented in November 2011.
[3.24] Prepare a comprehensive SOEs strategy document.	**Broadly observed:** While a draft document was submitted, important elements are missing, notably numerical targets on cost reductions.

[3.25] Prepare plan to tighten borrowing requirements for local and regional SOEs from 2012 onwards.	**Not observed:** Cost reduction plans for local and regional government SOEs have not been presented by end-September.
[3.30] Prepare reports on local and regional SOEs by end-October.	**Partially observed:** A White Paper on the Local Business Sector and a report on SOEs in the Azores became available in November 2011.
[3.34] Study to assess the costs and benefits of merging the social security administration with tax, customs and DGITA.	**Ongoing.** Preliminary study was sent by PT authorities on 7 October. PT authorities indicated the need for a reassessment once the details of the merger are being fleshed out.
[3.36] Make a new assessment of audit performance in the revenue administration.	**Ongoing:** Report on audit performance was sent by PT authorities on 30 September. However, the Tax Administration has been asked to provide an enhanced assessment by end-2011.
[3.36] Implement new tax arbitration law.	**Observed:** Tax arbitration law entered into force in July.
[3.38] Report on the state of IT in the revenue administration.	**Observed:** Report on IT in tax administration was sent by PT authorities on 30 September.
[3.39] Prepare a strategic plan 2012-2014 for the revenue administration, including concrete actions to combat tax fraud and evasion, to strengthen audit and enforce tax collection based on risk management techniques.	**Observed:** The strategic plan 2012-2014 was sent by PT authorities in November.
[3.40] Submit draft legislation to reduce management positions and administrative units in central administration by end-October.	**Largely observed:** In line with the PREMAC report of mid-September 2011, the organic laws of the ministries were adopted, while the legislation of the entities is still to be finalised.
[3.50] Draft law and other initiatives to ensure annual decreases of at least 1% in the number of central administration employees in 2012-14 and of at least 2% at regional and local levels.	**Observed:** Draft 2012 Budget Law makes hiring by central, regional and local governments dependent on authorisation by the Finance Minister.

Health care system	
[3.51] Draft legislative acts to substantially revise existing exemption categories from NHS moderating fees and increase moderating fees in certain services.	**Observed:** The MoH has publicly stated that all citizens with an income below the €628.83, that is, 1.5 times the IAS (Indexante dos Apoios Sociais) calculated on the basis of household income will be exempted from paying moderating fees. A decree law stating the general principles regarding changes in exemption categories, increases in fees and indexation to inflation has been approved. An ordinance ("portaria") needs now to be approved which presents in detail the fees and exemptions categories.
[3.52] Reduce tax allowances for healthcare by two thirds by end-October.	**Observed:** According to the 2012 Budget Law, tax allowances are reduced from 30% to 10% of taxes, and abolished for the highest incomes.
[3.55] Revise the pricing of the first generic.	**Ongoing:** A law proposal (13/XII – 01/09/2011) was approved in the Parliament in its generality. It proposes that price of generics is minimum 50% less than the price of the reference branded medicine. This law needs to be enacted.
[3.58] Make compulsory the electronic prescription for medicines and diagnostic.	**Observed:** Electronic prescription has been made compulsory by law on 1 August 2011. 97% of all prescriptions of medicines in the public sector will be electronic by end 2011. The share is lower for diagnostic tests and in the private sector. Legal and administrative procedures are being implemented to ensure full e-prescription in these areas. A new report will be published by end of December 2011.
[3.59] Establish the monitoring system of prescription and assessment by individual doctor with future regular feedback.	**Ongoing:** The first report has been submitted to physicians via hospital departments and health centres. A risk assessment system to identify fraud and misbehaviour is being developed. The establishment of sanctions and penalties requires the implementation of the legal and administrative procedures and the proper identification of doctors by specialty, as well as prescription guidelines.
[3.60] Measures to induce physicians to prescribe generic medicines and less costly available branded product (regulation or guidelines to doctors).	**Ongoing:** The law making prescription by active substance compulsory has been approved by Parliament in its generality and is now in the Parliament's Health Commission. It proposes that pharmacies have at least 3 of the 5 cheapest generics available in the pharmacy.
[3.66] Legislative and administrative framework for a centralised procurement system for the purchase of medical goods in the NHS.	**Ongoing:** The revised legal framework awaits final adoption. There is a plan and budget for the public tenders and pre-notices have been published in the Official Journal. First tenders will be launched by Q4 2011.
[3.71] Present timetable to clear arrears in the health system. Ensure coordination between Ministry of Health and Ministry of Finance.	**Not observed:** The strategy and timetable have not been presented. Authorities have presented some ideas and are focusing on strong monitoring and control to avoid the building up of new arrears but an assessment of the cash availability and fiscal impact is needed.

[3.72] Increase in the number of USF units contracting with regional authorities.	**Ongoing:** The number of USFs has increased since Q1-2011, though at a slow pace. A task force is assessing reforms in the primary care sector and should deliver a report in the coming month.
[3.75] Present detailed description of measures aimed to achieve a reduction of EUR 200 millions in the operational costs of hospitals in 2012.	**Observed:** Authorities have submitted a report detailing measures by hospital to reduce operational costs. They are starting to implement a tighter monitoring and control system of hospitals.
[3.76] Publish clinical guidelines and set up an auditing system of their implementation.	**Ongoing:** In cooperation with professional associations, new clinical guidelines have been published and additional ones are being developed and should be ready by the end-2011. Additional guidelines will be published next year.
[3.82] Update annually the inventory of all practising doctors by speciality, age, region, health centre and hospital, public and private sector.	**Observed:** The authorities have submitted a report with a preliminary inventory of physicians by speciality, age, region and sector and identifying needs. This report has been published by ACSS. It will require further work as better data on physicians becomes available notably through e-prescription registration.
[3.83] Prepare annual report on the allocation of human resources in the public health sector in the period up to 2014.	**Not applicable:** Anew deadline has been set for end April 2012 in order to better account for the findings of the inventory report [3.82].
[3.87] Reduce costs for patient transportation by one third.	**Ongoing:** Costs have been reduced on average by 15%. Further reduction requires a specification of "urgent transportation" (ongoing).
Labour market	
[4.4.i] Implement the fund agreed in the March Tripartite Agreement done through a law regulation, and provide a description of technical details.	**Ongoing:** The government has prepared preliminary draft legislation on the function of the fund to finance part of workers dismissals. It was agreed to move directly to a fund based on individual accounts but with some delay (necessary to reduce the cost of the fund in light of the further reduction in severance payments forthcoming). Draft legislation for the constitution of the fund must be submitted to Parliament by Q3 2012, with a view to having the fund operating at the latest early in 2013.
[4.7.i] Commit that no increase in the minimum wage will take place, over the Programme period, unless justified.	**Observed:** There has been no increase in the minimum wage.

Goods and services markets	
[5.1] Launch of an information campaign to raise the awareness of consumers about the phasing out of regulated tariffs.	**Observed:** An information campaign has been launched.
[5.3] Take measures to improve functioning of Iberian gas market through regulatory convergence.	**Observed:** The Portuguese and Spanish governments have signed a joint memorandum of understanding, reflecting their commitment to accelerate the establishment of MIBGAS. In parallel, the regulators of the two countries have adopted a joint roadmap on the actions to be taken. Technical work will continue.
[5.10] Report annually on action taken to improve the compensation schemes of new contracts in renewables (if any).	**Observed.** Report received explaining the absence of action as no new contracts in renewables were signed in 2011
[5.11] Report annually on the cost and benefits of new investments in renewables, including the consequences for energy prices.	**Observed**. Report received explaining the absence of action as no new investments in renewables were made in 2011
[5.13] Review consistency and possible overlapping of energy policy instruments.	**Observed.** The authorities have submitted a report providing an overview of financial and tax incentives related to energy policy and identifying possible overlapping or inconsistent instruments.
[5.16] Implement "Better Regulation Directive."	**Observed:** Law 51-2011 transposing the directive was published on 13 September.
[5.17] Decrease mobile termination rates.	**Observed:** Successive lowering has been undertaken (in May and in August) in accordance with the glide path provided for in ICP-ANACOM's decision of 18/05/11. At 3.50 cents, the overall reduction has been by approx. 22%. A further reduction has been announced for 2012.
[5.21] Implement Competition Authority recommendations to increase competition in fixed communications by increasing consumer mobility.	**Observed**: Report of October 2011 by the regulator (ANACOM) on the accomplished implementation of the measures.
[5.22] Transpose the Third Postal Directive to liberalise Postal Services.	**[Ongoing:]** Draft laws received on 17 and 26 October 2011. Compliance with Directive is currently being assessed. Given the need for Parliament approval the deadline has been postponed.
[5.23] Strategic Plan for Transport to rationalise, better	**Partially observed:** The authorities have submitted a plan, which focuses mainly on the

integrate and increase competition in the sector.	restructuring of SOEs in the transport sector. Important elements are missing such as a long-term vision of how to improve the efficiency of the overall transport system. A complementary plan needs to be prepared.
[5.24] Transpose EU Railway Package law and privatise the freight branch of CP.	**Ongoing:** The rail regulator has been established, its independence and staffing need to be reinforced in the context of the general overhaul of national regulatory authorities. The independence of the incumbent operator is sufficient. Plans for network rationalisation and achieving the operational balance of the infrastructure manager have been presented. Their implementation needs to be assured. Implementation of the other measures (revising Public Service Obligations (PSO), tendering of PSO contracts, introduction of a performance scheme and yield management, privatisation of freight rail operator) is ongoing.
[5.31] Law to improve recognition of professional qualifications: adopted (for professions not regulated by Parliament); presented to Parliament for the other professions.	**Ongoing:** A draft proposal of regulation on the recognition of professional qualifications obtained abroad was received on 14 October 2011. Reform for 18 highly regulated professions (which regulation involves professional bodies) is delayed. Deadline is extended by 1 quarter.
[5.33 and 5. 34] Make adjustments to the legislative framework in order to reduce the number of regulated professions and eliminate unjustified reserves of activity: adopted for professions not regulated by Parliament; presented to Parliament for the other professions.	**Ongoing:** DL 92/2011 liberalizing access and exercise to 170 regulated professions. Reform for 18 highly regulated professions (which regulation involves professional bodies) is delayed. Deadline is extended by 1 quarter.
[5.34] Adopt measures to liberalise access and exercise of regulated professions.	**Ongoing:** Reform for 18 highly regulated professions (which regulation involves professional bodies) is delayed. Deadline is extended by 1 quarter. Deadline is extended by 1 quarter.
[5.36] Present a roadmap to monitor progress of Points of Single Contact (PSC), and make PSC available in three languages by October 2011.	**Partially observed:** Roadmap was received on 5 August 2011, but PSC coverage needs to be improved (eg to include some procedures at local level).
Housing market	
[6.1] Present measures amending the New Urban Lease Act Law.	**Observed:** Guidelines on the urban rental reform were adopted by the Council of Ministers. Preliminary draft legislation will be presented by end-November.
[6.2] Prepare legislation to simplify administrative procedures for renovation.	**Observed:** Draft legislation on simplifying administrative procedures for renovation works were adopted by the Council of Minister and submitted to Parliament.
[6.3] Review the framework for the valuation of housing.	**Observed:** Study presented by PT authorities and changes to the current legislation will be adopted by end-December according to which all housing stock will be evaluated by end-2012.

Judicial system	
[7.2] Develop targeted measures to resolve court backlog.	**Observed:** Measure completed in time.
[7.4] Finalise roadmap for the implementation of the Judicial Reform.	**Ongoing:** The improvement of the efficiency of the court system and the ongoing review of Code of Civil Procedure (measure 7.11.) being closely interconnected, measure 7.4 has been adapted to better match with the revised measure 7.11 and its new deadlines on the review of the Code of Civil Procedure.
[7.7] Adopt new law on Arbitration.	**Observed:** The law on Arbitration was approved by Parliament on 2 November 2011.
[7.13] Introduce standardised court fee and special court fees for certain categories of cases to discourage spurious litigation.	**Observed:** A draft law, on which the Commission has been consulted, has been approved by the Cabinet of Ministers on 13 October 2011. This law will be adopted on 7 December 2011.
Competition, public procurement, and business environment	
[7.18] Restrict use of holding or acquisition caps beyond the privatisation transaction.	**[Partially observed/recurrent measure:]** Draft privatisation implementing laws of EDP and REN were submitted on 25 October 2011, and later signed by President. Both are in line with MoU objective.
[7.20] Launch the call for tender for the report on October.	**Partially observed:** Invitation and terms of reference were submitted on 26 October 2011, but no call for tender. Direct award expected in November.
[7.22] Eliminate exemptions permitting direct award of public contracts below the Public Procurement Directives thresholds wherever this does not entail amending the Public Procurement Code.	**Not applicable:** Government has informed EC/ECB and IMF staff that those exemptions are in the Public Procurement Code, except the one in the previous budget law, which has not been adopted. The present budget law does not contemplate such as exemptions (assessment of the budget law to be carried).

ANNEX 2. COMMISSION SERVICES' MACROECONOMIC PROJECTIONS, 2011-2015

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

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	2.3	-3.8	-5.8	-1.1	0.9	0.4
2. Government consumption expenditure	1.3	-3.7	-4.1	-2.4	-0.6	-0.3
3. Gross fixed capital formation	-4.9	-11.3	-10.3	0.6	4.3	3.6
4. Final domestic demand	**0.8**	**-5.1**	**-6.2**	**-1.0**	**1.2**	**0.8**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**0.7**	**-5.2**	**-6.1**	**-0.9**	**1.2**	**0.9**
7. Exports of goods and services	8.7	6.8	3.8	5.5	6.1	6.3
7a. - of which goods	9.7	7.2	4.3	5.3	5.9	6.1
7b. - of which services	6.3	5.8	2.5	6.2	6.7	6.8
8. Final demand	**2.4**	**-2.5**	**-3.6**	**0.9**	**2.6**	**2.5**
9. Imports of goods and services	5.1	-4.8	-5.0	1.2	3.2	3.0
9a. - of which goods	5.3	-6.4	-5.8	1.2	3.1	3.0
9b. - of which services	3.6	4.5	-1.0	1.0	3.6	3.2
10. Gross domestic product at market prices	**1.4**	**-1.6**	**-3.0**	**0.7**	**2.4**	**2.2**
Contribution to change in GDP						
11. Final domestic demand	0.8	-5.5	-6.5	-1.1	1.2	0.8
12. Change in inventories + net acq. of valuables	-0.1	-0.1	0.1	0.1	0.0	0.0
13. External balance of goods and services	0.6	3.9	3.3	1.6	1.2	1.4

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

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	4.0	-0.4	-2.6	0.3	2.3	2.0
2. Government consumption expenditure	0.7	-6.2	-10.9	-5.4	-0.3	0.7
3. Gross fixed capital formation	-2.3	-9.3	-9.1	3.0	6.5	5.5
4. Final domestic demand	**2.2**	**-3.1**	**-5.3**	**-0.3**	**2.6**	**2.4**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**2.2**	**-3.1**	**-5.0**	**0.1**	**2.6**	**2.3**
7. Exports of goods and services	13.4	13.0	5.4	7.5	8.0	7.9
8. Final demand	**4.5**	**0.5**	**-2.4**	**2.1**	**4.1**	**4.0**
9. Imports of goods and services	10.1	3.4	-3.5	2.6	4.7	4.6
10. Gross national income at market prices	3.3	-1.0	-2.2	1.9	3.9	3.7
11. Gross value added at basic prices	1.7	-1.1	-2.2	2.2	4.5	4.2
12. Gross domestic product at market prices	**2.5**	**-0.6**	**-1.9**	**1.9**	**3.9**	**3.7**

Table 3: Implicit price deflators

% change in implicit price deflator	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	1.6	3.5	3.3	1.4	1.4	1.6
2. Government consumption expenditure	-0.6	-2.6	-7.1	-3.0	0.3	1.1
3. Gross fixed capital formation	2.7	2.3	1.3	2.4	2.1	1.8
4. Domestic demand	**1.5**	**2.2**	**1.1**	**1.0**	**1.3**	**1.5**
5. Exports of goods and services	4.3	5.8	1.5	1.9	1.8	1.5
6. Final demand	**2.1**	**3.1**	**1.3**	**1.2**	**1.5**	**1.5**
7. Imports of goods and services	4.8	8.6	1.7	1.4	1.5	1.6
8. Gross domestic product at market prices	**1.1**	**1.1**	**1.1**	**1.2**	**1.4**	**1.4**
HICP	**1.5**	**3.6**	**3.3**	**1.3**	**1.5**	**1.5**

Table 4: Labour market and cost

Annual % change	2010	2011	2012	2013	2014	2015
1. Labour productivity (GVA per employee)	2.9	-1.2	-1.7	0.8	1.5	1.2
2. Compensation of employees per head	1.7	-0.4	-2.5	-0.4	1.5	0.8
3. Unit labour costs	-1.2	0.9	-0.8	-1.2	0.0	-0.4
4. Total population	0.0	0.0	0.0	0.0	0.0	0.0
5. Population of working age (15-64 years)	-0.2	-0.2	-0.1	0.0	0.1	0.1
6. Total employment	-1.5	-1.0	-1.6	0.2	1.4	1.5
7. Calculated unemployment rate - Eurostat definition (%)	10.9	12.7	13.8	13.6	12.5	11.6

Table 5: External balance

levels	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	38.9	44.4	47.1	50.6	54.6	58.8
2. Imports of goods (fob)	56.2	57.3	54.9	56.3	59.0	61.8
3. Trade balance (goods, fob/fob) (1-2)	**-17.2**	**-12.8**	**-7.8**	**-5.8**	**-4.5**	**-2.9**
3a. p.m. (3) as % of GDP	*-10.0*	*-7.5*	*-4.6*	*-3.4*	*-2.5*	*-1.6*
4. Exports of services	14.5	16.0	16.6	17.9	19.4	21.0
5. Imports of services	9.6	10.8	10.8	11.0	11.6	12.1
6. Services balance (4-5)	**4.9**	**5.2**	**5.8**	**6.9**	**7.9**	**8.9**
6a. p.m. 6 as % of GDP	*2.8*	*3.0*	*3.5*	*4.0*	*4.4*	*4.8*
7. External balance of goods & services (3+6)	**-12.4**	**-7.6**	**-2.0**	**1.1**	**3.4**	**6.0**
7a. p.m. 7 as % of GDP	*-7.2*	*-4.4*	*-1.2*	*0.7*	*1.9*	*3.2*
8. Balance of primary incomes and current	-4.4	-5.3	-5.7	-6.0	-6.3	-6.5
8a. - of which, balance of primary income	*-5.8*	*-6.4*	*-6.7*	*-6.9*	*-7.2*	*-7.4*
8b. - of which, net current Transfers	*1.3*	*1.1*	*1.0*	*0.9*	*0.9*	*0.9*
8c. p.m. 8 as % of GDP	*-2.6*	*-3.1*	*-3.4*	*-3.5*	*-3.5*	*-3.5*
9. Current external balance (7+8)	**-16.8**	**-13.0**	**-7.7**	**-4.8**	**-2.8**	**-0.5**
9a. p.m. 9 as % of GDP	-9.7	-7.6	-4.6	-2.8	-1.6	-0.3
10. Net capital transactions	2.4	2.5	2.4	2.5	2.6	2.7
11. Net lending (+)/ net borrowing (-) (9+10)	**-14.4**	**-10.5**	**-5.3**	**-2.3**	**-0.2**	**2.2**
11a. p.m. 11 as % of GDP	*-8.4*	*-6.1*	*-3.1*	*-1.4*	*-0.1*	*1.2*

Table 6: Fiscal accounts

	2010	2011	2012	2013	2014	2015
			% of GDP			
Indirect taxes	13.3	13.9	15.2	15.2	15.0	14.9
Direct taxes	8.9	9.4	9.3	9.4	9.5	9.5
Social contributions	12.2	12.4	12.0	11.8	11.6	11.4
Sales and other current revenue	4.4	4.5	4.7	4.7	4.7	4.7
Total current revenue	**38.9**	**40.2**	**41.1**	**41.1**	**40.8**	**40.6**
Capital transfers received	2.7	3.2	1.4	1.4	1.4	1.4
Total revenue	**41.6**	**43.5**	**42.5**	**42.5**	**42.2**	**41.9**
Compensation of employees	12.2	11.6	10.0	9.6	9.2	9.0
Intermediate consumption	5.0	4.6	4.6	4.3	4.2	4.1
Social transfers in kind via market producers	4.9	4.6	4.4	4.2	4.1	4.0
Social transfers other than in kind	17.0	17.0	16.7	16.7	16.4	16.2
Interest paid	3.0	4.2	5.0	5.2	5.3	5.2
Subsidies	0.7	0.9	1.0	0.9	0.9	0.9
Other current expenditure	2.8	2.2	2.1	1.9	1.9	1.8
Total current expenditure	**45.7**	**45.2**	**43.9**	**42.7**	**41.8**	**41.1**
Gross fixed capital formation	3.6	2.6	2.1	1.8	1.8	1.8
Other capital expenditure	2.1	1.5	0.9	0.9	0.9	0.8
Total expenditure	**51.3**	**49.3**	**47.0**	**45.5**	**44.5**	**43.7**
General Government balance (EDP)	**-9.8**	**-5.9**	**-4.5**	**-3.0**	**-2.3**	**-1.8**
			% change			
Indirect taxes	7.9	4.0	6.9	2.0	2.9	2.8
Direct taxes	0.7	5.6	-3.2	3.3	4.3	4.7
Social contributions	0.4	1.0	-5.3	0.1	2.5	1.9
Sales and other current revenue	-1.2	0.0	2.5	2.4	4.2	2.9
Total current revenue	**2.7**	**2.9**	**0.3**	**1.8**	**3.2**	**3.0**
Capital transfers received	195.1	18.8	-58.6	2.9	2.9	3.7
Total revenue	**7.2**	**4.0**	**-4.1**	**1.8**	**3.2**	**3.0**
Compensation of employees	-0.9	-5.8	-14.8	-2.5	-0.6	1.5
Intermediate consumption	4.1	-8.6	-1.7	-5.4	2.1	0.7
Social transfers in kind via market producers	2.2	-6.3	-6.0	-4.5	1.7	1.7
Social transfers other than in kind	2.5	-0.4	-3.8	1.6	2.0	2.4
Interest paid	6.8	39.4	15.6	5.4	5.6	2.6
Subsidies	-11.1	26.2	9.6	-3.3	-3.8	2.5
Other current expenditure	12.8	-22.6	-7.2	-7.6	2.0	2.2
Total current expenditure	**2.3**	**-1.7**	**-4.7**	**-0.8**	**1.7**	**2.0**
Gross fixed capital formation	24.1	-28.3	-19.1	-11.9	2.0	2.0
Other capital expenditure	84.7	-25.1	-39.9	-4.5	0.3	1.1
Total expenditure	**5.5**	**-4.5**	**-6.6**	**-1.4**	**1.7**	**2.0**
Nominal GDP, EUR bn	172.8	171.8	168.5	171.7	178.4	185.0

Table 7: Government debt developments

	2010	2011	2012	2013	2014	2015
			levels, EUR bn			
EDP deficit	**-16.9**	**-10.1**	**-7.6**	**-5.2**	**-4.1**	**-3.4**
Gross debt	161.3	184.2	195.9	202.8	207.0	210.4
Change in gross debt	21.3	22.9	11.7	7.0	4.2	3.4
Nominal GDP	172.8	171.8	168.5	171.7	178.4	185.0
Real GDP	170.9	168.1	163.1	164.3	168.3	172.0
Real GDP growth (% change)	**1.4**	**-1.6**	**-3.0**	**0.7**	**2.4**	**2.2**
Change in gross debt (% of GDP)	12.3	13.3	6.9	4.0	2.4	1.8
Stock-flow adjustments (% of GDP)	2.6	7.5	2.5	1.0	0.1	0.0
			% of GDP			
EDP deficit (% of GDP)	**-9.8**	**-5.9**	**-4.5**	**-3.0**	**-2.3**	**-1.8**
Gross debt ratio	**93.3**	**107.2**	**116.2**	**118.1**	**116.0**	**113.7**
Change in gross debt ratio	10.3	13.9	9.0	1.9	-2.1	-2.3
			Contribution to change in gross debt			
Primary balance	6.7	1.6	-0.5	-2.2	-3.0	-3.4
"Snow-ball" effect	1.0	4.8	7.0	3.0	0.7	0.9
of which						
Interest expenditure	*3.0*	*4.2*	*5.0*	*5.2*	*5.3*	*5.2*
Real growth effect	*-1.2*	*1.5*	*3.2*	*-0.9*	*-2.8*	*-2.6*
Inflation effect	*-0.9*	*-1.0*	*-1.2*	*-1.4*	*-1.7*	*-1.7*
Stock-flow adjustments	**2.6**	**7.5**	**2.5**	**1.0**	**0.1**	**0.0**
Implicit interest rate	*3.7*	*4.5*	*4.6*	*4.5*	*4.6*	*4.7*

ANNEX 3: INDICATIVE FINANCING NEEDS AND SOURCES

General government financing needs and sources (EUR billion) [1]

		2011 Jun-Dec	2012 Year	2013 Year	2014 Jan-Jun	2011-2014 Total
A	General government (GG) deficit [2]	8.8	7.5	5.1	3.3	**24.7**
B	Amortization of debt issued by central government (C+D)[3]	27.2	24.1	19.4	10.5	**80.9**
C	of which short-term debt[4]	20.8	9.0	9.0	4.2	**42.9**
D	of which long-term debt[5]	6.4	15.1	10.4	6.3	**38.1**
E	Net redemption of non-traded debt issued by central government	1.9	1.0	0.3	0.0	**3.2**
F	**Financing need for GG deficit and debt amortization (A+B+E)**	**37.9**	**32.6**	**24.8**	**13.7**	**108.8**
G	Rollover rate of short-term debt	43%	100%	100%	100%	72%
H	Rollover rate of long-term debt	0%	0%	96%	96%	42%
I	**New general government borrowing (J+K)**	**9.0**	**9.0**	**18.9**	**10.2**	**47.0**
J	of which short-term borrowing (C*G)	9.0	9.0	9.0	4.2	31.0
K	of which long-term borrowing (D*H)	0.0	0.0	10.0	6.0	16.0
L	**Privatisation receipts**	**0.5**	**4.0**	**1.0**	**0.0**	**5.5**
M	**Bank Solvency Support Mechanism**	**1.0**	**7.0**	**4.0**	**0.0**	**12.0**
N	**Others**[6]	**0.9**	**4.6**	**1.2**	**4.3**	**11.0**
O	**Financing gap (F-I-L+M+N)**[7]	**30.3**	**31.2**	**10.0**	**7.9**	**79.5**

SOURCE: Portuguese authorities and Commission services' estimates.

[1] Data in this table are subject to revision. The figures in each column report the financing needs and sources in the respective calendar year.

[2] 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).

[3] 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.

[4] Tentative schedule based on the stock of debt outstanding as at the time of the programme agreement. Half of the outstanding stock of T-bills at end-May 2011 are assumed to be rolled-over throughout the programme period. The financing need for the amortization of short-term debt in 2011 included the unwinding of repo operations.

[5] Includes maturing medium and long-term debt owed by state-owned enterprises classified within the general government sector. Estimates of SOE debt based on latest data provided by the Banco de Portugal, with reference date of June 2011 for domestic loans.

[6] Includes change in cash position and bank restructuring costs related to the resolution of BPN.

[7] Equal by definition to the amount of planned annual disbursement.

Planned quarterly disbursements

Review Approximate disbursement period Period covered by disbursement	TOTAL	Approval Jun 2011 Jun-Sept 2011	1 Sept 2011 Q4 2011	2 Dec 2011 Q1 2012	3 Mar 2012 Q2 2012	4 June 2012 Q3 2012	5 Sept 2012 Q4 2012	6 Dec 2012 Q1 2013	7 Mar 2013 Q2 2013	8 June 2013 Q3 2013	9 Sept 2013 Q4 2013	10 Dec 2013 Q1 2014	11 Mar 2014 Q2 2014	12 June 2014 Q3 2014
Loan disbursements (EUR) [1]	**79.5**	**18.8**	**11.6**	**8.1**	**14.9**	**4.0**	**4.2**	**2.4**	**1.9**	**2.7**	**2.9**	**2.7**	**2.5**	**2.7**
of which IMF (approx. ⅓)[2]	27.4	6.5	4.0	2.8	5.2	1.4	1.5	0.8	0.7	0.9	1.0	0.9	0.9	0.9
of which EU (approx. ⅔)	52.0	12.3	7.6	5.3	9.7	2.6	2.8	1.6	1.3	1.8	1.9	1.8	1.7	1.8

[1] The size of disbursements are subject to revision after each Review. IMF disbursements are in SDRs and therefore subject to changes in the EUR/SDR.

[2] IMF disbursements are in SDRs. The estimates for the future IMF disburements in EUR currency are based on the EUR/SDR exchange rate on 21 November 2011.

ANNEX 4: PROGRAMME DOCUMENTS

LETTER OF INTENT

Lisboa, 9 December 2011

Mr Jean-Claude Juncker
President
Eurogroup

Mr Jan Vincent Rostowski
Minister of Finance
Poland

Mr Olli Rehn
Vice President
European Commission

Mr Mario Draghi
President
European Central Bank

Dear Sirs,

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

2. Policy implementation is broadly on track. In particular, we believe that the recent adoption of a bold and comprehensive 2012 budget will decisively set public finances on a sustainable path and bolster market confidence in our programme. All the quarterly quantitative performance criteria for the second review were met, along with the continuous criterion on external arrears. However, our end-September indicative target on the non-accumulation of new domestic arrears by the general government was breached. As a corrective measure, to avoid further arrears accumulation, we are strengthening commitment controls and ensuring adequate budgetary allocations to the health sector.

3. Expenditure overruns and the materialization of fiscal risks have complicated the attainment of the end-2011 fiscal deficit target. However, we intend to meet the target through a partial transfer of bank pension funds to the social security system—a one-off revenue item.

4. Fiscal-structural reform is addressing deep-seated challenges with expenditure control. To this end, we are strengthening public financial management, halting new PPP contracts, fundamentally restructuring the SOE sector and limiting further debt increases, and reforming revenue administration and the health sector. We are also revising our inter-governmental fiscal framework to enhance fiscal responsibility. We will require a statement of affairs for Madeira ahead of a financial arrangement with the region.

5. Our commitment to support financial system stability remains unchanged. Banks' deleveraging is progressing, and we will continue to ensure that funding plans are consistent with the

level of credit implied by the programme's macroeconomic framework. The legal framework for temporary capital increase of viable banks will be significantly improved by early 2012 with a view to ensuring financial stability while protecting tax payers. The structural benchmark on amending legislation to strengthen the early intervention framework and adopting the new bank resolution framework will be met by year-end.

6. Our ambitious structural reform agenda to foster higher and sustainable growth is on track, although we did not implement a fiscal devaluation given the large fiscal consolidation. We are working to give firms the flexibility to respond to changing demand conditions without disruptive changes in employment, which is particularly important in the current adjustment process . We are continuing to advance legislation and practices to enhance the competition framework and facilitate market entry. We are also making progress on the other structural reforms foreseen in the programme, including the energy, telecommunication and services sector, of the housing market and of the judicial system. We remain committed to an ambitious and frontloaded structural reform agenda to support the rebalancing of the economy.

7. On the basis of the policies defined in this letter, we request completion of the second review under the Economic Adjustment Programme. The attached MEFP and MoU propose new structural benchmarks relating to the fiscal area (reforming the regional finance law, assessing PPPs, and priority elements of SOE restructuring plans), structural reform (developing a proposal to correct excessive rents in energy markets), the banking sector (the rules governing the provision of public capital to banks), and the judicial process.

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

9. This letter is copied to Ms Christine Lagarde.

Sincerely yours,

/s/ /s/

Vítor Gaspar
Minister of State and Finance

Carlos da Silva Costa
Governor of the 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

December 9, 2011

A Macroeconomic Outlook

1. **While activity has been stronger than expected in 2011, projections for 2012 have been revised down.** The contraction in domestic demand so far in 2011, resulting from fiscal consolidation and tightening credit and financial market conditions, has been buffered by stronger-than-expected export performance. The economy is expected to contract by 1.6 percent for the year as a whole. In 2012, with more limited support from exports and a larger fiscal adjustment than at the time of the program, activity is projected to fall by 3 percent. The path of inflation during 2012, as in 2011, will continue to be largely influenced by revenue measures (VAT and tariff adjustments) in the context of the fiscal consolidation effort, with inflation projected at 3.2 percent despite the weak cyclical position. While the external current account is expected to improve by close to 2 percent of GDP in 2012, it will remain high.

B Fiscal Policy

2. **Although the end-September cash deficit target was met, slippages have opened a gap for the year as a whole.** The additional revenue measures taken during the summer are insufficient to cover the significant slippages caused by a lack of expenditure control (both current and capital), and shortfalls in sales of real estate and concessions and non-tax revenue. As a result, a remaining projected gap of about 1.6 percent of GDP on an accrual basis has emerged, with 1.3 percent of GDP carrying over into 2012. In spite of this, we intend to meet the end-year fiscal deficit target of 5.9 percent of GDP through a partial transfer of banks' pension funds to the state social security system (see paragraph 19). Under ESA95 accounting rules the assets transferred in this context will be recognized as revenue.

3. **We have maintained our ambitious target for deficit reduction in 2012.** We are aiming at a general government deficit of 4.5 percent of GDP in 2012. This will bring the cumulative structural adjustment over 2011–12 to about 7½ percent. To achieve this, the 2012 budget approved by Parliament in late November (*prior action*) includes discretionary measures of over 6 percent of GDP against a no-policy- change scenario. These measures cover the gap already identified at the time of the program request, the carry-over of the 2011 slippages, as well as the impact of higher market interest costs and the downward revision in growth projections. Over two-thirds of the measures are on the expenditure side, in line with the objectives agreed under the program. Two key measures are: (i) suspending the 13th and 14th months' salaries and pensions in 2012 while protecting the lowest salaries and pensions; and (ii) a sharp decline in the number of goods and services subject to reduced VAT rates.

4. **We are committed to clear the stock of domestic arrears over time.** Despite our efforts, the continuous indicative target on non-accumulation of domestic arrears was breached in September, bringing the total increase to over €170 million since end-August and the stock to about 3.2 percent of GDP. To avoid further accumulation of arrears, the 2012 budget ensures adequate allocations to the health sector—where about 40 percent of the arrears are concentrated. Strengthened commitment controls will also help avoid accumulating new arrears (see below). We need more time to finalize our strategy to settle existing arrears for local and regional governments and the health sector, which will be presented by end-December 2011. This will include validation plans and a road map which will be discussed with the EC and the IMF. The speed of arrears clearance will depend on availability of financing. Various options will be considered, including using the financing generated by banks' pension fund transfers. The settlement process will give priority to arrears in hospitals, to improve the liquidity position of suppliers and likely allow hospitals to obtain discounts when re-negotiating delivery contracts.

C Streamlining the Public Sector

Public Financial Management (PFM)

5. **We will continue implementing public financial reforms aimed at improving fiscal reporting and strengthening the budget process.** In line with the program, we have published our Medium-Term Fiscal Strategy and implemented a monthly survey on arrears (both end-August SBs). We also have included in the 2012 budget information on tax expenditures and fiscal risks. We will strengthen our analysis by publishing a Tax Expenditure Report and a Fiscal Risk Statement by end-March 2012 in coordination with IMF/EC. Thereafter the reports will be submitted annually together with the budget proposal. We will also enhance fiscal transparency by publishing the level of State guarantees in our monthly budget execution bulletin. Consolidated general government cash-based reports will be published monthly starting in February 2012, and progressively enlarging the scope as indicated in the MoU.

6. **Given the 2011 expenditure slippages, we will ensure strict enforcement of expenditure plans through the adoption of stronger commitment controls.** In order to ensure tight control of budget execution in 2012, we will present appropriate legislation on public accounting by end-December 2011. Our objective is to adjust the current legal framework to reflect the new procedure through which we will control expenditure commitments in the 2012 budget execution—namely by starting to control commitments against the availability of funds.

Public-Private Partnerships (PPPs)

7. **Assessment and monitoring of PPPs is being strengthened.** We have published a comprehensive assessment of 36 PPPs (above the initial commitment of 20 PPPs) and 24 concessions, projecting future cash flows and risks. This assessment has shown rapidly increasing spending pressures affecting, in particular, the financial sustainability of Estradas de Portugal. We will reduce these pressures by increasing revenues and seeking renegotiation of contracts, already identified in our SOE strategy considering the costs and benefits of renegotiation. To increase transparency, we will, by December 15, publish all PPP contracts on the MOF website (with the exception of statements subject to confidentiality clauses).

8. **Due to difficulties in the bidding preparation, the end-December structural benchmark on hiring a top tier accounting firm to review PPP contracts is being delayed.** We are now planning to launch the tender by end-December (new structural benchmark) with a view to signing the service contract by end-March 2012 subject to legal contingencies associated with the procurement process. The conclusion of the study will be completed three months after the awarding of the contract. We remain firmly committed not to enter in new PPP contracts depending on the results of the study and, looking ahead, we will revise our current PPP framework in order to ensure a fiscally prudent model. We will ensure that the same commitments apply for regional PPPs, and that local governments do not enter into any PPP contracts.

State-Owned Enterprises (SOEs)

9. **We are fundamentally restructuring the SOE sector to enhance efficiency, restore its financial sustainability, and re-focus its activities on core public policy objectives**. We have prepared a strategic plan detailing how to (i) bring SOEs with commercial activities to operational balance by end-2012; (ii) close or privatize firms providing non-essential services or goods; and (iii) deal with the specific problems of the heavily indebted transport sector companies. The plan will be implemented with the aim of reducing SOE indebtedness and restructuring to ensure improved conditions for market financing. The 2012 budget incorporates cost savings (including the budgeted wage cuts) and tackles the financial burden of the central government SOEs. In order to further streamline the SOE sector, we will eliminate most subsidiaries and shareholdings in non-core activities by 2014. Concrete proposals on these divestments will be included in the report that will assess SOE's financial prospects, potential government exposure, and scope for orderly privatization (end-February 2012 structural benchmark). We are also addressing SOE problems at the local and regional levels (see below).

10. **Growth in SOE indebtedness has been excessive**. Additional efforts are necessary. We commit to limiting the increase in the overall borrowing requirements of the SOE sector,

including those inside and outside general government. We are preparing the new legal framework for SOEs to be submitted to Parliament by end-January 2012, in which we will include the prohibition for SOEs within the general government from incurring new debt with the private sector. We are also developing a strategy to manage the heavy debt load of these firms, including the sale of assets in non-core areas of these firms.

Revenue Administration

11. **We have made significant progress in implementing the program measures on revenue administration.** Our goals are to modernize and merge the tax and customs administrations; strengthen the audit function; improve tax compliance; and facilitate the efficient resolution of tax cases disputed in court. In particular:

- Plans for the creation of a new revenue authority—*Autoridade Tributária e Aduaneira* (AT) are advancing well. The AT will be operational starting January 1, 2012, and our focus in 2012 will be to merge central and support functions, adopt a full-fledged large taxpayers unit, and reduce the number of branches by 20 percent. We will continue deepening the reform in 2013 by introducing a business function-type structure and by reducing the number of offices by additional 20 percent.

- The 2012–14 Strategic Plan to Combat Tax and Customs Fraud and Evasion has been prepared. We will intensify our efforts to curb non-compliance, including through the full use of our anti-money laundering framework, focusing attention on high-evasion sectors and taxpayers and will adopt e-invoicing mechanisms to facilitate compliance and improve control. We will finalize the assessment of the net financial impact of the proposed incentive scheme that grants a rebate of up to 5 percent on the VAT paid, subject to a limit per taxpayer, on electronically transmitted invoices in selected sectors, and consult with the EC/IMF before implementing the scheme.

- We have undertaken a comprehensive assessment of our Information Technology (IT) systems. Based on this assessment, and with support from IMF/EC technical assistance, we will prepare an IT Strategic Plan for the AT by December 2011.

Health Sector

12. **We are undertaking reforms to make our health system more efficient and financially sustainable.** As specified in the MoU, we are implementing measures to generate savings in pharmaceutical expenditures and hospital operating costs. We have also enacted legislation increasing moderating fees (*taxas moderadoras*) and reducing exemptions by end-January 2012. We have established a working group to promote efficiency gains and rationalize the health system, in order to address long-term expenditure pressures, and we

will finalize a proposal by end-March 2012. We aim to implement these measures while maintaining the high quality and universal coverage of the Portuguese health care system.

Regional and Local Governments

13. **The inter-governmental fiscal framework needs to be thoroughly revised to enhance fiscal responsibility and transparency across the general government.** We will need more time to submit the regional and local public finance laws to Parliament than originally envisaged (end-December 2011). Therefore, we will re-phase our commitment and, by end-December, prepare a document setting out the key elements of the reform. Based on this document and with IMF/EC technical assistance, we will submit to Parliament a draft regional public finance law by end-March 2012 (structural benchmark) and a draft local public finance law by end-June.

14. **We will seek a financial arrangement with the Autonomous Region of Madeira.** The region poses a significant drag on the Portuguese public finances. The arrangement will include quantitative criteria on fiscal performance and structural reforms – the latter in line with the recommendations of the September technical assistance mission. As a pre-condition for signing the arrangement, the Madeira government will present a Statement of Affairs, which will be reviewed by the authorities and sent to the Court of Auditors (MoU paragraph 3.17). The 2012 Madeira budget should be fully consistent with the State budget. Under the program, we will ensure that all arrears are audited before any settlement strategy is implemented. Until the arrangement is in place, we will enhance our monitoring of Madeira's budget execution.

15. **An assessment of local and regional SOEs is being prepared.** Based on this analysis and in line with the Strategic Plan for the central government SOEs, we will prepare restructuring plans for the local SOE sector by end-January 2012. Regarding regional SOEs, restructuring in Madeira will start under the above-mentioned program, while work has already started in Azores.

Public Administration Reform

16. **Plans to streamline the public administration (including SOEs and foundations) are on track.** At the central level, we will fully implement the measures set out in the July PREMAC (Central Administration Restructuring and Modernization Plan), targeting a reduction of 40 percent in administrative structures and of 27 percent in management positions (which is above the 15 percent reduction agreed in the May 2011 MEFP). At the local level, we approved the "Green Paper for Local Administration Reform" in October and will submit the related draft laws to Parliament by end-June 2012.

Privatization

17. **We are entering the final stages of the privatization of EDP and REN.** Four bidders were selected for EDP, out of a shortlist of 6, and the second phase will be completed before end-2011. The financial closing of this privatization will occur in January 2012. As for REN, we will select the bidders and initiate the second phase of the privatization before end-2011. This transaction shall also be completed by early 2012. Bidders for both privatizations include large international strategic investors. We will proceed with the sale of GALP and the small remaining stake in REN on the free market, which we have delayed until market conditions improve. We expect to launch the sale of CP Cargo by mid-2012; are initiating the privatization process for ANA and TAP with a view to completing their sale in late 2012; and will launch the CTT privatization in the second half of 2012 and plan to complete the sale in early 2013. We are further considering the partial sale of RTP and Aguas de Portugal, and concessions for transport operators in Lisbon and Porto upon completion of restructuring of the public transport firms in these cities. We will begin to wind down Parpublica in 2013.

D. Protecting the Financial System amidst Deleveraging and the Sovereign Crises

18. **Bank liquidity remains under pressure.** We continue to encourage banks to strengthen their collateral buffers on a sustainable basis. Banco de Portugal (BdP), in consultation with the ECB, will continue to monitor closely the liquidity situation of the banking system and stands ready to take appropriate measures to maintain sufficient system liquidity.

19. **Policies must strike an appropriate balance between potentially conflicting objectives**. On the one hand, it is important that the banking system eliminates its funding imbalances, with a view to reducing its high dependence on Euro system liquidity as planned. On the other hand, the pace and composition of deleveraging should not jeopardize the provision of appropriate credit to finance productive investments in the economy, not least SMEs. Fiscal adjustment and an attendant reduction in the public sector's financing are crucial for reconciling potentially conflicting objectives. So far, the deleveraging has been facilitated by a reduction in banks' foreign activities, and there is no evidence of a domestic credit crunch. Moreover, deposits have been resilient throughout the crisis, reflecting the public's trust in the domestic banking system. We will continue to monitor credit market developments closely, and the periodic revisions of the medium-term funding plans will provide a tool for ensuring that the necessary deleveraging takes place in an orderly manner, consistent with the program's macroeconomic framework.

20. **The partial transfer of the banks' pension plans to the social security system will be done under balanced conditions.** The plan is to transfer, in 2011, only the

assets/liabilities relating to already-retired bank employees. The interest of all stakeholders, including the taxpayer, will be protected by ensuring that the pension liabilities and corresponding assets are taken over at a fair value, also respecting EU competition and state aid law. Additional capital requirements resulting from this transfer will be sought from private sources, as in other upcoming recapitalization efforts. However, if necessary, we will also offer to help banks cover the loss and the impact on capital by using part of the transfer itself and acquire common equity in banks. This would eliminate the need to use funding under the program for bank recapitalization. We will also ensure that the remainder of the transferred funds will be deposited in a blocked account until the completion of the third review.

21. **Pressures on bank capital have increased.** In addition to the targets and deadlines set under the program for end-2011, which banks are on track to meet from private sources, further strengthening in their capital position has become necessary. The capital exercise announced by the European Banking Authority (EBA) on October 26, including a new temporary buffer for sovereign exposures, requires substantial additional bank capital. Still more capital will be needed as a result of the planned partial transfer of banks' private pension plans as well as from the special on-site inspections program (SIP).

22. **The BdP has requested banks to present plans on how to augment their capital.** In addition to the EBA requirements in this field, banks will provide plans by end-February 2012 on how they intend to meet all their capital needs and the applicable deadlines, including their possible need for public capital. For the pension plan transfers and the SIP, the deadline for providing the capital will be the same as for the EBA exercise, namely end-June 2012. In the meantime, the impact of the pension plan transfers and the SIP on their end-2011 regulatory capital ratios will be temporarily neutralized.

23. **We are finalizing the rules governing the provision of capital from public sources to banks.** The draft law in the process of approval by Parliament and its implementing legislation are designed to extend temporary public support to viable banks, under strict conditions and with strong protection of the interests of the taxpayer. The legislation will ensure that the whole range of instruments deemed acceptable by the regulators, including EBA, will be available in Portugal. Whenever a beneficiary bank ceases to comply with the steps and deadlines agreed under the recapitalization plan, or does not manage to achieve the Core Tier 1 capital requirements within a time frame established by law, the government will start to exercise its full ownership rights. The price for shares issued as part of the public support will be in line with EU guidelines, and will include a sizeable discount to provide a large safety margin for the taxpayer. It will also include increasing incentives for early repayment. The repurchase price will be based on the issue price plus an accrued remuneration plus a share of any increase in value. In order to avoid

that the private shareholders are effectively subsidized by the public sector, and to enhance the prospects for capital injections, banks will be required to demonstrate that they have tried everything to achieve the capital increase via private sources before they receive any public funds. The framework for access to public capital will be finalized by end-January 2012 (structural benchmark) and will be consistent with EU state aid rules.

24. **We are continuing to streamline the state-owned CGD group to increase the capital base of its banking arm as needed.** Additional efforts will be deployed to meet the Core Tier 1 capital ratio target of 9 percent by end-2011, without relying on the sale of the insurance arm. This sale is expected to take place in 2012 directly to a final buyer and to contribute to meeting that year's additional capital needs. Insofar as these needs cannot be met from internal group sources, CGD will be provided with government capital support outside of the Bank Solvency Support Facility (BSSF).

25. **The BdP has enhanced its assessment of the banking sector's resilience under stress.** The recommendations made in June 2011 by a joint team of experts from the EC/ECB/IMF for the BdP's Solvency and Deleveraging Assessment Framework (SDAF) have been addressed. In the context of the assessment exercise planned for the third review, banks will incorporate the available results of the SIP, and the BdP will use the SDAF as a top-down benchmark as scheduled. The exercise will be performed in the context of the last step of the SIP and based on a three-year horizon, a 6 percent Core Tier 1 threshold, and a scenario prepared by the BdP and agreed with the EC/ECB/IMF, who will assess the quality of the results of the SDAF in that review. The BdP will continue to monitor on a quarterly basis the banks' potential capital needs with a forward looking approach under stress conditions.

26. **The BdP continues to strengthen its supervisory capacity.** It is making progress in widening the ranks of its specialist staff, and intends to establish a new division tasked with the maintenance of supervisory methodologies and tools, including the dissemination across its supervisory function of the experiences obtained via the SIP. Disclosure on non-performing loans has been improved by adding a new ratio in line with international practices to the current ratio that covers only overdue loan payments. Furthermore, the BdP remains committed to close coordination with home and host country supervisors, both within and outside the EU.

27. **Final negotiations to complete the sale of Banco Português de Negócios (BPN)** are proceeding**.** The conclusion of the transaction is pending a decision by the EC to ensure, inter alia, the transaction's legal certainty and to ensure minimum cost to the Portuguese taxpayers and the economy as a whole, including in relation to financial stability. The Portuguese government is fully co-operative in these matters with the relevant authorities.

28. **Progress continues to strengthen the early intervention, resolution, and deposit** insurance framework. The end-November 2011 structural benchmark for the legislative amendments will be met by end-year at the latest. Enabling legislation to strengthen the framework in these areas has already been passed by the Parliament and is awaiting promulgation by the President. The Decree Law implementing the detailed framework will thereafter need to be approved by the Council of Ministers and promulgated by the President. The Portuguese legislator, in establishing the legal framework for the resolution fund, is further examining the operational details, including the funding of such a fund, and will take into account the EU Directive on resolution more broadly as soon as it becomes available.

29. **We remain committed to strengthening the legal framework for corporate and household debt restructurings.** We are finalizing the corporate insolvency law amendments to support better early rescue of viable firms (end-December 2011 structural benchmark). Voluntary out of court restructuring guidelines in line with international best practices were issued in September 2011. We are also implementing an action plan to raise public awareness of restructuring tools.

30. **We will continue to enhance the monitoring of the high indebtedness of the corporate and household sectors.** The first quarterly monitoring report has been published and we will continue to improve its information content. The work of the task force will continue on detailing the pressure funding points of companies and households and suggesting policy actions to mitigate them. The Ministry of Economy will, in by end-December 2011, provide the EC/ECB/IMF with an assessment of existing support mechanisms to SMEs and details of policy measures on financial and non-financial support to this sector.

D Enhancing Competitiveness and Efficiency through Structural Reforms

31. **Competitiveness gains are critical to ensure a sustainable adjustment of the economy to a higher and more balanced growth path**. The adjustment in the current account so far has been a result of a compression in domestic demand; going forward, it must be driven by a more dynamic export sector. While we have decided against fiscal devaluation as a policy tool to cut labor costs to firms, we are pushing ahead with other measures to boost the competitive position of Portuguese firms.

Labor Markets

32. **We recognize that Portuguese firms' limited ability to match their workforce to their needs is a key constraint to a well-functioning labor market.** Portugal ranks high on both the generosity of severance pay and on the restrictiveness of conditions for fair individual dismissal. We have already implemented legislation to reform severance payments

for new hires, reducing significantly dismissal costs to 20 days per year of service, eliminating the three month minimum payment, and capping payments at 12 months of pay. To further alleviate relevant constraints, and in consultation with social partners, we are:

- giving careful consideration to ways of (i) extending the severance pay adjustment to include current employees without reducing accrued-to-date entitlements (law proposal to be submitted to Parliament by end-March 2012), (ii) benchmarking benefits to the EU average of 8–12 days per year of work, and (iii) introducing an employer-financed severance pay fund Draft legislation will be submitted to Parliament no later than end-September 2012.

- developing proposals, to be submitted to Parliament by end-March 2012, which would ease the requirements for dismissals based on the extinction of the work position and based on a worker's unsuitability.

33. **To promote wage developments consistent with improving firms' competitiveness, we will not grant automatic extensions of collective agreements during 2012, while we redesign the features of the extension mechanism**. This should reduce pressures on firms facing tight profit margins and reduced demand, so as to avoid disruptive declines in employment. In the meantime, we will continue to work on developing clear criteria for the extension of collective agreements by end-June 2012, so that the new mechanism can enter into force by end-January 2013 (MoU paragraph 4.7).

34. **We are pushing ahead with measures to address the rise of long-term unemployment.** Our **dialogue** with social partners has been productive, and we are well advanced in formulating proposals for reforming the unemployment insurance system. Our proposals aim to increase incentives to work and reduce the risk of long-term unemployment. To affect incentives in a decisive way, we aim to reduce the maximum duration of unemployment insurance benefits to no more than 18 months, while strengthening the role of the contributory careers vis-à-vis the workers age in determining benefits. At the same time, we will broaden social safety nets by granting access to unemployment benefits sooner, after 12 months of work, and extending coverage to self-employed (MoU paragraph 4.1 iv).

Competition Framework

35. **We are reducing the scope for rent-seeking behavior and removing clearly identified competitive distortions**.

Telecommunications

- We are committed to further lowering mobile termination rates, thus encouraging market entry by smaller operators and correcting the competitive disadvantage of smaller mobile operators. Two reductions have already taken place in 2011, and a decision to further lower mobile termination rates by over 60 percent by end-2012, as compared with 2010 termination rates, has been submitted to public consultation.

- Recommendations made by the Competition Authority in the fixed communications market have been adopted, including dissemination of tools to compare pricing and other characteristics for the majority of services, standardization of contracts, and publication of a consumer guide. We will examine the need for further action (MoU paragraph 5.17).

- We have published the spectrum auction rules in line with our commitments in the MoU. A number of important features of the auction rules should encourage new entry and ensure a level playing field. We will conduct an assessment of the state of play in the market and address any resulting anti-competitive practices or distortion (within two years of the auction). We are committed to use the enforcement mechanisms inscribed in the auction rules to ensure fair and reasonable access to national roaming agreements, which is critical for potential new entrants.

- We will renegotiate by end-2011 the concession contract with PT Telecom as it pertains to providing universal service, in order to award the contract through a tender procedure.

Competition Authority and Regulators

- The draft new Competition Law will be submitted to Parliament by end-January 2012 (structural benchmark). We will invite three qualified entities to submit proposals for the study of nomination practices, responsibilities, independence, and resources of the National Regulatory Authorities. The study, to be completed by April 2012, will be used to address any deficiencies in the regulatory framework. In the meantime, we will continue to strengthen sectoral regulators, ensuring they enjoy the independence they require to carry out their tasks (in line with our commitments under MoU paragraph 5.18 and 5.21).

Services and regulated professions

- **We are committed to more integrated and open services markets.** We will implement reforms in the services sector and regulated professions to facilitate the establishment and cross-border provision of services and to remove unjustified restrictions to access and activity exercise in regulated professions.

Rental market reform

- We have identified measures to amend the urban rental law and simplify procedures for renovation to promote mobility and foster an efficient housing market as detailed in the MoU. Draft legislation will be submitted to Parliament by end-December 2011.

Energy Markets

36. **Recognizing the need to address competitiveness comprehensively and across all sectors, we will take bold steps to reduce excessive rents in energy markets.** High rates of return granted to generators in the standard and special regimes are recovered from electricity consumers and represent a significant share of the total electricity payment and weighing on input costs in energy-intensive industries. In line with our decision to avoid excessively large increases in electricity prices, these policy costs are not currently fully compensated by electricity tariffs. The associated debt ("tariff deficit") to distributors is expected to rise steadily, potentially posing risks to cash flows or crowding out credit as the debt is securitized with banks. To that end, we will adopt measures to set the national electricity system on a sustainable path leading to the elimination of the tariff debt (*déficit tarifário*) by 2020 and ensure that it will stabilize by 2013. The latter deadline is subject to review, based on the specific measures that will be taken. To that end, by end-January 2012 (structural benchmark), we will prepare a proposal which specifically corrects excessive rents in special (co-generation and renewables) and standard regimes (CMECs, PPAs, and power guarantee mechanism). This proposal will consider the merits of a full range of concrete measures, and will cover all sources of rents.

Judicial Reforms

37. **We are implementing targeted measures to achieve a steady reduction of the backlogged enforcement cases.** An inter-agency task force will be established by end-November 2011 to set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, with the first report to be completed by February, 15 2012.To improve the legal and institutional framework for enforcement agents, we will prepare an action plan by end-February 2012 to: (i) identify measures over the next twelve months to achieve the objectives of strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, and (ii) include an analysis of the feasibility of a fee structure that incentivizes speedy enforcement. In addition, the oversight body's full access to the enforcement case files, including financial data, will become operational by March 15, 2012.

38. **We remain committed to streamlining the court structure and improving efficiency of the judicial process.** To this end, we will strive for timely implementation of

the end-January 2012 measures on a judicial roadmap to reduce the number of court districts and close down underutilized courts, an assessment of court management, a new personnel management plan, separate chambers within the Commercial Courts and allocation of resources based on court by court quantitative data. A revised judicial roadmap based on stakeholder consultations and cross country experience will be prepared by end-May 2012, and a bill to implement the roadmap will be submitted to Parliament by end-September 2012 (structural benchmark). We are also finalizing a proposal to improve the Code of Civil Procedure, including a single-judge procedure for small claims. Based on this proposal and comparative law analysis, the draft amendments to the Code of Civil Procedure will be prepared by end-June 2012, and submitted to Parliament by end-September 2012 (structural benchmark). Finally, the Ministry of Justice will submit to Parliament a bill to improve the Justices for the Peace regime by end-March 2012.

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

	Performance Criteria (unless indicated otherwise)						Indicative Targets		
	Jun-11		Sep-11						
	Program	Actual	Program	Actual	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
1. Floor on the consolidated General Government cash balance (cumulative) 1/	-5.4	-5.1	-6.7	-5.7	-10.3	-1.9	-4.4	-5.9	-7.6
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 2/	…	…	0	0.2	0	0	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	167.9	175.9	170.8	175.9	182.0	182.0	182.0	182.0
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	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 onwards. Insufficient information for application in June.
3/ Applies on a continuous basis.

Table 2. Portugal: Structural Conditionality 1/

	Measure	Timing	Status
Prior Actions			
1	Parliamentary approval of a 2012 budget consistent with the program, in line with paragraph 3 of the MEFP.		
Structural Benchmarks			
A. Strengthen financial stability and enhance banking sector monitoring:			
2	Amend relevant legislation in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework, introduce a regime for restructuring of banks as a going concern under official control and strengthen deposit insurance framework.	End-Dec. 2011 2/	
3	Amend the Insolvency Law to better facilitate effective rescue of viable firms .	End-Dec. 2011	
4	Amend the framework (Law No. 63-A/2008) for bank access to public capital. 4/	End-Jan. 2012	
B. Enhance competitiveness:			
5	Submit to Parliament legislation revising the Competition Law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonized with the European Union competition legal framework.	End-Jan. 2012 3/	
6	Prepare a proposal on measures to be used to correct excessive rents in special (co-generation and renewables) and standard regimes (CMECs, PPAs, and power guarantee mechanism). The proposal will consider the merits of a full range of measures and cover all sources of rents.	End-Jan. 2012 3/	
7	Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011	
8	Take all necessary legal, administrative, and other steps to make arbitration fully operational.	End-Feb. 2012	
C. Strengthen public financial management and reduce fiscal risks:			
9	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	Met
10	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	Met
11	Launch a tender to hire a top tier international accounting firm to review and complete a more detailed study of all 36 PPP contracts at the national level.	End-Dec. 2011	
12	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	
13	Revise and submit to Parliament the draft regional public finance law. 4/	End-Mar. 2012	

1/ Includes structural benchmarks through Q1 2012.
2/ Previously set for end-November 2011, delayed until end-December 2011.
3/ Previously set for end-December 2011, delayed until end-January 2012.
4/ New structural benchmarks.

PORTUGAL: TECHNICAL MEMORANDUM OF UNDERSTANDING

December 9, 2011

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

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

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

General Government

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

- 4.1. The Central Government. This includes:
  - 4.1.1. The entities covered under the State Budget, which covers the budgets of the Central Administration, including the agencies and services that are not administratively and financially autonomous, agencies and services that are administratively and financially autonomous (*Serviços e Fundos Autónomos* – SFA).
  - 4.1.2. Other entities, including Incorporated State-owned enterprises (ISOE), or extra-budgetary funds (EBF) not part of the State Budget, but which are, under

the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government.

- 4.2. Regional and Local Governments, that include:
  - 4.2.1. Regional Governments of Madeira and Azores and Local Governments (*Administrações Regionais and Locais*);
  - 4.2.2. Regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government.
- 4.3. Social Security Funds comprising all funds that are established in the general social security system.
- This definition of General Government also includes any new funds, or other special budgetary and extra budgetary programs or entities that may be created during the Program period to carry out operations of a fiscal nature and which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE in the correspondent subsector. The MoF will inform the EC, ECB, and IMF of the creation of any such new funds, programs, entities or operations at the time of its creation or statistical re-classification or, in the case of Regional and Local Governments, at the time the Government acknowledges its creation.
- The General Government, as measured for purposes of Program monitoring in 2011, shall not include entities nor operations that are re-classified into General Government during the remainder of 2011.[1] In 2012, it shall not include entities or operations (including pension funds) that are re-classified into General Government during 2012, but shall include those reclassified in 2011.[2]

5. **Supporting Material**

- 5.1. Data on cash balances of the State Budget will be provided to the EC, the ECB and the IMF by the MoF within three weeks after the end of the month. Data will

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

[2] On this issue, see also paragraph 13.

include detailed information on revenue and expenditure items, in line with monthly reports that are published by the MoF.

- 5.2. Data on the cash balances of the other parts of General Government as defined in paragraph 4[3] will be provided to the EC, the ECB and the IMF by the MoF within seven weeks after the end of the month. Data will include detailed information on revenue and expenditure items. Data will also include detailed information on PPP-related revenues and expenditures for those PPP reclassified within the General Government sector according to ESA 95, and called guarantees.

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

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

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

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

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

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

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

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

6.3. **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. From September 2011 onwards reports on the stock of arrears of the General Government will be published monthly. Data will be in line with the monthly publications of State Budget arrears, published on the MoF website.

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

Other provisions

7. For the purpose of the program, the expenditure of the central government that is monitored excludes payments related to bank support, when carried out under the program's banking sector and restructuring strategy. However, any financial operation by

central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to the EC, ECB, and IMF.

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

9. **Supporting material**.

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

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

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

10. **Definitions**. Commitment, liabilities, payables/creditors, and arrears can arise in respect of all types of expenditure. These include employment costs, utilities, transfer payments, interest, goods and services and capital expenditure. Commitments are explicit or implicit agreements to make payment(s) to another party in exchange for that party

supplying goods and services or fulfilling other conditions. Commitments can be for specific goods and services and arise when a formal action is taken by a government agency, e.g., issuance of a purchase order or signing a contract. Commitment can also be of a continuing nature that require a series of payments over an indeterminate period of time and may or may not involve a contract, e.g. salaries, utilities, and entitlement payments. Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources (usually cash) embodying economic benefits or service potential. In relation to commitment, the liability arises when a third party satisfies the terms of the contract or similar arrangement. Payables/creditors are a subset of liabilities. For the purposes of the program payables/creditors exclude provisions and accrued liabilities. Arrears are a subset of payables/creditors. For the purposes of the Program domestic arrears are defined as payables/creditors that have remained unpaid for 90 days or more beyond any specified due date (regardless of any contractual grace period). In case no due date is specified, arrears are defined as payables/creditors that have remained unpaid for 90 days or more after the date of the invoice or contract. Data on arrears will be provided within seven weeks after the end of each month. The continuous indicative target of non-accumulation of new domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the end of the previous month—based on the same perimeter with respect to the entities covered. 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 SOEs not includes in the General Government under ESA95 and ESA95 Manual on Government Deficit and Debt rules classification.

11. **Supporting material.** 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)

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

13. **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. From 2012 onwards, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) reclassification of entities or operations that affects the stock at end-December of the previous year.

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

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

15. **Definition**. For the purposes of the Program, the definition of debt is the same as in paragraph 12. An external debt payment arrear will be defined as a payment on debt to nonresidents, contracted or guaranteed by the general government, which has not been made within seven days after falling due (taking into account any applicable contractual grace period). The performance criterion will apply on a continuous basis throughout the Program period.

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

E Bank Solvency Support Facility

17. €**1** billion has been provided in cash and is made available in a separate dedicated account to be set up at the Bank of Portugal by end-June 2011. Future amounts for the bank support fund will be deposited into the dedicated account to the extent that there is a need for bank capital.

F Overall Monitoring and Reporting Requirements

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

PORTUGAL

MEMORANDUM OF UNDERSTANDING ON SPECIFIC ECONOMIC POLICY CONDITIONALITY

Second Update – 9 December 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, the second update of the Memorandum of Understanding on specific economic policy conditionality (MoU) details the general economic policy conditions as embedded in Council Implementing Decision 2011/344/EU of 17 May 2011 on granting Union financial assistance to Portugal.[1]

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

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

The second quarterly review was carried out in November 2011. It assessed compliance with the conditions to be met by end-October and the need and scope for additional policy steps. This second update of the MoU reflects the findings of the second review. The following reviews taking place in any given quarter will assess compliance with the conditions to be met by the end of the previous quarter or, where applicable, up to date of the mission.

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

[1] 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 specifies that the disbursements there under are subject to the compliance with the conditions of this Memorandum.

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

1. Fiscal policy

Objective

First, reduce the Government deficit to below EUR 10,068 million (equivalent to 5.9 percent of GDP based on current projections) in 2011 and EUR 7,645 million (4½ percent of GDP) in 2012. This should allow to reach a deficit target of 3 percent of GDP by 2013. Second, bring the government debt-to-GDP ratio on a downward path as of 2013. Third, maintain fiscal consolidation over the medium term up to a balanced budgetary position, notably by containing expenditure growth. This consolidation will be achieved by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups.

Fiscal policy in 2011

1.1. The Government will achieve a general government deficit of no more than EUR 10,068 million in 2011 on a European System of Accounts (ESA95) basis. The Government will also reach the (cumulative) quarterly ceiling for the consolidated General Government cash balance in the MEFP, as defined in the Technical Memorandum of Understanding (TMU). **[Q4-2011]**

1.2. With the information available as of early November, the Government has estimated a shortfall for the year 2011 as a whole of some 2¼ percent of GDP before the consideration of any corrective measure to achieve the 2011 fiscal target on an ESA 95 basis. Excluding the impact of selling the troubled bank BPN, the shortfall amounts to 2 percent of GDP.[2] A part of this shortfall had already been ascertained by August, while another part has been identified more recently, including slippages at the level of sales of concessions and real estate and higher capital spending.

1.3. The Government took some measures against the emergence of the shortfall, namely, a one-time surcharge in the context of the personal income tax and an increase in the VAT rates for natural gas and electricity to the standard rate was brought forward to October 01, 2011.

1.4. Despite these measures, a large gap remains to meet the General Government target in 2011. Therefore, already in August the authorities put forward a limited transfer of banks' pension funds to the Government sector, which were intended to be used exceptionally to meet the 2011 deficit target. The latest information indicates that the size of these transfers needs to be some 1.8 percent of GDP, substantially higher than projected in August, to

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

allow the government to meet the target.[3] The Government is committed to transfer the assets of these pension funds in full compliance with EU state aid rules.

Fiscal policy in 2012

1.5. The government will achieve a general government deficit of no more than EUR 7,645 million (4½ percent of GDP) in 2012.[4] **[Q4-2012]** The Government has not implemented the 'fiscal devaluation' as a tool to cut labour costs. The large fiscal consolidation and the associated risks to the projections of tax bases suggested postponing the fiscal devaluation to a later stage of the programme when uncertainties are reduced. Meanwhile, the government has introduced a number of other measures to boost the competitive position of Portuguese firms.

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

1.7. The measures listed below, worth 5.3 percent of GDP, when compared with the estimated outturn for 2011 (and above 6 percent of GDP when compared with a scenario of unchanged policies), will be carried out with the 2012 Budget Law [Q4-2011], unless elsewhere specified. Overall, expenditure reduction accounts for two thirds of that fiscal effort and revenue increases for one third. In addition, the Government will aim at reversing the expenditure overruns recorded in 2011.

Expenditure

1.8. Ensure that the public sector wage bill decreases in gross terms in 2012 by at least EUR 3,000 million (EUR 1,620 million taking into account the losses of government revenues at the level of income taxes and social contributions):

i. reduce wages for all general government sector employees in 2012 by (i) suspending the 13th and 14th monthly salary payments for those workers with monthly salaries of EUR 1,000 or more, (ii) suspending on average and in a progressive way the equivalent of one of those two salaries for those workers with monthly salaries between the minimum wage of EUR 485 and EUR 1,000. Similar measures will apply to all SOEs classified inside and outside the

[3] In order to meet the government deficit on an ESA95 basis. Excluding transactions related to the banking sector support and restructuring strategy under the programme as foreseen in the TMU, the size of the needed transfers would be 1.6 percent of GDP as the costs related to the sale of the troubled bank BPN are excluded.

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

perimeter of the government sector, and in any other public entity even if falling outside the perimeter of the government sector;[5]

ii. reduce the number of government employees by (i) limiting staff admissions in order to achieve annual decreases of 2% (full-time equivalent) in 2012-2014 in the permanent staff of central, regional and local governments, (ii) decreasing the number of temporary positions in specific areas of public administration. To support these objectives, binding numeric targets for staff reductions per main area of the administration will be defined by December 2011;

iii. make room to reverse the slippage in personnel costs recorded in 2011

iv. suspend all promotions in 2012;

v. reduce the overall budgetary cost of health benefits schemes for government employees schemes (ADSE, ADM and SAD);

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

1.9. Reduce pension expenditure in gross terms in 2012 by at least EUR 1,260 million (EUR 950 million taking into account the losses of government revenues at the level of income taxes): by (i) suspending the 13th and 14th monthly payments for those pensioners with monthly pension benefits of EUR 1000 or more, (ii) suspending on average and in a progressive way the equivalent of one of those monthly benefits for those with monthly pension benefits between EUR 485 and EUR 1000. The pensions of those receiving benefits below EUR 485 will be frozen and the lowest pensions will be marginally increased. In case a pensioner receives more than one pension, the consolidated pension income will be considered for the application of the thresholds defined here. These rules will also apply to subventions or subsidies paid by the government that take the nature of pensions even if designed otherwise.[6]

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

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

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

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

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[5] The discussion in Parliament of the 2012 Budget Law has led to a change in the salary threshold to EUR 1,100 for suspending both the 13th and 14th monthly salaries, and to between EUR 600 and EUR 1,100 for implementing the progressive suspension. The change has been done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital gains and investment income (e.g. dividends and interest payments) from 21.5% to 25%.

[6] The discussion in Parliament of the 2012 Budget Law has led to a change in the pension threshold to EUR 1,100 for suspending both the 13th and 14th monthly payments, and to between EUR 600 and EUR 1,100 for implementing the progressive suspension. The change has been done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital gains and investment income (e.g. dividends and interest payments) from 21.5% to 25%.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Revenue

1.18. 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. Raise VAT revenues through an increase in the efficiency of the VAT structure with a yield of at least EUR 2,040 million in 2012. This will be done by moving categories of goods and services from the reduced and intermediate VAT rates to higher ones. This includes the additional impact of the increase in the VAT rate for natural gas and electricity to the standard rate introduced in October 2011.

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

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

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

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

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

v. revising the taxation of income in kind;

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

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

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

i. abolishing all reduced corporate income tax rates;

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

iii. curbing tax benefits;

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

1.22. Increase excise taxes to raise at least EUR 180 million in 2012. In particular by:

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

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

iii. indexing excise taxes to core inflation.

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

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

Fiscal policy in 2013

1.25. The government will achieve a general government deficit of 3 percent of GDP or below. **[Q4-2013]**

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

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

Expenditure

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

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

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

iii. health sector: EUR 375 million;

iv. capital expenditure: EUR 350 million;

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

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

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

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

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

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

Revenue

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

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

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

iii. excise taxes: EUR 150 million.

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

Fiscal policy in 2014

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

1.33. Within the year, progress will be assessed against the (cumulative) quarterly ceilings for the consolidated General Government cash balance in the MEFP, as defined in the TMU, without prejudice to full-year ESA-95 deficit targets. **[Q1 and Q2-2014]**

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

2. Financial sector regulation and supervision

Objectives

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

Maintaining liquidity in the banking sector

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

Deleveraging in the banking sector

2.2. The banking system should eliminate its funding imbalances, with a view to reducing its high dependence on Euro system liquidity, as planned. Monitor the banks' implementation of the funding plans aiming at a loan-to-deposit ratio of about 120% in 2014. The pace and composition of deleveraging should not jeopardise the provision of appropriate credit to finance productive investment and working capital in the private sectors of the economy, not least SMEs. Fiscal adjustment and an attendant reduction in the public sector's financing are crucial for reconciling potentially conflicting objectives. Continue to monitor credit market developments closely and the periodic revisions of the medium-term funding plans will provide a tool for ensuring that the necessary deleveraging takes place in an orderly manner, consistent with the macroeconomic framework of the programme. [Ongoing]

Pension fund transfer

2.3. Ensure that the partial transfer of the banks' pension plans to the social security system will be done under balanced conditions. Only the assets/liabilities relating to the already retired bank employees will be transferred in 2011. The interest of all stakeholders, including the taxpayer, will be protected by ensuring that the pension liabilities and corresponding assets are taken over at a fair value, also respecting EU competition and state aid law [Q4-2011]. Additional capital requirements resulting from this transfer will be sought from private sources, as in other upcoming recapitalization efforts. However, if necessary, help will be offered to banks to cover the loss and impact on capital by using part of the transfer itself and acquire common equity in banks. This would eliminate the need to use funding under the programme for bank recapitalisation. The remainder of the transferred funds will be deposited in a blocked account until the completion of the third review[7].

Capital buffers

2.4. BdP will follow closely the plans the banks presented to reach a core Tier 1 capital ratio of 9 percent by Q4-2011 and 10 percent at the latest by Q4-2012.

2.5. In addition to the targets and deadlines set under the program for Q4-2011, which banks are on track to meet from private sources, further strengthen the banks' capital position. The capital exercise announced by the European Banking Authority (EBA) on October 26, including a new temporary buffer for sovereign exposures, requires substantial additional bank capital. Still more capital will be needed as a result of the planned partial transfer of banks' private pension plans as well as from the special on-site inspections program (SIP).

2.6. The BdP will request banks to present plans to augment their capital. In addition to the EBA requirements in this field, banks will provide plans by end-February 2012 on how they intend to meet all their capital needs and the applicable deadlines, including their possible need for public capital. For the pension plan transfers and the SIP, the deadline for providing the capital will be the same as for the EBA exercise, namely by Q2-2012. In the meantime, the impact of the pension plan transfers and of SIP on their Q4-2011 regulatory capital ratios will be temporarily neutralised.

2.7. Finalise the rules governing the provision of capital from public sources to banks. The draft law in the process of approval by Parliament and its implementing legislation are designed to extend temporary public support to viable banks, under strict conditions and with strong protection of the interests of the taxpayer. The legislation will ensure that the whole range of instruments deemed acceptable by the regulators, including EBA, will be available in Portugal. Whenever a beneficiary bank will cease to comply with the steps and deadlines agreed under the recapitalisation plan or does not manage to achieve the Core Tier 1 requirements within a time frame established by law, the government will start to exercise its full ownership rights. The price for shares issued as part of the public support will be in line with EU guidelines, and will include a sizeable discount to provide a large safety margin for the taxpayer. In order to avoid that the private shareholders are effectively subsidised by the public sector, and to enhance the prospects for capital injections, banks will be required to demonstrate that they have tried everything to achieve the capital increase via private sources before banks receive any public funds. It will also include increasing incentives for early repayment. The repurchase price will be based on the issue price plus an accrued remuneration plus a share of any increase in value. The

[7] As soon as the details of the transfer are defined, and no later than before the third quarterly review, the Government will present the estimated budgetary impact of this transfer over the programme period and corrective measures in case the transfer leads to gaps in and risks to government deficits.

framework for access to public capital will be finalised by end-January 2012[8] and will be consistent with EU state aid rules.

Caixa Geral de Depósitos (CGD)

2.8. Continue to streamline the state-owned CGD group to increase the capital base of its banking arm as needed. Additional efforts will be deployed to meet the Core Tier 1 capital ratio target of 9 percent by end-2011, without relying on the sale of the insurance arm. This sale is expected to take place in 2012 directly to a final buyer and to contribute to meeting that year's additional capital needs. Insofar as these needs cannot be met from internal group sources, CGD will be provided with government capital support outside of the BSSF.

Monitoring of bank solvency

2.9. In the context of the assessment exercise planned for the third review, the BdP will ensure that banks incorporate the available results of the SIP, and the BdP will use the SDAF as a top-down benchmark as scheduled. The exercise will be performed in the context of the last step of the SIP with a three-year horizon and a 6% Core Tier 1 threshold. [Ongoing]

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

Banking regulation and supervision

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

2.12. Publish the new non-performing loans ratio in addition to the current ratio that covers only overdue loan payments [Q4-2011].

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

Banco Português de Negócios

2.14. The authorities are asked to conclude the sale, pending a decision by the EC which is examining, inter alia, the transaction's legal certainty and to ensure minimum cost to the Portuguese taxpayer and the economy as a whole, including in relation to financial stability. The Portuguese government is fully co-operative in these matters with the relevant authorities. **[Ongoing]**

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

2.15. Once a decision by the EU Competition authorities is taken, the 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. **[Ongoing]**

Bank resolution framework

2.16. Strengthen the early intervention, resolution, and deposit insurance framework. The end-November 2011 deadline for the legislative amendments will be met by end-year at the latest. Enabling legislation to strengthen the framework in these areas has already been passed by the Parliament and is awaiting promulgation by the President. The Decree Law implementing the detailed framework will thereafter need to be approved by the Council of Ministers and promulgated by the President.

2.17. The legislator establishes the legal framework for the resolution fund and further examines the operational details, including the funding of such a fund and will take into account the EU Directive on resolution more broadly as soon as it becomes available. **[Ongoing]**

Corporate and household debt restructuring framework

2.18. Finalise the corporate insolvency law amendments to support better early rescue of viable firms by end-December 2011[9]. As voluntary out of court restructuring guidelines in line with international best practices were issued in September.

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

Monitoring of corporate and household indebtedness

2.20. Continue to enhance the monitoring of the high indebtedness of the corporate and household sectors. The first quarterly monitoring report has been published and will be further improved concerning its information content.. The work of the task force will continue on detailing the pressure funding points of companies and households and suggesting policy action to mitigating them. The Ministry of Economy will, by December 2011, provide the EC/ECB/IMF with an assessment of existing support mechanisms to SMEs and details of policy measures on financial and non-financial support to this sector.

3. Fiscal-structural measures

Objectives

Improve the efficiency of the public administration by eliminating redundancies, simplifying procedures and reorganising services; regulate the creation and functioning of all public entities (e.g. enterprises, Public-Private Partnerships, foundations, associations); re-focus their activities to core public policy objectives and enhance their cost efficiency and fiscal sustainability; streamline the budgetary process through the newly approved legal framework, including by adapting accordingly the budgetary and legal frameworks of

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

finance ; strengthen risk management, accountability, reporting and monitoring of all parts of the general government. Government action will build on the recommendations provided by the IMF/EU technical assistance missions that took place in July 2011.

Public Financial Management framework

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

Reporting

3.1. Apply the recently approved standard definition of arrears and commitments at all levels of general government. **[Ongoing]**

3.2. The existing survey of arrears will be covering all general government entities and SOEs classified outside the general government and all transactions (including employment costs, utilities, interest costs, transfers to local and regional governments, goods and services, capital expenditure, and transfers of withheld taxes and social contributions to respective responsible collection agencies and institutions). Following the survey, the authorities prepare a consolidated monthly report on arrears for the general government sector to be published in the monthly budgetary execution bulletin. **[Q4-2011]**

3.3. Enhance the existing monthly reporting on budgetary execution on a cash basis for the general government, on a consolidated basis. The monthly reporting perimeter currently includes the State, Other public bodies and entities, Social Security, regional and local governments and it will be progressively expanded, in line with the TMU, to include all SOEs and PPPs reclassified within the general government, regional and local governments. **[February 2012]**

3.4. 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]**

3.5. Develop intra-annual targets, and corrective measures in case of deviation from targets, for **[Q4-2011]**:

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 them with the standard definition of arrears and commitments. The commitment control procedures will be enforced and where necessary strengthened for all types of expenditure across the general government including the regional and local administration. All necessary legislation will be adopted by **end-2011** to ensure implementation of the commitment control procedures in accordance with the instructions issued to general government units in September 2011. In particular, the draft legislation will ensure:

i. from 1 January 2012:
   - commitments must be controlled against available funds recorded in the accounting system and evidenced by authorised commitment documents ("*cabimento*") bearing valid commitment numbers;
   - all other commitments will be considered illegal and not eligible for payment; and
   - any public official incurring such illegal commitment or expenditure will be subject to specified penalties in accordance with the budget framework law;

ii. systems and procedures will comply, by end-December 2011, with the revised budget execution rule, as set out in the above instruction;

iii. the Inspecção-Geral de Finanças (IGF) will carry out regular reviews of the commitment control system by **[Q2-2012]**.

3.7. Publish information on: number of general government staff on a quarterly basis (no later than 45 days after the end of the quarter); stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, special mobility condition flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. The regional and local administration will transmit the necessary information. Information on employment in SOEs (central, local and regional) and other public entities and/or bodies will also be compiled. **[Q1-2012]**

Monitoring

3.8. Apply the approved standard definition of contingent liabilities at all levels of government (central, local and regional)**. [Ongoing]**

3.9. Publish a comprehensive report on fiscal risks each year as part of the budget. The report will outline general fiscal risks and specific contingent liabilities to which the general government may be exposed, including those arising from Public-Private Partnerships (PPPs), SOEs and explicit guarantees to the banks. This year the fiscal risks report in the 2012 Budget will be enhanced, in cooperation with the EC and IMF staff and published by **Q1-2012**.

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

Arrears

3.11. The stock of domestic arrears will be significantly reduced by the end of the program period. To this effect, a strategy for the validation and settlement of arrears for the entities inside the general government as well as for SOEs classified outside the general government will be prepared. In this strategy, a roadmap will be provided setting out how and when the stock of arrears will be stabilised. Moreover, various options of settling arrears will be explored, providing appropriate incentive mechanisms including the potential of rebates for early settlements and rewarding entities that no longer accumulate new arrears. **[Q4-2011]**

Budgetary framework

3.12. Publish a fiscal strategy document for the general government annually in April. The document will be in compliance with the requirements of the 2011 revised Stability and Growth Pact and specify 4-year medium-term economic and fiscal forecasts and 4-year costs of new policy decisions. Budgets will include a reconciliation of revisions to the 4 year fiscal forecasts attributable to policy decisions and parameter revisions e.g. policy decisions, changes in the macroeconomic environment.

3.13. Following the recommendations of the July 2011 technical assistance mission, ensure full implementation of the Budgetary Framework Law adopting the necessary legal changes: **[Q4-2011]**

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. **[Q2-2012]**

3.14. The Fiscal Council will be operational by **[Q4-2011]**.

Regional and local budgetary frameworks

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

3.16. The budgetary frameworks at local and regional levels will be considerably strengthened, in line with recommendations by the IMF/EC technical assistance mission of July 2011. A proposal to revise the regional finance law **[Q1-2012]**[10] and a proposal to revise the local finance law **[Q2-2012]** will be submitted to Parliament. A document setting out a roadmap and the main elements and options for the revision of the laws will be presented to **[Q4-2011]**:

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

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

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

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

3.17. The Government will prepare a financial arrangement with the Autonomous Region of Madeira (RAM) given the significant drag that the region has caused on the Portuguese public finances and the high level of fiscal risks still remaining **[Q4-2011].** Responsibility for compliance with the measures and objectives laid down under the arrangement will be solely incumbent upon the RAM pursuant to the regional political autonomy granted under the Portuguese Constitution. This arrangement will comprise a debt sustainability analysis and will be designed similarly, and consistent with, the financial program between the Republic of Portugal and the EC/ECB/IMF. It will include quantified measures for fiscal performance and structural reforms which are in line with the recommendations set out in the September Technical Assistance mission. This arrangement will include in particular the following:

i. the 2012 RAM budget will be fully consistent with the State budget. Revenues will be increased through a significant reduction of the differences in rates to the mainland in corporate income tax, personal income tax and VAT, the introduction of road charging, and an adjustment of public services tariffs to cost recovery levels. The Fiscal Council will validate the revenue estimates of the RAM budget. Expenditure will be reduced according to the measures agreed in this MoU regarding public sector employment, wages, and administration;

ii. The central government will exert control of commitments and manage RAM's debt. All arrears will be audited before any settlement strategy is implemented.

iii. RAM's SOE sector will be significantly restructured in line with the requirements of this MoU. Public Private Partnerships will be evaluated with regard to the legality of contracts and the scope for their renegotiation identified.

3.18. As a pre-condition for signing the arrangement, the RAM will present a Statement of Affairs, which will be reviewed by the Republic's authorities and sent to the Court of Auditors. Until the arrangement has been agreed and its implementation by the RAM budget started, the Government will closely monitor the execution of the RAM budget, will keep its transfers to the RAM government suspended, and will not honour any new commercial or financial debt or guarantees by the RAM government and its SOEs that are not approved by the Ministry of Finance. **[Ongoing]**

Public Private Partnerships

Going beyond the obligation to assess the 20 most significant PPP contracts, the authorities provided an assessment of 36 PPPs and 24 concessions that are under the responsibility of the central government, projecting future cash flows and risks, showing rapidly increasing spending pressures that affect, in particular, the financial sustainability of Estradas de Portugal. These pressures will be reduced by increasing revenues and seeking renegotiation of contracts. Following this report and before end of December, all PPP contracts with the exception of statements subject to confidentiality clauses will be published. In particular, the Government will:

3.19. Commit to not enter into any new PPP agreement before the study results on existing PPPs and the legal and institutional reforms proposed become available (see below). **[Ongoing]**

3.20. Launch a tender, with a view to signing the service contract by **March 2012** subject to legal contingencies associated with the procurement process, to recruit a top tier international accounting firm to undertake a more detailed study to review PPP contracts of the central administration in consultation with National Statistical Institute (INE) and the Ministry of Finance.[11] **[Q4-2011]** The review will identify and, where practicable, quantify major contingent liabilities and any related amounts that may be payable by the Government. It will assess the probability of any payments by Government in relation to the contingent liabilities and quantify such amounts. The study, to be completed three months after the awarding of the contract**,** will assess the costs and benefits of renegotiating any PPP or concession contract to reduce the Government financial obligations.

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

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

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

State-owned enterprises[12]

The Government presented in November 2011 a strategy on how to restructure the State-owned enterprise (SOE) sector with the aim to enhance efficiency, restore its financial sustainability, and re-focus its activities on core public policy objectives. The strategy will be implemented with the aim of reducing SOE indebtedness and restructuring to ensure improved conditions for market financing. The 2012 budget incorporates cost savings (including the budgeted wage cuts) and tackles the financial burden of the central government SOEs. However, efforts to reduce operational costs across the sector by 15 percent with respect to 2009 have been met with mixed success. In order to make further progress in restructuring the SOE sector, while respecting EU competition and state aid rules, the Government will:

3.23. Fully implement ongoing plans to reduce operational costs of central government SOEs outside the health care sector by at least 15% on average compared with 2009 by the end of 2011. Most subsidiaries and shareholdings in non-core activities will be eliminated by 2014. Concrete proposals on these divestments will be included in the report that will assess SOE's financial prospects, potential government exposure, and scope for orderly privatization. **[February-2012]** Equivalent measures will be implemented for local and regional government SOEs. **[Ongoing]**

3.24. SOEs with commercial activity will reach operational balance by **[Q4-2012].** To this end the government will implement the comprehensive SOEs strategy by reviewing the tariff structure and service provision of SOEs, with numerical targets on cost reductions, including measures to realign wages or reduce employment, and further tariff increases as needed. Equivalent measures will be implemented for local and regional government SOEs. **[Q4-2012]**

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

3.25. Growth in SOE indebtedness has been excessive and additional efforts are necessary. The increase in the overall borrowing requirements of the SOE sector, both inside and outside general government, will be limited. In parallel with progress towards eliminating operational deficits, a strategy for managing the heavy debt load of SOEs will be developed, including the sale of assets in non-core areas of these firms, and in consultation with staff from EC, ECB and IMF. A new legal framework for SOEs will be submitted to Parliament by **January 2012**, which will include the prohibition for SOEs within the general government to incur new debt with the private sector.[13]

3.26. Prepare a report reviewing the operations and finances of SOEs at central, regional and local government levels. The report will assess each company's 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.[14] **[February 2012]**

3.27. 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, including in regional and local SOEs. **[Q4-2011]**

3.28. The Government will submit to Parliament a draft law to regulate the creation and the functioning of SOEs at the central level. No additional SOEs will be created until this law is adopted. 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]**

3.29. The authorities will prepare restructuring plans on local SOEs and the SOEs of each region by **January 2012**. As of next year, four annual SOEs reports will be prepared: for SOEs at central, local and the two regional levels. On the basis of these reports, MoF will present in its annual July report on SOEs a fiscal risk analysis of all SOEs at central, local and regional levels, including all liabilities (explicit and implicit). **[July-2012]**

Privatisation

3.30. The Government is implementing its privatisation programme under the new framework law for privatisation. The privatisation plan targets front-loaded proceeds of about €5 billion through the end of the program. Four bidders were selected for the electricity company (EDP), out of a shortlist of 6, and the second phase will be completed before end-2011. The financial closing of this privatization will occur in **January 2012**. As for the electricity network company (REN), the bidders will be selected and the second phase of the privatization initiate before **end-2011**. This transaction shall also be

[13] The special case of Estradas de Portugal is still being analysed and may thus be excluded.
[14] Structural benchmark in the Memorandum of Economic and Financial Policies.

completed by **early 2012**. Bidders for both privatizations include large international strategic investors. The sale of GALP and the small remaining stake in REN on the free market have been delayed until market conditions improve. The complete sale of the railway freight branch (CP Cargo) will be launched by mid-2012. The privatisation process for Aeroportos de Portugal (ANA) and the national air carrier (TAP) will be completed in late 2012. The privatisation of Correios de Portugal (CTT) will be launched in the second half of 2012 in order to complete the sale in early 2013. The partial sale of a public television channel (RTP) and Aguas de Portugal (AdP), and concessions for transport operators in Lisbon and Porto upon completion of restructuring of the public transport firms in these cities are being considered. The direct sale of CGD's insurance arm (Caixa Seguros) to a final buyer is expected to take place in 2012.

3.31. A strategy for Parpublica will be prepared, given that its sources of income will be affected by privatisation. **[Q4-2011]** The strategy will reconsider the role of Parpublica as a public company, including eliminating the obligation to remit the proceeds of the sale of assets to the Treasury in return for new assets, and considering the possibility of winding down the company or consolidating it with the general government. In the interim, the government will ensure that Parpublica will have sufficient income-generating assets to manage its debt and financing needs. The process of winding down Parpublica will begin in 2013.

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

Revenue administration

3.33. 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. **[Q1-2012]** It will proceed with the broader merger if the assessment is favourable. **[end-2013]**

3.34. Further comprehensive reform plans will be prepared, the focus in 2012 will be to merge central and support functions, adopt a full-fledged large taxpayers unit, and reduce the number of branches. The reform will be deepened in 2013 by targeting a business function-type structure. In particular, the following elements will be implemented:

i. establishing special chambers within the tax tribunals, specialised to handle large cases and assisted by a specialised technical staff pool; **[Q2-2012]**

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; **[Q4-2011]**

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; **[Q4-2011]**

iii. apply the new tax arbitration law; **[Ongoing]**

iv. establishing an integrated IT system between the revenue administration and the tax courts; **[Q1-2012]**

v. clearing cases worth above EUR 1 million by **Q4-2012** with the support of the tax court judges.

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**. [Q1-2012]**

3.37. Following the report assessing the current state of the information systems in the tax administration, an IT Strategic Plan will be prepared for the new merged revenue authority, with support from IMF/EC technical assistance. **[Q4-2011]**

3.38. The tax administration has concluded a strategic plan to combat fraud and evasion for 2012-2014. Additional efforts will be made for enforcement actions focused on high-evasion sectors and taxpayers. In particular, e-invoicing mechanisms will be adopted in order to facilitate compliance and improve control. The authorities will finalise the assessment of the net financial impact of the proposed incentive scheme that grants up to 5 percent rebate, subject to a limit per taxpayer, on VAT paid through electronically transmitted invoices in selected sectors and consult with the EC and IMF before implementing the scheme. **[Ongoing]**

Public administration

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

Central, regional and local administration

3.39. Reduce management positions and administrative units in the central administration according to the PREMAC report of 15 September 2011 by 27% and 40%, respectively. Following the organic laws of the ministries, the legislation of the entities will be finalised. **[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 (PREMAC). **[Q1-2012]**

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 so that each region will present its plan to attain the same target. **[Q4-2011]**

3.42. Prepare a detailed cost/benefit analysis of all public and quasi-public entities, starting with the foundations and extend later on to other bodies, across all levels of government. **[Q4-2011]** Based on the results of this analysis of the foundations, 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). **[Q1-2012**]

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 to be put in place to evaluate performance. Starting with the 2012 Budget, the number of SFAs will be reduced. The law will also aim at classifying as general government revenues, on a case-by-case basis, all own revenues of these funds that arise directly or indirectly from the use of the sovereign powers of the government (e.g. court fees, fines, fees for licenses or permits, and audit fees charged by the Court of Auditors). In addition, the Government will promote the initiatives needed so that the same objective is achieved by the regions. **[Q4-2011]**

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. In the context of the annual budget, promote flexibility, adaptability and mobility of human resources across the administration, including by providing training where appropriate. **[Q4-2011]** The mobility schemes, namely geographic mobility, will be reinforced as an instrument to manage human resources across administrations. **[Q2-2012]**

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

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

Health care system

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

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

Financing

3.51. Following the approval of NHS moderating fees (*taxas moderadoras*), enact legislation reviewing and increasing overall NHS moderating fees (*taxas moderadoras*) by **end December 2011** through:

i. a substantial revision of existing exemption categories, including stricter means-testing in cooperation with Minister of Social Security;

ii. an 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;

These measures should result in additional revenues of EUR 150 million in 2012 and an additional 50 million in 2013.

3.52. In the light of the urgency and size of the savings needed in the health sector to address large arrears and budget limitations, plans to achieve a self-sustainable model for health-benefits schemes for civil servants will be accelerated. The current plan foresees that the overall budgetary cost of existing schemes – ADSE, ADM (Armed Forces) and SAD (Police Services) - will be reduced by 30% in 2012 and by further 20% in 2013 at all levels of general government. The system would become 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 Fiscal Strategy. **[Q4-2011]**

Pricing and reimbursement of pharmaceuticals

3.54. The Government has approved legislation on setting the maximum price of the first generic introduced in the market to 50% of the branded product with the same active substance, and its enactment is expected by **[Q4-2011]**. Enact legislation which automatically reduces the prices of medicines when their patent expires. **[Q4-2011]**

3.55. Move the responsibility of pricing medicines to the Ministry of Health (for example to Infarmed). **[Q4-2011]**

3.56. The Government has approved legislation regarding the revision of the existing reference-pricing system based on international prices by using as countries of reference the three EU countries with the lowest price levels or countries with comparable GDP per capita levels; the enactment of this legislation is expected by **[Q4-2011]**. Countries of reference will be revised every year. **[Ongoing]**

Prescription and monitoring of prescription

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

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

3.59. The Government has submitted legislation making it compulsory for physicians at all levels of the system, both public and private, to prescribe by International Nonproprietary Name (INN) to increase the use of generic medicines and the less costly available product. Enactment of legislation is expected by **[Q4-2011].**

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

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

Pharmaceutical retailers and wholesalers

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

3.63. The Government has approved legislation changing 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 expenditure on drugs distribution in 2012. Its enactment is expected by **[Q4-2011**]. Additional measures leading to further savings in public expenditure on the distribution of medicines should be taken by **Q3-2012**.

3.64. If the new system of calculation of profit margin will not produce the expected savings in the distribution profits, an additional contribution in the form of an average rebate (pay-back) will be introduced which will be calculated on the mark-up. The rebate will reduce the new mark-up on producer prices further by at least 2 percentage points on pharmacies and 4 percentage points on wholesalers. The rebate will be collected by the

Government on a monthly basis through the Centro de Conferência de Facturas, preserving the profitability of small pharmacies in remote areas with low turnover. **[Q3-2013]**

Centralised purchasing and procurement

3.65. The Government has approved legislation regarding the administrative framework for a centralised procurement system for the purchase of medical goods in the NHS (equipments, appliances, medicines and services), through the recently created Central Purchasing Authority (SPMS), in order to reduce costs through price-volume agreements and to fight waste. Its enactment is expected by **[Q4-2011].**

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

3.67. Take measures to increase competition among private providers and reduce by at least 10 percent the overall spending (including fees) of the NHS with private providers delivering diagnostic and therapeutic services to the NHS by end 2011 and by an additional 10% by end 2012, regardless of the savings achieved in 2011. **[Q4-2011]**

3.68. 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]**

3.69. 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 therapeutic services. **[Q1-2012]**

3.70. 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

3.71. As part of the reorganisation of health services provision and notably the concentration and specialisation of hospital services and the further development of a cost-effective primary care service, the Government reinforces measures aimed at further reducing unnecessary visits to specialists and emergencies and improving care coordination **[Q1-2012]**. This will be done through:

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

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;

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

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

Hospital services

3.72. To avoid further accumulation of arrears, the 2012 budget ensures adequate allocations to the health sector. The settlement process will give priority to arrears in hospitals, improve the liquidity position of suppliers and likely allow hospitals to obtain discounts when re-negotiating delivery contracts. A strategy with a binding timetable to clear all arrears in the health sector, within the overall strategy for arrears, will be implemented. The strategy will include the introduction of standardised and tight control procedures for all health sector entities to prevent the re-emergence of arrears. In addition, a mechanism is put in place to ensure strong coordination between the Ministry of Health and the Ministry of Finance for the application of the same monitoring and control criteria to all types of hospitals. **[Q4-2011]**

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

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

3.75. Continue the publication of clinical guidelines and set in place an auditing system of their implementation. **[Q4-2011]**

3.76. 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]**

3.77. 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. Indicators are to include financial indicators. **[Q1-2012]**

3.78. 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]**

3.79. Continue with the reorganisation and rationalisation of the hospital network through specialisation, concentration and downsizing of hospital and emergency services, joint management (building on the Decree-Law 30/2011) and joint operation of hospitals.

These improvements will deliver additional cuts in operating costs by at least 5 percent in 2013. A detailed action plan is published by 30 November 2012 and its implementation is finalised by the first quarter 2013. Overall, from 2011 to 2013, hospital operational costs must be reduced by at least 15% compared to 2010 level. **[Q1-2012]**

3.80. Move some hospital outpatient services to primary care units (USF). **[Q1-2012]**

3.81. Annually update the inventory of all health staff by specialty, age, region (including autonomous regions), health centre and hospital, public and private sector so as to be able to identify practising, professional and licensed staff and current and future staff needs. **[Q1-2012]**

3.82. Prepare regular annual reports presenting plans for the allocation of human resources in the period up to 2014. The report specifies plans to reallocate qualified and support staff within the NHS. **[Q2-2012]**

3.83. 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 to reducing by at least 20% spending on overtime compensation in 2012 and another 20% in 2013. Implement a strict control of working hours and activities of staff in the hospital and reduce substantially expenditure for on-call services through rationalisation of services and elimination of duplication. **[Q1-2012]**

3.84. Review the payment mechanism for the prevention regime and per call payment ("*pagamento por chamada*") in the light of promoting efficiency and reducing costs in the health system. **[Q2-2012]**

Regional health authorities

3.85. Improve monitoring, internal control and fiscal risks management systems of the Administraçoes Regionais de Saude. **[Q4-2012]**

Cross services

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

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

4. Labour market and education

Labour market

Objectives
Revise the unemployment insurance system to reduce the risk of long-term unemployment while strengthening social safety nets; reform employment protection legislation to tackle labour market segmentation, foster job creation, and ease the transition of workers across occupations, firms, and sectors; ease working time arrangements to contain employment

fluctuations over the cycle, better accommodate differences in work patterns across sectors and firms, and enhance firms' competitiveness; promote labour cost developments consistent with job creation and enhanced competitiveness; ensure good practices and appropriate resources to Active Labour Market Policies to improve the employability of the young and disadvantaged categories and ease labour market mismatches.

Address early school leaving and improve the quality of secondary education and vocational education and training, with a view to 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, while strengthening the length of the contributory careers vis-à-vis the workers age in determining benefits. 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 **[Ongoing]**.

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

i. the Government will 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. A draft plan has been presented. This plan will lead to draft legislation to be submitted to Parliament by **[Q1-2012]**.

ii. By **Q1-2012**, the Government will prepare a proposal aiming at:

- aligning the level of severance payments to the EU average of 8-12 days;
- implementing the compensation fund for severance payments allowing the severance pay entitlements financed from the fund to be transferable to different employers by means of the creation of notional individual accounts.

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 has presented 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 work position (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).

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 was asked to prepare by **Q4-2011** 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. An action plan to promote the use of flexible working time arrangements was presented.

ii. Draft legislation will be submitted to Parliament by **Q1-2012** on the following aspects:

- 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;
- implementation of "bank of hours" working arrangements;
- 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 holidays); (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 **[Ongoing]**;

ii. ensure wage moderation by using the available discretion in the current legislation of not extending collective contracts until a clear criteria is defined as foreseen in point 4.7.iii.;

iii. define clear criteria to be followed for the extension of collective agreements and commit to them. The representativeness of the negotiating organisations and the implications of the extension for the competitive position of non-affiliated firms will have to be among these criteria. The representativeness of negotiating organisations will be assessed on the basis of quantitative indicators. To that purpose, the Government will take the necessary steps to collect data on the representativeness of social partners. Draft legislation defining criteria for extension and modalities for their implementation will be submitted by **Q2-2012**, with a view to entering into force by **Q1-2013**. Such legislation shall in particular provide criteria for the exclusion of the extension in cases where wage agreements are not representative;

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

- 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**;**
- 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. As requested, a first proposal for the implementation of these measures has been presented 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. As requested by the MoU, a first proposal for an action plan has been presented by **Q4-2011**.

iii. 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. A descriptive report is to be presented by Q4-2011. Following this, an evaluation report with econometric modelling is to be delivered by **Q2-2012**.

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

Objectives

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

Energy markets

Objectives

Complete the liberalisation of the electricity and gas markets; ensure the sustainability of the national electricity system and avoid further unfavourable developments in tariffs deficit; 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 1 January 2013**. Following the approval in the resolution of Council of Ministers of 28 July 2011 of a roadmap setting the main principles for the liberalisation of electricity markets, the government will implement it through legislation by **[Q4-2011].** The provisions will:

i. specify 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; and shorten the maximum length of the transitory period for the segment 10,35 kVA to 41,4 kVA, from 3 years, as set out in the resolution of the Council of Ministers, to 30 months.

ii. ensure that during the phasing-out period, transitory tariffs will be above market prices – while countering any anti-competitive behavior by market players – and that this difference will be increasing in time, if necessary, in order to create incentives for a gradual switching of consumers to the liberalised market;

5.2. Implement the Third EU Energy Package by **Q1-2012**. This will ensure the National Regulator Authority's independence and all powers foreseen in the package.

5.3. Take measures to accelerate the establishment of a functioning Iberian market for natural gas (MIBGAS), through regulatory convergence and the harmonisation of the tariff structures in Portugal and Spain. In particular, in accordance with the roadmap of 30 September 2011 agreed with the Spanish authorities, the regulators of each country will present proposals to harmonise the tariffs for access to the interconnection networks **[Q4-2011]** with a view to the future elimination of pancaking for cross-border flows, and will apply a harmonised congestion management mechanism to all the interconnection capacity between Portugal and Spain. **[Q1-2013]**

5.4. Regulated gas tariffs are to be phased out by **1 January 2013**. The government will implement, through legislation, the roadmap proposed in the resolution of Council of Ministers of 28 July 2011 by **[Q4-2011].**

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). **[January 2012]**

5.8. Review in a report the efficiency of support schemes for renewables, covering their rationale, their levels, and other relevant design elements. **[January 2012]**

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. **[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 **Q3-2012** and **Q3-2013**.

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

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

i. Eliminate fiscal incentives to promote investment in renewable energy equipment, energy efficiency in buildings and electric vehicles overlapping with other financing mechanisms or energy and tax policy instruments, such as the enhanced tax allowances under the personal income tax and taxation at the intermediate rate of VAT of acquisitions of solar and renewable energy equipment. **[Q4-2011]**

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

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

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

v. take measures by **[Q2-2012]** to phase out the power guarantee mechanism and reduce the associated policy costs. Incentives for power plants to invest should be revised downwards and phased out in light of the current situation of low electricity consumption, excess production capacity, and the overlapping interruptibility service mechanism, while taking into account developments in the Iberian electricity market and energy security considerations.

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

5.14. Increase excises for electricity (presently below the minima required by EU legislation). **[Q4-2011]**

Ensure sustainability of the national electricity system

5.15. Measures to set the national electricity system on a sustainable path leading to the elimination of the tariff debt (*déficit tarifário*) by 2020 and ensuring that it will stabilise by 2013 will be adopted. The latter deadline is subject to a review based on a government proposal which will also specify how excessive rents in the standard (CMECs, PPAs, and power guarantee mechanism) and special regimes (co-generation and renewables) will be corrected. This proposal will consider the merits of a full range of measures which will cover all sources of rents. **[January 2012]**[15]

Telecommunications and postal services

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

Telecommunications

5.16. Ensure an efficient, objective, transparent and non-discriminatory mechanism for the designation of the universal service provider(s), in compliance with the Court of Justice ruling of 7 October 2010. Re-negotiate the concession contract with the undertaking currently providing the universal service, by reducing the scope of the services covered, so as to exclude the universal service and launch a new tender process for designation of universal service provider(s). **[Q4-2011]**

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

Postal services

5.18. Further liberalise the postal sector by i) 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 **[Q4-2011]**; ii) amending the law laying down the framework of the concession contract and renegotiating the amendment of said contract with CTT, in order to reflect the new law transposing the postal directive**;** ensuring in particular that the current designation period for the universal service provision is shortened to 2020 and that investment needs and return on investment are taken into account when setting new designation periods. **[Q1-2012]**

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

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

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

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

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

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

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

v. Reform the transport and infrastructures' regulatory framework in order to improve the effectiveness, efficiency and independence of the entities regulating the transport sector.

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

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

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

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

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

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

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

Railways sector

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

i. ensure that the rail regulator enjoys the independence required under the EU rail Directives, in particular regarding the rules of appointment and dismissal of the director of the rail regulator. Strengthen the capacities of the railway regulator to fulfil its regulatory mandate effectively, including by exploring synergies with other transport regulators in the context of the revision of national regulatory agencies. **[Q3-2012]**;

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

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

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

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

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

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

Ports

5.22. 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. **[Q4-2011]**

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

5.24. 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. **[Q4-2011]**

5.25. 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. **[Q4-2011]**

Road pricing

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

Other services sector

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

Sector-specific legislation of Services

5.27. 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 **[Q4-2011]** and adopted by **[Q1-2012]**.

5.28. 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

5.29. 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 **[Q4-2011]** and present to Parliament the law for those regulated by Parliament but where regulation does not involve a professional body (*Ordens or Câmaras*) **[Q4-2011]** to be approved by **[Q1-2012]**.

Regulated professions

5.30. 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 **[Q4-2011]** and present to Parliament the law for those regulated by Parliament but where regulation does not involve a professional body (*Ordens or Câmaras*) **[Q4-2011]** to be approved by **[Q1-2012]**.

5.31. Adopt measures to liberalise 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 **[Q4-2011]** and present to Parliament the law for those regulated by Parliament but where regulation does not involve a professional body (*Ordens or Câmaras*) **[Q4-2011]** to be approved by **[Q1-2012]**.

5.32. Further improve the functioning of the regulated professions (such as accountants, lawyers, notaries) for which regulation involves a professional body (*Ordens or Câmaras*) by carrying out a comprehensive review of requirements affecting the exercise of activity and eliminate those not justified or proportional, including: i) adopting the measures included in 5.29, 5.30 and 5.31; ii) eliminating restrictions to the use of commercial communication (advertising), as required by the Services Directive; iii) to achieve the two conditions above the government will present a draft of a horizontal legal framework by **January 2012**, to be submitted to Parliament by **Q1-2012**, and expected to be adopted and enacted by **Q2-2012**. Upon enactment, the professional bodies will make the necessary changes in their statutes by **[Q3-2012]**.

Administrative burden

5.33. Continue the simplification reform effort by:

i. progressing further on making available the Points of Single Contact (PSC) in three languages with general information covering all relevant aspects of the Services Directive and of the Professional Qualifications Directive. In particular improve PSC access for EU/EEE service providers by more clearly differentiating information on requirements applicable to established providers and to cross-border ones **[Jan 2012]** and make available in the PSC single electronic forms, seamless of the municipality, for at least two procedures covered by the Services Directive of the responsibility of municipalities **[Q1-2012]**

ii. making the (PSC) more user-friendly and responsive to SMEs needs, extending on-line procedures to all sectors covered by the Services Directive and to Professional Qualifications Directive as well as adapt the content and information available at the PSC to the new legislation to be adopted **[Q1-2012]**;

iii. making available in PSC procedures on-line of establishments registration covered by "Zero authorization" (DL 48/2011, April 1st, Art 14º) by February 2012. Make fully operational the "Zero Authorisation" project that abolishes authorisations/licensing and substitute them with a declaration to the PSC for the wholesale and retail sector and restaurants and bars **[Q2-2012]**. The platform will be available to all levels of administration, including all municipalities **[Q3-2012]**;

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

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

6. Housing market

Objectives

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

Rental market

6.1. The Government will present draft legislation to amend the New Urban Lease Act Law 6/2006 by **end-November 2011**. The draft legislation will ensure balanced rights and obligations of landlords and tenants, considering the socially vulnerable, and review all aspects referred to in the urban rental reform guidelines adopted by the Council of Ministers in September 2011. The draft legislation will be submitted to Parliament for adoption by **Q4-2011**. In particular, the specific measures 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) grant landlords the possibility to ask for termination of the lease contract for major renovation works (affecting the structure and stability of the building) with a maximum 6 months of prior notice; v) simplify rules for the temporary relocation of tenants of building subject to rehabilitation works with due regard of tenants needs and respect of their living conditions; vi) provide for an extrajudicial eviction procedure for breach of contract, aiming at shortening the eviction time to three months; and vii) strengthen the use of the existing extrajudicial procedures for cases of division of inherited property.

Administrative procedures for renovation

6.2. The draft legislation to simplify administrative procedures for renovation presented in September 2011 is expected to be adopted by Parliament by **Q4-2011**. 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; and ii) standardise the rules determining the level of conservation status of property and the conditions for the demolition of buildings in ruin.

Property taxation

6.3. The Government will adopt the necessary changes to the legislation to review the framework for the valuation of the housing stock and land for tax purposes in line with the report presented on 30 September 2011. In particular, the measures will: (i) ensure that by end 2012 the taxable value of all property is close to the market value and (ii) property valuation is updated regularly (every year for commercial real estate and once every three years for residential real estate as foreseen in the law). 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. **[Q4-2011]**

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 **1 January 2012,** except for low income households. Principal payments will not be deductible as of **1 January 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.

Comprehensive Review

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

Objectives

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

Court backlog

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

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

7.2. Implement targeted measures to achieve steady reduction of the backlogged enforcement cases. In particular, to establish an inter-agency task force by end-November 2011 to set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, with the first report to be completed by **15 February 2012**.

7.3. Strengthen the legal and institutional framework for enforcement agents in line with international practice with a particular focus on the financing structure and authority of the oversight body. Adopt a regulation by end-December 2011 to ensure the oversight body's full access to the enforcement case files. To improve the legal and institutional framework for the enforcement agents, prepare an action plan by end-February 2012 to (i) identify measures over the next twelve months to achieve the objectives of strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, and (ii) include an analysis of the feasibility of a fee structure that incentivises speedy enforcement. In addition, make the oversight body's full access to the enforcement case files including financial data operational by **15 March 2012**.

Management of courts

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

7.4. To improve efficiency of the court system, develop a roadmap by **[January 2012]** on judicial reform map identifying key quarterly milestones to reduce the number of court districts and close down underutilised courts. Prepare a revised roadmap by **[June 2012]** on judicial reform taking into account consultations with stakeholders and cross country experience. Submit a Bill to implement the judicial reform roadmap to Parliament **by end-September 2012**.

7.5. Conduct an assessment of court management with a view to speeding up court proceedings and improving cost efficiency. **[January 2012]**

7.6. Develop a new personnel management plan to support judicial specialisation and mobility of court officials. **[January 2012]**

Alternative dispute resolution for out-of-court settlement

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

7.7. Adopt measures to give priority to the ADR enforcement cases in the courts by **end-2011**. The Government is committed to take all necessary legal, administrative, and other steps to make arbitration fully operational by February 2012.[16]

7.8. Submit the Bill to improve the Justices for Peace regime to Parliament by **March 2012**.

Civil law cases in the courts

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

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

7.10. Assess the need for separate Chambers within the Commercial Courts with specialised judges to enhance efficient and effective expedition of insolvency cases. **[January 2012]**

7.11. Prepare a proposal in a consultative manner, based on a review the Code of Civil Procedure, by **end-2011**, analysing the experience with the new experimental civil procedure regime, and building on such experience, identifying the key areas for refinement, including (i) to consolidate legislation for all aspects of enforcement cases before the court, (ii) to give the judge the power to expedite cases, (iii) to restrict the administrative burdens for judges, (iv) to enforce statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases and (v) to establish a single judge procedure for small claims[17]. Prepare by **June 2012** draft amendments, and submit them to the Parliament by **September 2012**.

7.12. Adopt measures for an orderly and efficient resolution of outstanding tax cases and, in particular, assess the scope for measures to expedite the resolution of tax cases such as: i) creating a special procedure for high value cases **[Q2-2011];** ii) establishing criteria for prioritizing; iii) extending statutory interests for the entire the court proceeding and iv) imposing a special statutory interest payment on late compliance with a tax court decision. **[Q4-2011]**

Budget and allocation of resources

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

7.13. Prepare a report on the allocation of resources based on court by court quantitative data. **[January 2012].**

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

7.14. Publish quarterly reports on recovery rates, duration and costs of corporate insolvency cases starting from **Q3-2011**, within four months after the end of the relevant quarter. Provide quarterly reports on recovery rates, duration and costs of tax cases starting from the third quarter of 2011 within two months after the end of the relevant quarter.

Competition, public procurement and business environment

Objectives

Ensure a level playing field and minimise rent-seeking behaviour by strengthening competition and sectoral regulators; eliminate special rights of the state in private companies (golden shares); reduce administrative burdens on companies; ensure fair public procurement processes; improve effectiveness of existing instruments dealing with export promotion and access to finance and support the reallocation of resources towards the tradable sector.

Competition and sectoral regulators

7.15. The Government shall take the necessary measures to ensure that the Portuguese State or any public bodies do not conclude, in a shareholder capacity, shareholder agreements the intention or effect of which hinder the free movement of capital or which influence the management or control of companies. Concerning the existing shareholder agreement of CGD in Galp, the Portuguese State will ensure that CGD alienates its participation in Galp. **[Q4-2011]**

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

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

i. following the already adopted legislation establishing specialised court for Competition, Regulation and Supervision, make it operational in the context of the reforms of the judicial system (see measure 7.9) [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 harmonised with the European Union competition legal framework, in particular:18 [January 2012]

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

- 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;
- rationalise 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]

7.18. Ensure that the national regulator authorities (NRA) have the necessary independence and resources to exercise their responsibilities. [by **Q3-2012** for the main NRAs and by **Q4-2012** for the others]. In order to achieve this:

i. provide an independent report (by internationally recognised specialists) on the responsibilities, resources and characteristics determining the level of independence of the main NRAs. The report will benchmark nomination practices, responsibilities, independence and resources of each NRA with respect to best international practice. It will also cover scope of operation of sectoral regulators, their powers of intervention, as well as the mechanisms of coordination with the Competition Authority. The call for tender for the report will be launched by **end-November 2011** and the report will be completed by **April 2012**;

ii. based on the report, present a proposal to implement the best international practices identified to reinforce the independence of regulators where necessary, and in full compliance with EU law by **Q2-2012**.

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:

7.19. 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]**

7.20. 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 **Q4-2011**.

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

7.22. 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]**

7.23. 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]**

7.24. 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. Amendments to the Court of Auditors' bylaws to be adopted by Parliament by **[Q4-2011].**

7.25. 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]**

7.26. Repeal 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 **[Q4-2011].**

Business environment

7.27. Adopt the “Simplex Exports” programme, including establishing in tax legislation measures to accelerate the procedures for requesting VAT exemption for exporting firms and to simplify procedures associated with indirect exports. **[Q4-2011]** The above mentioned procedures will be fully operational by **[Q3-2012].**

7.28. 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. This review, as well as the assessment of existing financing and non-financing support measures (therefore partially responding also to measure 2.20) will be the object of a report by **[Q4-2011].**

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

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

Appendix: Provision of data (reporting requirements)

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

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

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

8.	Data on arrears of: • the General Government, detailed by subsector • the incorporated (SOEs) government-owned hospitals that are not part of the General Government • other non-financial SOEs that are not part of the General Government	Monthly, 7 weeks after the end of each month (as of September 2011)
9.	Information on Public-Private Partnerships (PPP) related revenue and expenditure, for those PPP reclassified within the General Government (in line with paragraph 5.2 of the TMoU)	Monthly, 30 days after the end of the each month – November (data from October)
10.	New guarantees granted by the State to SOEs, PPPs, banks and the non-financial private sector	Monthly, 30 days after the end of each month
11.	Detailed information on called guarantees of the State	Monthly, 30 days after the end of each month
12.	Data on proceeds from asset sales by the Central, Regional and Local Government	Monthly for Central Government Quarterly for Regional and Local Government – to check if identified 30 days after the end of reference period
13.	Quarterly data on General Government accounts as per the relevant EU regulations on statistics, showing also the main items of the transition from cash balances to the General Government balances in national accounts	Quarterly, 90 days after the end of each quarter - INE, protocol as legal basis
	To be provided by ESAME	
14.	Report on progress with fulfilment of economic policy conditionality on a quarterly basis. In addition, a short summary report should be sent on a monthly basis	Quarterly (report), two weeks after the end of each quarter. Monthly (short summary report) two weeks after the end of each month for which a report is not due.
	To be provided by the Debt Management Office	
15.	Accrual data on interest spending of the State	Quarterly, 7 weeks after the end of the quarter – to check DMO
	To be provided by the Ministry of Labour	
16.	Data on labour market as follows: a. layoffs by type b. collective agreements by type and number of collective agreements that are extended by the Ministry of Labour to non-signatory firms c. number of collective agreements that regulate the use of the Bank of Hours working time arrangement	Every six months, 6 weeks after the end of each semester

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

Indicative timeline of financial sector and structural measures in the Memorandum of Understanding on specific economic conditionality[1, 2]

Actions for the third review (to be completed by end Q4-2011)	
Financial sector	**[2.3]** Ensure that pension liabilities are in line with EU competition and state aid law. **[2.4]** BdP to follow closely the banks in view of reaching a core Tier 1 capital ratio of 9%. **[2.12]** Publish the new non-performing loans ratio in addition to the current ratio. **[2.16]** Amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework and introduce a regime for restructuring of banks as a going concern under official control, by end-November. **(SB, MEFP ¶34)** **[2.18]** Amend the Insolvency Law to better facilitate effective rescue of viable firms and support rehabilitation of financially responsible individuals, by end-December. **(SB, MEFP ¶36)** **[2.20]** Provide the EC/ECB/IMF with an assessment of existing support mechanism to SMEs (by December).
Fiscal-structural	**[1.7]** Carry out measures with the 2012 Budget Law. **[3.2]** Prepare and publish a consolidated report on arrears for the general government. **[3.4]** Publish quarterly accounts for SOEs at the latest 45 days after the end of the quarter. **[3.5]** Develop intra-annual targets and corrective measures for the general government (monthly/quarterly, cash balance, expenditure, revenue targets). **[3.6]** Adopt the legislation to insure implementation of the commitment control. **[3.11]** Explore various options of settling the arrears. **[3.13]** Ensure full implementation of the Budgetary Framework Law. **[3.14]** Insure that the Fiscal Council is operational. **[3.16]** Present the roadmap and options for the revision of the laws. **[3.17]** Prepare a financial arrangement with Madeira. **[3.20]** 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. **(SB, MEFP ¶14)**

[1] Square brackets identify paragraph numbers in the MoU as signed on 15 December 2011. Items that are Structural Benchmarks under the program are flagged with SB, and also identified by the MEFP paragraph number. Items that are Prior Actions under the program are flagged with PA, and also identified by the MEFP paragraph number.
[2] MEFP as signed on 13 May 2011, http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/op79_en.htm

Actions for the third review (to be completed by end Q4-2011)	
	[3.25] Submit to Parliament a new legal framework for SOEs (January 2012). **[3.27]** Prepare a plan to strengthen the governance of SOEs (at central, local and regional level). **[3.30]** Select bidders and initiate the 2nd phase of the REN privatisation. **[3.31]** Prepare plan to privatise Parpublica. **[3.33]** Complete the design of the new structure that merges tax, customs and DGITA. **[3.35]** Review the assessment of audit performance. **[3.35]** Apply interest charges on outstanding debt over the court appeal period. **[3.37]** Prepare an IT Strategic Plan for the new merged revenue authority. **[3.39]** Reduce management positions and administrative units by 27% and 40%, respectively, in central government. **[3.41]** Submit law to Parliament to reduce management positions and administrative units in local administration; promote equivalent initiatives in regions. **[3.42]** Carry out a cost/benefit analysis of public entities (foundations, institutes, etc). **[3.43]** Draft law on creation and functioning of public entities (foundations, institutes, etc) in central and local administration. **[3.43]** Take initiative to regulate the creation and functioning of public entities in regional administration. **[3.45]** Identify inefficiencies and duplications between the central, local and locally based central administration. **[3.48]** Prepare plan of mobility of human resources within the administration.
Health care system	**[3.51]** Enact legislation on automatic indexation to inflation of NHS co-payments. **[3.52]** Reduce the public expenditure on public health-benefits schemes by 30% in 2012, by 20% in 2013. Ensure further similar reductions in subsequent years with a view to have the health-benefits schemes self-financed by 2016. **[3.53]** Prepare the health sector strategic plan. **[3.54]** Reduce the prices of drugs once their patent expires. **[3.54]** Enact legislation which reduces the prices of medicines when their patent expires. **[3.55]** Move the responsibility of pricing medicines to the Ministry of Health. **[3.56]** Enacting the legislation regarding the revision of the existing pricing system for medicines based on external prices. **[3.57]** Carry out the first quarterly feedback on prescription to each physician. **[3.59]** Enact the legislation to prescribe the International Non-proprietary Name (INN). **[3.60]** Establish rules for the prescription of drugs and complementary diagnostic exams (prescription guidelines). **[3.61]** Enact legislation to reduce the administrative/legal hurdles in generic medicines market.

Actions for the third review (to be completed by end Q4-2011)	
	[3.62] Effectively implement the existing legislation regulating pharmacies. **[3.63]** Change the calculation of profit margins for wholesale companies and pharmacies to ensure that at least EUR 50 million in savings in public expense comes from reduction in profits of pharmaceutical sector. **[3.65]** Enact legislation regarding the administrative framework for a centralised procurement system. **[3.66]** Finalise the uniform coding system and the common registry for medical supplies. **[3.67]** Reduce by 10 per cent in the overall spending (including fees) of the NHS with private providers delivering services to NHS – increase competition among private providers. **[3.72]** Implement a strategy to clear arrears. Put in place a mechanism to ensure strong coordination between Ministry of Finance and Ministry of Health. **[3.75]** Continue the publication of clinical guidelines. **[3.76]** Improve selection criteria and adopt measures to ensure a more transparent selection of the chairs and members of hospital boards.
Labour market and education	**[4.1]** Adopt an action plan to reform the unemployment benefits system, in line with specific commitments in MoU and MEFP. **[4.6]** Prepare plan to promote the use of flexible working time arrangements. **[4.8]** Implement commitments in the Tripartite Agreement on "organised decentralisation". Adopt an action plan to allow works councils to conclude firm-level agreements. Draft legislation on firm-level agreements concluded by works councils to be submitted to Parliament. **[4.9]** Report on current activation policies and other active labour market policies (ALMP). **[4.9]** Adopt an action plan to improve further activation policies and other ALMPs. **[4.10]** Prepare a monitoring, assessment and reporting system to evaluate education and training policies.
Goods and services markets	**[5.1]** Implement through legislation the roadmap setting the principles of liberalisation of electricity markets. **[5.4]** Implement the roadmap proposed in the resolution of Council of Ministers of 28 July 2011. **[5.3]** Take measures to accelerate the establishment of a functioning Iberian market for natural gas. **[5.5]** Report on lack of entry in gas market (reasons and measures). **[5.6]** Revise downwards payment to electricity producers under guarantee compensation mechanism and long-term power-purchase agreements. **[5.9]** Review the options for adjusting downwards the feed-in tariff used in co-generation (reduce the implicit subsidy) and renewables. **(SB, MEFP ¶41)** **[5.12]** Streamline administrative procedures and increase transparency of charges for renewable energy producers. **[5.13]** Take measures to modify energy policy instruments to ensure consistency and eliminate possible overlapping of

Actions for the third review (to be completed by end Q4-2011)	
	energy policy instruments. **[5.14]** Increase excises for electricity. **[5.16]** Launch a new tender process for designation of universal service provider(s). **[5.18]** Liberalise the postal sector by transposing the Third Postal Directive. **[5.22 and 5.24]** Prepare the Port Strategy and a proposal for legal framework to implement the Port Strategy for integration of ports into overall logistic and transport system and for improvement of governance. **[5.25]** Report on the objectives, instruments and efficiency gains on on-going and planned initiatives in the port sector. **[5.27]** Present to the Parliament the amendments to sector-specific legislation under the Services Directive in order to further liberalise the sector. **[5.28]** Eliminate unjustified restrictions to free establishment and to cross-border provision for construction and real estate, when transposing sector-specific regulation in accordance with the Services Directive. **[5.29, 5.30 and 5.31]** Adopt the law concerning professional qualifications not regulated by Parliament. **[5.29, 5.30 and 5.31]** Adopt the law concerning professions not regulated by Parliament. **[5.32]** Draft of legal framework concerning the remaining requirements in regulated professions and elimination of unjustified ones.
Housing market	**[6.1]** Draft legislation amending the New Urban Lease Act Law 6/2006 to be submitted to Parliament. **[6.2]** Adopt legislation to simplify administrative procedures for renovation. **[6.3]** Adopt the necessary changes to the legislation. **[6.4]** Modify property taxation with a view to i) level incentives for renting versus acquiring housing and ii) shift the tax burden towards the recurrent real estate tax.
Judicial system	**[7.7]** Take measures to give priority to alternative dispute resolution enforcement. **[7.11]** Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement. **(SB, MEFP ¶46)** **[7.12]** Prepare measures to expedite the resolution of tax cases. **[7.13]** Prepare report on the allocation of resources.
Competition, public procurement, and business environment	**[7.15]** Avoid shareholder agreements by public bodies; alienate CGD participation in Galp. **[7.17]** Ensure that the Portuguese Competition Authority has sufficient and stable financial means to guarantee its operation. **[7.18]** Launch the call for tender. **[7.19]** Eliminate exemptions permitting direct award of public contracts above the Public Procurement Directives

Actions for the third review (to be completed by end Q4-2011)	
	thresholds. **[7.20]** Eliminate all special, permanent or temporary exemptions, permitting the direct award of public contracts below the Public Procurement Directive. **[7.21]** Amend the Public Procurement Code provisions on errors and omissions and additional works/services, and to eliminate the remaining exemptions permitting direct award of public contracts below the Public Procurement Directives thresholds. **[7.22]** Implement measures regarding irregular direct awards for additional works/services. **[7.23]** Adopt measures making financially responsible contracting authorities for non-compliance with public procurement rules. **[7.24]** Establish rules ensuring ex-ante auditing/checks on public procurements by appropriate body. **[7.25]** Upgrade the national Public Procurement Portal (Base) based on Resolution 17/2010 of the National Parliament. **[7.26]** Modify Art 42 of the Public Procurement Code concerning R&D projects for large public contracts. **[7.27]** Adopt the "Simplex Exports" programme. **[7.28]** Implement the strategy to facilitate access to finance and export markets for companies, in particular SMEs.

Actions for the fourth review (to be completed by end Q1-2012)	
Fiscal-structural	**[1.6]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[1.16]** 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. **[2.7]** Finalise the framework for access to public capital. **[3.3]** Include in the monthly report all the SOEs and PPPs reclassified (February 2012). **[3.7]** Publish additional information on general government staff on a quarterly basis. **[3.9]** Publish the annual report on fiscal risks. **[3.10]** Complete an annual report on tax expenditures in cooperation with EC and IMF. **[3.16]** Submit a proposal to revise the regional finance law. **[3.20]** Sign the service contract by end-March with a top tier international accounting firm. **[3.21]** New legal and institutional framework for analysing PPPs. **[3.23]** Implement ongoing plans to reduce operational costs of central government SOEs outside the health sector by at least 15% on average over 2009 levels. **[3.25]** Submit to Parliament a new legal framework for SOEs. **[3.26]** Report on operations and finances of SOEs (at central, regional and local levels), by end-February 2012. **(SB,**

Actions for the fourth review (to be completed by end Q1-2012)	
	MEFP ¶16) **[3.28]** Draft law to regulate the creation and functioning of SOEs. **[3.29]** Prepare restructuring plans on local SOEs and the SOEs of each region by January 2012. **[3.30]** Financial closing of EDP and REN privatisation. **[3.33]** Study the costs and benefits of including the revenue collection units of the social security administration in the merge. **[3.35]** Integrate the IT systems between the revenue administration and tax tribunals. **[3.36]** Submit law to Parliament to strengthen the auditing and enforcement powers of the central tax administration. **[3.40]** Implement a second phase of the administration reform programme (PREMAC).
Financial sector	**[2.6] P**rovide plans on how to meet the capital needs (end-February 2012).
Health care system	**[3.58]** Devise and enforce a system of sanctions and penalties. **[3.68]** Implement the centralised purchasing of medical goods through the recently created Central Purchasing Authority. **[3.69]** Introduce a regular revision of the fees paid to private providers. **[3.70]** Comply with European competition rules of the provision of services in the private healthcare sector. **[3.71]** Reinforce measures at further reducing unnecessary visits to specialists and emergencies. **[3.74]** Implement measures aimed at achieving reductions in operational costs of hospitals. **[3.77]** Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators and regular reports. **[3.78]** Achieve full interoperability of IT systems in hospital. **[3.79]** Reduce by at least 15% hospital operational costs. **[3.80]** Move some hospital outpatients services to primary care units. **[3.81]** Update the inventory of all health staff by speciality, age, region, health centre and hospital to identify staff and current/future needs. **[3.83]** Adopt rules to increase mobility of healthcare staff including doctors within and across regions. **[3.83]** Adopt for all staff flexible time arrangements, to reduce by at least 10% spending on overtime compensation in 2012 and another 10% in 2013. **[3.83]** Implement a stricter control of working hours and activities of staff of hospital.
Labour market and education	**[4.2]** Draft legislation on unemployment benefits system to be adopted by the government. **[4.4]** Draft legislation on severance payment entitlements for current employees to be submitted to Parliament. **[4.4]** Prepare legislative proposal to: i) align the level of severance payments to the EU average; and ii) allow the

Actions for the fourth review (to be completed by end Q1-2012)	
	severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers. **[4.5]** Draft legislation on the cases for fair individual dismissals to be submitted to Parliament. **[4.6]** Draft legislation on the use of flexible working time arrangements and revision of the minimum additional pay for overtime. **[4.8]** Draft legislation to be submitted to Parliament. **[4.10]** Adopt an action plan to improve the quality of secondary education. **[4.10]** Adopt an action plan on attractiveness and labour market relevance of vocational education and training and enhancing career guidance mechanisms.
Goods and services markets	**[5.2]** Implement the Third EU Energy Package. **[5.7]** Report on the efficiency of support schemes for co-generation. **(SB, MEFP ¶41)** **[5.8]** Report on the efficiency of support schemes for renewable. **(SB, MEFP ¶41)** **[5.13]** Eliminate the exemption from thee tax on ISP. **[5.15]** Adopt measures to set the national electricity system on a sustainable path. **[5.17]** Present market analysis in fixed communications and adopt measures to reduce entry barriers. **[5.18]** Liberalise the postal sector by amending the law laying down the framework of the concession contracts. **[5.21]** Implement plans presented in the Stategic Plan for Transport. **[5.21]** Apply yield management on long distance passenger ticket prices. **[5.22]** Submit to Parliament a revised legal framework governing port work. **[5.27]** Adopt amendments to sector-specific legislation under the Services Directive. **[5.29]** Law to improve recognition of professional qualifications framework approved by Parliament. **[5.30]** Law to reduce the number of regulated professions and eliminate unjustified reserves of activity approved by Parliament. **[5.31]** Law to liberalise access and exercise of regulated professions approved by the Parliament. **[5.32]** Submit to Parliament the legal framework concerning the remaining requirements in regulated professions and elimination of unjustified ones. **[5.33]** Extend on-line procedures in PSC to all sectors under the Services Directive. Adapt PSC to incorporate new legislation in order to reduce administrative burdens for firms.

Actions for the fourth review (to be completed by end Q1-2012)	
Judicial system	**[7.2]** Prepare reports on implementation status of measures (first report 15 February 2012). **[7.3]** Strengthen legal and institutional framework in line with international practice with a particular focus on the financing structure and authority of the oversight body. Adopt a decree law to ensure the oversight body's full access to the enforcement case files. **[7.4]** Develop a roadmap to improve efficiency of the court system. **[7.5]** Assess court management to speeding up court proceedings and improving cost efficiency. **[7.6]** Develop courts personnel management plan. **[7.7]** Make arbitration for debt enforcement cases fully operational, by end-February 2012. **(SB, MEFP ¶48)** **[7.8]** Submit to Parliament the Bill to improve the Justices for Peace regime. **[7.9]** Make the specialised courts on Competition and IPR fully operational. **[7.10]** Assess the need for separate Chambers within the Commercial Courts with specialised judges for insolvency cases. **[7.13]** Prepare a report on the allocation of resources based on court by court quantitative data by end-January.
Competition, public procurement, and business environment	**[7.17]** Make operational the adopted legislation establishing specialised court for Competition, Regulation and Supervision. **[7.17]** Propose a revision of the competition law. **[7.19]** Revise the Competition Law to make it more autonomous from administrative and penal procedural laws and more in line with the EU legal framework. **(SB, MEFP ¶41)**

Actions for the fifth review (to be completed by end Q2-2012)	
Fiscal-structural	**[1.6]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[3.6]** Carry out regular reviews on the commitment control system. **[3.13]** Define the characteristics of the medium-term budgetary framework. **[3.16]** Submit a proposal to revise the local finance law. **[3.22]** Enhance annual PPP and concessions report. **[3.26]** Prepare report on reviewing the operations and finances of SOEs at all government levels. **[3.32]** Prepare an asset inventory, including real estate, owned by municipalities and regional government, examining scope for privatisation. **[3.35]** Establish specialised large tax cases courts and technical staff group. **[3.41]** Municipalities to present plans to reduce management positions and administrative units by at least 15% by the end of 2012. **[3.42]** Close the public entities with an unfavourable cost/benefit analysis.

Actions for the fifth review (to be completed by end Q2-2012)	
	[3.45] Eliminate inefficiencies and duplicities in the central, local and locally-based central administration. **[3.46]** Implement fully the strategy of shared services in central administration in the areas financial and human resources. **[3.48]** Reinforce the mobility schemes.
Financial sector	**[2.6]** Provide the capital for the pension plan transfers and the SIP. **[2.7]** Finalise the framework for access to public capital (end-January).
Health care system	**[3.79]** Reorganise and rationalise the hospital network continued through specialisation and concentration of hospital and emergency services and joint management. **[3.80]** Move some outpatient services to primary care units (USF). **[3.82]** Prepare reports presenting plans for the allocation of human resources in the period up to 2014. **[3.86]** Finalise the system of patient electronic medical records. **[3.84]** Review the payment mechanism for the prevention regime and per call payment.
Labour market and education	**[4.7]** Prepare draft legislative proposal containing criteria and modalities for the extension of collective agreements. **[4.7]** Prepare an independent review on how the tripartite concertation on wages can be reinvigorated and on the desirability of shortening the survival of contracts that are expired but not renewed. **[4.8]** Adopt the proposal to reduce the firm size threshold for works councils to conclude agreements below 250 employees. **[4.10]** Reinforce supervisory role of the General Inspectorate.
Goods and services markets	**[5.13]** Conduct a cost-benefit analysis on the effectiveness of the System for the Management of Energy-Intensive Consumption. **[5.13]** Review the effectiveness of the other exemptions and reduced rates of the tax on ISP. **[5.13]** Take measures to phase out the power guarantee mechanism. **[5.13]** Take measures to eliminate possible overlaps between PPEC and EEF. **[5.21]** Provide annual progress reports on implementation of balancing revenues and expenditures. **[5.21]** Make operational the performance scheme on infrastructure changes. **[5.21]** Privatise the freight branch of the state-owned rail operator. **[5.32]** Adopt and enact the legal framework concerning the remaining requirements in regulated professions and elimination of unjustified ones. **[5.33]** Implement the "Zero authorisation" project abolishing licenses on wholesale, retail and bars and restaurants.
Competition, public	**[7.20]** Present an independent report on the independence and resources of the national regulator authorities.

Actions for the fifth review (to be completed by end Q2-2012)	
procurement, and business environment	
Judicial system	**[7.4]** Prepare a revised roadmap. **[7.11]** Prepare draft amendments. **[7.12]** Create a special procedure for high value cases. **[7.18]** Complete the report by April 2012.

Actions for the sixth review (to be completed by end Q3-2012)	
Fiscal-structural	**[1.6]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[1.28]** Present and assess detailed plans for central administration functioning. **[3.29]** Include all SOEs in the MoF report as well as a comprehensive fiscal risk analysis (by July 2012). **[3.32]** Prepare an inventory of assets owned by municipalities and regional governments. **[3.44]** 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.
Health sector	**[3.63]** Take additional measures leading to further savings.
Labour market	**[4.4]** Draft legislation submitted to Parliament to: i) align the level of severance payments to the EU average; and ii) allow the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers
Goods and services markets	**[5.10]** Annual report on new contracts in renewables (see Q3-2011). **[5.11]** Annual report on new investments in renewables (see Q3-2011). **[5.20]** Present a list of actions to improve the efficiency of the transport sector. **[5.21]** Analyse the potential for further rationalisation in loss-making lines and services. **[5.32]** Make the necessary changes in the status of professional bodies. **[5.33]** Extend the "Zero authorisation project" abolishing licenses on wholesale and retail and restaurants and bars to all levels of administration.
Competition, public procurement, and business environment	**[7.18]** Ensure that main NRAs have the necessary independence and resources to exercise their responsibilities. **[7.27]** Make operational the procedures for requesting VAT exemptions for exporting firms.
Judicial system	**[7.11]** Submit draft amendments to Parliament.

Actions for the seventh review (to be completed by end Q4-2012)

Fiscal-structural	**[1.6]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[1.27]** Carry out measures with the 2013 Budget Law. **[3.24]** SOEs to reach operational balance. **[3.31]** Privatise Aguas de Portugal and RTP by end-2012. **[3.33]** Complete the implementation of the new structure that merges tax, customs and DGITA. **[3.34]** Reduce number of municipal tax offices by 20%. **[3.34]** Increase to 30% the number of auditors in the tax administration. **[3.35]** Clear cases above EUR 1 million with the support of the tax court judges. **[3.46]** Implement shared services in IT. **[3.49]** Reduce the number of central administration employees by at least 2% per year, with larger reductions at regional and local level of 2%. **[3.50]** Prepare a comprehensive review of wage scales.
Financial sector	**[2.4]** BdP to follow closely the banks in view of reaching a core Tier 1 capital ratio of 10%.
Health care system	**[3.73]** Change existing accounting framework and adopt accounting standards in line with the requirements for private companies and other SOEs. **[3.77]** Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators – first regular report. **[3.79]** Publish detailed action plan to deliver additional cuts in the hospitals network operating costs of at least 5% in 2013. **[3.85]** Improve monitoring, internal control and fiscal risks management systems of the Administracaoes Regionais de Saude. **[3.87]** Reduce costs for patient transportation by 1/3.
Goods and services markets	**[5.4]** Eliminate regulated tariffs in electricity and gas (Jan 1). **[5.19]** Implement the Strategic Plan for Transport for 2011-2015. **[5.21]** Reduce operational costs by at least 23%. **[5.26]** Adopt the necessary legislative amendments to achieve full compliance with Directive 1999/62/EC and EU Treaty.
Housing market	**[6.3]** Bring value of all property stock close to market value.
Competition, public procurement, and business environment	**[7.18]** Ensure that remaining NRAs have the necessary independence and resources to exercise their responsibilities.

Actions for the eighth review (to be completed by end Q1-2013)	
Fiscal structural	**[1.26]** Quarterly ceilings for the consolidated General Government cash balance to be assessed.
Labour market	**[4.7]** Enter the legislative proposal into force.
Goods and services markets	**[5.1]** Phase out regulated electricity tariffs by January 2013. **[5.3]** Apply a harmonised congestion management mechanism to all the interconnection capacity between Portugal and Spain. **[5.5]** Phase out regulated gas tariffs by January 2013.
Competition, public procurement, and business environment	**[7.29]** Implement the New Late Payments Directive. **[7.30]** Include all municipalities and all levels of public administration within the scope of the Simplex Programme.

Actions for the ninth review (to be completed by end Q2-2013)	
Fiscal structural	**[1.26]** Quarterly ceilings for the consolidated General Government cash balance to be assessed.
Goods and services markets	**[5.33]** Extend the Points of Single Contact reducing administrative burdens for firms to all sectors.
Housing market	**[6.5]** Review of the impact of all housing market reforms.
Judicial system	**[7.1]** Eliminate the court backlog.

Actions for the tenth review (to be completed by end Q3-2013)	
Fiscal structural	**[1.26]** Quarterly ceilings for the consolidated General Government cash balance to be assessed.
Goods and services markets	**[5.10]** Annual report on new contracts in renewables (see Q3-2011). **[5.11]** Annual report on new investments in renewables (see Q3-2011). **[5.33]** Extend the "Zero authorisation project" abolishing licenses to other sectors of the economy.
Health care system	**[3.64]** Introduce a contribution in the form of an average rebate, in case the change in the calculation of profit margin will not produce the expected savings.

Actions for the eleventh review (to be completed by end Q4-2013)	
Fiscal-structural	**[1.25]** Achieve a general government deficit of 3% of GDP. **[1.26]** Quarterly ceilings for the consolidated General Government cash balance to be assessed. **[1.32]** Define measures in the 2014 Budget Law to achieving a general government deficit in 2014 in line with the Medium-Term Fiscal Strategy defined in August 2011.

Actions for the eleventh review (to be completed by end Q4-2013)	
	[3.33] Merge the revenue collection units of social security administration, if cost-benefit assessment is favourable. **[3.34]** Reduce number of municipal tax offices by 20%. **[3.47]** Reduce the number of local branches of line ministries. **[3.49]** Reduce the number of central administration employees by 2% per year, with larger reductions at regional and local level of 2%.
Goods and services markets	**[5.21]** Bring the infrastructure manager to operational balance.