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The Economic Adjustment Programme for Portugal  
Seventh Review – Winter 2012/2013



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European Commission

Directorate-General for Economic and Financial Affairs

# The Economic Adjustment Programme for Portugal.

## Seventh Review – Winter 2012/2013

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

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## EXECUTIVE SUMMARY

*A joint European Commission (EC), European Central Bank (ECB) and International Monetary Fund (IMF) mission met with the Portuguese authorities in Lisbon between 25 February and 14 March, and subsequently between 14 and 17 April 2013 and between 8 and 11 May 2013, to assess compliance with the terms and conditions set out in Memorandum of Understanding as updated following the Sixth Review of the Portuguese Economic Adjustment Programme. The objectives of the Programme are to restore sound public finances, improve competitiveness and 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 mission concluded that the programme implementation is broadly on track, against the background of difficult economic conditions. The end-2012 fiscal deficit target of 5 percent of GDP has been met on a cash basis even though the headline deficit in ESA 95 terms is significantly above this level. Financial sector stability has been safeguarded and a wide range of structural reforms is progressing. External adjustment continues to exceed expectations.*

*Output in the last quarter of 2012 turned out significantly worse than expected. GDP contracted by 1.8 percent quarter on quarter of which only a part can be attributed to special factors, such as the port strike. Consequently, the macroeconomic outlook has been revised downward compared with the sixth Programme review. GDP is now forecast to contract by 2.3 percent this year. The revision is largely driven by the stronger negative carry-over from 2012, a weaker outlook for export demand, particularly from the euro area, and a more pronounced contraction in domestic consumption on the back of low confidence and high unemployment, which is now expected to peak at 18½ percent of the labour force in 2014. The economy is still expected to turn around towards the end of this year, resulting in positive growth of 0.6 percent in 2014 and 1.5 percent in 2015. The rebalancing of the economy towards the export sector is continuing at a fast clip, with the current account in 2013 expected to be in surplus for the first time in more than 40 years.*

*In view of the weaker growth outlook the government requested an adjustment of the fiscal targets which was supported by the mission. In spite of the continued government commitment to keeping spending under control, lower growth and higher unemployment make the original target for 2013 difficult to achieve without very substantial additional efforts. Moreover, a ruling by the Portuguese Constitutional Court which annulled a number of measures included in the 2013 budget law, notably the cuts in the bonus payments for public sector workers and pensioners and social security contributions on unemployment and sick leave benefits, opened a fiscal gap of 0.8 per cent of GDP which needed to be closed by additional measures. The mission therefore concluded that a revision of the deficit target for this year from 4.5 percent to 5.5 percent of GDP would be appropriate. This also implies a revision of the target for 2014, from 2.5 to 4.0 percent of GDP, and for 2015, from 2.0 to 2.5 percent of GDP. This path has been calibrated so as to keep the adjustment in terms of the improvement in the structural primary balance broadly unchanged at around 9 percent of GDP over the 2011-2015 period, while taking into consideration financing and debt constraints as well as the output and social costs of adjustment.*

*The credibility of the new deficit path will be underpinned by permanent and targeted spending reductions. A large part of these measures has been specified in the framework of a public expenditure review which the government has undertaken in recent months with the aim of streamlining and modernising public administration, improving the sustainability of the pension system and achieving targeted cost savings in individual line ministries. Overall, the package of measures announced by the government includes permanent savings of more than EUR 4.7 billion or 2.8 per cent of GDP over 2013-2014. Measures worth 0.8 percent of GDP will be frontloaded to this year. While protecting the most vulnerable parts of the society, the measures aim at increasing the efficiency and equity of public spending.*

*Achieving the revised targets will require the swift implementation of the measures announced by the government. The government has initiated a consultation process with social and political partners with*

a view to finalising the legislative proposals implementing the reform measures. In view of political and legal risks surrounding this implementation process some of the measures may be partly or fully replaced by others of similar volume and quality. Part of the measures are included in the Supplementary Budget which was submitted to Parliament on 30 May, while all other legislative changes and legislative proposals required to implement the reforms will be adopted or submitted to Parliament, as the case may be, by mid-July.

**Fiscal structural reforms have made good progress and should raise the efficiency of the state.** The adoption of the local and regional finance laws will strengthen the budgetary framework and could lead to sizeable cost savings at the subnational levels, if appropriately implemented. It should facilitate the coordination and allocation of tasks among different government levels. At the same time, the rationalisation of public administration is making good progress and resizing plans are ahead of schedule. Tax administration capacities are being enhanced by merging services and benefits from the VAT invoicing reform and the completion of the property revaluation. Budgetary risks are becoming more tightly controlled with the implementation of reforms in the region of Madeira, the renegotiation of contracts with public-private partnerships, and advances in the restructuring of state-owned enterprises.

**The banking sector's financial strength has improved although its prospects are still affected by the macroeconomic downturn in Portugal.** The capital augmentation exercise has strengthened the sector and made it more resilient to a longer than forecasted recession. Profitability in 2012, although weak, benefitted from one-off factors and gains linked to relatively high government bond yields. Some banks tapped international markets with covered bonds and unsecured lending even before the sovereign's first long-term issue in 2 years. Borrowing from the ECB has declined, partly reflecting better system liquidity, but remains high. Remuneration offered for new deposits came down substantially. Partly in reaction to this, deposits have declined but remain at pre-programme levels, with household deposits showing resilience. Demand for investment and house purchase credit remains very subdued. Amid on-going loan contraction, impaired loans are likely to rise further due to the weakening economy, especially in the construction and real estate segments. Bank lending rates have edged lower on the back of the fall in Euribor rates, lower demand, better liquidity and reduced deposit remuneration but are still high compared with other euro area countries.

**Structural reform momentum is being maintained to the benefit of Portugal's competitiveness in the medium and longer term.** The reduction of severance payments for new open-ended contracts to 12 days per year of work (from 30 days prior to the programme) will lower the cost of employment and promote job creation. The lowering of charges for using maritime ports, the alleviation of administrative burden and the simplification of licensing procedures should reduce companies' operating costs. The adoption of the new framework law strengthening the powers of regulatory authorities as well as the implementation of best European practices in the services sector should foster competition in network industries and the tertiary sector. Preparatory work for a comprehensive reform of the corporate income tax is advancing. It is aimed at simplifying the overly complex tax structure, reducing compliance and administrative costs, and gradually lowering the tax rate while broadening the tax base. Judicial reforms are progressing at a good pace, particularly in the areas of civil procedure and court management. These reforms are urgently needed to boost the competitiveness of the country and improve its business environment, even though their impact is not necessarily visible in the current subdued economic climate. This makes it all the more important to maintain the broad consensus around these reforms in order to assure their success.

**Portugal took advantage of its good programme implementation and the general improvement in market conditions to go ahead with the successful sale of a 10-year bond.** In early May, the government sold EUR 3 billion of a 10-year bond at a yield of 5.67 percent with strong participation from foreign investors. The Treasury has already built up substantial cash buffers, ensuring smooth financing at least until the end of the year, and plans to continue tapping the markets and expanding the investor base.

*Financing will be further facilitated by the Eurogroup and Ecofin Ministers' decision to lengthen the average maturity of the EU official loans by seven years.*

***The successful completion of the Seventh Review will release EUR 1.3 billion from the EU and EUR 0.7 billion from the IMF, bringing overall financing to around EUR 66 billion (more than 80% of the total envelope). These disbursements could take place in June 2013 subject to the approval by ECOFIN and Eurogroup for the EU loans and the IMF Executive Board for the IMF loan. The government's programme is supported by loans from the European Union amounting to EUR 52 billion and a IMF's Extended Fund Facility amounting to SDR 23.7 billion.***





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## INTRODUCTION

1. The report assesses compliance with the terms and conditions set out in the Memorandum of Understanding as updated following the Sixth 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 25 February to 14 March, with follow-up missions from 14 to 17 April 2013 and 8 to 11 May 2013 <sup>(1)</sup>. In accordance with the Council Implementing Decision amending Implementing Decision 2011/344/EU on granting EU financial assistance to Portugal <sup>(2)</sup>, the mission assessed compliance with the conditionality associated with the eight disbursement and progress towards the key objectives of the Programme of sound public finances, restoring competitiveness and putting Portugal's economy back on the path of sustainable growth and job creation. It also revised the specific policy conditionality while keeping unchanged its main objectives.

2. The Economic Adjustment Programme was agreed by the Ecofin Council on 17 May 2011 and by the IMF Executive Board on 20 May. The Programme, which covers the period 2011-2014, entails an external financing by the European Union, the euro-area Member States and the IMF of some EUR 79 billion <sup>(3)</sup>, 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. A successful completion of the Seventh Review will pave the way for the release of the next loan instalment of around EUR 2 billion. This instalment will bring EU and IMF financing to around EUR 66 billion, representing some 80 percent of total available financial assistance.

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<sup>(1)</sup> The cut-off date for the macro-economic and fiscal projections of this report is 15 March 2013

<sup>(2)</sup> OJ L 269 of 14.10.2011

<sup>(3)</sup> The IMF share of the Programme was set in Special Drawing Rights (SDR). Due to a weakening of the Euro against the SDR compared with May 2011, the projected pay-out by the IMF in Euro has become higher.



# 1. ECONOMIC DEVELOPMENTS AND OUTLOOK

## MACROECONOMIC OUTLOOK

4. **The last quarter of 2012 turned out significantly worse than expected with respect to both economic activity and labour market developments.** The 1.8 percent quarter-on-quarter contraction in the fourth quarter brought annual GDP in 2012 down to 3.2 percent, 0.2 percentage points below the projections of the previous review. The fall in employment was also stronger than expected (2.7 percent quarter on quarter in Q4-2012), bringing the average unemployment rate for the year to 15.7 percent.

5. **The macroeconomic outlook has been revised downward compared with the forecast of the 6th Programme review.** GDP is now forecast to contract by 2.3 percent this year (1.3 percentage points below the 6th review forecast) and to grow by 0.6 percent in 2014 and by 1.5 percent 2015. Over half of the downward revision for 2013 is implied by the additional negative carry-over from the larger-than-expected contraction in the last quarter of 2012. Beyond this mechanical effect, the revision largely reflects the deterioration in the growth outlook for Portugal's export markets.

6. **Labour market prospects have deteriorated, with the unemployment rate now expected to peak at 18.5 percent in 2014.** The worse-than-projected starting point, the weaker growth outlook and the further reduction in public sector employment are expected to weigh on the recovery of employment in 2013 and 2014. These labour market developments are expected to have additional negative feedback effects on households' consumption expenditure.

7. **In spite of headwinds coming from both domestic and external demand this year, economic activity is expected to pick up towards the end of this year.** An improvement in the external environment in the second half of 2013 is set to support exports. In addition, equipment investment and industrial production showed signs of bottoming out over the past months and there are indications of a rebound in the first quarter of this year.

Confidence indicators, although still relatively low in all sectors, have maintained an upward trend over the past five months.

8. **The rebalancing towards a more export-oriented growth pattern continues at a good pace.** The balance of trade in goods and services was close to zero last year as the deficit of the balance of goods was reduced significantly and the surplus of the balance of services increased further. The current account is projected to be balanced in 2013 for the first time in more than 40 years. Improvements in the external balance are set to continue over the forecast period. The current account is projected to remain close to balance with further improvements in the trade balance partly offset by rising interest burden on the still-high foreign debt stock.

9. **Subdued domestic demand and the weak labour market are expected to continue exerting downward pressure on wages and prices, which should support the ongoing rebalancing process in the economy.** HICP inflation has dropped to rates just above zero since the beginning of the year, lower than the euro area average inflation rate since the fourth quarter of 2012. Nominal unit labour costs have fallen significantly relative to the euro area average over the last three years, and this trend is expected to persist in 2013 and 2014. However, the recent adjustment in unit labour costs was to a significant extent due to labour shedding and public sector wage cuts, part of which has been reversed by the reinstatement of a monthly salary in the public sector. The terms of trade have not changed substantially over the past years.

10. **After the finalisation of the macroeconomic outlook in March risks to the forecast have become more tilted to the downside.** Domestic demand is set to remain weak in particular against the background of dismal labour market developments in the first quarter of this year that could impact negatively on private consumption. At the same time, exports have accelerated since the beginning of this year, and economic sentiment as well as other short-term leading indicators have kept improving for six months now and point to a progressive bottoming out of economic activity and to a turn-around later this year.

Table 1.1: Projections of main macroeconomic aggregates

	7th Review (March 2013)				6th Review (Nov 2012)			
	2012	2013	2014	2015	2012	2013	2014	2015
year-on-year volume change								
Gross domestic product	-3.2	-2.3	0.6	1.5	-3.0	-1.0	0.8	1.8
Private consumption	-5.6	-3.5	0.1	1.0	-5.7	-2.2	0.4	1.2
Public consumption	-4.4	-2.6	-2.0	-1.9	-3.5	-3.2	-2.0	0.9
Fixed investment	-14.5	-7.7	2.5	4.9	-13.7	-5.5	3.0	4.3
Exports of goods and services	3.3	0.8	4.4	4.9	4.6	2.9	5.0	5.5
Imports of goods and services	-6.9	-3.9	3.1	4.3	-5.9	-2.1	3.8	5.5
contributions to real GDP growth								
Domestic demand excl. inventories	-7.1	-4.1	0.0	1.1	-6.9	-3.0	0.3	1.6
Change in inventories	0.1	-0.1	0.0	0.1	0.1	0.0	0.0	0.0
Net trade	4.0	1.8	0.6	0.4	4.3	3.9	1.9	0.6
Employment (y-o-y change)	-4.2	-3.9	-0.5	0.4	-3.9	-1.6	0.5	0.6
Unemployment rate (level)	15.7	18.2	18.5	18.1	15.5	16.4	15.9	15.3
HICP (y-o-y change)	2.8	0.7	1.0	1.8	2.8	0.8	1.2	1.3
Current external balance (% of GDP)	-1.9	0.1	0.1	0.0	-2.7	-0.6	-0.2	0.1

Source: Commission services

## FISCAL DEVELOPMENTS

11. **In 2012, the headline deficit in ESA 95 terms reached 6.4 percent of GDP, which is above the 5.0 percent of GDP target.** Since for purposes of the programme a capital injection into the state-owned bank CGD, worth about 0.5 percent of GDP, is not taken into account under a programme perspective the deficit amounted to 6.0 percent of GDP. The remaining difference is explained by other one-off operations. In particular, following an advice by Eurostat the sale of the operating concession for the major airports in Portugal amounting to 0.7 percent of GDP was in view of its proximity in time with the privatisation of ANA (Portuguese airport operator) treated as equity withdrawal and hence not impacting on the government balance, contrary to what the government had foreseen in the budget. Furthermore, the re-routing through the government of the conversion of shareholder loans into equity of Parública to SAGESTAMO, two companies outside the general government perimeter, added 0.5 percent of GDP to the deficit in 2012. The impairments associated to the transfer of assets from BPN added another 0.1 percent of GDP to the deficit. Excluding the impact of these one-off factors, the general government deficit would have been 4.7 percent of GDP, thus below the target.

12. **Notwithstanding the headline deficit outcome, fiscal consolidation in 2012 was**

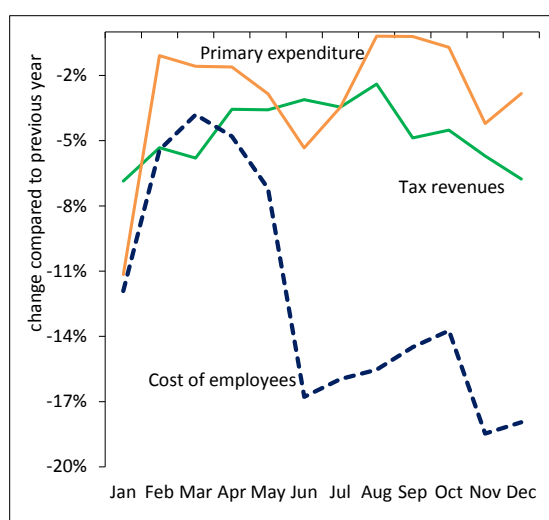
**remarkable and on an adjusted-cash basis the general government deficit was in line with the programme target for 2012.** Confining the deficit in 2012 was challenging as the macro-driven underperformance of revenues in the last quarter of the year and additional social transfers in kind had to be compensated by tight expenditure control. Expenditure savings were achieved in particular in the areas of the public wage bill, with the reduction in public employment proceeding ahead of plans, by reducing intermediate consumption and freezing budgetary appropriations for new investment projects. The budgetary execution of regional and local governments also turned out better than expected.

13. **On a cash basis, state tax revenues fell across the board in 2012 on account of the weak macroeconomic developments.** Tax collection fell by nearly 7 percent y-o-y in December. Direct taxes fell by 9.5 percent, with a particularly strong fall in corporate income taxes. Indirect taxes declined by 4.7 percent, mostly driven by the fall in VAT collection (-2.0 percent) due to lower consumption, but also vehicle taxes (-42 percent), tobacco taxes (-6.4 percent) and stamp duties (-8.4 percent). Whereas part of the VAT decline can be attributed to an unanticipated increase in reimbursements and transfers to the Social Emergency Programme, gross collection before reimbursements also fell in 2012 by more than expected. All in all, these developments together with some cash-accrual adjustments translate into a



negative carry-over to 2013 amounting to some ½ percent of GDP. The negative carry-over and the revised macroeconomic outlook prompted a revision of tax projections for 2013, down from the initial budget estimates. Preliminary data for the first quarter of 2013 point to a tax performance in line with the revised projections.

Graph 1.1: Budget execution: Tax Revenues, Cost of Employees and Primary Expenditure: January - December (cash-data)

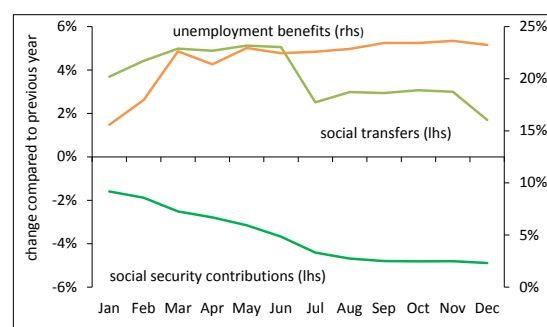


(1) includes non-consolidated data for the State and Autonomous Funds and Services. Primary expenditure includes data for the State subsector only.

Source: Ministry of Finance and Commission services

14. **Continued employment attrition in the public sector yielded substantial additional savings in compensation of employees.** These savings are expected to carry over into 2013. Primary expenditure was further reduced mostly through lower intermediate consumption and investment, which are however unlikely to carry over into 2013. Additional transfers for programme contracts of the National Health Service with hospitals had to be made, despite the efforts in reducing costs by hospitals pertaining to the state-owned enterprises (SOEs) sector, leading to a further negative carryover into the government balance for 2013. According to the latest estimates interests costs peaked in 2012 at around 4.4 percent of GDP.

Graph 1.2: Budgetary outturn for Social Security in 2012: January - December (cash-data)



(1) includes non-consolidated data for Social Security

Source: Ministry of Finance and Commission services

15. **The 2012 social security balance turned out better than expected at the sixth review.** This resulted mainly from tighter-than-projected budgetary execution for several expenditure items in the last quarter of the year, notably social action programmes, training expenditure and administrative costs. On the revenue side, the trend of social security contributions has stabilised at a year-on-year rate of about -5 percent.

16. **The fiscal effort in 2012 as measured by the change in the structural balance is estimated at 2.4 percent of GDP.** According to the revised EDP Recommendation of 9 October 2012, Portugal is requested to deliver an improvement in the structural balance by 2.3 percent of GDP. The current estimate of the structural balance in 2012 is -4.2 percent of GDP compared with a value of -6.6 percent in 2011 (see Table 5 in Section III). The improvement in the structural balance is hence above the effort recommended by the Council. Moreover, account taken of the fall in the estimate for potential output in 2012 as consequence of the worsening of the macro-economic scenario as well as the tax-poor growth, the measured fiscal effort would have been around ½ percent of GDP higher and therefore well above the value of the revised EDP Recommendation.

Table 1.2: Stock of arrears in 2012 (EUR million)

	2012 (1)											(2)	(3)=(2)-(1)	
Subsector of the General Government	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Δ Dec-Jan	% total
Central Government excluding NHS	151	165	153	140	135	155	129	122	120	96	105	58	-93	2%
NHS classified in General Government	219	194	152	185	202	216	200	36	37	32	24	19	-200	1%
Reclassified entities	51	50	45	46	61	48	39	39	33	30	33	29	-23	1%
Local Government	1,690	1,710	1,735	1,759	1,643	1,577	1,532	1,509	1,472	1,437	1,392	1,321	-369	42%
Regional Government	1,185	1,215	1,287	1,320	1,261	1,319	1,304	1,254	1,283	1,276	1,280	947	-238	30%
Total	3,296	3,334	3,372	3,450	3,301	3,315	3,204	2,960	2,946	2,871	2,835	2,373	-923	76%
Total Consolidated	3,180	3,215	3,248	3,325	3,186	3,208	3,098	2,856	2,843	2,766	2,730	2,294	-886	74%
Other entities outside General Government														
Enterprises excluding NHS	11	18	19	26	32	34	32	40	46	54	50	33	23	1%
NHS incorporated hospitals	1,695	1,697	1,856	1,948	1,996	1,877	1,806	1,086	1,044	1,028	1,018	792	-902	25%
p.m.: health sector inside + outside GG	1,914	1,891	2,007	2,132	2,197	2,093	2,006	1,122	1,081	1,060	1,043	811	-1,103	26%
TOTAL	4,886	4,930	5,123	5,299	5,214	5,119	4,936	3,982	3,934	3,848	3,799	3,120	-1,766	
p.m.: percent of GDP	2.9	3.0	3.1	3.2	3.1	3.1	3.0	2.4	2.4	2.3	2.3	1.9		

(1) Consolidated data concerns data net of intra-government sector arrears. Total amounts adjusted for arrears' settlement.  
Source: Ministry of Finance and Commission services

## Arrears

17. **Arrears fell across all general government subsectors in 2012, but the outstanding stock is still elevated.** Most of the decline in arrears – EUR 1.8 billion – is due to the debt settlement programme in the health sector that was successfully completed. A second programme, worth EUR 432 million is set to take place in the first half of 2013 along the same strategic guidelines. The payment of arrears by the local governments under the 'Support Programme for the Local Economy' (PAEL) is progressing more slowly than initially expected, largely due to the required controls by the Court of Auditors so that only EUR 113 million had been disbursed until end-February. The stock of arrears for the regional governments has also declined. The Region of Madeira (RoM) presented a revised strategy for the settlement of arrears in December 2012, with detailed information on the amounts due per sector and the criteria for the payment of arrears. This strategy envisages, inter alia, a EUR 1.1 billion state-guaranteed loan to pay arrears with potential savings of EUR 60 million. The administration of RoM expects that this operation would clear about half of the outstanding debt of the region. The implementation of the commitment control law seems to be on track at all levels of government although continued close monitoring is necessary. However, data for the first quarter of 2013 point to an increase in arrears for some sectors, which will be carefully assessed in the next review mission.

## FINANCIAL MARKETS AND FINANCIAL SECTOR DEVELOPMENTS

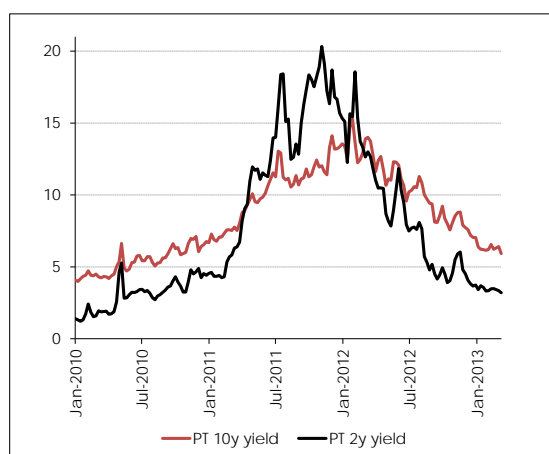
18. **In March 2013, 10-year bond yields fell to their lowest levels in two and a half years.** A further substantial improvement in government securities on the secondary market happened around the turn of the year. After two large banks accessed international bond markets with unsecured lending and covered bonds, the Portuguese Republic successfully issued EUR 2.5 billion through a five-year bond in January. This was the first bond issue since January 2011 and constituted a landmark in Portugal's adjustment programme. Yields were below 5 percent, the bid to cover ratio was 4.8 with more than 90 percent of demand coming from non-Portuguese investors.

19. **ECB lending to banks in Portugal has decreased by more than 10 percent since the last review.** Some banks reimbursed a part of their 36-months ECB lending in the early months of 2013 to regain more flexibility with respect to using ECB borrowing. The absolute amount of gross ECB lending now stands below EUR 50 billion, the lowest level since the second round of the Long-Term Refinancing Operation (LTRO) in February 2012.

20. **Banks lend relatively more to large companies and reduce lending for mortgages.** Bank loans granted in 2012 amount to roughly 70 percent of the past decade's average annual level,

causing the stock to fall by 6 percent. However, developments differ widely across sectors. Last year's disbursement of loans to companies above EUR 1 million stood at 93 percent of the 10-year average, loans to smaller companies at 74 percent. The decline in loans to SMEs was particularly marked in sectors more exposed to domestic developments. Given that in 2012 new company loans in total amounted to 84 percent of the 2003-2012 average, the stock fell by 8.3 percent (Graph 4). The 2012 mortgage vintage was less than a sixth compared to the decade's average which is partly explained by the high spreads on mortgages compared to pre-Lehman years (see Graph 5). As newly granted mortgages roughly replace a third of redemption, the mortgage stock shrank by 3 percent over 2012. Fresh consumer credit was about half the average and loans to private persons for other purposes amounted to two thirds of the decade's benchmark causing their combined stock to fall by 8.2 percent in 2012.

Graph 1.3: Yields of 10 year - and 2 year government bonds on the secondary market - daily closure

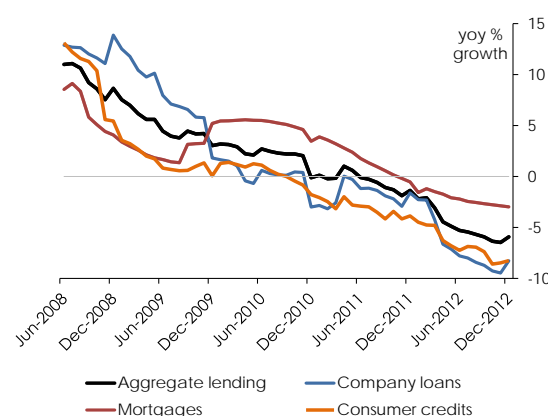


Source: Ecowin

21. **Aggregate deposits reverted to pre-programme levels.** In the early months of the adjustment programme banks bid up deposit remuneration very aggressively. Portfolio shifts from insurance products into term deposits followed. The supervisor successfully influenced ever higher term deposit remuneration through regulatory action in November 2011 and February 2012. Subsequently, deposit interest rates have come down but still fluctuate around 200 basis points above 3m-Euribor, which has a significant

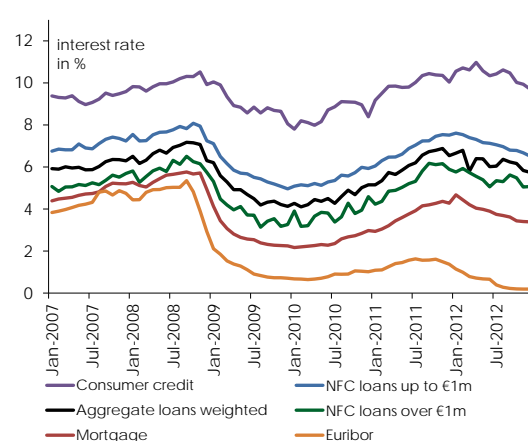
impact on banks' cost structure as the share of interest bearing deposits in the deposit base is higher in Portugal compared with the euro area average. The impressive deposit growth observed in 2011 has stalled in the first half of 2012 and turned negative in the second half. This reflects the lower deposit remuneration and the ensuing portfolio shift into debt securities issued by banks and companies, but also lower money demand in a context of declining economic activity.

Graph 1.4: Loan stock evolution per segment



Source: Banco de Portugal

Graph 1.5: Interest rate evolution per segment



Source: Banco de Portugal

22. **While still significantly higher than in other euro area countries, interest rates of new bank loans in selected segments displayed a slight decrease.** This is the case for some segments of bank loans to NFCs and housing

Table 1.3: Soundness indicators of the Portuguese banking system

%	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Return on Equity (1)	6.0	7.2	7.6	7.1	6.7	6.2	4.3	2.4	-3.8	6.3	1.0	-0.3	-4.2
Gross Income on Assets	2.8	2.5	2.6	2.6	2.7	2.4	2.5	2.5	2.5	2.6	2.7	2.6	2.5
Cost to Income Ratio	56.8	57.7	57.1	57.2	57.6	59.1	58.3	59.0	61.4	56.1	52.9	56.5	58.9
Non-Performing Loans	4.8	5.4	5.5	5.8	5.2	5.5	6.2	6.9	7.5	8.2	9.0	9.9	9.8
Coverage Ratio	59.0	63.2	62.9	60.8	61.5	60.7	57.7	55.3	56.7	53.0	51.9	50.8	54.3
Capital Adequacy Ratio	11.6	11.3	10.9	11.0	11.1	11.4	11.0	10.1	10.7	10.7	12.3	12.3	12.5
Core Tier 1 Ratio (3)	7.9	7.8	7.8	8.0	8.1	8.4	8.7	8.5	9.6	9.6	11.2	11.3	11.5
Loan-to-deposit ratio	161.5	163.4	166.6	158.4	157.8	156.7	149.7	146.2	140.2	136.9	136.3	133.3	127.7

(1) Income before minority interests / Average shareholders' equity before MI

(2) Excluding the banks in resolution (BPN until end 2011 and BPP)

(3) The Core Tier 1 ratio according to Programme definition and excluding the banks in resolution (BPN until end 2011 and BPP)

Source: Banco de Portugal

loans, where differences of 60 to 140 basis points can be found among average interest rates for new loans between January 2013 and one year ago. Whether this reflects a sustained downward trend remains to be seen.

23. **Following a process of progressively smaller increases in credit standards, lending criteria have remained unchanged in recent months, while private sector credit has continued to contract due to less favourable expectations for economic activity.** However, Banco de Portugal's lending survey points to some stabilisation in the demand for loans to private businesses to finance inventories, working capital and debt restructuring. Household lending was negatively affected by the deteriorating outlook for the housing market and the worsening of consumers' credit worthiness. The tendencies observed in late 2012 continued throughout the first quarter of 2013 with on-going selective deleveraging of the private sector implying the market exit of economically non-viable companies or their adjustment to present market conditions.

24. **Bank profitability in 2012 was weak but in line with expectations.** Bank profitability improved somewhat compared with the particularly difficult year in 2011, which was heavily affected by one-off charges and write-offs. Results continue to be impacted by rising bad debt charges, extra impairment requirements by the central bank, and the Greek exposure of BCP Millennium. At the same time, subsidiaries located outside the euro area positively influenced earnings. The other positive factor was gains from the sale of Portuguese sovereign debt on the back

of improving market sentiment. However, in general the positive international contribution and trading gains were not sufficient to offset the weaker domestic performance in core business. Going forward, pressure on Portuguese bank profitability will remain in view of the continued recession, growing unemployment and general deleveraging of the economy.

## 2. PROGRAMME IMPLEMENTATION

### FISCAL POLICY

Fiscal path over the programme period and beyond

26. **Given the larger-than-expected negative carry-over from 2012, the significant deterioration of the macro-economic outlook as well as the Constitutional Court decision invalidating several measures of the 2013 budget worth 0.8 percent of GDP, the target of 4.5 percent of GDP in 2013 does not seem feasible.** Taking into account second-round effects, meeting the target would require additional measures of more than 1½ percent of GDP on top of the consolidation measures of more than 3 percent of GDP already included in the budget, which could trigger significant negative macro-fiscal feedback loops.

27. **Supported by the mission, the Portuguese authorities requested a revision of the targets from 4.5 percent to 5.5 percent of GDP for 2013, from 2.5 percent to 4.0 percent of GDP in 2014 and from 2.0 percent to 2.5 percent of GDP in 2015.** This path has been calibrated so as to keep the adjustment in terms of the improvement in the structural primary balance broadly unchanged at around 9 percent of GDP and to deliver a fiscal effort (EDP definition) of some 7 percent of GDP over the period 2011-2015 (see Table 2.1), while taking into consideration financing and debt constraints as well as the output and social costs of adjustment. The credibility of the new deficit targets will be underpinned by permanent expenditure-based consolidation measures building on the results of the public expenditure review.

#### *Fiscal consolidation in 2013*

28. **The fiscal projections for 2013 are underpinned by permanent consolidation measures the net amount of which is estimated at 3½ percent of GDP.** These include the measures defined in the 2013 budget law, the frontloading of expenditure reducing measures identified in the context of the public expenditure review (PER) as well as other measures to replace the budget measures that were ruled unconstitutional. Some of the consolidation measures are included in the Supplementary Budget submitted to Parliament on 30 May,

whereas all other legislative changes linked to the implementation of the PER will be adopted by the Government or submitted to Parliament, as the case may be, by the end of the legislative session in mid-July 2013. The 2013 budget law included permanent consolidation measures worth slightly above 3 percent of GDP, after accounting for the reinstatement of one of the two bonus payments for public sector workers and 1.1 times of the two bonus payments for pensioners that had been cut in 2012. On 5 April, however, the Constitutional Court ruled against some of the 2013 budget provisions, including the remaining cut of one of the two bonus payments for public workers and 0.9 times of the two bonus payments for pensioners and the introduction of social security contributions on unemployment and sick leave benefits, thereby creating a budgetary gap of 0.8 percent of GDP. To close this gap and to underpin the required fiscal adjustment in the years ahead, the government adopted in the course of April and May a package of permanent expenditure-reducing measures with a cumulative yield of EUR 4.7 billion (2.8 percent of GDP) over 2013-2014, of which measures worth 0.8 percent of GDP are frontloaded into 2013. In addition, given the need for a rapid reaction to the Constitutional Court ruling, some of the measures in 2013 are of temporary nature and will be compensated for by permanent measures in 2014. On the whole, revenue increases will bear the brunt of the adjustment in 2013 but the balance between revenue and expenditure-based consolidation will be re-established in 2014.

29. **Revenue side measures include inter alia a restructuring of the personal income tax and the corporate income tax as well as increases in excise duties and property taxation.** In particular, the restructuring of the personal income tax (PIT) was implemented by reducing the number of brackets and increasing the average tax rate in line with European standards, while preserving progressivity and curbing tax benefits. In addition, a tax surcharge is imposed on incomes above a certain threshold. Corporate tax revenues are increased by means of limiting the deductibility of interest costs, reducing the threshold for applying the highest surcharge on profits and changing the methodology for special prepayment to companies, among others. The budget also considers changes in indirect taxation

Table 2.1: Fiscal targets and structural adjustment 2011 - 2015

	2011	2012	2013	2014	2015
<b>Deficit</b>	-4.4	-6.0	-5.5	-4.0	-2.5
<b>Budget deficit, net of one-offs</b>	-7.4	-5.8	-5.6	-3.7	-2.5
<b>Structural balance</b>	-6.6	-4.2	-3.6	-2.2	-1.7
<b>Primary balance</b>	-0.4	-1.6	-1.1	0.4	1.8
<b>Structural primary balance</b>	-2.5	0.2	0.8	2.2	2.7
<b>Fiscal adjustment</b>	3.4	2.7	0.6	1.4	0.5
<b>Fiscal effort (EDP definition)</b>	2.2	2.4	0.6	1.4	0.5

(1) Fiscal adjustment measured as the change in the structural primary balance; fiscal effort defined as the change in the structural balance;

(2) For the purposes of the Programme, the budget deficit in 2012 excludes the impact of CGD recapitalisation (about 0.5% of GDP)

Source: Ministry of Finance and Commission services

by means of higher excises on tobacco, alcohol and natural gas and broadening the property tax base after the revaluation of properties. In addition, social contributions will rise as an extraordinary solidarity contribution will be levied on pensions and social security contributions will be charged on supplementary payments for public employees and on unemployment and sick leave benefits above a minimum threshold, so as to ensure compatibility with the Constitutional Court ruling. As part of the measures the government decided in early May, the public employees' contribution to the special health insurance schemes will be increased. In addition, the government will also adopt non-permanent measures including a frontloading of revenues from EU funds through, inter alia, the transfer of Cohesion Fund resources from less mature projects to more advanced ones. Finally, with a view to stimulating investment, the authorities recently announced the introduction of a temporary credit on the corporate income tax to be applied on new investment made until the end of the year.

30. **On the expenditure side, a comprehensive package of measures will be implemented to reduce the public sector wage bill through employment restraint and a reduction in overtime payments and compensations.** These include the measures foreseen in the 2013 budget law and additional measures decided by the government in April and May. In particular, a further reduction in public employment and compensations is foreseen through the transformation of the Special Mobility

Scheme into a Requalification programme, the convergence of public and private sector working rules – especially by raising working hours in the public sector from 35 to 40 hours per week - and a cut in fringe benefits. Rationalisation efforts across line ministries, SOEs and PPPs will be deepened beyond the original budget plans and social spending will be streamlined. Among the non-permanent expenditure measures, a further reduction of capital expenditure is envisaged.

31. **Budgetary consolidation in 2013 needs to compensate for a negative primary balance drift of about 3 percent of GDP.** The negative balance drift reflects more subdued labour market and growth developments as well as the continued rebalancing towards a more export-driven but also less tax-intensive economy. In addition, the package of measures also compensates for the effect of the reinstatement of two bonus wages and pensions (1.5 percent of GDP) following the rulings by the Constitutional Court on 6 July 2012 and 5 April 2013. Given the large magnitude of these effects, the headline deficit figure is expected to improve by a mere 0.5 percent of GDP in spite of overall net consolidation measures amounting to more than 4½ percent of GDP (see Table 2.2).

32. **The structural adjustment in 2013 has been reduced due to the inclusion of one-offs in the package of measures aimed at closing the budgetary gap generated by the Constitutional Court ruling.** Following the developments in 2012, the 2013 baseline assumes that the revenue shortfalls and increased costs of the NHS



Table 2.2: Arithmetic of the government deficit: from the deficit in one year to the next

	% of GDP
2010 balance (observed)	-9.8
p.m. 2010 balance (without one-offs)	-9.2
Primary balance drift in 2011	-1.4
Change in interest expenditure	-1.2
Dissipation of one-offs and non-recurrent effects from previous year	0.7
New consolidation measures	4.3
One-off measures	3.0
2011 balance (estimate)	-4.4
p.m. 2011 balance (without one-offs)	-7.4
Primary balance drift in 2012	-3.8
Change in interest expenditure	-0.4
Dissipation of one-offs and non-recurrent effects from previous year	-3.0
New consolidation measures	5.8
One-off measures	-0.2
2012 balance (target)*	-6.0
p.m. 2012 balance (without one-offs)	-5.8
Primary balance drift in 2013	-3.1
Change in interest expenditure	0.0
Dissipation of one-offs and non-recurrent effects from previous year	0.2
New consolidation measures	4.8
Reinstatement of 13th and 14th salary and pension	-1.5
One-off measures	0.2
2013 balance (target)	-5.5
p.m. 2013 balance (without one-offs)	-5.6
Primary balance drift in 2013	-0.1
Change in interest expenditure	0.0
Dissipation of one-offs and non-recurrent effects from previous year	-0.2
New consolidation measures	2.0
One-off measures	-0.3
2014 balance (target)	-4.0
p.m. 2014 balance (without one-offs)	-3.7

(1) 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, removing the effect of one-off measures. It includes the impact of economic activity on the balance, including the composition of growth, and the structural increase in expenditure in real terms, e.g. the increase in pension expenditure.

\* For the purposes of the Programme, the budget deficit in 2012 excludes the impact of CGD recapitalisation (about 0.5% of GDP)

Source: Ministry of Finance and Commission services

programme contracts with hospitals are carried over into 2013 whereas a large part of the expenditure savings in the last quarter of the year are considered non-permanent. This implies a negative carry-over of about 0.4 percent of GDP. In addition, given the need for a rapid response to the Constitutional Court ruling, part of the measures to close the gap in 2013 will be of temporary nature or consist of using budgetary buffers and margins. Due to these revisions, the structural effort in 2013 is now estimated at 0.6 percent of GDP which falls short of the effort of 1.6 percent of GDP requested by Council Recommendation of 9 October 2012 in the framework of the EDP. However, taking into account the impact of the change in the macro-economic scenario since the Council Recommendation on potential output growth as well as the effect of revenue shortfalls the estimated effort in 2013 would be some 0.7 percent of GDP higher. Moreover, the unemployment rate is now expected to increase by almost 2 percentage points more than the projection at the time of the Council Recommendation while the contribution of domestic demand to economic activity has further declined. Taking these developments into account, the revised target does not imply a relaxation of the fiscal effort as can be seen also from a 'bottom-up' approach which shows that the fiscal effort in 2013 will increase compared to previous assumptions.

**33. Risks to the attainment of the 2013 deficit target concern mainly the implementation of the full package of consolidation measures.** The timely and full implementation of the measures compensating for the Constitutional Court ruling will be crucial and requires quickly addressing the potential political and legal risks of the process. In addition, the strongly revenue-based consolidation makes the adjustment more vulnerable to shortfalls from worse-than-expected growth and/or a further erosion of tax bases as a result of a household expenditure shift to less-taxed goods, as witnessed in 2012.

#### *Fiscal consolidation in 2014*

**34. In 2014, the fiscal adjustment will proceed on the basis of the PER that includes permanent expenditure-reducing measures of 2**

**percent of GDP in 2014.** The main impact of the PER measures acts along three main axes: (1) reduction of the public sector wage bill; (2) reduction of pension benefits and (3) sectoral expenditure cuts across line ministries and programmes. The PER measures are part of a wider effort to reform the state with the objective of increasing equity and efficiency in the provision of social transfers and public services. The reduction in the wage bill in 2014 aims at reducing the size of the public-sector work force while shifting its composition towards higher-skilled employees, aligning the public sector work rules with those of the private sector and making the remuneration policy more transparent and merit-based. Specific reforms include the transformation of the Special Mobility Scheme into a Requalification Programme, aligning public sector working hours with those in the private sector (i.e. increase from 35 to 40 hours work week), introduction of a bank of hours, reduction in holiday entitlements, the implementation of a voluntary redundancy scheme (which is estimated to generate one-time upfront cost of about 0.3 percent of GDP) and the introduction of a single wage and supplement scale. A comprehensive pension reform will generate another important part of the savings and will be based on equity principles and income progressivity, thereby protecting the lowest pensions. Specifically, the reforms will aim at reducing the current differences between the civil servants' system (CGA) and the general system, increasing the statutory retirement age by changes to the sustainability factor and introducing – if strictly needed – a progressive sustainability contribution. Finally, savings in intermediate consumption and expenditure programmes across line ministries will be stepped up.

**35. The government has initiated a consultation process with social and political partners with a view to finalising the legislative proposals implementing the reform measures in the coming weeks.** Part of the measures were included in a Supplementary Budget submitted to Parliament by end-May, while all other legislative changes and legislative proposals required to implement the reforms will be adopted or submitted to Parliament, as the case may be, by mid-July. However, the package faces risks of a political and legal nature, such as the consistency of the measures with the Portuguese Constitution.

As to the latter, it will be important to limit these risks by submitting reform proposals that appear contestable from a constitutional point of view to a prior legal review. In view of the political and legal risks surrounding the implementation process, some of the measures may be partly or fully replaced by others of similar volume and quality.

36. **Finally, a comprehensive reform of the Portuguese corporate income tax (CIT) will come into force in 2014.** The goal is to boost investment and growth by simplifying the CIT system through the redefinition of the tax base, the gradual lowering of the effective rates and the revamping of the tax benefits. It will also enhance legal stability, lowering compliance costs and reducing litigation. In addition, the reform aims at improving the international competitiveness and strengthening the territorial approach applicable to dividends and capital gains. The reform will also envisage further reducing policy-induced debt bias. Given the limited fiscal space, the CIT reform should aim at being budget-neutral.

#### *Fiscal consolidation in 2015*

37. **Consolidation is expected to continue beyond the programme period so as to bring the deficit to clearly below the Treaty threshold of 3 percent of GDP in 2015.** With the revision of the targets for the deficit path, part of the necessary fiscal effort to move towards a balanced budget position has been pushed back to 2015. Therefore expenditure-based consolidation has to continue in the period after the programme. For 2015, the package adopted by the Government on 2 May, worth additional 0.3 percent of GDP in measures for that year, foresees further reductions of the public sector wage bill and expenditure cuts across line ministries and programmes.

#### *Debt developments*

38. **Debt is projected to peak at over 124.2 percent of GDP in 2014 and enter on a sustainable downward path afterwards assuming further progress in the reduction of the deficit.** The upward shift compared with the 6th review projections by about 2 percentage points is mostly driven by the statistical treatment of the transfer of privatisation receipts from Parpública to the State as well as the effect of the

lower GDP path and the revised deficit projections. The authorities will put forward various measures to curb the increase in the debt ratio such as the sale of foreign assets of a social security fund and the completion of privatisation efforts. Albeit small, a primary surplus is already expected in 2014 reflecting the strength of fiscal consolidation and the more benign macroeconomic developments. Assuming further that the Medium Term Objective (MTO) of a structural deficit of 0.5 percent will be reached from 2017 on, the debt-to-GDP ratio would be on a firm downward path from 2015 onwards falling below 100 percent at the beginning of the next decade.

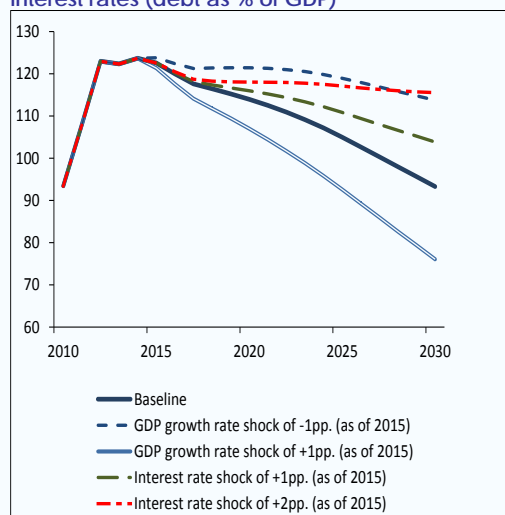
### Box 2.1: Government Debt and Fiscal Sustainability in Portugal

Under the Programme scenario, government debt is projected to peak at 124.2 percent of GDP in 2014 before starting a gradual decline. The baseline long-term calculations shown below incorporate the Programme scenario up to 2016. More details on these figures are shown in Table 7 in the annex. The turning point is the result of achieving a small primary surplus, combined with a modest GDP growth. After 2016, it is assumed that: (i) the structural primary fiscal balance remains unchanged at a surplus of 2.6 percent of GDP; (ii) nominal interest rates are around 5 percent; (iii) nominal GDP growth stays fluctuates between 3 and 4 percent; (iv) ageing costs are taken into account following the Commission's 2012 Ageing Report projections; and (v) the expected fiscal impact of PPPs costs and bank recapitalisation costs of EUR 12 billion over the Programme period is factored into the analysis.

Full compliance with the Programme consolidation path ensures a gradual decline of the debt ratio over the longer term. Nevertheless, for a large number of years the debt ratio would remain higher than before the current crisis. The graphs in this box present a sensitivity analysis with respect to macro-economic risks, the effect of alternative fiscal consolidation paths, and the potential impact of contingent liabilities such as reclassifications and other changes in the government perimeter.

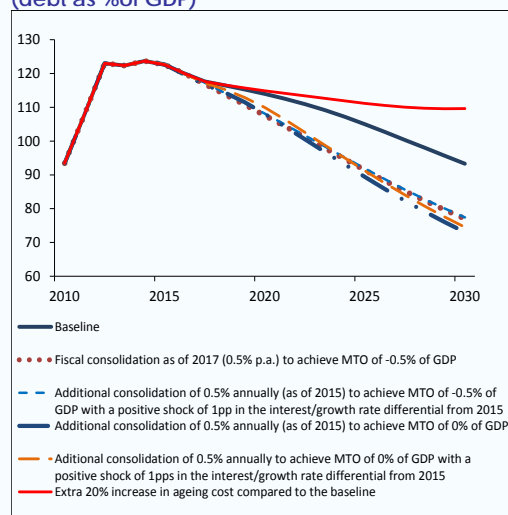
Graph I illustrates the sensitivity to macro-economic assumptions by considering a shock to real GDP growth and hikes in interest rates as from 2015. A lower GDP growth rate by one percentage point or a higher interest rate on maturing and new debt by two percentage points would put at risk the declining trend over the medium term. An interest shock of 1 percentage point would slow down the the pace of debt reduction but keeping the declining trend. Conversely, a positive shock to growth in the medium-term on the account of the thorough structural reforms undertaken may result in visibly lower debt-to-GDP ratios and a higher pace of debt reduction.

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



Source: Commission services

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



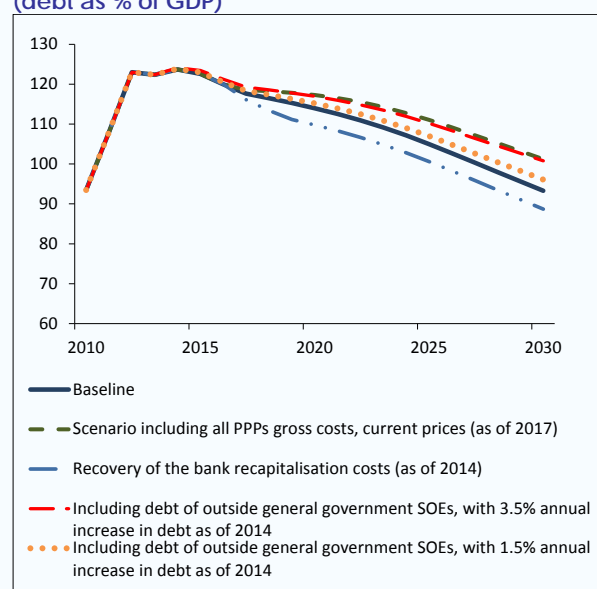
Source: Commission services

(Continued on the next page)

Box (continued)

Additional fiscal consolidation beyond 2015 and the Programme horizon would clearly accelerate the debt reduction path (Graph II). In particular, the fulfilment of the fiscal compact requirements, reaching the Medium Term Objective (MTO) of a structural deficit of 0.5 percent in 2017, would imply a fiscal effort of about 1.9 percent and a primary surplus of 4.5 percent – this scenario assumes that no fiscal effort takes place in 2016, whereas at least the minimum 0.5 percent is expected to take place. Maintaining the MTO over the longer term horizon will require primary surpluses of up to 4.5 percent in 2020 declining gradually to close to 3.0 percent a decade later. Under these assumptions, the debt to GDP ratio will start declining already in 2015 falling below 100 percent at the beginning of the next decade and maintaining the sustainable downward path thereafter. Aiming at a more ambitious MTO of 0 percent would accelerate even further the debt decline in the long run. On the other hand, if ageing costs are allowed to rise significantly (simulated as a 20 percent increase)\*, the fall in the ratio would be severely curtailed, stabilising at a high level in the absence of compensating fiscal consolidation.

**Graph III: Changes in general government perimeter (debt as % of GDP)**



Source: Commission services

Graph III illustrates the impact of changes in the government perimeter. The inclusion of all gross costs of PPPs and the debt of all state-owned enterprises (SOE) classified outside general government would lead to noticeable increase in government debt, especially if further increases in SOE debt are not reined in. The ongoing renegotiation of PPPs contracts will limit the cost of a reclassification scenario. Similarly, a far-reaching privatisation programme combined with the necessary reforms to reduce SOEs operational costs and a strategy to reduce their debt burden will also contain the risks stemming from SOEs. By the same token, a quick repayment of the bank recapitalisation funds to the government would quicken the adjustment towards lower debt-to-GDP ratios

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

\* According to the EU ageing report Portugal is part of the low risk countries where the increase in age related expenditure is amongst the lowest in Europe.

## FISCAL STRUCTURAL REFORMS

### *Fiscal policy framework*

39. **The Budget Framework Law was amended to incorporate the reinforced EU fiscal governance framework.** It transposes, ahead of schedule, the principles of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (fiscal compact) and the six-pack. This reform shows the authorities' commitment towards fiscal sustainability over the medium term. An additional revision is foreseen by the end of 2013 to further enhance budgetary procedures and principles of budgetary management, accountability, transparency and simplification, as well as transposing other relevant EU legislation. The process will be conducted in consultation with the relevant stakeholders. The implementation of the three-year public finance management action plan published in the budget is proceeding at good pace.

### *Revenue administration*

40. **Significant progress in the revenue administration reform agenda has been achieved.** The reform was ambitious and many of its key components have been successfully completed up to early 2013. The formal merger of three separate agencies into a single tax and customs administration was managed well despite difficulties and with minimal impact on normal business operations. Taxpayer segmentation has been enhanced with the full functionality of the Large Taxpayers Office that manages the largest companies and is responsible for taxpayer service, risk analysis, audit and resolution of administrative appeals. Recruitment strategies to meet the targeted increase in the audit workforce are in progress: 350 auditors have been recruited while the process to hire additional 1000 staff for audit tasks is ongoing and should be completed in early 2013. Furthermore, the massive revaluation of properties was successfully completed by March 2013. This has been a major initiative involving the revaluation of 4.9 million properties and underpinning changes to the property tax regime, key to support the achievement of the 2013 revenue targets.

41. **Key steps to curb tax fraud evasion have been made.** A major reform of the VAT invoicing system came into force in 2013: mandatory invoicing and electronic transfers of invoice data are now in place for all business sectors and transactions. This data is transferred to a centralised VAT monitoring database managed by the tax authorities. This reform is complemented by a tax incentive for final consumers to request invoices for services delivered by restaurants, hairdressers and vehicle repair shops. Whilst it is not possible to assign a definitive monetary value to the reform in terms of improved VAT collection yet, the available indicators point to a successful implementation of the measures: more than 900 million invoices were processed by the tax administration in the 1st quarter of 2013 and notably from hard-to-tax sectors. The recently introduced unified monthly return covering information on both social contributions and withholding taxes and the forthcoming unified form on Independent Workers' annual revenue will also strengthen control of the personal income tax compliance, a top priority, given the high reliance of the 2013 fiscal targets on this tax.

### *Regional and local governments*

42. **Regional and local policy frameworks are being strengthened.** Draft Regional and Local Finance Laws were submitted to Parliament at the end of December 2012, applying the principles of the Budgetary Framework Law and the new EU fiscal policy framework. The laws set improved coordination mechanisms between the central and the local and regional administrations, a multi-annual budgetary framework and tighter fiscal rules. The local administration reform with the reduction of 1,165 parishes is proceeding in preparation of the local elections in September or October this year.



### Box 2.2: Reform Needs in the Public Administration

The modernisation and rationalisation of the public administration is an essential element of the ongoing public expenditure review. Public administration reform at central, regional and local level to improve public sector efficiency and strengthen its institutional capacity for better policy implementation is an important part of the Memorandum\*.

Over the past two years significant progress has been made. At central level, the number of managers and administrative units has been lowered significantly ("PREMAC"), public support to foundations has been reduced, and more use is made of shared services. At local level, the number of manager positions in the local administration has been limited, the number of parishes is being reduced, and a legal basis for the decentralisation of responsibilities to the local level is under preparation. Similar efforts are made by the two autonomous regions.

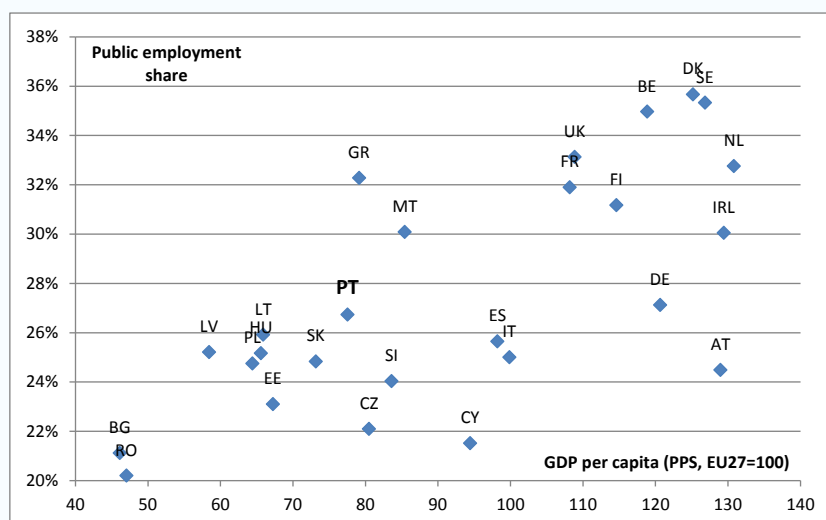
Despite this undeniable progress, the agenda is far from completed and action in a number of areas is necessary with a view to streamlining public administration, improving the efficient use of public resources and taking into account equity aspects across sectors. The latter aspect has been reinforced by the ruling of 5 April 2013 of the Constitutional Court on the budget 2013 which referred notably to the principles of proportional equality and fair burden-sharing between public and private sector employees. Reform needs exist in particular in the following areas:

- Overall size of employment: The share of employment in public administration, education and health in total employment in 2011, whether public or private, was 26.7% in Portugal relative to 28.3% in the EU on average, but relative to its income per head Portugal's share looks high (see Graph I). According to "Statistical Summary of Public Employment" (SIEP), employment in the public administration stood at 583,669 at the end of 2012, 4.6% less than at the end of 2011, with the decrease mostly resulting from retirement flows and termination of fixed term contracts. This represents 10.7% of Portugal's active population and 12.9% of the employed population. In terms of structure, about  $\frac{3}{4}$  are employed in the central administration and the remainder in regional and local administrations. Education and science represent more than one third of the employment in the central administration, and security and military another sixth. Graph I confirms that, with the exception of Greece and Malta, Portugal had in 2011 the highest public employment share when compared to its peers in terms of income per capita.
- Adequacy of qualifications and skills: The SIEP database shows that 36.6% of all employees in the general government are administrative, operational or auxiliary assistants. Considering today's standards of public service provision in a modern administration, this seems to represent a high mismatch in terms of required qualifications and skills.
- Wage structures: Based on Eurostat data, in 2011 Portugal's government wage bill relative to GDP was 11.4% compared to an EU average of 10.8%. The public sector wage bill in Portugal appears thus relatively high again, particularly when compared with Member States with similar per capita income.

(Continued on the next page)

Box (continued)

**Graph I: Employment in public administration, education and health (2011)**



Note: Sum of shares in total employment of sectors O, P and Q of NACE rev. 2

Source: Eurostat

These figures do not take into account the cuts in public sector wages implemented since 2011, which have to be reinstated this year. The average monthly pay in the general government in October 2012 was EUR 1,594. More than 13% of this amount is paid in the form of supplements of which there is a large variety. Wage supplements differ across government departments and as currently no overview is available there could be a lack of coherence and rigour.

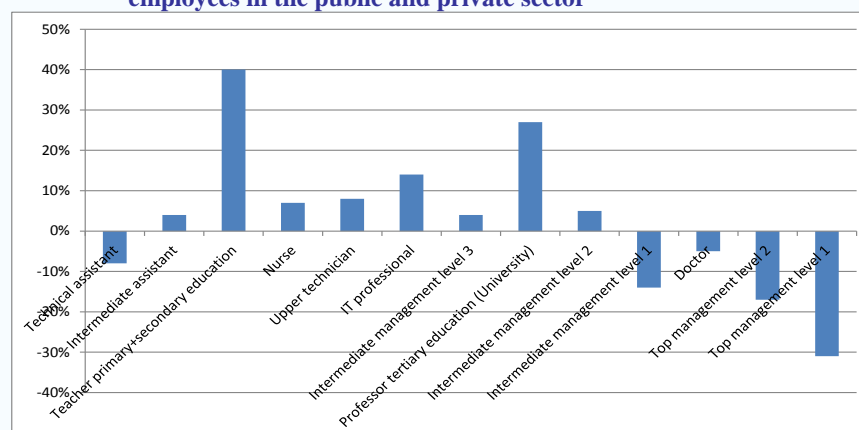
A recent study prepared for the government compared public and private sector wage scales for similar job profiles. According to this study, for a large part of the job profiles the remuneration offered in the public sector is higher than in the private sector. Teachers' salaries stand out with a particularly high public sector premium, while salaries for top managers in the public sector come with a significant negative wage premium (see Graph II).

- **Promotion system:** The current system of career development is based de facto on tenure which is not in line with incentivising efforts. There is therefore clear scope for enhancing merit-based elements in the promotion system.

(Continued on the next page)

Box (continued)

**Graph II: Estimated gross monthly remuneration in EUR for some categories of employees in the public and private sector**



Note: Categories in the order of average remuneration, increasing from left to right. Remuneration includes the base and some supplements such as extra working hours, risk premium, or compensations for transport, food or accommodation. It does not include some fringe benefits such as performance bonus, use of car, IT equipment, life insurances, etc.

Source: Mercer 2013

- **Working conditions:** There are considerable differences in working conditions between the public and the private sector resulting in privileges which are difficult to justify from an equity point of view. Most of the public administration has a 35-hour working week which compares to a 40-hour working week in much of the private sector. Since the revision of the private labour code last year, private sector employees are entitled to 22 days of leave while for public sector employees this could be more than 25 days.

As dismissals are practically impossible in the public sector the 'special mobility scheme' is the only option to reallocate underperforming employees after a reorganisation process. Once in the scheme they stop working and after one year continue to receive half of their salary without time limit other than retirement. Moreover, the current use of the scheme is limited - the SIEP database showing 1,108 employees at the end of 2012 - not least because managers have few incentives to propose candidates to the scheme (as the post is lost when an employee is moved to the scheme) but also because the mobility rules have been enhanced (and therefore, workers can find a different job when the current service is facing a reorganization).

\* To enhance information on human resources of general government and changes in public employment, a detailed database called "Information System on the Organisation of the State" (SIOE) was developed by the Directorate-General for Administration and Public Employment in the Ministry of Finance. This database tracks developments in the different government sectors since the end of 2011.

\*\* See Gerd Schwartz, Paulo Lopes, Carlos Mulas Granados, Emily Sinnott, Mauricio Soto, and Platon Tinios: Rethinking the State—Selected expenditure reform options, IMF Fiscal Affairs Department, January 2013, page 19

\*\*\* Mercer: Análise comparativa das remunerações praticadas no sector público e no sector privado – relatório final, 22 de Fevereiro 2013.

43. **The regional government of Madeira has made progress in budget consolidation and public finance management reforms.** The regional deficit target for 2012 was achieved in the face of disappointing revenue because of good expenditure control. The central government

released the suspended disbursements under its adjustment programme with the region. The deficit target of EUR 40 million in 2013 is challenging in view of a weak regional economy. A strategy to restructure and privatise public enterprises was approved and needs to be implemented.

### *Public sector reform*

44. **Public administration reform is making good progress and delivering budgetary savings.** The 2 percent programme target for the reduction in the number of public employees per year was substantially overachieved in 2012, with a decrease of 4.6 percent by the end of the year, and the target achieved by all sub-sectors of government. The process for the rationalisation of public support to foundations is almost complete and expected to allow a reduction in expenditure already in 2013. A study to compare wage scales in the public and private sector at comparable job descriptions was presented to the mission. The study indicates that the wage pattern differs between the public and private sector, which is particularly evident for some specific functions/jobs (see Box 2.2). The use of shared services is advancing well, even though completion will require slightly more time than foreseen. Finally, the authorities will pursue the preparation of a new labour code for public administrations as the current situation with multiple references is creating problems of legal certainty.

### *SOEs, PPPs and privatisations*

45. **Most SOEs reached operational balance by the end of 2012.** On the expenditure side, cost reductions mostly derived from wage cuts (suspension of the 13th and 14th salary) and the reduction in employment combined with efficiency-improving measures. On the revenue side, tariffs were increased and exemptions and fare evasion reduced. In 2013, the sector plans to compensate the cost of reinstating the 13th salary by further measures such as rationalising personnel, containing salaries, cutting current expenses, streamlining investment and a strict implementation of the commitments control law. The strategy for the restructuring of water and waste sectors was discussed during the 7th review and is being implemented after revising the legal framework. The restructuring of the water company Águas de Portugal (AdP) envisages to raise efficiency by merging 19 bulk operator companies into 4, promoting the integration of bulk and retail activities and launching private sub-concessions.

46. **Proceeds from privatisation have exceeded the Programme target, and further privatisations are being prepared.** The privatisation of the health care subsidiary CGD and of the airport operator ANA were signed before the end of 2012. The suspended sale of the national air carrier TAP will be resumed before the end of this year. Throughout the process, the authorities remain committed to respect EU competition and state aid rules. Regarding the waste sector, the sale of EGF (AdP's waste sub-holding company) will be launched once changes in the regulatory framework are fully in place. The privatisation of Correios de Portugal (CTT) will be launched, once changes underway in the regulation of this sector have their full impact, in order to receive binding offers by the end of 2013.

47. **The renegotiation of public private partnerships (PPPs) is progressing and significant savings are expected for the 2013 budget and beyond.** The revised legal framework and the newly established central PPP unit at the Ministry of Finance (UTAP) have substantially increased the public institutional capacity to deal with the complex and large PPP sector. The staffing of UTAP is growing according to its tasks, namely giving advice, strategic guidance and financial and legal support to sector PPP units and contract managers. Renegotiations of road PPPs are progressing to achieve the targeted sustainable savings for the 2013 budget and beyond. The objective is to revise the baseline scenario of all road PPPs, allowing for more private partner risk-taking and imposing a lower internal rate of return for shareholders. Additional savings in the 2013 budget include operational measures in toll collection and revising the service level requirements stemming from the regulatory framework that is currently being updated. UTAP will also provide technical support for renegotiating road PPPs in the region of Madeira, replicating the mainland's strategy. The re-appraisal of the Hospital de Lisboa Oriental PPP project is ongoing, with UTAP support.

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#### *Healthcare sector*

50. **Policy implementation is continuing broadly in line with programme deadlines. Reforms produced important results in 2012.**

Revenues from moderating fees (co-payments) and fees charged to cross-border/ foreign patients doubled by the end of 2012, resulting in additional EUR 120 million compared with 2011. The authorities are implementing several measures to further improve the billing and collection process.

51. **Regarding pharmaceuticals, authorities continue to fine-tune the set of measures adopted since 2011, which are leading to important savings in outpatient public and private spending:** an 11.4 percent reduction in public spending in 2012 compared to 2011 (savings of about EUR 150 million) and a 15 percent reduction in direct private spending associated to cost-sharing. The impact of some measures has been assessed and the authorities submitted reports on e-prescription and INN prescription. The share of e-prescription is now more than 90 percent in NHS facilities (in some more than 99 percent) and 75 percent in private practices. Additional steps are planned to further increase the share of e-prescription. Regarding compulsory INN (active substance) prescription and dispensing, although positive results can be seen in the current transitory period there is room for further improvement in generalizing INN prescription and promoting the dispensing of the cheapest medicines.

52. **Savings on pharmaceuticals in hospitals have been slower to materialise:** with only 2.5 percent reduction and spending staying at about EUR 1bn (EUR 926 million once discounts are taken into account) and therefore slightly above the 2012 target of EUR 842 million for inpatient. The collection of additional paybacks under the agreement with the pharmaceutical industry will permit the achievement of the 1.25 percent of GDP target for 2012.

53. **An important additional effort is required in 2013 to reach the 1 percent of GDP target, which has been accounted for in the 2013 budget but which faces strong resistance from the pharmaceutical industry.** Therefore, the authorities need to further improve e-prescription systems to ensure default INN prescription, include prescription guidelines and, based on a better understanding of the behaviour of doctors, pharmacies and patients, devise appropriate additional measures. In addition, the authorities will have to assess and remove

administrative and legal barriers to the entry of generics which still appear to exist. The authorities are considering an additional set of measures to achieve a greater use of outpatient generic medicines with a view to meeting the 2013 target of 45 percent of all outpatient prescriptions reimbursed by the NHS (currently at 37 percent) and of inpatient generic medicines. Regarding the latter, where savings appear to be more difficult, centralised purchasing, the implementation of the national formulary and a 40 percent target for generics in hospitals are some of the measures planned.

**54. Regarding the hospital sector, important savings were realised in 2012. Operational costs went down by 6 percent compared with 2011 (about EUR 316 million).** Savings were observed in the area of outsourcing of diagnostics and rehabilitation and personnel costs, notably overtime (with an observed 17 percent reduction i.e. about EUR 50 million). These savings are contributing to the MoU targets of a 15 percent reduction in costs over the period 2011-2013, but further important savings are necessary in 2013 to achieve the target. In addition, the stock of arrears and overdue debt has been significantly reduced through the debt settlement strategy. About EUR 1.5 billion have been paid and an additional amount of EUR 432 million is available to pay off a large part of the remaining arrears.

**55. The authorities confirmed their commitment to implement a hospital reform leading to hospital reorganisation and changes to hospital financing and hospital performance measurement.** The authorities have presented the requested reports on benchmarking and hospital network organisation plan for 2013-2014. These reports established general targets for hospital reorganisation by region and indicative overall savings of between EUR 250-400 million. Several mergers/closures of hospitals and departments have already taken place since 2011, leading to a concentration of medical departments and laboratories, a reduction of about 1000 beds and a reduction in overtime in the sector. Regional Health Administrations are now preparing their respective reorganisation plans, which will lead to the definition of 3-year hospital strategic plans expected by end Q2-2013. Following an intensive process of information gathering and analysis since

2011, the authorities should now move into the practical implementation of the findings of the various reports.

**56. Regarding primary care, the authorities continue to take steps to create new family care units (USFs), ensure that all the population is served by family doctors and to implement patient medical records.** These measures are to reduce the current share of patients not covered by family doctors. In addition, the system of electronic medical records system can improve safety of care and avoid the duplication or unnecessary use of services such as diagnostics.

**57. Regarding centralised purchasing, progress can be observed but there is still room to extend its use.** Outside medicines savings can still be achieved in areas for which centralised procurement is not compulsory for SOE hospitals. The authorities have presented an action plan to further centralised procurement in these areas. Authorities continue to develop a uniform coding for medical devices and, as this develops, more tenders become possible.



### Box 2.3: Restructuring in the Water and Waste Sector

The current structure of the water and waste sector dates back to reform in 1993 which unbundled upstream and downstream networks. The reform was designed to cope with the new challenges resulting from the entry into the European Union, assigning to central government further investment in bulk activities through the creation of Multi-Municipal Systems (MMS) with a business management model, through the state-owned enterprise Águas de Portugal (AdP), and enabling stronger participation of the private sector in the retail market through Municipal Systems concessions (MS). AdP played a major role in developing the Multi-Municipal Systems' concessions (MMS) by creating joint-venture companies together with the geographically covered municipalities to provide bulk services to the majority of Portugal's mainland (covering approx. 75%, 76% and 67% in water supply, wastewater and waste, respectively). In the retail networks a multitude of management bodies still prevail, with emphasis on local direct management operators:

POPULATION COVERAGE BY EACH TYPE OF DIFFERENT MANAGEMENT MODELS		Water - bulk -	Water - retail -	Wastewater - bulk -	Wastewater - retail -	Waste - bulk *-
Multi-Municipal Systems' concessions – MMS (32 companies, including 2 State-Local Partnerships)		75%	9%	76%	3%	67%
Municipal concessions (31 private companies)		6%	18%	9%	15%	0%
Municipal or Intermunicipal Owned Companies (36)		5%	17%	6%	18%	21%
Intermunicipal or Local Associations (4) or Local (278) direct management		14%	56%	9%	64%	12%
<b>Total (by Activity or type of Operators)</b>		<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

\* Regarding waste, private companies are diluted in the concessions launched by the several local models (two bottom lines).

Source: RASARP 2010, ERSAR (the Water and Waste Regulatory Authority)

Although the MMS model had some success in delivering the necessary investments to accomplish the European water directives' targets and channelling large amounts of EU funds (mainly Cohesion Fund), important disruptions and dysfunctions between bulk and retail networks have arisen over time. Due to the 1993 break-up of networks, municipalities are now both minority shareholders and end-users of the upstream AdP bulk systems (MMS). Municipalities are in charge of the retail network whose final customers are households and private companies but, because they are political bodies, they show higher sensibility towards end-users' reaction to price increases and consequently tend to set tariffs below cost recovery (and sometimes even below the tariff rates charged by the upstream supplier). This misalignment of objectives between the downstream supply operated by the municipalities and the upstream supply operated by the MMS/AdP causes the build-up of significant arrears towards the latter (municipalities' commercial debt arrears in Q1-2012 was over EUR 325 million). Adding to the arrears issue, year on year the public grantor, when settling the annual tariff up-dates (increases), has allowed the increase in the tariff below what is foreseen in the concessions' contracts. The tariff deficit in the first quarter of 2012 exceeded EUR 380 million, pushing AdP into lower operational cash flow that reduces its financial capacity to meet the financial liabilities resulting from the investments made. Notwithstanding, AdP has been consistently delivering net profits over the last five years.

To achieve financial and economic sustainability in the water sector, reduce AdP's current debt stock of EUR 3 billion and raise fresh capital necessary to meet additional infrastructure investment requirements, the government and AdP designed a strategy for the water and waste sectors' restructuring. This strategy will produce efficiency gains during 2013 and 2014 expected to yield approximately EUR 175 million of yearly savings. The strategy is divided in three partially overlapping stages: (1) merging 19 bulk operator companies into four companies with territorial exclusivity, geographically extending from coastal to interior regions; (2) promote the integration of bulk and retail activities; and (3) implementing private sub-concessions. This strategy will allow for tariff harmonisation, improved river basin management and benefit from both

(Continued on the next page)

*Box (continued)*

economies of scale and scope stemming from the merger into four water companies and higher synergies in the value chain. It further ensures that end-users' tariffs are set at a level allowing full cost recovery. The higher private sector participation is also expected to increase operational efficiency and bring about investment rationalisation. Although this strategy implies some elements of cross-subsidisation between coastal and interior regions due to their different costs of water provision, this can be justified with considerations of affordability in view of the significant regional income disparities, in addition to the above-mentioned expected benefits. The solution defined by the government for the waste branch of AdP consists of the revision of the regulatory model and a full privatisation of the company that now holds the MMS concessions.

Legislative changes are being prepared to support the restructuring strategy and to ensure the effectiveness of the new legal and economic regulatory framework, namely regarding the access of private capital, the legal framework for MMS mergers and the powers of the Regulatory Authority (ERSAR). In particular, ERSAR will be granted powers to define tariff principles that ensure the full cost recovery in case the tariffs set by local bodies or companies are too low. The new ERSAR by-laws will also give the regulatory authority greater independence, autonomy and more extensive powers of action enabling it to impose a new economic regulatory model better suited for higher private sector participation and ensuring that the tariff principles of full cost recovery are applicable to all operators independently of their legal nature. The changes to the regulatory model are deemed essential whenever the provision of services of general economic interest is made through private companies. These changes will enable the regulator to effectively enforce principles such as universality of access, continuity, high quality of service, price efficiency and tariff fairness

## FINANCIAL SECTOR

**58. Portuguese banks comply with Banco de Portugal prudential requirements of a Core Tier 1 ratio of 10 percent, but some institutions needed government support.** The reinforcement and maintenance of adequate capitalisation levels is a crucial element for preserving the Portuguese banking system's strength and resistance to adverse shocks. Banks successfully met both national and international prudential capital requirements reinforcing their own funds through targeted private and public recapitalisations. This improvement relied, however, significantly on the financial support from the Portuguese State, which has so far subscribed EUR 7.25 billion in shares and hybrid financial instruments in four institutions (including the publicly owned CGD), which represent some 60 percent of the system's balance sheet. Although banks are planned to reimburse the government financial support over a five-year period, the Portuguese State has already been repaid EUR 600 million out of the government financial support granted. The recapitalisation of the four banks receiving public

funds must follow EU state-aid rules. The conditionality that is currently under negotiation with the EU competition authority will most likely comprise a multiannual restructuring plan which aims at improving the business' viability going forward while complying with competition rules that prohibit state-aided banks to exercise commercially aggressive policies, share buybacks, dividend distribution and acquiring other companies.

**59. Banking regulatory and supervisory framework is being strengthened.** The BdP continues to monitor and implement the findings of the targeted OIP inspection programme (focused on real estate and construction sectors) into the recommendations stemming from the original Special On-site Inspections (SIP). Parvalorem successfully launched on 18 January 2013 the tender process aimed at selecting loan portfolio managers to manage and recover BPN's legacy assets. The bidding process is expected to be finalised by mid-2013.

**60. The implementation of the resolution framework recorded substantial progress, although it will take time to have the resolution**

**fund adequately funded.** Significant progress was achieved in the implementation of the bank resolution framework. The fund is operational after the adoption of a ministerial order of the Resolution Fund regulation (last December) governing its functioning, competence and governance structure. A decree-law published in February determines the Fund's initial, periodic and special contributions by banks. The initial and periodic contributions will be topped up by the proceeds from the financial sector levy enabling the Fund to reach some EUR 200-225 million in size in the first year and EUR 2 billion in 10 years time. The state will not contribute to the fund, however it could be called to do so should the need arise, in line with the contingent liabilities (EUR 1.5 billion) assumed in the state budget for 2013. The Resolution Fund targets a size of some EUR 2 billion in assets within 10 years. The BdP board approved the setting-up of a dedicated resolution unit. Furthermore, in line with the December supervisory notice on the resolution plans, Portugal's eight largest banks have already submitted the reports necessary for the preparation of the resolution plans by the central bank. The remaining banks were asked to submit similar reports before November 2013. Lastly, the proposal for amendments into the Recapitalisation Law was submitted to Parliament at the end of January. The setting up of an appropriate intervention and resolution toolbox will allow a rapid and an effective intervention in a financial institution in financial distress, leading to its orderly winding-down.

61. **Efforts to improve access to finance by SMEs through state-supported credit lines and financing alternatives continue.** The allocation of an additional EUR 1 billion to the already existing EUR 1.5 billion of the mutual guarantee line (PME Crescimento) is aimed at easing financing conditions of micro-companies and SMEs and remains a key measure since the last review. This instrument provides a partial guarantee varying between 50 percent and 75 percent. The two-tiered selection of beneficiaries is based on banks credit assessment in a first stage and on the four Mutual Guarantee Societies in a second stage. The default rate of companies financed under this guarantee scheme is below 4 percent. Micro-corporations have benefited from more than 50 percent of the total amount of loans provided under this scheme so far. Authorities also continue to explore

alternative financing sources, though progress is slow. A detailed assessment of the proposal concerning the grouped issuance of corporate debt is under discussion. This EUR 100-million pilot initiative aims to facilitate access of smaller companies to debt markets and builds on the resources and expertise of the national Mutual Guarantee System. The final product offered to the market would be an investment fund investing in long maturity bonds issued by a few dozens of high-rated companies and including a partial state guarantee. Additionally, a draft proposal for developing the commercial paper market through regulatory and tax changes is debated, though its fiscal impact has not been assessed yet.

62. **The Central Credit Registry will be upgraded with a view to further enhancing its data coverage and detail.** The BdP is planning to add additional features to the BdP-based Central Credit Registry to increase its information coverage, namely by including additional financial products and supplementary classifications to loans. This will include data on restructured bank loans due to the financial difficulties of the borrowers. Subject to the authorisation of the Portuguese Data Protection Authority, BdP will implement the possibility of financial institutions to access the historical credit data of their new clients. It is also assessing options *inter alia* for the disclosure by firms, on a voluntary basis, of selected information contained in other databases such as the Central Balance Sheet Database, with the objective of reducing information asymmetry between smaller companies and credit providers.

63. **The process towards the renewal of the export credit insurance mechanisms is on-going.** The authorities notified two schemes under the Commission communication of December 2012 on export credit-insurance: OECD I and OECD II. The first scheme has a mutual guarantee coverage of 60 percent and the second of 80 percent. The schemes were notified to the European Commission and its final adoption is subject to compliance with EU state aid rules.

64. **The government is conducting a stock-taking exercise aiming at streamlining and centralising the management of EU structural funds.** The initiative aims at improving the effectiveness of structural funds allocated to the corporate sector by reducing the proportion of

grant-based subsidies and increasing the proportion of reimbursable subsidies. The mechanism being conceived aims to bring under a common balance sheet ('specialised financial institution') the different structural funds-based financial instruments spread across different institutions which use a revolving scheme. The potential for fiscal risks that the implementation of such initiative entails will be monitored closely. The way the initiative inter-plays with the financial sector commercial activity from a competition perspective is a matter of concern and is subject to the fulfilment of the relevant EU competition rules. The solutions envisaged for the operation of this mechanism must take into account the need not to duplicate institutions and/or structures which perform similar roles, ensuring consistency with MoU measures aimed at improving the efficiency of the public administration.

## STRUCTURAL REFORMS

Reform of labour, goods and services markets

### *Labour market*

65. **Severance payments for new open-ended work contracts will be reduced to 12 days per year while for all other work contracts a reduction to 18 days is envisaged in the first 3 years of service and to 12 days afterwards.** The draft law presented to Parliament in December 2012 envisaged, in line with MoU requirements, severance payments to be reduced from 20 days per year of service to 12 days for all contracts. The new agreement differentiates between new open-ended contracts for which the reduction in the accumulation of severance payments to 12 days per year of service will be implemented in one step and existing open-ended contracts and new and existing fixed-term contracts for which the reduction will be in two steps (to 18 in the first 3 years of services and to 12 days thereafter). In either case accrued rights are preserved and the cap of 1-year salary as a maximum statutory severance payment is maintained. The government has submitted to Parliament a draft law setting up Compensation Funds to partially finance severance payments to be paid by employers.

66. **The government prepared a report on the financial impact of the reform of the unemployment benefit system enacted on 1**

**April 2012.** The three main measures analysed were the reduction of the ceiling of unemployment benefits from three to two and a half times the social support index, the decline by 10 percent in daily unemployment benefits after 6 months of unemployment, and the reduction of the contributory period from 15 months to 12 months for eligibility to unemployment benefits. The cut in the unemployment duration could not be analysed because the reform preserved the accrued rights to duration to protect for a longer period the unemployed during the recession. The three analysed measures combined led to an increase in expenditure in 2012 of about EUR 18.7 million. The authorities have also presented plans to (i) enlarging financial support for job creation for people with disability; and (ii) reinforcing training grants which will replace unemployment benefits instead of suspending them as it is currently the case.

67. **Further progress was registered in the implementation of active labour market policies (ALMP).** In 2012, about half a million unemployed were involved in policies managed by the Public Employment Services. A majority of those were involved in training programs. The authorities are still preparing a report on various elements of ALMP, including activation programmes. One component is related to training, especially in view of the evaluation study which showed relatively poor employability results of some of the training measures. Other important components of the report under preparation have to do with the functioning of the activation/sanction system and job counseling/job search assistance system, not covered by the previous evaluation report. The completion of this work will allow a more in-depth discussion on the overall activation and ALMPs during the next review mission.

### *Education*

68. **Instruments for the monitoring and implementation of education and training policies are being set up according to schedule.** The monitoring tool to evaluate the results and impact of education policies is well advanced. It contains very rich information, differentiated by district, on key variables regarding public schools (more than 6 700), teachers (more than 120 000) and students (more than 1.2 million) in all levels of the education system. Data regarding teachers are

updated on a monthly basis and those regarding students on a quarterly basis. The tool will be fully operational for policy purposes for the next school year 2013/2014. The government has reiterated that at least 80 trust agreements, which provide significant pedagogical, curricular and/or organisational autonomy, will be signed by the beginning of the next school year. All schools selected present good results in the external evaluation system. The government is also finalising the formula-based funding framework of the schools, which will be mostly based on the number of students but will also incorporate other criteria such as the location of the school, its performance and the number of students with special needs. The formula will be fully operational over the next months and will govern the financing of schools as from the next school year. A report on strengths and weaknesses of the new inspection model has been presented, which is based on answers provided by the teachers and the evaluators themselves. On this basis, a Decree Law to be adopted by the Council of Ministers will set the improved framework for the external evaluation of schools. In the area of training, the government has published an Ordinance setting up Centres for Qualification and Vocational Training which replace the Centres for New Opportunities (Centros de Novas Oportunidades). The government expects a training offer more consistent with market needs in secondary level vocational education and training and significant budgetary savings resulting from a streamlining of the training centres network. Finally, contacts with relevant stakeholders are still happening with a view to implementing professional schools of reference in some specific sectors.

### *Energy*

69. **New legislation has been adopted to implement the Third Energy Package to give regulators the necessary autonomy and independence.** A significant step for the efficient functioning of the electricity and gas market after full liberalisation in January 2013 has been taken. The law on the penalty system of the energy regulator (ERSE) was published on 28 February 2013 (lei 9/2013) and the amendment to ERSE bylaws, to ensure the regulator's independence and its capacity to guarantee an efficient and competitive functioning of the energy sector, was

approved by the Council of Ministers in March 2013.

70. **All key measures were taken to accelerate the establishment of the single Iberian Gas Market (MIBGAS).** The proposals to harmonise the cross-border gas transmission tariffs were presented, following the public consultation last year. The Portuguese government reiterates its willingness to harmonise the methodologies and to eliminate the tariff pancaking, but point to the Spanish reform of their national gas tariff methodology as a prerequisite. Once this step is completed, the joint works between the authorities from both countries can continue to finalise the harmonisation of cross-border tariff. The harmonised capacity allocation and congestion management mechanism for cross-border gas flows were implemented. The joint capacity allocation mechanism began in July 2012 to allocate the interconnection capacity from October 2012 to September 2013.

71. **Works are ongoing to reduce electricity costs and to eliminate tariff debt by 2020 to ensure the sustainability of the system.** The government has completed several of the measures foreseen to address the energy tariff debt by decreasing costs/subsidies to generators. However, negotiations on the Sines and Pego power plants, which were expected to achieve important savings, have reached an impasse. Moreover, the worse-than-expected macroeconomic scenario might adversely affect the evolution of the tariff debt. This could entail a reassessment of the projections of the tariff deficit path and make additional measures necessary. Concerning the policy costs embedded in CMEC and PPA contracts, the executive order that reduces the CMEC annuity discount rate to 4.72 percent was adopted on February 2013. Negotiations concerning the Sines and Pego power plants have reached an impasse and are unlikely to deliver the expected outcome. The measures to limit the policy costs of renewables were approved. The legislation aiming at creating a compensation for consumers was also adopted and is expected to be implemented shortly. Moreover, the maximum duration for the feed-in tariff in small hydro plants was introduced. The report on the CMEC scheme and the process for extension of the concession of the public hydro resource has been delivered. Further analysis and discussions on the consequences of the report and



the need for potential measures will continue in the eighth review.

**72. The national framework was clarified with respect to the scope of competencies of the logistics operator for switching suppliers.** The relevant amendments were introduced to Decree Laws 140/2006 and 172/2006 establishing the fundamental rules for the functioning of gas and electricity markets. A comprehensive plan was devised to create a single logistics operator for switching suppliers (OLMC) by merging two existing platforms for electricity and gas in a cost-efficient way. It is expected that the plan will be implemented in Q2.

#### *Transport*

**73. The first milestone of maritime port reform has been accomplished.** The draft law on port work entered into force on 1st February 2013. The government has demonstrated determination and effectiveness during its adoption process and it would be important that this commitment is maintained also for the adoption of other crucial components of the port reform package. The historical collective bargaining contracts for port labour are expected to be revised without delay to ensure their compliance with the new port labour law. The draft Decree Law on port governance that was expected by the end of the year has not been presented yet. The goal of this draft law is to increase efficiency of Portuguese ports by making the operation concessions more performance-oriented, opening up the activity to new operators and ensuring that cost savings are passed on to port customers. The government will explore the scope for a revision of new concession schemes. A significant part of cost reductions in ports (around 25 to 30 percent compared with the present situation) are expected to come from the reform of concessions. In order to further alleviate the burden on Portuguese tradable sector the tariffs levied by the port authorities (TUP Carga) were reduced by 20 percent.

**74. Another set of reforms improving the land transport was implemented.** The necessary legislative amendments to achieve full compliance with Directive 1999/62/EC (Eurovignette Directive), in particular, to guarantee non-discriminatory application of tolling schemes to non-resident road users were adopted. Performance

Scheme Contracts between the infrastructure manager and all the rail operators were signed. Following reaching overall SOE operational balance in 2012 and a reduction in the rail infrastructure operational costs of over 30% the government has reiterated its commitment to achieving operational balance of REFER by 2015. The rough outline of the long-term vision for transport has been presented; it will be focused on freight investments in rail and a number of relatively small investments in roads that will deliver large efficiency gains. The new Public Obligation Scheme contracts will be presented in the context of the planned opening of public transport sub-concessions to private capital in the metropolitan areas of Lisbon and Porto. An efficient, incentive based regulator is one of the key factors to viably protect the interests of port, rail and road users, therefore it is important that the regulatory authority "Instituto da Mobilidade e Transportes" (IMT) is endowed with sufficient financial and human resources to viably carry out its mission.

#### *Services and professions*

**75. Progress to align legislation with the principles of the Services Directive has continued steadily.** 51 out of 68 legal regimes have been submitted by the government for publication or for subsequent adoption by the Parliament, as required by the legislative framework. Legislative amendments for the remaining sectors should be adopted by June 2013. The law simplifying the regulatory framework for real estate activities was published in February 2013. By contrast, the adoption of regulatory framework governing construction activity has met with some delay due to an unforeseen additional step, whereby the draft laws on construction and reserves of activity have to be submitted for consultation to social partners. The fees charged by the body governing construction activities for granting various authorisations and certificates and the value of the yearly regulatory taxes will be the object of a thorough review by the end of 2013.

**76. A significant step has been taken to open up professional services.** The horizontal framework law on public professional associations has been adopted. The law is a first step towards ensuring a more open access for the exercise of some highly regulated professions and an

improvement in the legal framework applicable to public professional associations. To complete the reform on highly regulated professions, the professional bodies' statutes and internal rules are being amended accordingly to be approved by the Government and subsequently submitted to Parliament with the aim to bringing them in conformity with the principles laid down in the law and of removing requirements that are not justified or proportionate. In this context, the bodies' statutes of all but two professional bodies have been submitted to the government for review. A first review of professions not regulated by professional associations has been carried out and resulted in the full deregulation of seven other regulated professions; a second phase of the review was initiated by the government in February 2013 which seeks to identify and ease requirements currently laid down to access the professions that may no longer be justified or proportionate.

**77. Important legislative pieces have been adopted to improve the recognition framework of professional qualifications.** An exhaustive list of professions that require prior qualification checks for temporary service providers to avoid risks of public health is being revised and will be published to increase transparency of the regulatory framework. This and other information for professionals concerning their rights will be made available at the Point of Single Contact.

**78. There has not been visible progress on the work of the Point of Single Contact ("Balcão do Empreendedor") since the last review.** Even though a clear roadmap and work programme is in place and is updated monthly, the operational deliverables needed for this reform are still lacking. Limited administrative capacity and insufficient cooperation from municipalities appear as the major bottlenecks. The "Zero Authorisation" pilot project to facilitate establishment of small retail in 21 municipalities will be ready at the end of March and the "Zero Authorisation" project is expected to be fully operational in June 2013.

#### Reform of framework conditions

##### *Housing market*

**79. The update of the cadastral value of the housing stock is globally completed.** The update

of the rents in open-ended contracts concluded before 1990 may be slower than expected because the full information on tenants' 2012 personal income, which is a relevant factor for a possible cap in the increase of the rent, will not be available at least until May. A monitoring committee consisting of all levels of stakeholders, including landlords, tenants and real state, and the governmental departments responsible for the enforcement of the law (Fiscal Authority, "Direção-Geral da Administração da Justiça" – Balcão Nacional do Arrendamento, "Instituto da Habitação e da Reabilitação Urbana" and "Instituto da Segurança Social") has been put in place to follow-up the actual implementation of the housing rental market law. This committee will monitor on a quarterly basis to what extent the objectives of the reform are being achieved and will gather quantity and quality indicators of the state of the reform and identify possible weaknesses and obstacles in its implementation. In addition, some additional pending pieces of complementary legislation to the rental market reform were adopted (Decree Laws 266B/2012 and 266C/2012 and Decree Law 1/2013).

##### *Competition and sectoral regulators*

**80. Progress has been made to ensure the functioning of the Competition authorities, Competition Court and National Regulator Authorities:**

- Financing of the Competition Authority has been ensured. The transfers relative to 2012 from the National Regulatory Authorities to the Competition Authority have been completed. The executive order published in November 2012 setting the modalities for the transfers to the Competition Authority took effect in 2012 and cover 2013 in the absence of a new executive order.
- The monitoring of inflow cases and report on the functioning of the specialised court for Competition, Regulation and Supervision has not revealed at this stage significant backlogs but monitoring will be continued by the Ministry of Justice.

- The framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs) was approved by



the government and submitted to the Parliament in March 2013. This legal framework is an important milestone in ensuring the NRAs' independence and autonomy, which are major requirements for efficient functioning of the sectors subject to regulation and for the effective implementation of competition rules in the economy. It complies with the provisions in the existing EU laws and includes the necessary conditions to guarantee adequate human and financial resources allowing NRAs to attract and retain sufficiently qualified staff. In the three months following the publication of the framework law, the corresponding amendments to the bylaws of the NRA will be approved by the government.

#### *Judicial system*

81. **Reforms of the judicial system advance according to the agreed schedule.** Progress has been achieved on the new Code of Civil Procedure and the geographical reorganisation of the court districts. Both legislative proposals were sent to the Parliament in November 2012. The Portuguese Ministry of Justice continues their efforts to eliminate the backlog bearing into consideration the commitment in the Memorandum of Understanding.

- A task force to expedite the backlog resolution and quarterly monitoring was put in place, and regulations adopted to ensure the oversight body's full access to the enforcement cases. Over 840 000 cases have been investigated, of which nearly 165 000 have been closed. This includes the work of the dedicated teams set up to expedite small claims enforcement cases in enforcement courts in Lisbon, Porto, Sintra, Vila Nova de Gaia, Maia and Oeiras.
- The control and supervision of the enforcement agents by CPEE was reinforced resulting in several disciplinary proceedings last year. In addition, a fully independent organisation will soon be established by the new legislative proposal to replace the CPEE. With one supervisory and control structure in place, and the right incentives, the legal framework of the enforcement agents will be improved.
- Following the road map of judicial reform, the judicial districts will now be aligned with the administrative districts. The court, as a

unit, will consist of the court sitting in the capital of each district, local instances courts, and extensions without judges, if needed. However, as these will be considered as one unit, the management will be streamlined and a better allocation of human resources ensured.

- **Code of Civil Procedure:** The government has finalised the proposal in order to implement an even more ambitious reform, with extensive consultation with stakeholders and experts, including through expert meetings with the IMF and EC technical assistance. The Code is currently being discussed in Parliament.

#### *Business environment*

82. **The government has adopted the Decree Law transposing the European Late Payments Directive 2011/7/EC.** According to the Directive the period of payments in commercial transactions where the debtor is a public authority should not exceed 30 calendar days and should not exceed 60 calendar days in transactions between undertakings. These deadlines must apply to commercial transactions concluded after 16 March 2013 and should help to alleviate the liquidity constraints of companies. The Commission is currently assessing whether the Decree Law is in compliance with the provisions of the Directive.

#### *Licensing*

83. **Many legislative acts are under revision to reduce business licensing requirements.** While the completion and adoption of some legal acts is running slightly behind of the initial schedule, the most relevant pieces of legislation will in principle be adopted over the next three months. This legislative reform concerns inter alia the areas of environment and territorial planning, land use, industry, commercial activities, geological production and tourism. The reform of the legal regime for urbanism and building is a major milestone in this process and is expected to be adopted over the next weeks. The new programme for industrial licensing is already ongoing and several legal provisions for the less hazardous industries have already been adopted in order to ease their licensing requirements. The new legal framework for the National Ecological Reserve has already been adopted. It gives more powers to municipalities and significantly extends

the actions that only require prior communication and not an authorisation by the Environmental Agency. The principle governing these reforms is to move from an 'ex-ante' approach which requires prior control and authorisation by the administration to a Zero Authorisation principle based on an 'ex-post' control by the Administration. The full operability of the Point of Single Contact will be essential for the success of this process. The final result of this ambitious reform, which represents a full change of paradigm in a country with a deep-rooted legalistic approach and a complex and cumbersome licensing tradition, will depend much on the cooperation and commitment of the different levels of government.

**Box 2.4: Summary of compliance with policy conditionality for the Seventh Review**

The joint EC/ECB/IMF staff mission concluded that the implementation of the Programme is broadly on track.

Fiscal policy	<p>On an ESA-95 basis, the deficit reached 6.4 per cent of GDP owing to several large one-off items. Since for purposes of the programme, a capital injection into the state-owned bank CGD, worth about 0.5 percent of GDP, is not taken into account under a programme perspective the deficit amounted to 6.0 percent of GDP. Fiscal consolidation was, nonetheless, remarkable, with the improvement in the structural balance in line with the Council Recommendation of 9 October 2012. In view of the weaker economic outlook the fiscal targets were revised to 5.5 percent of GDP in 2013, 4.0 percent of GDP in 2014 and 2.5 percent of GDP in 2015. The new deficit path is underpinned by permanent spending reductions, which also closed the fiscal gap which was generated by a ruling of the Constitutional Court in early April.</p>
Fiscal-structural	<p><u>Public financial management</u>: The Budget Framework Law was amended to incorporate the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the six-pack.</p> <p><u>Regional and local government reform</u>: Draft Regional and Local Finance Laws were submitted to Parliament, strengthening the budgetary framework by, inter alia, improving the coordination across government levels and introducing a multi-annual fiscal framework and tighter fiscal rules. The Region of Madeira has made progress in budgetary consolidation and public finance management. Local administrative costs will fall due to a sizeable reduction in the number of parishes.</p> <p><u>Public sector reform</u>: Reform is proceeding at good pace, with public employment and public entities being rationalised. Public employment fell by 4.6 percent by the end of 2012, against a target of 2 percent. An improved method for public support to foundations has been put in place and the use of shared services is being enhanced.</p> <p><u>State-owned enterprises (SOEs), Public Private-Partnerships (PPPs) and privatisations</u>: Following the on-going restructuring, most SOEs have reached operational balance by the end of 2012. Additional reforms are expected in the coming years to further improve the public companies' results. Privatisation plans are proceeding according to schedule, with the sale of ANA and the health insurance branch of CGD signed at end of 2012. The re-launch of the sale of TAP is expected to occur before the end of 2013. The sale of AdP's waste branch and Correios de Portugal (CTT) will be launched in the course of the year. The AdP's water branch will be further restructured during the year to launch sub-concessions to private management and capital at a later stage. The renegotiation of PPPs is advancing and significant savings are expected already in 2013.</p> <p><u>Health</u>: Policy implementation is continuing broadly in line with the programme deadlines. Reforms produced important results in 2012. Revenues from moderating fees (co-payments) and fees charged to cross-border/ foreign patients doubled by the end of 2012, resulting in additional revenue of EUR 120 million compared with 2011. The authorities are implementing several measures to further improve the billing and collection process.</p> <p><u>Revenue administration</u>: Progress has been made in most areas of the revenue administration reform agenda, notably the integration of three services (tax, customs and IT services), the establishment of a large taxpayer unit and the major initiative of revaluation of properties. The management of taxpayer compliance has been significantly strengthened through the VAT invoicing reform and other reporting obligations, such as the monthly PIT return.</p>

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Box (continued)

Financial sector	<p>The programme target on banks' capital adequacy (Core Tier 1 ratio of 10 percent) has been reached by all banks domiciled in Portugal. The State launched in mid-January a competitive bidding process for selecting a professional third-party to manage the assets held by Parvalorem. A first report by Banco de Portugal on restructured loans due to debtors' financial difficulties was delivered in January. The early intervention, resolution and deposit guarantee frameworks have been strengthened. The decree-law governing the banks' contributions to the resolution fund was adopted. A supervisory notice on the banks' resolution plans was adopted. The government approved on 31 January a decree-law containing the amendments to the legal framework governing access to public capital in order to allow the State to exercise temporary control over a credit institution that received state aid. A detailed assessment of the pilot issue of grouped issuance of corporate debt aimed at obtaining capital markets financing was presented but remains work in progress.</p>
Reform of labour, goods and services markets	<p><u>Labour market and education:</u> A new agreement on the level of severance payments was reached. For new open-ended contracts severance payments will be accumulated at a rate of 12 days per year of service. For current open-ended contracts and all fixed-term contracts, severance payments will be accumulated at 18 days per year in the first three years of service and 12 days per year thereafter, while protecting accrued-to-date rights and maintaining the cap of 12 months of pay. The government has also submitted to Parliament a draft law setting up Compensation Funds to partially finance severance payments to be paid by employers. Following the reform of the unemployment benefit system enacted on 1 April 2012, the government has prepared a report on the financial impact of the main measures. Further progress was registered in the implementation of ALMPs. In 2012, about half a million unemployed were involved in policies managed by the Public Employment Services. On education, the monitoring tool to evaluate the results and impact of education policies is well advanced; the formula-based funding framework will be ready over the next few months; and a report which assesses strengths and weaknesses of the new inspection model has been presented. In the area of training, the government has decided to reorganise the provision of Vocational and Education Training with the aim of further aligning it with market needs.</p> <p><u>Energy:</u> Implementation of the electricity costs reduction and tariff debt elimination by 2020 is on-going. The legislation implementing the change in the CMEC annuity discount rate in line with EC/ECB/IMF recommendation was approved. The measures to limit the policy costs of renewables were also approved. By contrast, negotiations on the Sines and Pego power plants have reached an impasse and are unlikely to achieve a successful outcome. Concerning small hydro plants, the maximum duration for feed-in tariffs was introduced. The report on the CMEC scheme and the process for extension of the concession of the public hydro resource has been delivered. Further analysis of, and discussions on the consequences of the report and the potential need for additional measures will continue in the eight review. The law on the penalty system of the energy regulator (ERSE) was published and the amendments to the ERSE bylaws were approved by the Council of Ministers. The proposals to harmonise the cross-border gas transmission tariffs were presented. The harmonised capacity allocation and congestion management mechanism for cross-border gas flows was implemented. The national framework was clarified with respect to the scope of competencies of the logistics operator for switching suppliers.</p> <p><u>Transport:</u> The draft law on port work entered into force on 1st February 2013. The historical collective bargaining contracts for port labour need to be revised without delay to ensure their compliance with the new port labour law. A reduction by 20 percent in tariffs levied by the port authorities (TUP Carga) took place. The government will explore the scope for the revision of the existing concession contracts. The necessary legislative amendments to achieve full compliance with the Directive 1999/62/EC (Eurovignette Directive) were adopted.</p> <p><u>Services and professions:</u> Progress on the adoption of the legislative amendments to align legislation with the principles of the Services Directive has continued steadily. The law simplifying the regulatory framework for real estate activities has been published. The horizontal framework law on public professional associations has been adopted. Slow progress is observed in making the Point of Single Contact fully operational. Lack of sufficient administrative capacity could compromise the timely implementation of this</p>

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Box (continued)

Reform of framework conditions	<p><u>Housing market</u>: The update of the cadastral value of the housing stock is globally completed. The update of the rents in open-ended contracts concluded before 1990 may be slower than expected. The government has set-up a Monitoring Committee for the follow-up the actual implementation of the housing rental market law.</p> <p><u>Competition and sectorial regulators</u>: The framework Law setting the main principles of the functioning of the main National Regulator Authorities (NRA) was approved by the government and submitted to the Parliament in March 2013. Financing of the Competition Authority has been ensured.</p> <p><u>Judicial system</u>: Reforms of the judicial system continue to advance according to the agreed schedule. Progress has been achieved on the reduction of backlogged cases, the reform of the judicial system, including the geographical reorganisation of the court districts, and the reform of the Code of Civil Procedure.</p> <p><u>Business environment</u>: The Decree Law for the transposition of the Late Payments Directive 7/2011/EC has been adopted. The guarantee line PME Crescimento has been renewed with an additional EUR 1 billion in order to facilitate access to credit to viable micro-companies and Small and Medium Enterprises, notably export- oriented to ones. Progress made within the scope of the Simplex Programme is mixed. The implementation of the VAT simplex measures is expected to reduce from 40 to 4 days the expected time to obtain the VAT exports documents that allow exporters to apply for VAT reimbursement.</p> <p><u>Licensing</u>: The new legal framework for the National Ecological Reserve has been adopted. The most relevant pieces of legislation to reduce business licensing requirements in different policy areas are expected to be adopted in the next months.</p>
Data submission	Requirements under the Programme have been observed. Work is ongoing to improve further data submission.

### 3. PROGRAMME FINANCING

84. **With the successful sale of a 10-year bond in early May, the Portuguese Treasury re-entered the long-term debt market for the first time since the inception of the adjustment programme.** The sale of EUR 3 billion at an average yield of 5.67 percent which was conducted through syndication witnessed strong demand and was sold in large part to foreign investors, which acquired 86 percent of the issuance. Hedge funds and asset managers not constrained by the sub-investment grade rating of the Portuguese sovereign took around 60% of the transaction. The long-term debt issuance is an important step towards self-financing by Portugal, which the Programme foresees for maturing debt from mid-2013.

85. **In 2013, the only bond that the Treasury will have to roll over is the bond maturing on 23 September, currently amounting to EUR 5.8 billion.** This bond originally amounted to nearly EUR 10 billion but the Treasury pre-emptively swapped part of this bond (EUR 3.8bn) into a longer maturity bond last autumn, reducing the outstanding amount and easing the refinancing burden. At the same time, the upward revision of the budgetary deficit target for 2013 will require more than EUR 2 billion of additional funds compared with the previous estimates (the softening of 2014 target adds a further financing burden going forward). However, this is more than compensated by the issuance of medium and long-term bonds amounting to some EUR 5½ billion.

86. **The Treasury has built a substantial cash buffer.** This buffer was a result of several factors, including the above-mentioned bond issuance, a large increase in short-term debt throughout 2012, delays in arrears settlement and cash centralisation of public entities under the single IGCP umbrella. The buffer removes funding pressure and provides a backstop in case market conditions for bond issuance deteriorate, allowing the Treasury to tap markets opportunistically.

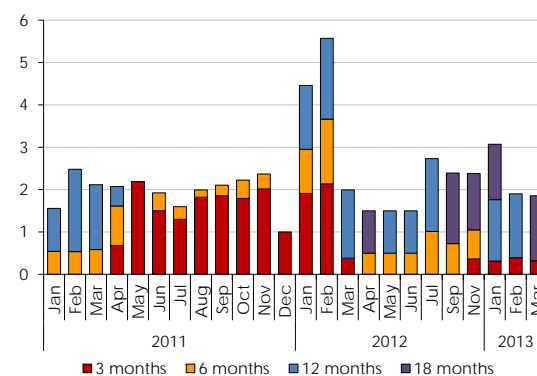
87. **Investor sentiment towards Portuguese debt continued improving.** The reviving risk appetite amid high global liquidity combined with the good track record of programme implementation and policy actions on the European front contributed to both rising prices of

the Portuguese bonds and more active trading. The yields of the 10-year bonds fell below 6 percent, while the 2-year bond yield fluctuated in a 2.5-3 percent range. The significant compression of spreads, compared to the German bund, has occurred. A Portuguese spreads fell to pre-Programme levels for the first time. Furthermore, a rapid narrowing of bond yields with other vulnerable but non-Programme sovereigns took place. The CDS contracts' dynamics also reflects more positive risk assessment. Portugal's CDS fell dramatically over the last year and stabilised at around 400 bps since early 2013.

88. **The Treasury intends to further tap markets for medium and long-term debt and to engage in other forms of debt-raising.** The Treasury keeps close contacts with large international and domestic investors to best suit their needs. At the same time, the Treasury is reviving their current and preparing new financial products for retail investors.

89. **Portugal continued issuing short-term debt at falling yields.** The Portuguese Treasury kept the short-term debt auctions throughout the programme. Lately, the Treasury concentrated on the longer end of the curve, 12- and 18-months bills, in absence of funding pressures. The yields of the short-term debt further fell, reaching in early 2013 the lowest levels in two years' time. The foreign investors are gradually returning to the Treasury bill auctions.

Graph 3.1: Portugal - Treasury bill auctions, amounts (EUR bn)



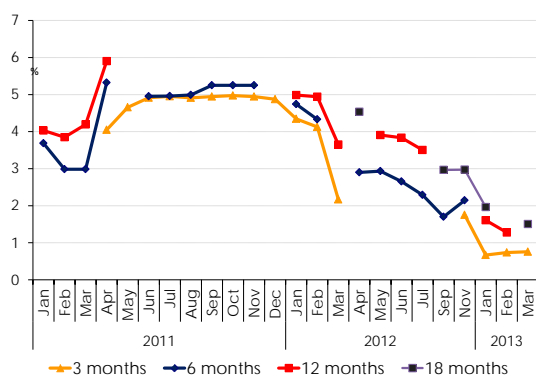
Source: IGCP

90. **The key challenges are to broaden the investor base and to raise large amounts of bonds in the coming years in light of Portugal's very high debt.** Portugal is rated as a sub-investment grade by all three major rating agencies. This rating narrows the investor circle, limiting it to the less constrained asset managers and hedge funds, and hampering the return of traditional institutional investors, such as European pension and insurance funds. On the positive side, the current ample global liquidity and low returns on other investments are luring more and more investors into Portuguese bonds. Nonetheless, the risk of a shift in investor sentiment exists and is further aggravated by the particularly large stock of Portugal's public debt, which requires raising debt amounts that are particularly large by historical and peer standards. The relatively high redemptions due in 2016 and 2021 were potentially difficult to refinance, which led Portuguese authorities to request an extension and reprofiling of EU loans.

that of EFSF loans to 22 years, thereby contributing importantly to smooth the debt redemption profile in the immediate post-programme years.

92. **The successful completion of the seventh review will trigger the release of EUR 2 billion of official funds,** out of which EUR 1.3 billion will come from the EU and about EUR 0.7 billion from the IMF.

Graph 3.2: Portugal - short-term auctions (weighted average yield)



(1) rounded months to maturity

Source: IGCP

91. **The agreement by Eurogroup and Ecofin Ministers to extend the maturities of EU official loans by 7 years will smooth the debt redemption profile and lower the refinancing needs in the post-programme period.** To support Portugal's efforts to regain full market access and successfully exit the programme, in the context of continued strong programme implementation and compliance, Eurogroup and Ecofin ministers have agreed to an extension of the maturities of the EFSF and EFSM by 7 years. This will raise the average maturity for EFSM loans to 19.5 years and



## ANNEX 1

### Assessment of Compliance: Monitoring Table

<i>Actions for the seventh review (to be completed by end Q4-2012)</i>		<i>Status</i>
<b>Fiscal-structural</b>	[3.7] Revise the Budget Framework Law to take account of the reinforced EU fiscal framework.	<b>Observed.</b> A draft law was submitted to Parliament on schedule.
	[3.10] Submit to Parliament the draft proposal to revise the regional finance law.	<b>Observed.</b> The draft proposals have been submitted to the Parliament at the end of 2012.
	[3.14] Regions will design a framework for assessing fiscal risks derived from PPP, concessions and other public instruments.	<b>Delayed.</b> In view of the autonomy of regions, this has been modified into an on-going measure.
	[3.16] Reach operational balance for SOEs by implementing the SOEs strategy.	<b>Observed.</b> Preliminary data for the end of 2012 suggest that an overall operational balance of SOEs was achieved. As this measure is on-going, it will be monitored continuously.
	[3.20] Prepare a strategy for Aguas de Portugal (AdP).	<b>Observed.</b> The strategy was presented and is being implemented.
	[3.21] Prepare an inventory of municipalities and regional government's assets including real estate.	<b>Modified:</b> According to the modified measure the more important assets should be reflected in the commitment to further consider expanding the privatisation programme to include additional companies and assets for sale or concession in 2013.
	[3.22] Complete the implementation of the new structure that merges tax, customs and DGITA.	<b>Observed:</b> The formal merger of three separate agencies into a single tax and customs administration has been managed with minimal impact on normal business operations.
	[3.23 ii] Increase to 30% the number of auditors in the tax administration.	<b>Delayed:</b> The recruitment strategies to meet the targeted increase in the audit workforce are in progress and should be completed in early 2013.

	<b>[3.25]</b> Clear cases above EUR 1 million with the support of the tax court judges.	<b>Ongoing:</b> The task force of judges has increased the pace of its work on high-value tax cases, and will continue clearing the remaining cases in courts.
	<b>[3.26]</b> Implement a full-fledged Large Taxpayer Office (LTO).	<b>Observed:</b> The LTO is fully functional, enhances taxpayer segmentation and supports the efforts to curb tax evasion.
	<b>[3.28 i]</b> Prepare a report on tax compliance situation.	<b>Observed:</b> Insights from the analysis is being used to reinforce tax compliance.
	<b>[3.31]</b> Reform the existing framework of central, local and locally-based administration services.	<b>Delayed.</b> An assessment will be provided by the end of 2013 to identify potential duplications of competences/services and other inefficiencies between the central administration and local administration.
	<b>[3.32 ii]</b> Fully implement the strategy of shared services in central administration in the area of human resources.	<b>Partially observed.</b> GerHup is already implemented in four entities of the Ministry of Finance, but is delayed in the remaining six.
	<b>[3.32 iii]</b> Implement shared services in IT.	<b>Partially observed.</b> Based on a strategy with general guidelines, the Ministries are still implementing their sectoral plans.
	<b>[3.35]</b> Prepare a comprehensive review of wage scales.	<b>Observed:</b> A study comparing the wage scales in the public and private sector for comparable jobs was presented to trade unions and published. This serves as basis for the ongoing comprehensive review of wage scales, within the framework of the public expenditure review. A specific law regarding the single wage scale and wage supplement reforms will be made effective by 1 January 2014.
<b>Financial sector</b>	<b>[2.2]</b> Issue the first report by the BdP on recently restructured loans due to debtors' financial difficulties by end-November 2012.	<b>Observed.</b>

	<b>[2.3]</b> Ensure that the programme target of a Core Tier 1 ratio of 10% by end-2012 target is reached.	<b>Observed.</b>
	<b>[2.10]</b> Reflect the OIP findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies.	<b>Observed.</b> BdP continues to work on the implementation of the OIP findings in the implementation of the SIP recommendations.
	<b>[2.12]</b> Launch the bidding process in order to select the party managing the credits currently held by Parvalorem.	<b>Not observed.</b> The procurement contract has been shared with the Troika and the international public tender limited by prior qualification procedure has been launched on 18 January 2013 in view to be completed in H1 2013.
	<b>[2.13]</b> Approve the decree-law on the banks' contributions to the resolution fund and approve the supervisory notices on recovery plans.	<b>Observed.</b> The notice on resolution plans was published on 26 December 2012 and the BdP Board approved the creation of a Resolution Unit. The decree law establishing the legal framework for contributions to the Resolution Fund was published on 19 February 2013.
	<b>[2.15]</b> Submit to Parliament by end-January 2013 amendments to the legal framework governing access to public capital.	<b>Observed.</b> The proposal for amendments to the Recapitalisation was submitted to Parliament on 31 January 2013.
	<b>[2.18]</b> Develop and evaluate the different options put forward with a view to set priorities and submit a detailed assessment on the proposal concerning the grouped issuance of corporate debt, in particular of SMEs, to obtain capital markets financing.	<b>Partially observed.</b> The detailed assessment of the proposal concerning the grouped issuance of corporate debt is ongoing.
<b>Health care system</b>	<b>[3.38]</b> Additional revenue of EUR 150 million following the revision and better billing and collection of NHS moderating fees, payments from insurance companies and fees for the treatment of cross-border/foreign patients.	<b>Observed:</b> revenue collection has increased by €110 million, though slightly below the target. Importantly, fees have moderated consumption resulting in a decrease in unnecessary emergency consultations and hospital outpatient consultations (which in turn explains lower fee revenues). ACSS is developing several measures to further improve the billing and collection process.

<p><b>[3.39]</b> The overall budgetary cost of health benefit schemes –ADSE, ADM, SAD-will be reduced by 50% of the employers contribution through transfer of resources to the NHS in exchange for provision of services.</p>	<p><b>Observed:</b> the 2013 State Budget makes a provision for the transfer of financial resources to the NHS.</p>
<p><b>[3.40]</b> Enact legislation which automatically reduces the price of medicines when the patent expires to 50% of their previous price.</p>	<p><b>Not observed:</b> but transformed into a contingency measure to ensure compliance with the 2013 target of 1% of GDP target for public pharmaceutical expenditure.</p>
<p><b>[3.45]</b> Publish implementation report of the legislation making compulsory the prescription by INN to increase the use of generic medicines.</p>	<p><b>Observed:</b> the report has been submitted and commented upon. A follow-up report has been requested by end December 2013.</p>
<p><b>[3.49]</b> Publish an action plan concerning the centralised acquisition of vehicles, utilities, external services and other cross functional goods and services by all entities included in NHS.</p>	<p><b>Observed:</b> the report has been submitted and commented upon.</p>
<p><b>[3.51]</b> Reduce by an additional 10% the overall spending of the NHS with private providers delivering diagnostic and therapeutic services.</p>	<p><b>Observed:</b> in 2012 overall spending was reduced by 11%, i.e. about €78 million, when compared to 2011.</p>
<p><b>[3.55]</b> implement the strategy to clear arrears in the health sector, within the overall strategy for settling arrears.</p>	<p><b>Observed and on-going:</b> till the end of 2012 authorities have cleared about €1.3bn in late payments of over 90 days and in total about €1.5bn in overdue debt. Additional €432 million are to be used to clear late payments.</p>
<p><b>[3.57]</b> Implement measures aiming at reducing the operational costs by at least EUR 200 million.</p>	<p><b>Observed:</b> operational costs were reduced by 6% i.e. about €316 million as compared to 2011.</p>
<p><b>[3.59]</b> Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators and regular reports.</p>	<p><b>Observed and on-going:</b> the report has been submitted and commented upon. The web portal has been delayed as a result of funding constraints but will be available as of Q2-2013.</p>

	<p><b>[3.61]</b> . A detailed action plan for the reorganisation and rationalisation of the hospital network is published by <b>30 November 2012</b>.</p>	<p><b>Observed and on-going:</b> a report has been submitted and commented upon. The report provided general national and regional targets for the rationalisation of hospital services. Authorities have agreed to define detailed strategic plans and respective timeline by Q2-2013.</p>
	<p><b>[3.63]</b> Update working time legal framework, increase mobility of staff, adopt flexible time arrangements and review payment mechanisms of health care staff to reduce by at least 20% spending on overtime compensation in 2012.</p>	<p><b>Observed:</b> spending on overtime was reduced by a cumulative 28% between 2010-2012 i.e. savings of about €88 million.</p>
	<p><b>[3.64]</b> Improve monitoring, internal control and fiscal risks management systems of the Administrações Regionais de Saúde.</p>	<p><b>Observed and on-going:</b> a coordination group has been created. ACSS developed control and fiscal risks management procedures. ARS Norte implemented the control and fiscal risks management procedures. Procedures are under implementation in the other ARSs and implementation is to be finalized by Q1-2013.</p>
	<p><b>[3.66]</b> Reduce costs for patient transportation by 1/3.</p>	<p><b>Observed:</b> spending on patient transportation was reduced by a cumulative 42% between 2010-2012 i.e. savings of about €55 million.</p>
<b>Labour market</b>	<p><b>[4.1]</b> Prepare an analysis on benefit dependency and long-term unemployment.</p>	<p><b>Observed.</b> Report submitted on 15 February 2013.</p>
	<p><b>[4.3]</b> Submit to Parliament draft legislation aiming at aligning the level of severance payments with the EU average of 12 days.</p>	<p><b>Observed.</b> Relevant legislation has been submitted to Parliament. Changes to the draft are expected in line with the agreement reached at the 7<sup>th</sup> review.</p>
	<p><b>[4.5 iv]</b> Prepare an independent review on defining wage norms that into account competitiveness and on the desirability of shortening the survival of contracts that are expired but not renewed.</p>	<p><b>Delayed.</b> The report on wage norms has been submitted. Report on survival of collective agreements was postponed to Q3-2013 due to funding problems reported by the authorities.</p>
	<p><b>[4.7]</b> Present a report on expenditure and financing of ALMPs, the role of job counselling and propose actions to improve the effectiveness of employment and training measures.</p>	<p><b>Delayed.</b> The report is still under preparation. The new deadline is Q1-2013.</p>

	<b>[4.8 ii]</b> Define and implement funding framework for public schools and schools under autonomy agreements.	<b>Ongoing.</b> According to the authorities, the framework should be available over the next two months.
	<b>[4.8 iii]</b> Reorganise modalities for the provision of VET, enhance students' orientation and career guidance.	<b>Observed.</b> New Ordinance setting up the new VET system has been published.
<b>Goods and services markets</b>	<b>[5.1]</b> Adopt the new regulators' bylaws agreed in July 2012 and the law on penalty system.	<b>Observed:</b> the Decree Law amending ERSE bylaws has been approved by the Council of Ministers. The law on the penalty system of ERSE was published.
	<b>[5.2. i]</b> Present proposals to harmonise cross-border gas tariffs.	<b>Observed.</b>
	<b>[5.2 ii]</b> Prepare a report for improving the harmonised mechanism for capacity allocation and congestion management of cross-border flows with Spain.	<b>Observed.</b>
	<b>[5.3 iii]</b> Apply a harmonised capacity allocation and congestion management mechanism for cross-border gas flows.	<b>Observed.</b>
	<b>[5.4]</b> Conclude the measures aiming at reducing excessive rents and to address the sustainability of the national electricity system.	<b>Partially observed:</b> Several measures were concluded however a missing measure as well as external factors require a reassessment of projections of the tariff deficit path and additional measures might be implemented.
	<b>[5.5]</b> Conclude the measures to limit the policy costs embedded in CMECs and PPAs.	<b>Partially observed:</b> CMEC legislation was adopted on February 2013. Negotiations concerning the Sines and Pego power plants have come to a standstill and are unlikely to be pursued.
	<b>[5.6]</b> Present a report on the CMEC scheme.	<b>Observed:</b> the report was delivered. Analysis and discussions of the consequences of the report will take place in the 8th review.
	<b>[5.7]</b> Conclude the measures to limit the policy costs of renewables under the special regime.	<b>Observed:</b> Legislation setting the terms for the compensation for wind producers was approved and is expected to be implemented shortly. The maximum duration for the feed in tariff in small hydro plants has been introduced.

<b>[5.13]</b> Further liberalise the postal sector by amending the decree-law laying down the framework of the concession contract.	<b>Delayed.</b>
<b>[5.14]</b> Implement the Strategic Plan for Transport for 2011-2015.	<b>Partially observed</b> – EBITDA balance of transport SOEs improves, PPPs are being renegotiated.
<b>[5.15]</b> Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability	<b>Observed</b> – an outline of the long-term vision was presented.
<b>[5.16 ii]</b> Continue to implement the plans to bring the infrastructure manager to operational balance.	<b>Observed</b>
<b>[5.16 iii]</b> Ensure that the new railway Public Service Obligation (PSO) contracts concluded on rail passenger transport respect EU legislation including Regulation (EC) N° 1370/2007 and provide a detailed breakdown of state contributions for each line under PSO.	<b>Delayed:</b> The new Public Obligation Scheme (PSO) contracts will be presented in the context of the planned opening of public transport sub-concessions to private capital.
<b>[5.16 iv]</b> Extend the performance scheme on infrastructure charges to other operators.	<b>Observed</b>
<b>[5.16 v]</b> Review and render more effective the yield management on long-distance passenger ticket prices.	<b>Observed</b>
<b>[5.16 vii]</b> Ensure that the main rail terminals currently owned by CP Carga are transferred to another entity that will guarantee non-discriminatory access to all rail freight operators	<b>Delayed</b> The transfer of terminals is affected by the delay of CP Carga privatisation process.
<b>[5.17]</b> Adopt the revised legal framework on port work.	<b>Observed:</b> Entered into force on February 1 <sup>st</sup> . Law 3/2013 of 14 January.
<b>[5.18]</b> Take further steps to improve the governance model of the ports system with the objective to enhance the competitiveness and the	<b>Delayed</b> No concrete actions were presented on port governance and on concession reform.



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efficiency of ports.

<b>[5.19]</b> Adopt the necessary legislative amendments in order to achieve full compliance with Directive 1999/62/EC (Eurovignette Directive)	<b>Observed.</b>
<b>[5.20]</b> Complete the adoption of the outstanding sectorial amendments to comply with the Services Directive.	<b>On-going.</b> Internal work within the government on the preparation of the seventeen reforms pending has been progressing and most of them were shared and are being discussed with EC/ECB/IMF.
<b>[5.20]</b> Approval by the Parliament of the amendments in the area of real state.	<b>Observed.</b> Law 15/2013 published in the Official Gazette on 8 February 2013.
<b>[5.20]</b> Submit to Parliament amendments in the area of construction services.	<b>Delayed.</b> The final drafts of the laws on construction and reserve of activity have been sent for consultation to social partners. This additional step was not foreseen and has delayed the legislative roadmap.
<b>[5.21]</b> Adopt the law for professions where regulation does not involve a professional body (Ordens or Câmaras).	<b>Observed.</b> Law 5/2013 and 6/2013 deregulating 3 professions were published in the Official Gazette on 22 January 2013. Further laws deregulating 4 professions will be published.
<b>[5.21]</b> Approval of the draft horizontal legal framework of regulated professions submitted to Parliament.	<b>Observed.</b> Law 2/2013 published in the Official Gazette on 10 January 2013.
<b>[5.23i]</b> Adapt the content and information available at the PSC for the 48 amended regimes to ensure conformity with the Services Directive.	<b>Delayed.</b> Lack of sufficient administrative capacity was mentioned as a reason for delays. 18 regimes were published online on the PSC and 16 online procedures are under construction.
<b>[5.23ii]</b> Adapt the content and information available at the PSC for the 15 regimes approved to ensure conformity with the Professional Qualifications Directive.	<b>Delayed.</b> Lack of sufficient administrative capacity. All the regimes were analysed but the information is under discussion with the competent authorities.

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	[5.23 iii] Make available in PSC on-line procedures for the registration of establishments for the 5 municipalities identified covered by "Zero Authorisation" pilot project.	<b>Not observed:</b> expected to be ready by the end of March.
	[5.23 iii] Identify municipalities with most significant economic impact and be ready for the extension of the PSC tool to major municipalities.	<b>Partially observed:</b> 16 municipalities identified however extension has not taken place.
<b>Housing market</b>	[6.1] Bring value of all property stock close to market value and ensure that property valuation is updated regularly.	<b>Observed.</b> The revaluation of properties was successfully completed in March 2013.
<b>Competition, public procurement, and business environment</b>	[7.5] The Portuguese State will ensure that CGD alienates its participation in GALP.	<b>Observed.</b> The sale of 1 per cent share of CGD in GALP was completed in November 2012.
	[7.7] Monitor the inflow of cases and report on the functioning of the specialised court for Competition, Regulation and Supervision.	<b>Observed:</b> monitoring will be continued by the Ministry of Justice.
	[7.8] Take necessary actions to ensure effective functioning of the Competition Authority financing model and report on the conditions for the proper execution of Competition Authority mandate.	<b>Observed:</b> the transfers relative to 2012 from the National Regulatory Authorities to the Competition Authority have been completed
	[7.9] Submit to Parliament the framework Law setting the main principles of the functioning of the main National Regulator Authorities (NRA)	<b>Observed:</b> The draft law was approved by the Council of Ministers and following the adoption by the Parliament, the Government will adopt the corresponding bylaws within three months of publication.
	[7.12] Report on progress on the measures aiming at facilitating access to finance and to export markets for SMEs.	<b>Ongoing.</b> The guarantee line <i>PME Crescimento</i> has been renewed with an additional EUR 1 billion in order to facilitate access to credit to viable microcompanies and Small and Medium Enterprises, notably those oriented to exports. Some of the measures presented raise some doubts regarding their added value.
<b>Judicial</b>		

<b>system</b>		
	[7.2] Set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, by inter-agency task forces with the fifth report to be completed by mid-February 2013.	<b>Observed</b> Report sent on 19 February 2013
	[7.3] Approve by the government the draft bills for enforcement agent's framework (i) strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, (ii) to include a fee structure that incentivizes speedy enforcement by end-February.	<b>Ongoing</b>
	[7.4] 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 end of relevant quarter	<b>Observed</b> Report sent on 31 January
<b>Licensing</b>	[7.17] Create a working group to analyse the licensing of planned investment projects which are left unsolved or undecided for more than 12 months.	<b>Delayed.</b> Q1-2013 has been set as new deadline.
	[7.18] Review the legal regimes at all levels of Government in the area of territorial planning.	<b>Delayed.</b> Q1-2013 has been set as new deadline except for 7.18 ii. The legal provisions regarding the National Ecological Reserve have been adopted (Decree Law 239/2012 and Ordinance 419/2012).
	[7.20] Change the legal regime for Environment Impact Evaluation to increase the speed and effectiveness of this regulation and reduce associated money and time costs.	<b>Delayed.</b> Q1-2013 has been set as new deadline.
	[7.21 ii a] Implement zero licensing procedures for Type 3.	<b>Delayed.</b> Q1-2013 has been set as new deadline.
	[7.21 ii d] Ensure that the new Industrial Licensing is aligned with the review of the New Base Law of Soil and Territorial and Urbanism	<b>Delayed.</b> Q1-2013 has been set as new deadline.

Planning.		
[7.22]	Review the commercial licensing regime.	<b>Delayed.</b> Q1-2013 has been set as new deadline.
[7.23]	Review the geological licensing regimes.	<b>Delayed.</b> Q1-2013 has been set as new deadline.
[7.24]	Review the licensing in tourism.	<b>Delayed.</b> Q1-2013 has been set as new deadline.

## ANNEX 2

### Commission Services Macroeconomic Projections 2011-2016

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

<i>Annual % change</i>	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	-3,8	-5,6	-3,5	0,1	1,0	1,3
2. Government consumption expenditure	-4,3	-4,4	-2,6	-2,0	-1,9	-1,5
3. Gross fixed capital formation	-10,7	-14,5	-7,7	2,5	4,9	5,7
<b>4. Final domestic demand</b>	<b>-5,2</b>	<b>-6,9</b>	<b>-4,0</b>	<b>0,0</b>	<b>1,1</b>	<b>1,6</b>
5. Change in inventories	--	--	--	--	--	--
<b>6. Domestic demand</b>	<b>-5,7</b>	<b>-6,8</b>	<b>-4,1</b>	<b>0,0</b>	<b>1,1</b>	<b>1,6</b>
7. Exports of goods and services	7,2	3,3	0,8	4,4	4,9	5,1
7a. - of which goods	7,4	4,3	0,9	4,6	5,1	5,3
7b. - of which services	6,7	0,3	0,4	3,9	4,5	4,8
<b>8. Final demand</b>	<b>-2,8</b>	<b>-4,2</b>	<b>-2,8</b>	<b>1,3</b>	<b>2,3</b>	<b>2,7</b>
9. Imports of goods and services	-5,8	-6,9	-3,9	3,1	4,3	4,8
9a. - of which goods	-6,9	-6,8	-3,8	3,5	4,6	4,9
9b. - of which services	0,7	-7,8	-4,6	0,5	2,3	4,4
<b>10. Gross domestic product at market prices</b>	<b>-1,6</b>	<b>-3,2</b>	<b>-2,3</b>	<b>0,6</b>	<b>1,5</b>	<b>1,8</b>
<i>Contribution to change in GDP</i>						
11. Final domestic demand	-5,5	-7,2	-4,0	0,0	1,1	1,5
12. Change in inventories + net acq. of valuables	-0,6	0,1	-0,1	0,0	0,1	0,1
13. External balance of goods and services	4,5	4,0	1,8	0,6	0,4	0,3

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

<i>Annual % change</i>	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	-0,2	-3,6	-3,1	1,1	2,6	2,9
2. Government consumption expenditure	-8,1	-11,8	3,3	-2,0	-4,3	-1,0
3. Gross fixed capital formation	-9,7	-14,1	-8,2	4,3	7,7	9,2
<b>4. Final domestic demand</b>	<b>-3,5</b>	<b>-7,0</b>	<b>-2,7</b>	<b>1,0</b>	<b>2,1</b>	<b>3,2</b>
5. Change in inventories	--	--	--	--	--	--
<b>6. Domestic demand</b>	<b>-4,1</b>	<b>-6,9</b>	<b>-2,8</b>	<b>1,0</b>	<b>2,2</b>	<b>3,3</b>
7. Exports of goods and services	13,0	4,7	1,2	5,7	6,5	6,8
<b>8. Final demand</b>	<b>-0,3</b>	<b>-3,9</b>	<b>-1,7</b>	<b>2,4</b>	<b>3,4</b>	<b>4,4</b>
9. Imports of goods and services	1,7	-5,4	-4,3	3,5	5,5	6,2
10. Gross national income at market prices	-1,4	-2,1	-1,1	0,9	2,3	3,7
11. Gross value added at basic prices	-1,3	-3,2	-0,4	1,9	2,6	3,7
<b>12. Gross domestic product at market prices</b>	<b>-1,0</b>	<b>-3,3</b>	<b>-0,7</b>	<b>1,9</b>	<b>2,6</b>	<b>3,6</b>

**Table 3: Implicit price deflators**

<i>% change in implicit price deflator</i>	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	3,8	2,1	0,5	1,0	1,5	1,5
2. Government consumption expenditure	-4,0	-7,7	6,1	0,0	-2,4	0,5
3. Gross fixed capital formation	1,1	0,5	-0,6	1,7	2,7	3,2
<b>4. Domestic demand</b>	<b>1,6</b>	<b>-0,1</b>	<b>1,3</b>	<b>1,0</b>	<b>1,0</b>	<b>1,7</b>
5. Exports of goods and services	5,5	1,4	0,5	1,2	1,4	1,5
<b>6. Final demand</b>	<b>2,6</b>	<b>0,4</b>	<b>1,1</b>	<b>1,0</b>	<b>1,1</b>	<b>1,6</b>
7. Imports of goods and services	8,1	1,6	-0,5	0,4	1,2	1,4
<b>8. Gross domestic product at market prices</b>	<b>0,5</b>	<b>-0,1</b>	<b>1,7</b>	<b>1,3</b>	<b>1,1</b>	<b>1,7</b>
<b>HICP</b>	<b>3,6</b>	<b>2,8</b>	<b>0,7</b>	<b>1,0</b>	<b>1,5</b>	<b>1,5</b>

Table 4: Labour market and cost

<i>Annual % change</i>	2011	2012	2013	2014	2015	2016
1. Labour productivity (real GDP per employee)	0,0	1,1	1,7	1,2	1,1	1,2
2. Compensation of employees per head	-0,6	-2,7	1,4	0,0	0,0	0,8
<b>3. Unit labour costs</b>	<b>-0,6</b>	<b>-3,7</b>	<b>-0,3</b>	<b>-1,1</b>	<b>-1,1</b>	<b>-0,4</b>
4. Total population	0,1	-0,5	-0,2	0,0	0,0	0,0
5. Population of working age (15-64 years)	-1,3	-1,0	-0,5	0,0	0,5	0,5
6. Total employment (fulltime equivalent)	-1,5	-4,2	-3,9	-0,5	0,4	0,6
<b>7. Calculated unemployment rate - Eurostat definition (%)</b>	<b>12,9</b>	<b>15,7</b>	<b>18,2</b>	<b>18,5</b>	<b>18,1</b>	<b>17,5</b>

Table 5: External balance

<i>levels, EUR bn</i>	2011	2012	2013	2014	2015	2016
1. Exports of goods (fob)	45,1	47,8	48,4	51,3	54,7	58,5
2. Imports of goods (fob)	58,4	55,4	53,0	55,1	58,3	62,0
<b>3. Trade balance (goods, fob/fob) (1-2)</b>	<b>-13,3</b>	<b>-7,6</b>	<b>-4,6</b>	<b>-3,8</b>	<b>-3,6</b>	<b>-3,5</b>
<i>3a. p.m. (3) as % of GDP</i>	<i>-7,8</i>	<i>-4,6</i>	<i>-2,8</i>	<i>-2,2</i>	<i>-2,1</i>	<i>-2,0</i>
4. Exports of services	16,0	16,3	16,4	17,2	18,3	19,4
5. Imports of services	10,2	9,6	9,1	9,2	9,5	10,1
<b>6. Services balance (4-5)</b>	<b>5,8</b>	<b>6,7</b>	<b>7,3</b>	<b>8,0</b>	<b>8,7</b>	<b>9,4</b>
<i>6a. p.m. 6 as % of GDP</i>	<i>3,4</i>	<i>4,1</i>	<i>4,5</i>	<i>4,8</i>	<i>5,1</i>	<i>5,3</i>
<b>7. External balance of goods &amp; services (3+6)</b>	<b>-7,5</b>	<b>-0,8</b>	<b>2,7</b>	<b>4,3</b>	<b>5,2</b>	<b>5,9</b>
<i>7a. p.m. 7 as % of GDP</i>	<i>-4,4</i>	<i>-0,5</i>	<i>1,7</i>	<i>2,6</i>	<i>3,0</i>	<i>3,3</i>
8. Balance of primary incomes and current transfers	-4,9	-2,3	-2,6	-4,2	-5,1	-5,5
<i>8a. - of which, balance of primary income</i>	<i>-6,5</i>	<i>-4,3</i>	<i>-4,9</i>	<i>-6,6</i>	<i>-7,4</i>	<i>-7,6</i>
<i>8b. - of which, net current Transfers</i>	<i>1,5</i>	<i>2,0</i>	<i>2,3</i>	<i>2,4</i>	<i>2,3</i>	<i>2,0</i>
<i>8c. p.m. 8 as % of GDP</i>	<i>-2,9</i>	<i>-1,4</i>	<i>-1,6</i>	<i>-2,5</i>	<i>-3,0</i>	<i>-3,1</i>
<b>9. Current external balance (7+8)</b>	<b>-12,4</b>	<b>-3,1</b>	<b>0,1</b>	<b>0,1</b>	<b>0,1</b>	<b>0,4</b>
<i>9a. p.m. 9 as % of GDP</i>	<i>-7,2</i>	<i>-1,9</i>	<i>0,1</i>	<i>0,1</i>	<i>0,0</i>	<i>0,2</i>
10. Net capital transactions	2,8	3,8	2,8	2,9	2,8	2,9
<b>11. Net lending (+)/ net borrowing (-) (9+10)</b>	<b>-9,5</b>	<b>0,6</b>	<b>2,9</b>	<b>3,0</b>	<b>2,8</b>	<b>3,2</b>
<i>11a. p.m. 11 as % of GDP</i>	<i>-5,6</i>	<i>0,4</i>	<i>1,7</i>	<i>1,8</i>	<i>1,7</i>	<i>1,8</i>

**Table 6: Fiscal accounts**

	2011	2012	2013	2014	2015	2016
<i>% of GDP</i>						
Indirect taxes	13.7	13.6	13.2	13.3	13.5	13.6
Direct taxes	9.9	9.2	11.0	10.6	10.6	10.6
Social contributions	12.2	11.6	12.0	12.0	11.4	11.3
Sales and other current revenue	4.7	5.2	5.3	5.2	5.3	5.1
<b>Total current revenue</b>	<b>40.5</b>	<b>39.7</b>	<b>41.4</b>	<b>41.2</b>	<b>40.7</b>	<b>40.6</b>
Capital transfers received	4.5	1.3	1.1	0.9	0.9	0.9
<b>Total revenue</b>	<b>45.0</b>	<b>41.0</b>	<b>42.6</b>	<b>42.1</b>	<b>41.6</b>	<b>41.5</b>
Compensation of employees	11.4	9.9	10.5	9.3	8.5	8.1
Intermediate consumption	4.7	4.6	4.4	4.3	4.1	4.1
Social transfers in kind via market producers	4.7	4.6	4.7	4.6	4.5	4.4
Social transfers other than in kind	17.3	18.0	19.2	18.6	18.1	18.0
Interest paid	4.0	4.4	4.4	4.4	4.3	4.3
Subsidies	0.7	0.6	0.5	0.5	0.5	0.5
Other current expenditure	2.6	2.3	2.4	2.4	2.2	2.2
<b>Total current expenditure</b>	<b>45.4</b>	<b>44.4</b>	<b>46.1</b>	<b>44.2</b>	<b>42.3</b>	<b>41.6</b>
Gross fixed capital formation	2.6	1.8	1.8	1.7	1.6	1.6
Other capital expenditure	1.4	1.2	0.0	0.2	0.2	0.2
<b>Total expenditure</b>	<b>49.4</b>	<b>47.4</b>	<b>48.0</b>	<b>46.1</b>	<b>44.1</b>	<b>43.4</b>
<b>General Government balance (EDP)</b>	<b>-4.4</b>	<b>-6.4</b>	<b>-5.5</b>	<b>-4.0</b>	<b>-2.5</b>	<b>-1.9</b>
<b>General Government balance (Programme)</b>	<b>-4.4</b>	<b>-6.0</b>	<b>-5.5</b>	<b>-4.0</b>	<b>-2.5</b>	<b>-1.9</b>
<i>% change</i>						
Indirect taxes	1.5	-3.7	-3.6	2.7	3.9	4.6
Direct taxes	11.4	-9.9	17.9	-1.1	2.0	3.8
Social contributions	-1.6	-8.1	2.3	2.2	-2.3	2.0
Sales and other current revenue	6.2	7.1	1.5	0.7	3.2	1.0
<b>Total current revenue</b>	<b>3.3</b>	<b>-5.3</b>	<b>3.8</b>	<b>1.3</b>	<b>1.5</b>	<b>3.2</b>
Capital transfers received	55.6	-71.6	-14.5	-19.1	2.6	5.4
<b>Total revenue</b>	<b>6.9</b>	<b>-11.9</b>	<b>3.2</b>	<b>0.7</b>	<b>1.5</b>	<b>3.2</b>
Compensation of employees	-8.1	-16.1	5.9	-9.8	-6.5	-0.9
Intermediate consumption	-10.1	-6.3	-4.8	0.8	1.0	4.0
Social transfers in kind via market producers	-5.0	-5.2	2.3	0.1	0.1	0.5
Social transfers other than in kind	0.3	0.5	6.0	-1.1	-0.1	2.7
Interest paid	41.3	5.4	-1.2	1.5	1.6	4.2
Subsidies	-7.4	-12.5	-13.8	0.5	2.7	2.7
Other current expenditure	-9.7	-13.0	4.6	-0.7	-6.2	2.7
<b>Total current expenditure</b>	<b>-1.9</b>	<b>-5.5</b>	<b>3.4</b>	<b>-2.5</b>	<b>-1.8</b>	<b>2.0</b>
Gross fixed capital formation	-31.7	-31.1	-1.0	-4.7	-2.0	1.1
Other capital expenditure	-29.5	-17.2	-97.0	470.9	21.4	-28.5
<b>Total expenditure</b>	<b>-5.1</b>	<b>-7.2</b>	<b>0.7</b>	<b>-2.2</b>	<b>-1.7</b>	<b>1.8</b>

Nominal GDP, EUR bn

Note: For the purposes of the Programme, the budgetary costs of bank support measures in the context of the financial sector strategy shall not be considered in the general government balance.



**Table 7: Government debt developments**

	2011	2012	2013	2014	2015	2016
<b>EDP deficit (% of GDP)</b>	<b>-4.4</b>	<b>-6.4</b>	<b>-5.5</b>	<b>-4.0</b>	<b>-2.5</b>	<b>-1.9</b>
EDP gross debt (% of GDP)	108.3	123.6	122.9	124.2	123.1	120.5
<i>levels, EUR bn</i>						
<b>EDP deficit</b>	<b>-7.5</b>	<b>-10.6</b>	<b>-9.0</b>	<b>-6.7</b>	<b>-4.3</b>	<b>-3.4</b>
Gross debt	185.2	204.5	202.1	208.1	211.7	214.6
Change in gross debt	22.8	19.2	-2.4	6.1	3.6	2.9
Nominal GDP	171.1	165.4	164.5	167.5	171.9	178.1
Real GDP	165.5	170.7	174.7	173.8	171.1	168.0
<b>Real GDP growth (% change)</b>	<b>-1.6</b>	<b>-3.2</b>	<b>-2.3</b>	<b>0.6</b>	<b>1.5</b>	<b>1.8</b>
Change in gross debt (% of GDP)	13.3	11.6	-1.5	3.6	2.1	1.6
Stock-flow adjustments (% of GDP)	8.9	5.2	-6.9	-0.4	-0.4	-0.3
<i>% of GDP</i>						
<b>Gross debt ratio</b>	<b>108.3</b>	<b>123.6</b>	<b>122.9</b>	<b>124.2</b>	<b>123.1</b>	<b>120.5</b>
Change in gross debt ratio	14.3	15.3	-0.8	1.4	-1.2	-2.6
<i>Contribution to change in gross debt</i>						
Primary balance	0.4	2.0	1.1	-0.4	-1.8	-2.4
"Snow-ball" effect	4.9	8.0	5.0	2.1	1.0	0.1
of which						
<i>Interest expenditure</i>	<i>4.0</i>	<i>4.4</i>	<i>4.4</i>	<i>4.4</i>	<i>4.3</i>	<i>4.3</i>
<i>Real growth effect</i>	<i>1.5</i>	<i>3.4</i>	<i>2.9</i>	<i>-0.7</i>	<i>-1.9</i>	<i>-2.2</i>
<i>Inflation effect</i>	<i>-0.6</i>	<i>0.2</i>	<i>-2.2</i>	<i>-1.6</i>	<i>-1.4</i>	<i>-2.1</i>
<b>Stock-flow adjustments</b>	<b>8.9</b>	<b>5.2</b>	<b>-6.9</b>	<b>-0.4</b>	<b>-0.4</b>	<b>-0.3</b>
<i>Implicit interest rate</i>	<i>4.3</i>	<i>3.9</i>	<i>3.5</i>	<i>3.6</i>	<i>3.6</i>	<i>3.7</i>

## ANNEX 3

### Financing needs and sources

**Table 8: Financing needs and sources (EUR billion)**

	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2011-2014</b>
	<b>Jun-Dec</b>	<b>Year</b>	<b>Year</b>	<b>Year</b>	<b>Total</b>
<b>Public sector deficit</b>	<b>11.3</b>	<b>13.3</b>	<b>16.0</b>	<b>7.2</b>	<b>47.8</b>
Treasury balance <sup>1</sup>	7.1	8.9	9.0	6.7	31.7
Other public sector cash needs <sup>2</sup>	4.2	4.4	7.0	0.5	16.2
<b>Amortization</b> <sup>3</sup>	<b>9.5</b>	<b>27.8</b>	<b>9.0</b>	<b>14.6</b>	<b>60.9</b>
Medium- and long-term debt (incl debt exchange)	4.9	16.6	5.8	14.1	41.5
Other debt (retail, repos, incl SOE), net	4.6	11.2	3.2	0.5	19.4
<b>Banking support</b> <sup>4</sup>	<b>1.0</b>	<b>7.5</b>	<b>2.9</b>	<b>0.4</b>	<b>11.8</b>
<b>Financing needs</b>	<b>21.8</b>	<b>48.6</b>	<b>27.9</b>	<b>22.2</b>	<b>120.5</b>
<b>Market financing</b>	<b>-6.4</b>	<b>8.9</b>	<b>8.1</b>	<b>16.3</b>	<b>26.8</b>
Medium- and long-term debt	0.0	3.6	3.8	16.3	23.6
T-Bills, net	-6.4	5.3	4.3	0.0	3.2
<b>Own resources</b> <sup>5</sup>	<b>-5.7</b>	<b>12.3</b>	<b>9.9</b>	<b>-2.0</b>	<b>14.4</b>
<b>EU-IMF loan</b>	<b>34.0</b>	<b>27.4</b>	<b>9.9</b>	<b>7.9</b>	<b>79.3</b>
EFSM/EFSF	21.0	19.2	6.5	5.2	52.0
IMF <sup>6</sup>	13.0	8.2	3.4	2.7	27.3
<b>Financing sources</b>	<b>21.8</b>	<b>48.6</b>	<b>27.9</b>	<b>22.2</b>	<b>120.5</b>

SOURCE: Portuguese authorities and Commission services' estimates.

1/ Calendar-year cash basis.

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

3/ Central government, excl. T-Bills.

4/ From 2012 includes actual banking sector needs; for 2011 - payments to BSSF.

5/ Includes privatisation receipts, use of deposits, pension fund assets and centralisation of cash management of general government ent

6/ Numbers do not add up to EUR 26 bn due to changes in EUR-SDR rate compared to beginning of programme; SDR rate of 30/05/2013 applied for 2013-2014 disbursements, no revisions for 2011-2012 data.

Table 9: Planned quarterly disbursements (EUR billion)

Review	Period covered by disbursement	Approximate disbursement period	Loan disbursements <sup>1</sup>	of which IMF <sup>2</sup> (1/3)	of which EU (2/3)
Approval	Jun-Sept 2011	Jun-11	18.9	6.5	12.4
1	Q4-2011	Sep-11	11.6	4.0	7.6
2	Q1-2012	Dec-11	8.1	2.8	5.3
3	Q2-2012	Apr-12	14.8	5.1	9.7
4	Q3-2012	Jul-12	4.0	1.4	2.6
5	Q4-2012	Oct-12	4.3	1.5	2.8
6	Q1-2013	Jan-13	1.6	0.8	0.8
7	Q2-2013	Apr-13	2.8	0.7	2.1
8	Q3-2013	Jul-13	2.8	1.0	1.8
9	Q4-2013	Oct-13	2.7	0.9	1.8
10	Q1-2014	Jan-14	2.7	0.9	1.8
11	Q2-2014	Apr-14	2.6	0.9	1.7
12	Q3-2014	Jul-14	2.6	0.9	1.7
TOTAL			79.4	27.4	52.0

<sup>1</sup> Data is subject to revision due to EUR - SDR fluctuations.<sup>2</sup> IMF disbursements are defined in SDR. Actual disbursement in EUR is subject to changes in the EUR-SDR exchange rate

## ANNEX 4

### Provision of Data (Reporting Requirements)

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

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

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
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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 ( <i>Administrações Regionais and Locais</i> ); 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
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Accrual data on budget execution of the National Health System (NHS)	Monthly, 3 weeks after the end of each month
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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
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Publish information on: number of general government staff on a quarterly basis (no later than 45 days after the end of the quarter); stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, special mobility condition flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. The regional and local administration will transmit the necessary information. Information on employment in SOEs (central, local and regional) and other public entities and/or bodies will also be compiled	Quarterly, no later than 30 days after the end of the quarter (as of March 2012)
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Consolidated account on an accrual basis of the non-financial SOEs that are classified within the Central Government	Quarterly, 90 days after the end of the quarter (as of March 2012)
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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
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Data on arrears of:	Monthly, 7 weeks after the end of each month (as of September 2011)
-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	
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
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
Detailed information on called guarantees of the State	Monthly, 30 days after the end of each month
Data on proceeds from asset sales by the Central, Regional and Local Government	Monthly for Central Government
	Quarterly for Regional and Local Government
	30 days after the end of reference period
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
<b>To be provided by ESAME</b>	
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.
<b>To be provided by the Debt Management Office</b>	
Accrual data on interest spending of the State	Quarterly, 7 weeks after the end of the

	quarter
<b>To be provided by the Ministry of Labour</b>	
Data on labour market as follows:	Every six months, 6 weeks after the end of each semester
-layoffs by type	
-collective agreements by type and number of collective agreements that are extended by the Ministry of Labour to non-signatory firms	
-number of collective agreements that regulate the use of the Bank of Hours working time arrangement	
-proportion of unemployed receiving unemployment benefits	
-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)	
-unemployment duration	
<b>To be provided by Ministry of Justice</b>	
Publishing quarterly reports on recovery rates, duration and costs of corporate insolvency cases	Quarterly, starting in 2011 Q3, within four months after the end of each quarter.

## ANNEX 5

### Programme documents



## ANNEX 5

### Letter of Intent

Lisbon, 25 June 2013

Mr Jeroen Dijsselbloem  
President  
Eurogroup

Mr Michael Noonan  
Minister of Finance  
Ireland

Mr Olli Rehn  
Vice President  
European Commission

Mr Mario Draghi  
President  
European Central Bank

Dear Sirs,

The attached Memorandum of Understanding (MoU) describes the progress made in recent months towards the objectives laid out in our Programme. It also updates previous MoUs and highlights the policy steps to be taken in the months ahead.

We continue to advance the policies necessary to eliminate the macroeconomic imbalances that engendered the economic crisis:

- Despite weak economic conditions, the end-December and end-March deficit and debt performance criteria were met. The regional and local finance laws and the implementation of the Large Taxpayer Unit were completed on time. We also timely submitted to Parliament amendments to the law governing banks' access to public capital.
- As a condition for completion of this review, we have identified measures to close the fiscal gap created as a result of an unfavourable Constitutional Court ruling regarding a number of provisions in the 2013 budget.

Steady program implementation and important policy actions at Euro area level have successfully strengthened market prospects, setting the path for Portugal's gradual return to the international bond markets. Nevertheless, the economic outlook remains fragile, with weaker external and domestic conditions posing sizable challenges to fiscal performance, despite our corrective actions. As a result, we are recalibrating the fiscal targets under the program in a delicate balancing act between the output and social costs of adjustment and the need to secure fiscal consolidation and debt sustainability.

To support the still sizable fiscal efforts ahead, we have identified measures to strengthen the sustainability, effectiveness, and social equity of the expenditure programs and functions of the government. These measures underpin the medium-term fiscal framework—including fully-specified measures to meet the 2014 deficit target—which was adopted and published by the Council of Ministers for completion of this review. By the end of the legislative session (15 July 2013), we will finalise all the key legislative changes required to implement the public expenditure review (PER), through approval by

the Council of Ministers or submission to Parliament if needed, as specified in the attached MoU. In parallel, we are conducting a comprehensive reform of the corporate income tax, to simplify and rationalise existing schemes in support of investment and employment. Moreover, we are making important progress in strengthening our budget controls, streamlining the public administration, and curbing tax evasion to ensure an equitable distribution of the fiscal adjustment.

We are committed to preserving financial sector stability and supporting a balanced and orderly deleveraging in the economy. The capital and liquidity conditions of the banking system have significantly strengthened, under the vigilant supervision of Banco de Portugal (BdP). Nevertheless, the challenges posed by the ongoing balance sheet adjustment call for renewed work to promote adequate funding conditions for the most productive and innovative segments of the economy, while ensuring prompt restructuring of viable firms in financial difficulties. We are exploring the setting-up of a mechanism to securitise high-quality mortgage credit with a supranational guarantee. Moreover, we are promoting new initiatives in support of viable SMEs, focused on developing their access to financial markets, retargeting existing government-sponsored initiatives, and facilitating information sharing.

We strive to push further ahead our ambitious structural agenda to bolster price and cost competitiveness and set the basis for a strong and durable recovery. Significant steps are underway to improve the dynamism and efficiency of the labour market, reduce costs for exporters, addressing the excessive rents in the energy sector and port costs, and further improve our business environment.

On the basis of the strength of the policies defined in this letter, and in light of our performance under the program, we request the completion of the seventh review under the Economic Adjustment Programme and the release of the eight instalment under the Programme in the amount of EUR 1 300 million.

The eight review mission by the European Commission, ECB and IMF staff is expected to take place by mid-July 2013.

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

This letter is copied to Ms Christine Lagarde.

Sincerely yours,

/s/

/s/

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Vítor Gaspar

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Carlos da Silva Costa

Minister of State and Finance

Governor of the Banco de Portugal

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

## ANNEX 5

### Memorandum of Understanding on Specific Economic Policy Conditionality

Seventh Update – May 2013

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 seventh 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.

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 seventh quarterly review assessed compliance with the conditions to be met by end-January and the need and scope for additional policy steps. This seventh update of the MoU reflects the findings of the seventh 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 consulting with the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) on the adoption of policies falling within the scope of this updated Memorandum, allowing sufficient time for review. Staff of the EC, the ECB and the IMF will, in cooperation with the Portuguese authorities, monitor and assess progress in the implementation of the programme and track the economic and financial situation. Staff will also monitor whether the implementation and effects of measures taken by the Portuguese authorities fall short of the commitments of previous versions of the MoU; such commitments might be re-inserted. To this effect the authorities commit to providing all required information as soon as available. In areas where there are risks of significant delays in the implementation of policies under this programme the authorities in cooperation with the EC, the ECB and the IMF consider making use of technical assistance.

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

#### 1. Fiscal policy

##### Objectives

Reduce the Government deficit to 5.5 per cent of GDP in 2013, 4 per cent of GDP in 2014 and 2.5 per cent of GDP in 2015 by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups. The fiscal consolidation over the medium-term up to a balanced budgetary position will be maintained, notably by containing expenditure. Growth-friendly tax policy will be pursued through, among others, a comprehensive reform of corporate taxation to promote investment and competitiveness.

## Fiscal policy in 2013

Compared to a target of 5 per cent of GDP, the 2012 deficit reached 6.4 per cent of GDP on ESA-95 basis. Adjusting the figures for a capital injection amounting to 0.4 per cent of GDP into the state-owned bank CGD the deficit was 6 per cent of GDP. A large part of the remaining difference resulted from the statistical treatment of the sale of the operating concession for the major airports in Portugal, amounting to 0.7 per cent of GDP, which contrary to initial plans was recorded as a (deficit-neutral) equity withdrawal. On cash basis, the general government deficit for programme purposes reached 4.7 per cent of GDP, below the 5 per cent target. Confining the deficit in 2012 was challenging as the macro-driven underperformance of revenues had to be compensated by tight expenditure control, notably by reducing public employment ahead of plans, freezing budget appropriations for new investment projects and achieving further savings in intermediate consumption. To assess the new 2013 baseline, revenue falls are assumed to carry-over to 2013 whereas a large part of savings executed in the last quarter of 2012 are considered non-permanent (mainly from investment and acquisition of goods and services).

1.1. The government will achieve a general government deficit target of no more than 5.5 per cent of GDP [Q4-2013].

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

1.3. The 2013 Budget Law approved in November 2012 contained consolidation measures worth slightly above 3 per cent of GDP. On April 5, a Constitutional Court ruling annulled some of the consolidation measures included in the 2013 budget, amounting to 0.8 per cent of GDP. To close the fiscal gap opened by this ruling and to underpin the fiscal adjustment in the years ahead, the government adopted in the course of April and May, a package of permanent expenditure-reducing measures with cumulative yields of EUR 4.7 billion (2.8 per cent of GDP) over 2013-2014 (0.8 per cent of GDP frontloaded to 2013). Some of these measures will be included in a Supplementary Budget and submitted to Parliament by [end May 2013] and all other legislative changes and legislative proposals required to implement the reforms linked to the public expenditure review (see below) will be adopted by the Government or submitted to the Parliament, as the case may be, by the end of the legislative session in [mid-July 2013].

1.4. The fiscal adjustment in 2013 will be underpinned by the budget measures and the measures of the April/May packages as described below, worth 3.5 per cent of GDP, and will be implemented by [Q4-2013]. Overall, the revenue increases account for about two thirds of the fiscal effort and expenditure cuts for one third. Measures are primarily of permanent nature.

## Expenditure

1.5. Reduction in the public sector wage bill (at least EUR 1400 million) by well-targeted measures that will include among others:

i. Reducing the size of the public sector workforce by (i) limiting staff admissions in order to achieve annual decreases at least of 2 per cent (full-time equivalent) in 2013-2014 in the permanent staff of central, regional and local governments; (ii) reducing fixed-term contracts, in particular in subsectors with excessive employment; (iii) optimising the allocation of resources as specified below under the section on the Public Administration/Human Resources, mainly by redesigning the special mobility scheme into a requalification programme.

- ii. Remuneration measures such as reducing over-time payments and fringe benefits, enforcing private sector sickness benefit regime in the public sector and reducing compensation during extraordinary leave.

Limiting outlays in the public wage bill will be ensured by, among others, the convergence of the public sector work rules and regulations towards the legal regimes in the private sector, notably working hours, working time arrangements and holiday entitlements.

1.6. Savings in the national health service (at least EUR 180 million) by further rationalisation of available resources and pharmaceuticals' policy. Further savings, in particular in hospital SOEs, are specified below under the section on the health-care system.

1.7. Streamlining of social benefits expenditure by strengthening control and better targeting social support (at least EUR 650 million).

1.8. Reduction in intermediate consumption across line ministries (at least EUR 400 million).

1.9. Reduction in capital expenditure, particularly in SOEs (at least EUR 250 million).

1.10. Savings from the renegotiation of PPP contracts (at least EUR 300 million).

1.11. Reductions in current transfers, among others to foundations (at least EUR 120 million).

1.12. Reduction in spending on the Polis programme (at least EUR 50 million).

#### Revenue

1.13. Amendment of the personal income tax (at least additional EUR 2.7 billion) by:

- i. reducing the number of tax brackets and increasing the average tax rate in line with European standards, while preserving progressivity of the tax and delinking social benefits from the tax structure;
- ii. introducing a surcharge of 3.5 % on the part of taxable income above minimum wage, and a solidarity surcharge of 2.5% on the income of the top tax bracket and of 5% on the income exceeding EUR 250 000;

- iii. increasing the tax rate on capital income;

- iv. equalising the tax rates on capital income between residents and non-residents;

- v. lowering the basic personal deduction;

- vi. reducing deductibility of mortgage interest payments;

- vii. curbing some fiscal benefits.

1.14. Increase in corporate tax revenues by at least EUR 200 million by:

- i. limiting the deductibility of interest costs;

- ii. curbing tax benefits;

- iii. reducing the threshold for application of the highest tax rate on profits;
  - iv. amending the method for special prepayment applicable to companies under the regime for taxation of groups of companies.
- 1.15. Increase in other indirect taxes (at least EUR 650 million), such as:
- i. excise duties, by raising taxes on tobacco, alcohol and natural gas;
  - ii. property taxes by broadening the property taxable base after revaluation, and stamp tax surcharges for high-value properties;
- 1.16. Introduction of an "extra-ordinary solidarity contribution" on pensions (at least EUR 400 million).
- 1.17. Increase in public employees' contributions to the special health insurance schemes (at least EUR 80 million).
- 1.18. Increase in social contributions (at least EUR 190 million), by including supplementary payments to public employees and unemployment and sickness benefits in the social contributions' calculations (the latter above a minimum threshold).
- 1.19. Reprogramming of EU structural funds (at least EUR 300 million).
- 1.20. Strengthen efforts to fight tax evasion, fraud and informality for various types of taxes inter alia by increasing means available for audits, increasing penalties for the most serious tax crimes and monitoring the new VAT invoicing system.
- 1.21. Maintaining the standstill rule for tax expenditures at central, regional or local level, except for the possibility of introducing additional tax benefits aimed at boosting investment.
- 1.22. In order to stimulate productive investment in 2013, the government will grant a credit on the corporate income tax of 20% of investment expenses or EUR 1 million (whichever is lower) and a maximum annual deduction of 70% of the tax liability. This measure will be applicable to eligible investments made between [May 1st], 2013 until December 31st, 2013.

#### Fiscal policy in 2014

- 1.23. The government will achieve a general government deficit of no more than 4 per cent of GDP in 2014 [Q4-2014].
- 1.24. Within the year, progress will be assessed against the (cumulative) quarterly ceilings for the consolidated general government cash balance in the Memorandum of Economic and Financial Policies (MEFP), as defined in the Technical Memorandum of Understanding (TMU), without prejudice to full-year ESA-95 deficit targets [Q1 and Q2-2014].
- 1.25. Since the second half of 2012 a major public expenditure review has taken place with the objective of enhancing the efficiency and equity of public spending. It aims at addressing redundancies across the public sector functions and entities, reallocating resources toward growth-friendly spending

areas and ensuring social equity of the expenditure programmes and sustainability of public finances. All legislative changes required to implement the measures under this public expenditure review will be finalised and approved by the Council of Ministers, and submitted to Parliament if needed, by the end of the legislative session in [mid-July 2013].

1.26. The total package of measures from the public expenditure review in 2014 will amount to 2% of GDP. It will limit outlays on the public wage bill and pensions as well as deepen sector-specific reforms by the following measures:

i. (i) reduce the size of the public sector workforce—addressing excessive employment in particular sub-sectors—while tilting its composition toward high-skilled and better-trained civil servants; (ii) ensure convergence of the public sector work rules and regulations toward private sector standards; and (iii) simplify the remuneration policy by implementing a single wage scale, streamlining the wage supplement scale, and reducing fringe benefits. The reduction in the workforce will be achieved through a combination of policies, including lower replacement of retirees, voluntary redundancy schemes, and enhanced use of the mobility pool/requalification programme. These reforms will be implemented through a series of legislative and regulatory amendments. In particular, a new draft public administration labour law will be submitted to Parliament by the end of the legislative session in [mid-July 2013] that will aim at aligning current public employment regime to the private sector rules, including for working hours, holiday time, and termination of tenure. In addition, a draft law on the redesigned mobility pool/requalification programme will be submitted by the end of the legislative session in [mid-July 2013]. A specific law regarding the single wage scale and wage supplement reforms will be made effective by [1 January 2014];

ii. A comprehensive pension reform based on equity principles and income progressivity, with a view to protecting those who earn the lowest pensions. Specifically, the reform will take into consideration the need to reduce the current differences between the civil servants' regime and the general social security regime, aiming at enhancing the fairness of the overall pension system and the need to reassess sustainability of the system on the back of demographic developments. Accordingly, the reform will be based on the main elements: (i) an effective increase by one-year in the pension age to 66 years (implemented by adjusting the demographic sustainability factor); (ii) aligning the rules for calculation of benefits of the public sector pension funds, CGA, to the general pension regime. The necessary legislative proposals will be submitted to Parliament by the end of the legislative session in [mid-July 2013]. In addition, and if strictly necessary, a third measure also considered is a sustainability contribution on pensions that effectively lowers pension replacement rates to more affordable levels. This measure, however, may be replaced by identified measures of equivalent value and quality.

iii. Generate other savings through a combination of sector-specific reforms, which mainly include targeted dismissals of personnel and intermediate consumption cuts. In the education sector for example, consider the rationalisation of the school network and a convergence of the teacher/student ratio toward peer levels. Generate further savings from reforms in the hospitals network and from additional cutbacks in SOE and PPP.

1.27. Following the ongoing consultations with social and political partners, the above listed measures may be partly or fully replaced by others of equivalent value and quality, after discussion with EC/ECB/IMF staff, in time to allow the finalisation of all legislative changes required to implement the public expenditure review by the end of the legislative session [mid-July 2013].

1.28. Take a number of steps aiming at mitigating the legal risks from future potential Constitutional Court rulings. First, design expenditure reforms with the principle of public/private sector and intergenerational equity in mind as well as the need to address the sustainability of social security systems. Second, emphasize the need to comply with the fiscal sustainability rules in the Treaty on Stability, Coordination and Governance (Fiscal Compact). Third, rely as much as possible on general



laws—rather than on one-year budget laws—consistent with the structural nature of the reforms and, finally, consider the possibility of prior constitutional review of said laws, thus allowing early reaction from the government in case there reforms raise constitutional issues.

1.29. The government has appointed a Committee for Corporate Income Tax Reform that presented reform guidelines at the seventh review. The reform will aim at promoting simplification as well as boosting internationalisation and competitiveness of Portuguese companies. The main features of the reform will include the redefinition of the corporate income tax base, the reduction of marginal rates, the optimisation of tax incentives, the reduction of uncertainties in tax legislation to prevent litigation, the simplification of compliance obligations, the strengthening of the territoriality principle (universal participation exemption) and the restructuring of international tax policy. The reform will also envisage further reducing policy-induced debt bias. The authorities will work closely with the IMF/EC/ECB staff in the design and impact assessment of the reform with a view to preparing a draft project of the reform by [Q2-2013] and, following public consultation, a final project by [Q3-2013].

## 2. Financial sector regulation and supervision

Preserve financial sector stability; maintain liquidity and support a balanced and orderly deleveraging in the banking sector; ensure adequate financing and working capital for the productive sectors; strengthen banking regulation and supervision; develop and implement solutions that provide financing alternatives to traditional bank credit for the corporate sector; optimise the process for recovering the assets transferred from BPN to the three state-owned SPVs; streamline state-owned Caixa Geral de Depósitos; complete the bank resolution framework; complete the corporate and household insolvency frameworks and smoothen their implementation.

### Maintaining liquidity in the banking sector

2.1. Encourage banks to strengthen their collateral buffers on a sustainable basis and to take full advantage of the broadening of the range of eligible collateral for the purpose of Eurosystem re-financing. The Banco de Portugal (BdP), in close cooperation with the ECB, will continue to monitor closely the liquidity situation of the banking system and stands ready to take the appropriate measures to maintain sufficient system liquidity [Ongoing]. Following the successful launch of a platform for interbank unsecured lending, the BdP has extended its use to secured transactions in early May 2013 to facilitate the functioning of the domestic interbank market.

### Deleveraging in the banking sector

2.2. The banking system should in the medium run eliminate its funding imbalances.. The BdP monitors the banks' implementation of the funding plans aimed at achieving a stable market-based funding position. It is important to ensure that the pace and composition of deleveraging, as also envisaged under the restructuring plans of state aided banks, does not jeopardise the provision of appropriate credit to finance productive investment and working capital in the private sectors of the economy, not least SMEs in the sectors of tradable goods and services. The BdP, as part of its regular prudential supervision activity, monitors the implementation of the main findings of the On-site Inspections Programme (OIP) regarding restructured loans and implements measures to discourage evergreening of doubtful loans with a view to facilitating an effective adjustment of bank balance sheets respecting EU state aid rules. Banks' funding and capital plans and broader credit developments will continue to be monitored closely. There is room for the necessary deleveraging to take place in an orderly manner and it is crucial that the pace and composition of the deleveraging remain consistent with the macroeconomic framework of the programme. The authorities will continue reflecting on a mechanism to securitise banks' high quality

mortgage credit as a contribution to this objective and to reinforce long-term viability of the Portuguese banking system. [Ongoing].

#### Capital buffers

2.3. Ensure that the programme target of a Core Tier 1 ratio of 10% is maintained including through the monitoring of the restructuring plans of banks having received public capital support [Ongoing].

2.4. BdP closely monitors compliance with the capital requirements for all banks, with a view to promptly taking appropriate action if needed [Ongoing].

2.5. Remain committed to providing further support to the banking system, if needed. In the event new capital needs were to arise encourage banks to seek private solutions while resources from the Bank Solvency Support Facility (BSSF) are available in line with EU-state aid rules to further support viable banks, subject to strict conditionality. Avoid subsidising private shareholders and prevent further migration of private liabilities to the public sector balance sheet [Ongoing].

#### Caixa Geral de Depósitos (CGD)

2.6. Continue to streamline the state-owned CGD group [Ongoing].

#### Banking regulation and supervision

2.7. The BdP will continue to strengthen its supervisory organisation, optimise its supervisory processes and develop and implement new supervisory methodologies and tools [Ongoing]. Launch a thematic review of banks' operational capacity in the area of loan restructuring and asset recovery to be completed by [October 2013].

2.8. In addition, the BdP is steps up the monitoring of banks, including via ad hoc audits [Ongoing].

2.9. The BdP continues to monitor on a quarterly basis the banks' potential capital needs with a forward looking approach under stress conditions. In this context, banks reflect the OIP findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies [ongoing], with the update of the treatment of collective impairments expected to be finalised at the latest by [end-June 2013].

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

#### Banco Português de Negócios

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

2.12. Outsource the management of the credits currently held by Parvalorem to a professional third party, with a mandate to gradually recover the assets over time. Award the service contract to the party managing the credits through a competitive bidding process by [mid-2013], at the latest. Include proper incentives to maximise the recoveries and minimise operational costs into the mandate. Ensure timely disposal of the subsidiaries and the assets in the other two state-owned SPVs.

#### Bank resolution framework

2.13. The early intervention, resolution and deposit guarantee framework has been strengthened. Conclude the implementing measures, in particular: (a) analyse the recovery plans of the top 8 banks [end-June 2013] and of the remaining banks [Ongoing]; (b) issue guidelines to the system on recovery plans by [September-2013]; (c) prepare resolution plans on basis of the reports to be provided by banks [Ongoing]. The resolution fund was set up and its funding arrangements concluded. The initial contributions by banks will be settled by [mid-June 2013] and the annual contributions by [end-September 2013].

2.14. The legislator will closely follow the process of adoption of the EU Directive on bank resolution and recovery and will revise the national resolution framework as soon as the Directive is adopted [Ongoing].

#### Central Credit Registry

2.15. The BdP enhances the data coverage of the Central Credit Registry (CCR) to include additional financial products and to add supplementary classifications to the loans already reported to the CCR. Implement the possibility of access by the financial institutions to historical information on their potential new clients, subject to the authorisation of the Portuguese Data Protection Authority (CNPD). In parallel, the BdP assesses options for the disclosure by firms, on a voluntary basis, of selected information contained in other databases such as the Central Balance Sheet Database (CBSD) with a view to reducing information asymmetry between smaller companies and credit providers. These enhancements, as well as a first progress report on the two last referred issues, are expected to be completed by [end- 2013].

#### Corporate and household debt restructuring framework

2.16. Implement the recently established framework for financial institutions to engage in out-of-court debt restructuring for households, smoothen the application of the framework for restructuring of corporate debt and implement an action plan to raise public awareness of the restructuring tools [Ongoing]. Prepare quarterly reports on the implementation of the new restructuring tools with the first report due by [end-June 2013]. Conduct a survey of insolvency stakeholders to inquire about the appropriateness of the existing debt restructuring tools and possible gaps or bottlenecks by [end-July 2013]. Explore alternatives to increase the successful recovery of companies adhering to the PER and the SIREVE [Ongoing].

#### Monitoring of corporate and household indebtedness

2.17. Continue the monitoring of the high indebtedness of the corporate and household sectors through the quarterly reports [Ongoing].

#### Encouraging the diversification of financing alternatives to the corporate sector

2.18. The Ministry of Finance, the BdP, and other stakeholders, have put forward a set of measures to encourage the diversification of financing alternatives to the corporate sector.

- i. focus the scope and prioritise the measures to be implemented [Ongoing].
- ii. finalise a detailed assessment of the grouped issuance of corporate debt to obtain capital market financing [end-April 2013].
- iii. prepare a first draft of the necessary amendments of the rules governing the commercial paper market by [end-June] and review any potential tax implications.

## Government sponsored initiatives

2.19. Assess scope for improving the performance and governance of existing government-sponsored credit lines by ensuring in the selection process the targeting of productive and viable companies with temporary financing difficulties. Establish a quarterly monitoring and reporting mechanism on the allocation of the government sponsored credit lines aimed at facilitating access to finance to SMEs, with the first report due by [end-June 2013]. Conduct an external audit of the National Guarantee System, with a report of the main findings and policy recommendations to be submitted by [end-April 2013].

## 3. Fiscal-structural measures

### Objectives

Improve the efficiency of the public administration by eliminating redundancies, simplifying procedures and reorganising services; regulate the creation and functioning of all public entities including SOEs, PPPs, foundations, associations; re-focus their activities to core public policy objectives and enhance their cost efficiency and fiscal sustainability; streamline the budgetary process, including by adopting new financing laws at regional and local level; strengthen risk management, accountability, reporting and monitoring of all parts of the general government. Government action will build on the recommendations provided by the IMF/EU technical assistance missions.

### Public Financial Management framework

#### Reporting and Monitoring

3.1. Publish a comprehensive report on fiscal risks [each year as part of the budget]. The report will outline general fiscal risks and specific contingent liabilities to which the general government may be exposed, including those arising from Public-Private Partnerships (PPPs), SOEs and explicit guarantees to the banks. Technical assistance will be provided if necessary.

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

3.3. Reduce the number of Serviços e Fundos Autónomos (SFA) in view of reducing budget fragmentation and improving efficiency in the general government. In particular, this reform will be deepened by reviewing the classification of own revenues to enlarge central government revenues [Q3-2013].

#### Arrears

3.4. The stock of domestic arrears will be significantly reduced by the end of the programme period. A significant part of the existing arrears was reduced as laid down in the strategy for the settlement of arrears. The Inspeção Geral de Finanças (IGF) will carry out inspections throughout the process to verify compliance of the commitment control system through a risk-based approach [Ongoing].

3.5. IGF will reinforce the verification of local governments' arrears claims and commitment control systems. Disbursements under the "Programa de Apoio à Economia Local" (PAEL) will only take place where IGF has certified the full functioning of the commitment control system. Transparency of the use of the credit line will be ensured through the monthly publication of the amounts lent, disbursed, and used to settle arrears and other liabilities by municipality in the framework of the PAEL [Ongoing].

### Budgetary framework

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

3.7. Conduct a review of the Budget Framework law to enhance budgetary procedures and principles of budgetary management, reinforce accountability, transparency and simplification, as well as implementing relevant EU legislation [Q4-2013].

3.8. Define in detail the characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry-over rules, commitment controls, and appropriate contingency reserves and related access rules after modification of the Budget Framework Law [April-2013] .

### Regional and local budgetary frameworks

3.9. 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].

3.10. The budgetary frameworks at local and regional levels will be considerably strengthened, in line with recommendations by the IMF/EC technical assistance mission of July 2011 and the new EU fiscal policy framework. Draft proposals to revise the regional finance law and the local finance law were submitted to Parliament which include the following main elements [Ongoing]:

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 regional governments own revenue projections and multi-annual fiscal plans (ii) a contingency reserve is included under the overall current expenditure envelope as a buffer against negative revenue surprises or erroneous expenditure planning, and (iii) the revised legal and institutional PPP framework is applied (see below);

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

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

iv. 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.

v. Include requirements for data provision to support the revenue projections, balancing the need to preserve tax secrecy and the elaboration of sound forecasts.

3.11. Coordinate with representatives from the Ministry of Finance to exchange information along the lines defined in the draft financing laws to facilitate revenue forecasting for the budgets 2014 of the Autonomous Regions and the local authorities [Q2-2013].

3.12. The Government's financial arrangement with the Autonomous Region of Madeira (RAM), which is in full compliance with the Memorandum of Understanding, will be implemented. The Portuguese Government will monitor progress of implementation by RAM and present the results on a quarterly basis in advance of the reviews of the Memorandum of Understanding [Ongoing].

#### Public Private Partnerships

3.13. PPP road contracts shall continue to be renegotiated in line with the strategic plan presented by the government and with the regulatory framework revision concerning notably service levels, in order to obtain substantial fiscal gains, particularly in 2013, while ensuring a sustainable reduction in government liabilities [Ongoing].

3.14. The government will further work towards implementing the PPP framework law and making the new technical unit in the Ministry of Finance (UTAP) fully operational by completing staffing, as needed, and developing the tools for managing and monitoring all PPPs. No PPP will be launched until the institutional framework measures are fully effective. UTAP will provide technical support to the regional government of Madeira in the renegotiation of road PPPs. Regions will be encouraged to design a similar framework for assessing fiscal risks derived from PPP, and other relevant public investments, as well as for monitoring their execution [Ongoing].

3.15. The annual PPP report will provide a comprehensive assessment of the fiscal risks stemming from PPPs and concessions. The report will provide information and analysis at sectorial level and an analysis of credit flows channelled to PPPs through banks (loans and securities other than shares) by sector and an impact assessment on credit allocation and crowding out effects. This particular element will be done in liaison with the Banco de Portugal to the extent of data available to this entity. The report will serve as input to the fiscal risks assessment for the budget [Q3-2013].

#### State-owned enterprises

3.16. SOEs with commercial activity will reach operational balance from [end of 2012 onwards]. This will be achieved by substantially reducing operational costs and raising revenues. To this end the government is implementing the comprehensive SOEs strategy by reviewing the revenue structure and service provision of SOEs, with numerical targets on cost reductions, including measures to realign wages, reduce employment, and additional measures as appropriate. The government is further assessing options for managing the heavy debt load of SOEs, including Parpública [Ongoing].

3.17. The government shall adopt the relevant follow-up legislation as mandated by the law on general rules and principles of SOEs to strengthen the governance of SOEs in accordance with international best practices. It reviews the existing shareholder approach, giving the Ministry of Finance a decisive role in financial matters of the enterprises, including monitoring of local SOEs. This will enhance the monitoring powers of the central administration over all SOEs. In addition, the timing and content of financial and operational reporting will be defined. The decisions adopted at central level to improve the efficiency of the enterprises while reducing their financial burden will be implemented at all SOEs, taking into account their specificities. It will include the prohibition for SOEs within the general government to incur new debt with the private sector. No additional SOEs will be created until this follow-up legislation is adopted [Q2-2013].

3.18. Following the comprehensive review of wage scales in the general government, an equivalent study of SOEs will follow in [Q2-2013].

3.19. Equivalent measures on operational results, debt, restructuring and governance will be taken at the local and regional levels, while respecting their administrative autonomy as foreseen in the law. The annual and quarterly SOEs reports will assess progress towards achieving these objectives for central and local SOEs. Each Autonomous Region will provide similar annual reports. These will serve as inputs to the fiscal risks analysis in the budget [Ongoing].

3.20. Continue to implement the strategy to restructure Águas de Portugal (AdP) water and waste water services with a view to introducing private capital and management in concessions [Ongoing].

#### Privatisation

3.21. The government is implementing its privatisation programme under the new framework law for privatisation. The privatisation plan targets front-loaded proceeds of about EUR 5 billion through the end of the programme. The sale of GALP and the small remaining stake in REN on the free market have been delayed until market conditions improve. The privatisation or concession of the freight subsidiary of CP (CP Carga) will be launched and completed by [Q4-2013]. The tender for the privatisation of the national air carrier (TAP) will be launched in the course of 2013. The privatisation of Correios de Portugal (CTT) will be launched, once changes underway in regulation of this sector have their full impact, in order to receive binding offers by [Q4-2013]. The sale or concession of a television channel and radio station belonging to RTP has been postponed and its resumption will be subject to the company's ongoing restructuring process and appropriate market conditions. Likewise, the concessions for transport operators in Lisbon and Oporto are being considered upon completion of restructuring of the public transport firms in these cities. The sale of the waste management company (EGF) will be launched once changes underway in regulation of this sector are implemented, envisaging binding offers by [Q4-2013]. The government will further consider expanding the privatisation programme to include additional companies and assets for sale or concession in 2013.

#### Revenue administration

3.22. The recent reforms of the Autoridade Tributária e Aduaneira (AT) will be deepened in 2013 by targeting a business function-type structure. In particular, the following elements will be implemented:

- i. reduce the number of municipal offices by at least 25 per cent in 2013 [Q4-2013] and 25 per cent in 2014 [Q2-2014];
- ii. increase in the resources devoted to auditing in the tax administration to at least 30 per cent of the total staff, mostly through reallocations of staff within the tax administration and other parts of the public administration. The threshold should be attained by [Q2-2013];
- iii. publish quarterly reports on duration and costs of tax cases starting from [Q4-2013] within four months after the end of the relevant quarter.

3.23. With the aim of curbing fraud and evasion, a key reform on the VAT invoicing system entered into force on 1st January 2013. The reform implies mandatory invoicing across all sectors and transactions, a centralised VAT monitoring database, a system to electronically monitor goods in circulation and a tax incentive for final consumers to ask for invoices in hard-to-tax sectors. A first evaluation report of the measures for the different economic sectors will be prepared by [Q2-2013], followed by a final report in [Q3-2013].

3.24. The authorities will continue to focus on measures to combat fraud and evasion and strengthen taxpayers' compliance. To this end the authorities will:



(i) continue analysing the current tax compliance situation, including a risk analysis of different categories of taxpayers, notably focusing on income taxation. The analysis will leverage among others on information from the recently implemented unified monthly tax return and the unified form on Independent Workers' annual revenue [Q3-2013].

(ii) continue building capacity in revenue administration by phasing in a more modern approach to managing compliance over a three-years period. In the short term this will focus on the reinforcement of key reforms such as the recently established compliance projects for high-wealth individuals and self-employed professionals and the establishment of a risk analysis unit [Q3-2013].

#### Public administration

##### Central, regional and local administration

3.25. Review the regulation on the creation and the functioning of associations and observatories. The revised regulation will also facilitate the closure of existing associations and observatories and define the monitoring and reporting mechanisms to be put in place [Q2-2013].

3.26. Based on the new framework law of local attributions and competences, the inter-ministerial working group for territorial issues will provide an assessment to identify potential duplications of competences/services and other inefficiencies between the central administration and local administration [Q4-2013].

##### Shared services

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

i. complete the implementation of the strategy of shared services in the area of financial resources (GeRFIP) [Q1-2013]. GeRFIP will also be implemented in the Autonomous Region of Madeira and in the Autonomous Region of Azores [Q4-2013];

ii. fully implement the strategy of shared services in the area of human resources (GeRHuP) in the Ministry of Finance's entities [Q2-2013], with the exception of the Tax Authority by [September 2013]. Other Ministries will follow in 2014. The Autonomous Region of Madeira will implement GeRHuP gradually;

iii. continue the implementation of the "Overall Strategic plan to rationalise and reduce costs on ICT in Public Administration" [Ongoing].

3.28. 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

3.29. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of at least 2 per cent per year (in full-time equivalents) in the staff of central administration and 2 per cent in local and regional administrations (in full-time equivalents); including a significant reduction of fixed-term contracts and the application of mutual agreement schemes on contract termination. 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].

3.30. Following the comprehensive review of wage scales in the public administration, a deeper analysis of the remuneration policies will be initiated starting with a survey on cash supplements, aiming at their rationalisation and consistency among all public entities [Q3-2013].

3.31. Converge the system of social protection for staff in the Regime de Proteção Social Convergente (RPSC) to the rules of Regime Geral de Segurança Social [Q4-2013].

3.32. The Special Mobility scheme will be reviewed aiming at being more oriented to support Public Administration Reform, addressing training and requalification for a better allocation of Human Resources. The existing Special Mobility Law need to be revised: (i) to ease/simplify the procedures for the management of the employees that can be targeted with this tool; (ii) to address the compensation that would be set to decline further over time and its duration; and (iii) to be applied to all sectors of Public Administration, including teachers and health professionals [Q2-2013].

3.33. Develop a new public administration law to simplify and compile the existing rules of public sector employment along the structure of the private labour code by [Q3-2013].

#### Health care system

##### Objectives

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

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

##### Financing

3.34. The improvements in the billing and collection of revenues from NHS moderating fees (taxas moderadoras), insurance companies and fees for the treatment of cross-border/foreign patients, will result in additional revenues of €50 million [Q4-2013].

3.35. 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 50 per cent of the employers' contribution in 2013 through transfer of resources to the NHS in exchange for the provision of services. The employer's contribution rate will be reduced to 1.25% in 2014 and will be accompanied by an adjustment in the scope of health benefits [Q3-2013]. The system would become self-financed by 2016.

#### Pricing and reimbursement of pharmaceuticals

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

3.37. If public expenditure diverges from the objective that has been set for 2013, the government will implement contingency measures including administrative price reductions (in addition to the regular annual price revision), such as enacting legislation which automatically reduces 50% in prices of medicines without generics and with 15 years of market authorisation [Q2-2013].

#### Prescription, monitoring of prescription and guidelines

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

3.39. Continue to devise and enforce a system of sanctions and penalties, as a complement to the assessment framework [Ongoing]. Assess the possibility of establishing agreements with private sector physicians for the application of prescription rules as applied in the NHS.

3.40. Strictly monitor the implementation of the legislation making it compulsory for physicians at all levels of the system, both public and private, to prescribe by International Non-proprietary Name (INN) to increase the use of generic medicines and the less costly available products. E-prescription systems should ensure INN prescription as default. A follow up report will be published by [December 2013].

3.41. Continue to publish clinical and prescription guidelines with reference to medical care, medicines and the realisation of complementary diagnostic exams on the basis of international prescription guidelines. Continue auditing their implementation and integrate them in the electronic prescription system. A first set of guidelines is introduced in the e-prescription system by [Q2 2013].

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

3.43. The above measures should aim at gradually and substantially increasing the share (in volume) of generic medicines reaching 45% of all NHS reimbursed medicines in the outpatient setting by end of 2013. This share will increase to 60% by the end of 2014.

#### Centralised purchasing and procurement and competition

3.44. INFARMED will continue implementing the uniform coding system and a common registry for medical devices, including 3 new families of medical devices per quarter [Ongoing]. Additionally, INFARMED will promote, whenever possible and adequate, the use of reusable materials and will implement a program for reprocessing medical devices in line with international benchmark, namely in terms of efficiency and safety [Q3-2013].

3.45. Continue to implement the centralised purchasing of medical supplies and services through the Central Purchasing Authority (SPMS), using the uniform coding system for medical supplies and pharmaceuticals. Continue to implement the compulsory use of a formulary in all hospitals to monitor the stock and flows of hospital medicines and medical supplies and monitor compliance with central

purchasing. INFARMED will develop the national formulary (hospitals and outpatient) including 4 new therapeutic areas per quarter, starting in the second quarter 2013 [Ongoing].

3.46. Continue to monitor NHS spending with private providers delivering diagnostic tests and therapeutic services (with particular reference to dialysis, rehabilitation, respiratory care). Take further measures to increase competition among private providers and between private and public providers in these areas of service provision with a view to ensuring competition and fair prices in private markets. These measures should aim at reducing the overall spending of the NHS with private providers. Take measures to ensure competition in the pharmacies sector [Q4-2013].

#### Primary care services

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

i. review the incentives system linked to performance assessment and continue to increase the number of USF units (Unidades de Saúde Familiares). Extend performance assessment to the other primary care units (UCSPs). Make sure that the new system leads to a reduction in costs and more effective provision;

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

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

iv. updating patients' registration lists and the national register in order to increase by at least 20 per cent the maximum number of patients per primary care/family doctor for health centres and by 10 per cent for the USF.

#### Hospital services

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

3.49. Hospital SOEs will change the existing accounting framework and adopt accounting standards and appropriate IT systems 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. The implementation of new common financial platform to all SOEs will be hired until end of June 2013 and its development prepared until the end of 2013. The first 3 SOEs will start-up with it on the next 1st January. The remaining SOEs will be gathered in 3 groups, and the rollout of this platform to each group will take place in one new group per quarter [Q4-2014].

3.50. On the basis of the comprehensive set of indicators continue to produce regular quarterly reports comparing hospital performance (benchmarking) and the monthly hospital reporting sheet (tableaux de bord), using the results to establish targets for less performing hospitals [ongoing]. Make the web-portal with publicly available information fully operational [Q2-2013].

3.51. Continue work to ensure full interoperability of IT systems in hospitals, in order for the ACSS to gather real time information on hospital accounting and activities and to produce monthly reports to the Ministry of Health and the Ministry of Finance [Ongoing].

3.52. Continue with the reorganisation and rationalisation of the hospital network through specialisation, concentration and downsizing of hospital services, joint management (building on the Decree-Law 30/2011) and joint operation of hospitals. The aim is to adjust hospital provision within the same health region, notably in the presence of newly established PPP hospitals, adjust the activity of some hospitals from curative care towards areas such as rehabilitation, long-term and palliative care and revise emergency and transplantation structures. These improvements aim at eliminating unnecessary duplication, achieving economies of scale and deliver additional cuts in operating costs by at least 5 per cent in 2013 while improving the quality of care provided. Overall, from 2011 to 2013, hospital operational costs must be reduced by at least 15 per cent compared to 2010 level. The reorganisation and rationalisation of the hospital network includes the following steps: the definition of the service portfolio for NHS hospitals and the definition of the detailed strategic 3-year plans for hospitals [Q2-2013].

3.53. Annually update the inventory of all health staff and prepare regular annual reports presenting plans for the allocation of human resources in the period up to 2014. The report specifies plans to reallocate qualified and support staff within the NHS [Q2-2013].

3.54. Through the application of new payment scales for overtime and new rules to increase mobility within and across Regional Health Authorities (Administrações Regionais de Saúde - ARSs), overtime compensation is reduced by a further 20% in 2013 [Q4-2013].

#### Regional health authorities

3.55. The Regional Health Authorities (Administrações Regionais de Saúde - ARSs) are implementing the new internal control procedures manual, with the objective of having it finalised by the end of the second quarter 2013 [Q2-2013].

#### Cross services

3.56. Continue to develop the system of patient electronic medical records and ensure access to all relevant health care facilities [Ongoing].

### 4. Labour market and education

#### Labour market

##### Objectives

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

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

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

#### Employment protection legislation

4.1. 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].

4.2. Following the entry into force of law n. 53/2011 concerning the reform in the severance payments for new hires and the entry into force of law n. 23/2012, further adjustments to the severance payment regime will be introduced:

- For new permanent hires, severance payments will be accumulated at 12 days per year of services up to a limit of 12 months of pay;
- For existing permanent contracts and all fixed-term contracts, severance payments will be accumulated at 18 days per year in the first three years of the service and at 12 days per year of service thereafter, while protecting accrued-to-date rights and maintaining the cap of 12 months of pay.

A revision of the Labour Code defining the new severance pay regime is expected to enter into force by [Q3-2013].

The Government will consider the implementation of a compensation fund for severance payments possibly allowing the severance pay entitlements financed from the fund to be transferable to different employers.

4.3. Following the changes to the dismissal rules as stated in law n. 23/2012, the government will prepare a report on the effects of these changes on relevant labour market indicators by [Q3-2013].

#### Wage setting and competitiveness

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

- i. commit that, over the programme period, any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of the programme review [Ongoing];
- ii. ensure wage moderation when deciding on the extension of collective agreements that fulfil the criteria set out in Council of Ministers Resolution 90/2012, by taking into account the implications of the extension on competitiveness of non-affiliated firms [Ongoing];
- iii. prepare an independent review on the desirability of shortening the survival (*sobrevigência*) of contracts that are expired but not renewed (art 501 of the Labour Code) by [Q3-2013].

4.5. The Government will promote wage adjustments in line with productivity at the firm level. Following the implementation of the organised decentralisation (which creates the possibility for

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

#### Active labour market policies

4.6. The Government will ensure good practices and an efficient amount of resources to activation policies to strengthen job search effort by the unemployed and to other Active Labour Market Policies (ALMPs) to improve the employability of the young and disadvantaged categories and ease labour market mismatches. Following the preparation of a report assessing the effectiveness of ALMPs and the publication of the Council of Ministers Resolution n.20/2012, which sets a plan to improve ALMPs, including the role of Public Employment Services (PES), the Government by [Q1-2013] will present a report:

- i. detailing expenditures and sources of financing of the different ALMPs;
- ii. assessing the role played by the job counselling/ job search assistance and activation/sanctions systems in facilitating the transition out of unemployment;
- iii. reviewing the implementation of the Council of Ministers Resolution n. 20/2012 regarding the reorganisation of the PES and other ALMPs;
- iv. proposing specific action to improve the effectiveness of training measures in light of the results of the report assessing the effectiveness of employment and training measures.

#### Education and training

4.7. 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 increasing 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). The tool should be fully operational by [Q2-2013];
- ii. in line with the action plan to improve the quality of secondary education the Government will:  
(i) continue to promote trust agreements with public schools and report about progress [Ongoing]; (ii) define and implement a simple formula-based funding framework comprising performance evaluation criteria and accountability for public schools and schools under autonomy agreements [Q1-2013]; (iii) following the assessment of the new inspection model, report on the results and the follow up of the first year of the new evaluation cycle and on possible further improvements of the model [Q2-2013];
- iii. in line with action plan on vocational and educational training (VET) the Government will report on: (i) involvement of businesses in the provisions of traineeships [Ongoing]; (ii) action taken to reorganise modalities for the provision of VET, improve the quality and attractiveness of VET, and to enhance students' orientation and career guidance [Ongoing]; (iii) the establishment of "professional schools of reference" [Q1-2013].



- iv. present an assessment on the latest developments in the apprenticeship system [Q1-2013].

## 5. Goods and services markets

### Objectives

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

### Energy markets

#### Objectives

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

#### Liberalisation of electricity and gas markets

5.1. In order to fully transpose the Third EU Energy Package, ensure the National Regulatory Authority's independence, autonomy and all powers foreseen in the package by adopting the new regulators' bylaws according to the agreement reached in the course of the seventh review [Q1-2013].

5.2. Following the adoption of the legal framework regarding the scope of competence of the logistics operator for switching suppliers, implement the plan to create a new gas and electricity logistics operator independent company as presented in the seventh review [Q2-2013].

#### Ensure sustainability of the national electricity system

5.3. Conclude the measures approved in the Council of Ministers on 17 May 2012 to reduce excessive rents and to address the sustainability of the national electricity system. Provide an update report on the tariff debt which analyses the impact of the measures already adopted on the projections of the tariff debt path up to 2020 and takes into account factors such as the reduction in demand and the CMEC annual evolution. Present any additional cost reduction measures that might be necessary to eliminate the tariff debt by 2020, namely in regards to cost reduction targets previously agreed for each segment of generators [mid-June 2013] .

5.4. Following the report on the CMEC scheme and the process for the extension of the concession of the public hydro resource by the former CAE hydro power plants, analyse and discuss the consequences of the report and the need for potential measures at the [eighth review]; take the necessary measures to comply with EU regulations and decisions [Ongoing].

5.5. Conclude the announced measures to limit the policy costs of renewables under the special regime - excluding those granted under tender mechanisms by [Q1-2013]. In particular, following the approved legislation, take the necessary action to implement the compensation to be paid by the wind power producers (yielding a NPV of EUR 110 million). The updated estimation of cost reductions that will be achieved will be presented and assessed at the [eighth review].

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

5.7. For new contracts in renewables, revise downward the feed-in tariffs and ensure that the tariffs do not over-compensate producers for their additional costs as compared to market prices 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). Report on action taken will be provided by [Q3-2013]. 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. Report on action taken will be provided by [Q3-2013].

#### 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

5.8. 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. 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 and following the launch of a new tender process in October, proceed with the designation of universal service provider(s) [Q2-2013].

5.9. Following the corrective measures already taken, monitor the competitive situation in the telecommunications sector, in particular wholesale and retail broadband access, and mobile origination charges [Ongoing].

##### Postal services

5.10. Following the transposition of the Third Postal directive, further liberalise the postal sector by amending the decree-law laying down the framework of the concession contract and renegotiating the

amendment of said contract with CTT, in order to reflect the new law (Law 17/2012) transposing the Third Postal Directive; ensuring in particular that the current designation period for the universal service provision is shortened to 2020 and that investment needs and return on investment are taken into account when setting new designation periods [Q2-2013].

#### Transport

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

#### Strategic Plan for Transport

##### 5.11. Implement the Strategic Plan for Transport for 2011-2015, namely:

- i. continue the reforms in the transport SOEs to achieve their EBITDA balance, by focusing efforts on the reduction of operational costs [Ongoing];
- 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 [Ongoing];
- iii. 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 [Ongoing];
- iv. reform the transport and infrastructures' regulatory framework in order to improve the effectiveness, efficiency and independence of the entities regulating the transport sector [Q3-2013].

5.12. Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability. It will specifically include an assessment of the existing rail, road and port networks and present a set of investment priorities for the 2020 and 2030 horizons, taking also into account TEN-T networks, with an estimate of the financial needs and the foreseen sources of financing [Q2-2013].

#### Railways sector

##### 5.13. 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 appropriate human resources and synergies with other transport regulators in the context of the revision of national regulatory agencies [Q3-2013];
- ii. continue to implement the plans to bring the infrastructure manager to full operational balance by 2015. On the revenue side, track access charges for freight services should not be increased in order to prevent a deterioration of the competitiveness of rail freight services. Reintroduce incentives to REFER to reduce costs and access charges. Provide annual progress reports on the implementation of balancing revenues and expenditures [Ongoing];
- iii. 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. 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 [Q1-2013];

iv. present an assessment of the impact of the extended performance schemes on infrastructure charges in different traffic categories [Q4-2013];

v. to prepare the privatisation of the freight branch of the state-owned rail operator, carry out an analysis for transferring part or whole of CP Carga's rolling stock to a rolling stock operating company [Q4-2013];

vi. on the basis of the assessment presented ensure that the main rail terminals currently owned by CP Carga are transferred to another entity that will guarantee non-discriminatory access to all rail freight operators. [Q2-2013].

#### Ports

5.14. Present a review of the port work law, in particular its impact on port usage cost and the overall savings generated by [Q4-2013].

5.15. Take further steps to improve the governance model of the ports system with the objective to enhance the competitiveness and the efficiency of ports in line with the Strategic Plan of Transport 2011-2015. The Government will deliver and enforce policies that ensure strong integrated policy-making, strategic planning and surveillance functions common to all ports in the country. Moreover, policy decisions will be taken and enforced so that (i) efficiency gains and cost-savings are passed to port customers; and (ii) concession-holders of terminals and land facilities in ports respect minimum performance criteria [Q1-2013].

#### 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

5.16. Further to the adoption of a significant number of amendments to the sector specific legislation, complete the adoption of the outstanding sectorial amendments (such as construction, universities and higher education courses) necessary to fully implement the Services Directive and submit them to Parliament where necessary by [Q1-2013] in view of approval by [Q2-2013]. The appropriateness of fees linked to construction activities will be reviewed by [Q4-2013].

##### Regulated professions

5.17. Following the final report by the Comissão de Regulação do Acesso a Profissões (CRAP), launch by [Q1-2013] a second phase investigation of the review of regulated professions to eliminate unjustified requirements by [Q2-2013].

5.18. Following the approval by Parliament of Law 2/2013 which establishes the horizontal legal framework meant to improve the functioning of the regulated professions (such as accountants, lawyers, notaries) for which regulation involves a professional body (Ordens or Câmaras), the government will submit to Parliament the professional bodies' amended statutes. These changes, will (i) ensure that requirements affecting the exercise of activity which are not justified or proportional, such as those restrictions to the use of commercial communication (advertising) prohibited by the Services Directive, will be eliminated and (ii) further improve the conditions for mobility of professionals (in and out of Portugal) in line with EU Directives in the area of free movement of professionals [Q1-2013].

#### Administrative burden

5.19. Continue the simplification reform effort by:

i. adapting the content and information available at the Point of Single Contact (PSC) for the missing 33 out of 51 amended regimes (some of which still have to be published) to ensure conformity with the Services Directive and for those that have not required amendments so far by [Q1-2013] and make available online forms for the completion of procedures by [Q1-2013]. Constantly adapting the content and information available at the PSC to the remaining 17 sector-specific regimes that are about to be adopted to ensure conformity with the Services Directive (see 5.16 above) at the latest 1 month after the adoption of each sector-specific regime, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by making available online forms and extend on-line procedures for all sectors covered by the Services Directive no later than 2 months after adoption of the sector-specific regime;

ii. adapting the content and information available at the PSC for the 15 regimes approved to ensure conformity with the Professional Qualifications Directive by [Q1-2013] and online forms by [May 2013]. Constantly adapting the content and information available at the PSC to the new legislation to be adopted to ensure conformity with the Professional Qualifications Directive at the latest 1 month after the adoption of amendments, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by extending on-line forms and procedures for each profession no later than 2 months after adoption of amendments;

iii. making available in PSC on-line procedures for the registration, installation, modification, occupation of public space regimes, and closing up of restaurants, bars and other establishment for the 5 municipalities (Porto, Águeda, Abrantes, Portalegre and Palmela) covered by "Zero Authorisation" pilot project (DL 48/2011) by [Q1-2013]. Foster collaboration from municipalities in providing the content for the working hours map for the stores and establishments services and advertisement regimes for which they have full competence to make the PSC operational [Q1-2013]; Extend this tool to all municipalities by [May-2013]. 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 by [Q2-2013]. The platform will be available to all levels of administration, including all municipalities [Q2-2013];

iv. extending PSC to services not covered by the Services Directive [Q4-2013];

v. extending the "Zero Authorisation" project to other services sectors of the economy [Q4-2013].

5.20. Provide a monthly update of the detailed work programme of AMA to fulfil 5.19.

## 6. Housing market

### Objectives

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

### Property taxation

6.1. The government will finalise the appraisal of the taxable value of the housing stock [Q1-2013]. In particular it will ensure that the taxable value of the properties in 2012 is close to the market value. Property valuation will be updated regularly in the future (every year for commercial real estate and once every three years for residential real estate as foreseen in the law).

6.2. The government will gradually rebalance property taxation towards the recurrent real estate tax (IMI) and away from the transfer tax (IMT), while considering the socially vulnerable [Ongoing].

### Comprehensive review of the housing market

6.3. Following the adoption of the amendments to the New Urban Lease Act Law 6/2006 and the Decree Law which simplifies the administrative procedures for renovation, the government will undertake a comprehensive review of the functioning of the housing market with the support of internationally-reputed experts. The review will determine whether the new legal provisions adopted are sufficient to make the housing market more dynamic and, if necessary, will propose new policy measures [Q2-2013].

## 7. Framework conditions

### Judicial system

#### Objectives

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

#### Court backlog

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

7.1. Aim to resolve the backlog of court cases by [Q2-2013].

7.2. Implement targeted measures to achieve steady reduction of the backlogged enforcement cases. In particular, set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, by inter-agency task forces with the sixth report to be completed by [mid-May 2013].

7.3. Submit to Parliament a draft bill to strengthen the authority and financing structure of the oversight body for enforcement agents and insolvency administrators (CACAJ) as well as recruitment

which aims to meet market demands by [end-June 2013]. Approve by the government a fee structure that incentivises speedy enforcement by [end-June 2013].

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

## Competition, public procurement and business environment

### Objectives

Ensure a level playing field and minimise rent-seeking behaviour by strengthening competition and sectoral regulators; avoid 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

7.5. 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 [Ongoing].

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

7.7. Building on the independent report on the main National Regulator Authorities, the government approved a framework law for regulators in broad consultation with the Regulatory Authorities. This law (i) establishes a regulatory environment that protects the public interest and promotes market efficiency, (ii) guarantees the independence and financial, administrative and management autonomy of the National Regulatory Authorities in the exercise of their responsibilities, in full compliance with EU law, including the necessary conditions to guarantee adequate human and financial resources and being able to attract and retain sufficiently qualified staff and (iii) strengthens the overarching role of the Competition Authority in enforcing competition rules, therefore supporting and complementing the effect of the recently adopted competition law. The framework law will be submitted to parliament by [Q1-2013] and the corresponding amendments to the bylaws of the National Regulatory Authorities will be approved by the Government in the three months following publication of the framework law.

### Public procurement

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



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

#### Business environment

7.9. Following the set-up of the procedures for requesting VAT exemptions for exporting firms and to simplify procedures associated with indirect exports, the government will assess the impact of this measure by [Q4-2013].

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

7.11. Continue reducing administrative burdens by including municipalities and all levels of public administration within the scope of the Simplex Programme [Ongoing].

#### Licensing environment

##### Objectives

The government is launching a new comprehensive programme to tackle excessive licensing procedures, regulations and other administrative burdens in the economy. These explicit and implicit barriers represent a major obstacle for economic growth in Portugal. Companies face substantial costs and uncertainty which affect investment decisions, thus limiting job creation. Furthermore, these barriers affect small and medium-sized enterprises in a disproportionate way because they have fewer resources to surpass these obstacles, deteriorating the competitive environment. Foreign investment is also affected disproportionately because national companies have information advantages. The various new initiatives laid out below cover all families of licenses and will have a substantial impact in the business environment. The reviews of the legal regimes of environment and territory planning and of industrial and commercial licencing aim at ensuring their mutual compatibility.

##### Regulatory simplification

7.12. To deal with the legacy of excessive licence procedures and other administrative burdens, carry out an inventory and an analysis of the costs of regulations that are likely to have a higher impact on economic activity (at central, regional and local levels) [Q2-2013]. On the basis of the analysis the government will devise a roadmap for regulatory simplification.

7.13. To prevent future growth in excessive licenses and regulations, study the feasibility of a rule that prohibits at all levels of government the creation of a new regulation generating costs for businesses without the elimination of an existing regulation or regulations with an equivalent cost. The feasibility of such rule will be decided by [Q1-2013] with a view of being in place by [Q2-2013].

7.14. Create a working group to analyse and fast-track applications for the licensing of planned investment projects which are left unresolved or undecided for more than 12 months [Q1-2013].

#### Environment and territory planning

7.15. In consultation with the relevant stakeholders, review the legal regimes at all levels of Government in the area of territorial planning, in order to increase and facilitate the establishment of



investors while at the same time limiting urban sprawl. In particular, review the following legal regimes, in the area of territorial planning:

- i. new Base Law of Soil and Territorial and Urbanism Planning (Lei dos Solos), that should be aligned with the new Industrial Licensing regime (measure 7.24 ii) [Q1-2013];
- ii. Joint Dispatch of the Secretaries of State of Environment and Territorial Planning and of Internal Administration in order to determine the creation of Risk Sectorial Plan [Q2-2013];
- iii. review the legal regimes of the Territorial Management Instruments (RJIGT) and of the related regulations [Q1-2013];
- iv. diploma for the regularisation of activities not in accordance with Territorial Management Instruments [Q1-2013];
- v. Hharmonisation of Regional Plans – new generation will be included in the transitional rules of the RJIGT[Q1-2013];
- vi. review the Legal Regime for Urbanism and Building (RJUE) , that should be aligned with, the new Industrial Licensing regime (measure 7.24 ii) [Q1-2013].

7.16. Increase a nationwide land registration system (registo cadastral) to allow a more equal (perequativa) distribution of benefits and costs in the execution of urban planning. The government will:

- i. implement a Legal Regime of Land Registration (registo cadastral) [Q4-2013];
- ii. create a diploma on Land Registration and Land Registration Experts [Q4-2013];
- iii. review the cartography for plans regime [Q4-2013], and the diploma on Cartography [Q4-2013];
- iv. enforce the Council of Ministers Resolution 56/2012 by [Q4-2013], to collect all land registration procedures, currently scattered in various departments.

7.17. Change the legal regime for Environment Impact Evaluation in order to increase the speed and effectiveness of this regulation and reduce associated monetary and time costs [Q1-2013].

#### Industrial Licensing

7.18. Implement the new Industrial Licensing regime by means of fully implement the approved System of Responsible Industry (“SIR - Sistema da Indústria Responsável” [Q2-2013], as follows:

- i. implement zero licensing procedures for Type 3 [Q1-2013] and Type 2 industries [Q2- 2013] including fully integration of these procedures in the one-stop shop (“Balcão do empreendedor”). Implement fast-track procedures for Type 1 industries [Ongoing];
- ii. define and establish the Zones of Responsible Enterprises (ZER – Zonas Empresariais Responsáveis) by [Q1-2013], which will allow the installation of industries in areas previously licensed with all industrial, building and environmental provisions required by national and European law;
- iii. create and define standardised industrial licenses [Ongoing];

- iv. ensure that the new Industrial Licensing is aligned with, and strengthened by, the review of the New Base Law of Soil and Territorial and Urbanism Planning while at the same time limiting urban sprawl (measure 7.21 i) [Q1-2013];
- v. ensure that the new Industrial Licensing is aligned with, and strengthened by, the review of the Legal Regime for Urbanism and Building (RJUE - measure 7.21 vi) [Q1-2013].

#### Commercial licensing

7.19. Review the commercial licensing regime. Approval of a new legal regime for commercial activities and establishment of the Program for the Competitiveness of Commerce and Services activities ("Programa para a Competitividade do Comércio e Serviços), which will simplify and condense in a single law more than 20 dispersed existing legal regimes [Q1-2013].

#### Geology

7.20. Reviewing the geological licensing regimes, including:

- i. revision of the legal regime concerning the licensing of mining and geological production and investment in line with international best practices in this field [Q1-2013];
- ii. simplify the legal and bureaucratic procedures pertaining to mining and geological investments, especially in terms of assessment, search, development, and production activities [Q1-2013].

#### Tourism

7.21. Review the Licensing in Tourism regime:

- i. eliminate or transforming into a voluntary regime the mechanism of prior communication in the Regime for Urbanism and Building [Q1-2013]. Simplify the legal regime for touristic establishments [Q1-2013];
- ii. expand the range of ex post control mechanisms in urban operations, significantly reducing administrative procedures and costs for developers [Q1-2013];
- iii. simplified and transparent requirements on the classification of the several types of touristic establishments (number of stars) [Q1-2013];
- iv. review of the sanction legislation on the touristic establishments regime as a way to fight informal touristic economy, giving more powers to ASAE (Authority for Economic and Food Safety) [Q1-2013].

## ANNEX 5

### Memorandum of Economic and Financial Policies

May 31, 2013

1. Macro-financial adjustment. Strong program implementation is gradually correcting the sizable macro-financial imbalances accumulated in the pre-crisis period. Fiscal consolidation is underway, with significant progress achieved in reducing structural deficits in both 2011 and 2012. The current and capital account turned positive in 2012, reversing a long-run pattern of external deficits and starting to reduce the large external debt. Financial stability has been preserved, with Portuguese banks benefiting from strengthened capital and liquidity buffers. We have implemented ambitious structural reforms that will improve competitiveness and support employment creation over the medium term. Market confidence has improved markedly, allowing successful issuances at 5 and 10 year maturities in January and May 2013, respectively, well ahead of program schedule. Political support from the European partners is contributing to the success of the program. Important steps are still needed in the period ahead to strengthen debt sustainability and market prospects, while supporting a strong and durable recovery.

2. Activity. Economic conditions remain difficult, with unemployment higher and output lower than previously envisaged. The economy contracted by 3¼ percent last year and unemployment rose to 17¾ percent in the first quarter of this year. The outlook for 2013 remains difficult. In the main, this reflects the headwinds from the deeper euro area recession. The effect of this has been to slow export growth—an important source of support for overall economic activity—in recent months. With a smaller contribution to output from exports and the recovery in private investment delayed somewhat, we now expect output to contract by 2¼ percent in 2013 (compared to 1 percent at the time of the sixth review). As before, the recession is expected to trough this year, but with recovery only starting in the fourth quarter of the year, one quarter later than previously expected. Reflecting weak domestic demand and the effect of tax measures dissipating, we expect the headline inflation to average around ¾ percent this year. Unemployment is expected to peak at 18½ percent in 2014.

3. External Adjustment. The current account deficit narrowed faster than expected in 2012, to below 2 percent of GDP from 6.5 percent of GDP in 2011, implying a total adjustment since 2009 of some 9 percentage points of GDP. Sustained demand from non-EU destinations has supported robust exports growth for the year as a whole, despite the negative impact from the strike of port workers in late 2012 and the marked slowdown in activity in major EU trading partners. We expect the adjustment to continue, with the current account reaching a balanced position this year. Portugal's market share in most export markets has been improving. But the improvement in competitiveness indicators has been gradual. Additional challenges would arise if the slowdown of our main trading partners deepens. We therefore reaffirm our commitment to structural reforms to bolster competitiveness and ensure durable external adjustment, reducing external indebtedness.

#### I. FISCAL POLICY

4. 2012 Budget Outturns. The government deficit for program purposes reached 4.7 percent of GDP in 2012 —6.4 percent of GDP excluding the one-off transaction related to the ANA concession and including the increase in the share capital of CGD (as capital expenditure), the reclassified operations of the public entity Sagestamo, and changes in the valuation of the assets of BPN SPVs. This compares with a deficit target of 5 percent of GDP and is consistent with a structural primary adjustment of some 2.8 percentage points of GDP. The end-year general government cash deficit performance criterion was accordingly met. Compliance with the program objective was achieved on account of a significant tightening of budget execution—particularly intermediate consumption and capital expenditure—in the last few months of the year, to offset broad-based tax revenue shortfalls (in the order of ½ percent of GDP) due to weaker economic activity. Significant expenditure savings were also realized on the wage bill, as the reduction in the number of employees exceeded our targets. Domestic arrears declined by €700

million in the fourth quarter, but increased slightly in February; still, the stock of domestic arrears, as defined in the TMU, declined by €1 billion between September 2012 and February 2013.

5. **2013-15 Fiscal Path.** The deterioration in the macroeconomic outlook and a negative carry-over from 2012 have opened a fiscal gap of over 1 percent of GDP in 2013. Taking into consideration the financing constraints and implications for debt as well as the output and social costs of adjustment, we are recalibrating fiscal policy to contain the deficit to 5½ percent of GDP in 2013 and 4 percent of GDP in 2014. We estimate that permanent measures of about 2.9 percent of 2013 GDP will be necessary to achieve the revised fiscal objectives—with the equivalent of 0.9 percent of GDP frontloaded to the second half of 2013. These measures will be drawn from the ongoing public expenditure review (PER). The fiscal consolidation needed to achieve our commitment under the Excessive Deficit Procedure—of reducing the deficit to below 3 percent of GDP—would then be completed by 2015, with a targeted deficit of 2½ percent of GDP.

6. **Supplementary Budget for 2013.** On April 5, the Constitutional Court declared unconstitutional some key provisions of the 2013 budget: (i) the cuts in the 14th monthly payment to public wage earners and pensioners; and (ii) a new contribution on illness and unemployment benefits. The Court ruling opened a fiscal gap of about €1.3 billion (0.8 percent of GDP). In light of this, we have identified a series of measures that add-up to this amount and will allow us to meet our revised fiscal objective for 2013. These include mainly (i) expenditure compression in line ministries, (ii) a reprogramming of EU structural funds, and (iii) a minimum threshold for applying the contribution on illness and unemployment benefits. These measures have been included in a supplementary budget and submitted to Parliament at the end of May (prior action). Some of these savings are of temporary nature, but we are committed to replacing them with permanent savings from the PER starting in 2014. In addition, some of our Public Expenditure Review measures (PER—see below) will be frontloaded.

7. **Public Expenditure Review.** We have completed our major initiative to review and ensure the sustainability, effectiveness, and social equity of the expenditure programs and functions of the state. This comprehensive exercise, which was launched in the second half of 2012, has identified measures to underpin fiscal adjustment in the years ahead. On this basis, the Council of Ministers has adopted and published a medium-term (2013-17) fiscal framework (DEO), which will form the basis for the 2014 budget. Fully-specified measures to meet the revised 2014 deficit target have been approved by the Council of Ministers and made public (prior action for completion of the review). By the end of the legislative session (July 15), all the key legislative changes, as described below, required to implement the public expenditure review will be finalized, and approved by the Council of Ministers or submitted to Parliament if needed.

8. **Expenditure Reforms.** Savings will be generated mainly by limiting outlays on the public wage bill and pensions—which account for almost 60 percent of primary spending and where Portugal spends relatively more in comparison to peer countries—as well as sector-specific reforms. To do so, the ongoing reform of the state implements measures that increase equity and efficiency in the provision of social transfers and public services. The total package of measures for 2014 will amount to €4.7 billion (net of reduced income tax and social contribution collections). The underlying reforms will be organized around three main pillars:

- A well-targeted wage bill reform will generate at least one-third (€2.2 billion) of the savings. The overall objective will be to (i) reduce the size of the public sector workforce—addressing excessive employment in particular sub-sectors—while tilting its composition toward high-skilled and better-trained civil servants; (ii) ensure convergence of the public sector work rules and regulations towards private sector legal regimes (including regarding working hours, working time arrangements, and holiday entitlements); (iii) increase beneficiaries' contributions to ensure self-sustainability of public sector health subsystem; and (iv) simplify the remuneration policy by implementing a single wage scale, streamlining the wage supplement scale, and reducing fringe benefits. The reduction in the workforce, which will be

facilitated by increasing the working hours to 40-hours per week, will be achieved through a combination of policies, including lower replacement of retirees, voluntary separations, and enhanced use of the redesigned mobility pool. These reforms will be implemented through a series of legislative and regulatory amendments. In particular, we will submit to Parliament a new draft public administration labor law by the end of the legislative session (July 15) that will aim at aligning current public employment regime to the private sector rules, including for working hours and holiday time, and termination of tenure (structural benchmark). We will also submit a draft law on the redesigned mobility pool by end-June (structural benchmark). The single wage scale and wage supplement reforms will be made effective by January 1, 2014 through the adoption of a specific law.

- A comprehensive pension reform will also be a significant source of savings. It will be based on equity principles with preservation of minimum socially-acceptable income levels, thus protecting those who earn the lowest pensions. Specifically, the reform will take into consideration the need to reduce the current differences between the civil servants' regime and the general social security regime, aiming at enhancing the fairness of the overall pension system. Moreover, while reforms implemented over the past two decades have contributed to long-term sustainability, the amount of pension benefit payments for which the government is currently liable makes the system excessively costly under the current circumstances reassessing the need to take into account demographic developments. Accordingly, the reform will be based on two main elements: (i) an effective increase by one-year in the statutory retirement age to 66 years (implemented by adjusting the demographic sustainability factor); (ii) aligning the rules and benefits of the public sector pension funds, CGA, to the general pension regime by changing one of the replacement rate parameters from about 90 to about 80 percent for all applicable beneficiaries. Each of these reforms will be implemented through modifications to the relevant laws. The necessary legislative proposals will be submitted to Parliament by the end of the legislative session (July 15) (both structural benchmarks). In addition and if strictly necessary, a third measure we are also considering is a sustainability contribution on pensions that effectively lowers pension replacement rates to more affordable levels. This measure, however, may need to be replaced by identified measures of equivalent value and quality, as discussed below.

- Other savings will be generated through a combination of sector-specific reforms, which mainly include targeted dismissals of personnel and intermediate consumption cuts. Additional cutbacks in SOE and PPP expenditure will be generated through further negotiation and operational restructuring (see ¶15 and ¶17). In the education sector for example, rationalization of the school network and a convergence of the key indicators, namely class size, towards peer levels will be at the core of our reforms. In the health sector, savings will come from further reforms in the hospitals network.

Following the ongoing consultations with social and political partners, some of the above listed measures may be replaced by others of an equivalent value and quality, following discussion with EC/ECB/IMF staff, in time to allow for the finalization of all legislative changes required to implement the public expenditure review by July 15, 2013.

9. Legal safeguards. We will take a number of steps aimed at mitigating legal risks from future potential Constitutional Court rulings. First, expenditure reforms will be designed with the principle of public/private sector and intergenerational equity in mind as well as the need to address the sustainability of social security systems. Second, legislation underpinning the expenditure reforms will be duly justified on compliance with the fiscal sustainability rules in the recently-ratified European Fiscal Compact which now ranks higher than ordinary legislation. Third, the government will rely as much as possible on general laws—rather than on one-year budget laws—consistent with the structural nature of the reforms. This also opens the possibility of prior constitutional review of said laws, thus allowing early reaction on the part of the government in case these reforms raise constitutional issues.

10. Debt Path. Under this revised fiscal path, debt is set to peak at close to 124 percent of GDP in 2014. This projection is contingent on the government implementing two planned measures: (i) a partial

reallocation of the Social Security portfolio from foreign assets to government securities; and (ii) the transfer of its CGD shares to Parpública.

11. CIT Reform. We have launched a far-reaching reform of the Portuguese corporate income tax (CIT). Our goal is to boost investment and growth by simplifying the CIT system through the redefinition of the tax base, the gradual lowering of the rate, the reduction of multiple surcharges, and the rationalization of the incentive schemes. We will also focus on enhancing legal stability, lowering compliance costs and aiming at reducing litigation. In addition, the reform will improve the international competitiveness of the tax and strengthen the territorial approach through measures that include, but are not limited to, the adoption of a universal participation exemption regime, while keeping track with internationally accepted standards. The reform will also envisage reducing policy-induced debt bias. We will work on a detailed and fully quantified proposal over the next months, in consultation with the EC/ECB/IMF staff. We will prepare a first draft law by end-June 2013, which will be sent for public discussion, ahead of its submission to Parliament. In order to stimulate productive investment in 2013, the Government will grant a CIT credit limited to 20 percent of investment expenses or €1 million (corresponding to a maximum eligible investment of €5 million). This measure will be applicable to eligible investments made between June 1, 2013 and December 31, 2013.

## II. CONTAINING FISCAL RISKS

12. Public Financial Management. We have made significant progress in advancing our Public Financial Management reform. Parliament approved legislation transposing the EU economic and governance fiscal framework into the Budgetary Framework Law (BFL) and further changes are expected by year end to streamline budgetary procedures. We have published a comprehensive tax expenditure report, in line with international standards and greatly expanding public information in this domain, which from now on will accompany the budget proposal to support policy decision making. We remain committed to continue reducing the stock of outstanding arrears (€3.1 billion in December 2012) and halting its accumulation. In particular, we are working closely with the enforcement authorities in order to effectively sanction public officials who do not comply with the commitment law. In the health sector, we will proceed with a second settlement program—in the value of €432 million—following the same procedures envisaged in the March 2012 strategy document. All resources under this program will be applied to settle debt overdue above 60 days.

13. Revenue Administration. We will keep focusing our efforts on curbing tax evasion to support the achievement of the 2013 revenue targets. Key steps to support this effort have been made, notably the full functionality of the new Large Taxpayer Unit and the successful implementation of the VAT invoicing reform. We will establish a Risk Management Unit to speed up the phasing in of a modern compliance risk model, under the aegis of the new Compliance Council. Strengthening the PIT compliance management is a top priority, given the high reliance of the 2013 fiscal targets on this tax. To this end, we will accelerate the pilot projects on the High Net Wealth Individuals and the Self-employed Professionals, and strengthen the control of the monthly PIT withholding information. We have completed the property revaluation process, successfully bringing the property tax base closer to market values. Finally, we are advancing in our efforts to modernize tax litigation. The task force of judges has increased the pace of its work on high-value tax cases, and remains committed to clearing the remaining cases in courts. The State has registered a positive win/loss balance in terms of merit-based decisions in 2012.

14. Public Administration. Streamlining the public administration continues to be a top priority and a key component of the PER. We have achieved strong results in 2012, reducing the number of public employees by 4.6 percent, well above the 2 percent target. We have put in place a new framework increasing flexibility of the working hours, geographical mobility, and regulating the mutual agreement



on contract termination, which will support the PER efforts. Finally, drawing on the survey on foundations, we have taken key steps towards streamlining this sector and reducing its budgetary support.

15. **State-Owned Enterprises.** Cost-reduction efforts and voluntary redundancy programs have successfully brought the state-owned enterprises (SOEs) sector as a whole back to operating balance ahead of schedule, with even more problematic firms in the infrastructure and transport sectors showing results well ahead of expectations. We retain formal cost-cutting objectives for those firms still showing operating deficits, while other firms are required to continue improving operating balances with a view to reducing debt burdens and financial costs. We continue to manage the high debt burdens of some firms, and treasury support has remained within the envelope of budgeted transfers.

16. **Privatization.** The sale of the airport operator, ANA, represents another milestone in our privatization program. Following high quality proposals from several bidders, the financial transaction is expected to be successfully completed by end-July, allowing us to fully meet our revenue objectives for the full privatization program. The sale of the airline, TAP, did not go through due to inadequate financial assurances by the final bidder. The firm remains in good financial health and we expect to re-launch the process this year. We will launch the privatization process for the rail cargo firm, CP Carga, in the second half of the year, for completion by year end. With changes in the legal framework for postal services underway, we expect to launch the privatization process for the postal company CTT in the second quarter, and receive binding offers by end-2013. We have prepared a strategic plan for the water and waste sector, with a view to introducing private capital and management in the system. Binding offers for the sale of the waste management business will be sought by the end of the year. Opening water concessions to private capital and management is in course and will take longer.

17. **Public-Private Partnerships.** We are taking bold steps to achieve a fiscally-responsible PPP model. We continue to advance in staffing our newly-created PPP unit in order to bring it into fully operational status. We are also taking steps toward enhancing fiscal transparency and improving reporting in this area. Additional renegotiation commissions have been appointed in order to extend the Government's effort to other road concessions, the relevant meetings being expected to start until the end of 2Q2013. Preliminary agreements have been reached with the majority of the private partners', which set forth the terms under which the concession contracts will be reformed, as well as the expected public savings arising thereof. These agreements constitute a crucial milestone in the renegotiation process and offer solid prospects for reaching the revised savings goal of €300 million in 2013. The results of the renegotiation process are paramount to achieve the fiscal savings envisaged in the budget, leading to a relevant contribution of this sector to fiscal consolidation. The ongoing revision of the regulatory framework is also part of the strategy to achieve road sector sustainability by reviewing downwards the service levels and capturing additional savings on other roads and concessions to the state. Finally, the PPP unit has started supporting similar negotiation efforts in the autonomous region of Madeira and is bringing expertise to the committee for the re-appraisal of the Lisboa Oriental PPP hospital.

18. **Regional and Local Governments.** The draft Regional and Local Finance Laws submitted to Parliament last-December 2012 (structural benchmark) aim at improving our inter-governmental fiscal framework, notably by applying the same principles of the Budgetary Framework Law to sub-national governments. The establishment of a coordination council between the central and sub-national governments is expected to enhance the exchange of information in order to support budgetary planning. The €1 billion credit line to support local governments' arrears settlement is being implemented, following the necessary procedures to validate the claims. The regional government of Madeira has made progress in budget consolidation and PFM reforms, justifying the release of the disbursements under its adjustment program with the central government, but we remain vigilant to budget risks.

### III. SAFEGUARDING FINANCIAL STABILITY

19. Capital Augmentation Exercise. Following the successful completion of the capital augmentation exercise, all banks have met the 10 percent Core Tier 1 target set under the program. In addition, the results of the recent On-site Inspections Program, focused on assets related to the construction and commercial real estate sectors, and the latest round of stress tests have confirmed the continued resilience of the participating banks, including under adverse conditions. We remain committed to providing further support to the banking sector, in the event new capital needs were to arise. While we will continue to encourage banks to seek private solutions, resources from the Bank Solvency Support Facility (BSSF) remain available to support viable banks if needed. The resources in the BSSF will solely be utilized to provide public support, if needed, to the banking system. State aid will remain subject to strict conditionality, in line with EU rules, aimed at avoiding subsidizing private shareholders and preventing migration of private liabilities to the public sector balance sheet, while ensuring adequate lending to the real economy, with special focus on SMEs, particularly within the sectors of tradable goods and services.

20. Funding and Liquidity Conditions. Non-standard measures by the ECB to restore the proper transmission of monetary policy have helped ease liquidity pressures and improve market conditions, supporting an important first step in the gradual return of banks to international bond markets. Better funding conditions, stable customer deposits, and additional resources from the recent capital exercise, together with orderly balance-sheet deleveraging, have also allowed Portuguese banks to start reducing their reliance on Eurosystem liquidity, including through partial early repayment of the 3-year LTROs. Exceptional liquidity support is still playing a pivotal role in absorbing remaining funding constraints and mitigating the lingering risk of excessive credit contraction, while strengthened collateral buffers provide an important shield against potential adverse shocks. Moreover, following the successful creation of a platform for interbank unsecured lending to facilitate the functioning of the domestic interbank market, the BdP has launched in early May a new platform for secured transactions.

21. Credit Conditions and Orderly Deleveraging. Despite the improvement in market sentiment and liquidity conditions, the credit situation remains difficult. While to date the sustained decline in bank credit is broadly in line with demand conditions and the necessary private sector deleveraging, lending rates on new business remain elevated across all segments of the economy. Moreover, while large corporations have been increasing access to funding alternatives through capital markets, this is currently not feasible for the smaller firms. In the context of this difficult credit environment, banks' funding and capital plans should keep ensuring that the deleveraging process takes place in an orderly manner to achieve a stable market-based funding position, while adequate and sustainable financing is provided to the economy. In particular, we will continue to ensure that the pace and composition of the deleveraging, as also envisaged under the restructuring plans of the aided banks, remains consistent with the program's macroeconomic framework and objectives. We presented an initial proposal for a mechanism to securitize banks' high quality mortgage credit as a contribution to this objective and to reinforce long-term viability of the Portuguese banking sector.

22. Initiatives to Support Funding to SMEs. The Ministry of Finance, together with the BdP, the Ministry of Economy, and other stakeholders, continue their efforts to promote more efficient financing allocation to the productive segments of the economy through the review and rationalization of existing government-sponsored measures, along EU state aid rules, as well as the promotion of alternative private funding options for SMEs. Specifically,

- Review of Government-Guaranteed Credit Lines. We will continue to strive to improve the performance of existing government-guaranteed credit lines, in line with international best practice. We have recently conducted an external audit of the National Guarantee System (NGS), which has helped identify preliminary policy recommendations aiming at making these schemes more efficient and minimizing risks for the state, by further enhancing pricing mechanisms and investment selection processes as well as the NGS risk management capabilities and governance structure. We will prepare by



mid-June a detailed implementation plan of the key report recommendations, including a timetable of all the needed execution steps. Moreover, to support viable firms in financial difficulties, we will explore specific modalities for the provision of guaranteed credit conditional on the successful completion of a corporate restructuring process, with an initial proposal expected by early September. To support these efforts, we are establishing a new quarterly monitoring framework including key balance sheet indicators of the firms benefiting from government-guaranteed credit lines, with a first report to be prepared by end-June.

- **Development of SMEs Commercial Paper.** We are exploring possible changes to the regulatory and taxation environment to facilitate the expansion of the commercial paper market among a wider investor base, with a view to promote alternative funding options for SMEs. Detailed proposals by relevant entities have been requested by the government last April and are expected to be received by end-May. A first draft of the necessary amendments of the rules governing the commercial paper market will be prepared by end-June and will be subject to a review of any potential tax implications.

New initiatives to facilitate credit to firms by the Ministry of Finance, Ministry of Economy, and other relevant entities will be primarily focused on streamlining and improving the efficiency of existing schemes, without creating additional burden or posing risks to public finance. In this context, the government is conducting a stock-taking exercise aiming at streamlining and centralizing the management of EU structural funds.

23. **Central Credit Registry.** Efforts to promote information sharing, especially for SMEs, are ongoing. The BdP is further enhancing the data coverage and detail of the Central Credit Registry (CCR), namely to include additional financial products and to add supplementary classifications to the loans already reported to the CCR. Furthermore, BdP intends to implement the possibility of access by the financial institutions to historical information on their potential new clients, subject to the authorization of the Portuguese Data Protection Authority (CNPD). In parallel, the BdP is assessing available options for reducing information asymmetry for smaller companies, taking also into consideration other available data sources, such as the Central Balance Sheet Database (CBSD). The above mentioned enhancements, as well as a first progress report on the two last referred issues, are expected to be completed by end-October 2013.

24. **Private Sector Debt Restructuring.** We are stepping up our efforts to monitor closely the situation in the area of corporate and household insolvency. We will prepare quarterly reports on the application of the new corporate restructuring tools, including viability indicators for the companies going through these processes by end-June 2013. On household debt restructuring, we will continue to assess the effectiveness of the new regimes. We will conduct a survey of all insolvency stakeholders to inquire about the appropriateness of the existing debt restructuring tools and possible gaps or bottlenecks by end-July 2013.

25. **Bank Supervision.** Banks are making progress implementing recommendations with regard to their stress testing methodologies and impairment projections, issued as part of the original Special On-site Inspections Program. The BdP will launch a thematic review of banks' operational capacity in the area of loan restructuring and asset recovery to be completed by end-October 2013, with the aim to ensure that the banking system can effectively support the balance sheet adjustment of the private sector, by timely engaging troubled debtors before their financial viability is in jeopardy.

26. **Bank Recapitalization and Resolution Frameworks.** We have submitted to Parliament amendments to the law governing banks' access to public capital, allowing the state—under strict circumstances—to exercise control over recapitalized institutions and to perform mandatory recapitalizations. We are reviewing the recovery plans of the largest banks, and expect to receive recovery plans from all the other banks by end-November 2013. Institutions for which resolution plans are mandatory are expected to submit the data required in the supervisory notice of December 2012 by end-

July 2013. We remain committed to swiftly transpose the new EU Directive on bank recovery and resolution once it has been adopted.

27. BPN SPVs. We are implementing the strategy for managing the distressed assets from Banco Português de Negócios (BPN). The competitive bidding process to select a third party that will manage the credits currently held by Parvalorem, a state-owned Special Purpose Vehicle (SPV), has been launched in January and is on track to be completed by mid-2013. We will also ensure timely disposal of the subsidiaries and the assets in the other two state-owned SPVs. CGD's state guaranteed claim will be gradually settled in cash, according to the schedule agreed with the EC, ECB, and IMF staff. Any net recoveries realized on the assets will also be applied towards the settlement of CGD's claim.

#### IV. BOOSTING EMPLOYMENT, COMPETITIVENESS, AND GROWTH

28. Labor Market Institutions. Significant steps have been taken over the past year to make the labor market more dynamic and efficient—including the adoption of a revised labor code, the reform of unemployment benefits and a reform of the wage-setting mechanism. A new reform of severance pay is currently under consideration by Parliament. This reform will reduce severance payments to 12 days per year of service for all new permanent labor contracts. For existing permanent contracts and all fixed-term contracts, severance payments will be reduced to 18 days per year of service for the first three years of the contract, and to 12 days per year of service for subsequent years. The cap of 12 months of pay will remain in place for all contracts, and acquired rights will be protected. The relevant law will become effective on October 1, 2013 (structural benchmark).

29. Ports. To help reduce costs for exporters, we have reduced fees on port use (TUP-Carga) by 20 percent to date. The landmark revision of the Ports Work Law became effective in February 2013. It is aimed at lowering wage costs and making the use of labor more flexible. We are now seeking effective transmission of lower labor costs to end-users of port services. In particular, we will engage with concessionaires with a view to modifying existing concession contracts so as to foster price reductions. We will also revise incentives for port operators by adopting a new performance-based model for future concessions and encourage entry of new operators. A review of the overall savings generated and these reforms will be conducted by December 2013.

30. Energy. We continue our efforts to reduce excessive policy-induced rents and improve the sustainability of the national electricity system. With overall cost reduction targets broadly within reach, shortfalls are emerging with respect to a specific measure. This, as well as downward pressures on demand for electricity, is likely to lead to upward revisions to tariff debt projections. In light of this, the government will update its projections of the medium-term tariff debt path and identify policy options—including additional cost reduction measures—to achieve the initial objective of eliminating the tariff debt by 2020. These revised projections and potential corrective measures will be prepared by mid-June (structural benchmark) and discussed at the time of the 8th review.

31. Services. Reforms in the services sector aim at eliminating entry barriers and increase competition. Significant progress has already been made in amending sector specific legislations to align them with the Services Directive. We expect adoption of the remaining necessary amendments (including for construction, universities and higher education courses) by Parliament by end-June 2013. A new legal framework aimed at improving the functioning of the regulated professions (such as accountants, lawyers, notaries) for which regulation involves a professional body was recently published. The professional bodies' statutes are being amended accordingly for approval by Parliament, including by eliminating unjustified restrictions to activity and further improving the conditions for mobility of professionals in line with EU Directives in the area of free movement of professionals.

32. Licensing and Administrative Burden. Progress is being made on initiatives to tackle excessive licensing procedures, regulations and other administrative burdens—which are impeding the

establishment, operation, and expansion of firms. We are carrying out an inventory of the costs of regulations in the economy, starting with the most burdensome. On the basis of this analysis, to be presented by end-June 2013, the government will devise a roadmap for a regulatory simplification. We will step up the efforts to make operational the Point of Single Contact, an e-government portal which allows administrative procedures to be done online. Progress is being made toward implementing the New Late Payments Directive, which will help promote liquidity conditions for businesses.

33. Regulation. We have approved ahead of schedule a framework law for the functioning of regulators that draws on the findings and recommendations of the recently completed expert report, benchmarking the responsibilities, resources, and independence of the main sectoral regulators against best international practices. The law : (i) establishes a regulatory environment that protects the public interest and promotes market efficiency, (ii) guarantees the independence and financial, administrative and management autonomy of the National Regulatory Authorities in the exercise of their responsibilities, including the necessary conditions to guarantee adequate human and financial resources being able to attract and retain sufficiently qualified staff, and (iii) strengthens the role of the Competition Authority in enforcing competition rules. The framework law has been submitted to Parliament. The corresponding amendments to the bylaws of the National Regulatory Authorities will be approved by the Government in the three month following publication of the framework law. Once the NRA framework law and follow-up bylaws and internal regulations are in place, the regulators will continue to pursue adoption best international regulatory practices, including by organizing international peer review exercises.

34. Judicial. We continue pushing ahead with targeted measures to reduce the backlogged enforcement cases. Despite the challenges in addressing the backlog court cases, an additional 52,000 enforcement cases have been cleared, bringing down the total number by about 165,000 enforcement cases since November 2011. The inter-agency task forces have set quarterly targets for reviewing enforcement cases to be closed. We have further advanced the reforms to improve the efficiency of the judicial system. We have started preliminary steps to implement the comprehensive judicial roadmap to reduce the number of courts and streamline the court structure and the new Code of Civil Procedure to speed up the judicial process. We will submit to Parliament by end-June 2013 an important draft bill to strengthen the authority and financing structure of the oversight body for enforcement agents and insolvency administrators (CACAJ) as well as recruitment which aims to meet market demands. The government will approve by end-June 2013 a fee structure that incentivizes speedy enforcement.

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

	Dec-12		Mar-13		Jun-13	Sep-13	Dec-13 2/
	Program	Actual	Program	Actual			
1. Floor on the consolidated General Government cash balance (cumulative)	-9.0	-8.3	-1.9	-1.4	-6.0	-7.3	-8.9
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 1/	0	Met	0	Not met	0	0	0
3. Ceiling on the overall stock of General Government debt	180.0	177.2	182.2	178.5	187.3	188.9	187.4
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government (continuous performance criterion)	0	0	0	0	0	0	0

1/ Domestic arrears for the purpose of the program declined by close to €0.7 billion between end-September and end-December 2012, but increased in February 2013. Overall, domestic arrears declined by €1 billion between September 2012 and February 2013.

2/ Indicative target.

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

Measure	Timing	Status
<b>Prior Actions</b>		
1 Adopt by the Council of Ministers and publish the medium-term fiscal framework that includes fully-specified measures to meet the 2014 deficit target (LOI ¶4 and MEFP ¶17).		Met
2 Submit to Parliament the supplementary budget that includes measures needed to meet the 2013 fiscal objective (MEFP ¶16).		Met
<b>Structural Benchmarks</b>		
<b>A. Fiscal policy</b>		
1 Submit to Parliament a new draft public administration labor law that will aim at aligning current public employment regime to the private sector rules, including for working hours and holiday time, and termination of tenure (MEFP ¶18).	July 15, 2013	
2 Submit to Parliament a draft law on the redesigned mobility pool (MEFP ¶18).	End-June 2013	
3 Submit to Parliament a legislative proposal that increases the statutory retirement age to 66 years (MEFP ¶18).	July 15, 2013	
4 Submit to Parliament a legislative proposal that aligns the rules and benefits of the public sector pension fund, CGA, to the general pension regime (MEFP ¶18).	July 15, 2013	
<b>A. Strengthen financial stability</b>		
5 Submit to Parliament amendments to the law governing banks' access to public capital (LOI ¶2).	End-January, 2013	Met
<b>B. Enhance competitiveness and address bottlenecks to growth</b>		
6 Enact the severance pay reform that reduces severance payments to 12 days per year for all new permanent labor contracts (MEFP ¶128)	October 1, 2013	
7 Update projections of the medium-term energy tariff debt path and identify policy options to eliminate the tariff debt by 2020 (MEFP ¶130).	June 15, 2013	
<b>C. Strengthen fiscal institutions and reduce fiscal risks</b>		
8 Revise and submit to Parliament the draft regional and local public finance law (LOI ¶12 and MEFP ¶118).	End-Dec 2012	Met
9 Implement a full-fledged Large Taxpayer Office (LTO), to cover audit, taxpayer services, and legal functions concerning all large taxpayers, including the adoption of account managers (LOI ¶12 and MEFP ¶113).	End-Dec 2012	Met

## ANNEX 5

### Technical Memorandum of Understanding

May 31, 2013

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 2013, shall not include entities nor operations (including pension funds) that are re-classified into the General Government during 2013, but shall include those reclassified in 2011-12.

## 5. Supporting Material

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

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

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

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

5.5. Data on the revenues, operating expenses, capital expenditure, remuneration of personnel, EBITDA, and number of staff will be provided for state-owned enterprises (SOEs) on a quarterly basis, within 7 weeks after the end of each quarter. Aggregate data for the SOEs within the perimeter will be provided, with company-specific information for REFER, Estradas de Portugal, Metro de Lisboa, and Metro de Porto. Furthermore data for Comboios de Portugal and Parpública (outside the perimeter) will also be provided.

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

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

6. Definition. The consolidated General Government cash balance (CGGCB) is defined as the sum of the cash balances of the entities covered by the State Budget, the ISOE, the Regional and Local Governments, and the Social Security Funds, and other entities and EBFs, as defined in paragraph 4. Privatization receipts will be excluded from cash receipts. In 2012 and beyond, revenues from the reclassification of pension funds into the general government will not be accounted for as cash revenues for the purpose of the calculation of the consolidated general government cash balance. In 2012-13, the cash proceeds from the sale of the ANA airport concession will be accounted for as cash expenditure-reducing transactions. The net acquisition of financial assets for policy purposes, including loans and equity participation will be recorded as cash expenditures, except for transactions related to the banking



sector support and restructuring strategy under the Program. Called guarantees (excluding those related to the banking sector support and restructuring strategy), where entities of the General Government make cash payments on behalf of entities that are not part of the General Government, will be recorded as cash expenditures.

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

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

6.3. Adjustor. The 2013 quarterly floors on the consolidated general government cash balance will be adjusted for the cumulative amount of arrears settled in the context of the arrears clearance strategy: (i) health sector arrears (up to €432 million), (ii) local government arrears settled through the €1 billion credit facility created in May 2012, and (iii) RAM government arrears subject to concluding the agreement with the central government (up to €1.1 billion).

#### Other Provisions

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

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

## 9. Supporting Material

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

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

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

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

11. Supporting Material. The stock of arrears will be measured through a survey. Reports on the stock of arrears of the General Government are being published monthly. The MoF will provide consistent data on monthly expenditure arrears of the General Government, as defined above. Data will be provided within seven weeks after the end of each month and will include total arrears classified by the different constituent sectors of the General Government sub-sector as defined in paragraph 4, as well as the monthly amounts of arrears cleared under the arrears clearance strategy (see paragraph 6.3).

12. Adjustor. In 2013, the monthly change in the stock of arrears will be adjusted for any stock adjustment related to the arrears clearance strategy as per paragraph 6.3. This will allow monitoring the underlying flow of new arrears.

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

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

14. Adjusters. For 2013, 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 2012 general government debt of EUR 204.5 billion. From 2014 onwards, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) reclassification of entities or operations that affects the stock at end-December of the previous year.

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

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

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

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

E. Bank Solvency Support Facility

18. The dedicated Bank Solvency Support Facility (BSSF) account will be maintained at the Bank of Portugal. As per previous review, resources for the BSSF will be agreed at each review and deposited in the dedicated account.

F. Overall Monitoring and Reporting Requirements

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

## ANNEX 6

### Indicative timeline

#### Indicative timeline of financial sector and structural measures in the Memorandum of Understanding on specific economic conditionality<sup>(4)</sup>

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##### *Actions for the eighth review (to be completed by end April 2013)*

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<b>Fiscal structural</b>	[3.6] Publish a fiscal strategy document for the general government (April).
	[3.8] Define the characteristics of the medium-term budgetary framework.
	[3.27 i] Complete the implementation of the strategy of shares services in the area of financial services (GeRFIP).
<b>Financial sector</b>	[2.16] Prepare report on the implementation of the new restructuring tools (end-April).
	[2.18 ii] Finalise the assessment of the grouped issuance of corporate debt to obtain capital market financing (end-April).
	[2.18 iii] Submit a plan to facilitate the expansion of the commercial paper market (end-April).
<b>Health care system</b>	[3.42] Produce a report assessing the legislation aimed at removing all effective entry barriers for generic medicines.
<b>Labour market</b>	[4.7 ii] Define a framework comprising performance evaluation criteria and accountability for public schools and schools under autonomy agreement.
	[4.7 iii] Establish "professional schools of reference".
	[4.7 iv] Prepare an assessment on the latest developments in the apprenticeship system.
<b>Goods and services markets</b>	[5.1] Ensure the National Regulatory Authority's all powers foreseen in the package.
	[5.5] Limit the policy costs of renewables under the special regime – excluding those granted under the tender mechanism.
	[5.15] Deliver and enforce policies that ensure strong integrated policy-making, strategic planning and surveillance functions common to all ports.
	[5.16] Submit to Parliament the sectorial amendments necessary to implement the Services Directive.
	[5.17] Launch a 2 <sup>nd</sup> phase of investigation of the review of regulated professions.
	[5.18] Submit to Parliament the professional bodies' amended statutes.

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<sup>(4)</sup> Square brackets identify paragraph numbers in the MoU as signed on 25 June 2013. 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.

<i>Actions for the eighth review (to be completed by end April 2013)</i>	
	<p>[5.19 i] Adapt the content and information available at the PSC for the missing 33 amended regimes to ensure conformity with the Services Directive and make available online forms for the completion of procedures.</p> <p>[5.19 ii] Adapt the content and information available at the PSC for the 15 regimes to ensure conformity with the Professional Qualifications Directive.</p> <p>[5.19 iii] Make available in PSC on-line procedures for the registration, installation, modification, occupation of public space regimes.</p> <p>[5.19 iii] Make the PSC operational.</p>
<b>Housing market</b>	[6.1] Finalise the appraisal of the taxable value of the housing stock.
<b>Competition, public procurement, and business environment</b>	<p>[7.7] Submit to Parliament the framework law for regulators.</p> <p>[7.8] Submit a report analysing the impact of the amendments to the revised Public Procurement Code as well as of the enhanced role of the Court of Auditors.</p> <p>[7.10] Implement the New Late Payments Directive.</p> <p>[7.11] Include all municipalities and all levels of public administration within the scope of the Simplex Programme.</p>
<b>Licensing</b>	<p>[7.13] Study the feasibility of a rule that prohibits at all levels of government the creation of a new regulation generating costs for businesses without elimination of an existing regulation.</p> <p>[7.14] Create a working group to analyse applications for the licensing of planned investment projects.</p> <p>[7.15 i] Review the new Base Law of Soil and Territorial and Urbanism Planning.</p> <p>[7.15 iii] Review the legal regimes of the Territorial Management Instruments (RJIGT).</p> <p>[7.15 iv] Review the diploma for the regularisation of activities not in accordance with RJIGT.</p> <p>[7.15 v] Harmonise the Regional Plans. Include the new generation in the RJIGT's rules.</p> <p>[7.15 vi] Review the RJUE that should be aligned with the new Industrial Licensing regime.</p> <p>[7.17] Change the legal regime for Environmental Impact Evaluation.</p>

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***Actions for the eighth review (to be completed by end April 2013)***


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- [7.18 i] Implement zero licensing procedures for Type 3 industries.
  - [7.18 ii] Define and establish the Zones of Responsible Enterprises.
  - [7.18 iii] Create and define standardized industrial licenses.
  - [7.18 iv] Ensure that the new Industrial Licensing is aligned with the review of the New Base Law of Soil and Territorial and Urbanism Planning.
  - [7.18 v] Ensure that the new Industrial Licensing is aligned with the review of the Legal Regime for Urbanism and Building.
  - [7.19] Review the commercial licensing regime.
  - [7.19] Review the geological licensing regimes.
  - [7.19] Review the licensing in tourism.
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***Actions for the ninth review (to be completed by end Q2-2013)***


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|---------------------------|---|
| <b>Fiscal structural</b>  | <ul style="list-style-type: none"> <li>[3.12] Coordinate with MoF to exchange information along the lines defined in the draft financing laws.</li> <li>[3.17] Adopt the follow-up legislation to strengthen the governance of SOEs in accordance with international best practices.</li> <li>[3.19] Conclude the privatisation or concession of the cargo handling subsidiary of CP Carga.</li> <li>[3.22 ii] Increase the personnel working in auditing of the tax administration by 30% of the total staff.</li> <li>[3.23] Prepare an evaluation report on the measures for the different economic sectors.[3.25] Review the regulation on the creation and the functioning of associations and observatories.</li> <li>[3.27] Complete the implementation of the strategy of shared services in the area of financial services (GeRFIP).</li> <li>[3.32] Review the Special Mobility Law.</li> </ul> |
| <b>Health care system</b> | <ul style="list-style-type: none"> <li>[3.37] Implement contingency measures including administrative price reductions.</li> <li>[3.41] Introduce in the e-prescription system a first set of guidelines.</li> </ul>  |
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*Actions for the ninth review (to be completed by end Q2-2013)*

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	<p>[3.50] Make the web-portal with publicly available information fully operational.</p> <p>[3.53] Prepare annual reports on plans to reallocate qualified and support staff within the NHS.</p> <p>[3.55] Finalise the implementation of the new internal control procedures manual.</p>
<b>Financial sector</b>	<p>[2.1] Extend the new platform for interbank unsecured lending to secured transactions.</p> <p>[2.9] Finalise the update of the treatment of collective impairments expected to be finalised at the latest by end-June 2013.</p> <p>[2.13] Analyse the recovery plans of the top 8 banks.</p> <p>[2.13] Settle the initial contributions by banks by mid-June 2013.</p> <p>[2.19] Present a report on quarterly monitoring and reporting mechanism on the allocation of the government sponsored credit lines.</p>
<b>Labour market</b>	<p>[4.5] If needed, prepare an action plan to ensure works council can negotiate wages at firm level.</p> <p>[4.7 i] Make operational an analysis, monitoring, assessment and reporting system.</p> <p>[4.7 ii (iii)] Report on the results and follow-up of the first year of the new evaluation cycle.</p>
<b>Goods and services markets</b>	<p>[5.2] Implement the plan to create a new gas and electricity logistics operator independent company.</p> <p>[5.3] Conclude the measures to reduce excessive rents and to address the sustainability of the national electricity system.</p> <p>[5.6] Undertake the revision of the co-generation remuneration scheme in line with the framework of the transposition of the efficiency directive.</p> <p>[5.8] Proceed with the designation of universal service providers.</p> <p>[5.10] Amend the decree-law laying down the framework of the contract and renegotiating the amendment of the said contract with CTT.</p> <p>[5.12] Assess the existing rail, road and port networks and present a set of investment priorities for the 2020 and 2030 horizons.</p> <p>[5.13 vi] Ensure that the main rail terminals currently owned by CP Carga are transferred to another entity.</p>

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***Actions for the ninth review (to be completed by end Q2-2013)***


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	<p>[5.16] Approve by the Parliament the amendments to the sector specific legislation.</p> <p>[5.19 iii] Prepare the extension of the PSC to major municipalities.</p> <p>[5.19 iii] Make fully operational the "Zero Authorisation" project.</p> <p>[5.19 iii] Make the "Zero Authorisation" platform available to all levels of administration, including municipalities.</p>
<b>Housing market</b>	[6.3] Review of the impact of all housing market reforms.
<b>Judicial system</b>	<p>[7.1] Eliminate the court backlog.</p> <p>[7.2] Prepare quarterly reports on implementation status of measures to achieve reduction of the backlogged enforcement cases.</p> <p>[7.3] Submit to Parliament a draft bill to strengthen the authority and financing structure of the CACAJ.</p> <p>[7.3] Approve by the government fee structure that incentivises speedy enforcement.</p>
<b>Licensing</b>	<p>[7.12] Carry-out a fully inventory and an analysis of the costs of all regulations in the economy (at central, regional and local levels).</p> <p>[7.13] If feasible, put in place the rule that prohibits at all levels of government the creation of the new regulation generating costs for businesses without the elimination of an existing regulation.</p> <p>[7.18 i] Implement zero licensing procedures for Type 2 industries.</p>

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***Actions for the tenth review (to be completed by end Q3-2013)***


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<b>Financial sector</b>	<p>[2.7] Complete the thematic review of banks' operational capacity in the area of loan restructuring.</p> <p>[2.13] Settle the annual contributions by end-September 2013.</p> <p>[2.16] Conduct a survey of insolvency stakeholders.</p>
<b>Fiscal structural</b>	<p>[3.3] Reduce the number of Servicos e Fundos Autonomos (SFA) in view of reducing budget fragmentation.</p> <p>[3.15] Provide annual PPP report on the risks stemming from PPPs and concessions.</p>

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<i>Actions for the tenth review (to be completed by end Q3-2013)</i>	
	<p>[3.24 i] Continue the analysis of the current tax compliance situation, including a different categories of taxpayers, focusing on income taxation.</p> <p>[3.24 i] Continue building capacity in revenue administration to manage compliance over a 3-y period.</p> <p>[3.30] Initiate a deeper analysis of the remuneration policies.</p> <p>[3.44] Promote the use of reusable materials and implement a program for reprocessing material devices.</p>
<b>Labour market</b>	<p>[4.3] Prepare a report on the effects of the changes to the dismissal rules on labour market indicators.</p> <p>[4.4 iii] Prepare an independent review on the desirability of shortening the survival of contracts that are expired but not renewed.</p>
<b>Goods and services markets</b>	<p>[5.7] Annual report on new contracts in renewables.</p> <p>[5.7] Annual report on new investments in renewables.</p> <p>[5.11 iv] Reform the transport and infrastructure's regulatory framework.</p> <p>[5.13 i] Ensure that the rail regulator enjoys the independence required under the EU rail Directives.</p>
<i>Actions for the eleventh review (to be completed by end Q4-2013)</i>	
<b>Fiscal-structural</b>	<p>[3.7] Conduct a review of the Budget Framework law.</p> <p>[3.21] Complete the privatisation or concession of the freight subsidiary of CP.</p> <p>[3.22 ii] Reduce the number of municipal tax offices by 25%.</p> <p>[3.26] Provide an assessment to identify potential duplications of competences/services between central and local administration.</p> <p>[3.27 i] GeRFIP to be implemented in the Autonomous region of Madeira and in the Autonomous Region of Azores.</p> <p>[3.28] Reduce the number of local branches of line ministries.</p> <p>[3.32] Converge the system of social protection for staff in RPSC regime to the rules of Regime Geral de Segurança Social.</p>
<b>Health care system</b>	<p>[3.46] Take measures to increase competition among private providers and</p>

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***Actions for the eleventh review (to be completed by end Q4-2013)***


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between public and private providers in relevant areas of service provision.

[3.55] Reduce overtime compensation by 20%.

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<b>Goods and services markets</b>	[5.13 v] Prepare the privatisation of the freight branch of the state-owned rail operator.
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[5.14] Present a review of the port law.

[5.16] Review the fees linked to the construction activities.

[5.19 iv] Extend PSC to services not covered by the Services Directive.

[5.19 v] Extend the "Zero Authorisation project" abolishing licenses to other sectors of the economy.

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<b>Licensing</b>	[7.16] Increase a nationwide land registration regime to allow a more equal distribution of benefits and costs in the execution of urban planning.
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