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The Economic Adjustment Programme for Portugal Tenth Review

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The Economic Adjustment Programme for Portugal

Tenth Review

EUROPEAN ECONOMY Occasional Papers 171

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EXECUTIVE SUMMARY

A joint EC/ECB/IMF mission met with the Portuguese authorities in Lisbon between 4 December and 16 December to assess compliance with the terms and conditions set out in the Memorandum of Understanding, as updated following the combined Eighth and Ninth Reviews 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. On this basis, Portugal is expected to regain durable access to market-based financing at sustainable interest rates. This report provides an assessment of compliance and summarises the findings of the mission.*

Amid signs of a recovery in economic activity, Programme implementation remains broadly on track. *External rebalancing has continued, although growth in net exports has slowed somewhat as imports have picked up driven by stronger-than-expected domestic demand. Despite renewed challenges posed by another unfavourable ruling of the Constitutional Court in relation to public sector reform, the Portuguese authorities remain determined to achieve the objectives of the Programme. This determination is being rewarded by falling yields on Portuguese debt – amid a generalised improvement in market sentiment toward euro-area sovereign debt - allowing the government to pre-finance much of its funding needs during 2014.*

Positive developments in the third quarter of 2013 have confirmed the gradual improvement in the economy, as already foreseen in the previous Review. *In consequence, the projections for economic activity in 2013 have been revised upward slightly with the contraction now estimated at -1.6 percent. The projected growth rates for 2014 and beyond have been left unchanged, i.e. positive but still moderate growth of slightly below 1 percent of GDP in 2014 is expected to be followed by a further acceleration to 1½ percent in 2015. The current account is still expected to post a surplus of ½ percent of GDP in 2013 and almost 1 percent of GDP in 2014, even if the contribution of net exports to growth will be reduced somewhat by stronger-than-expected import growth. An improvement is also evident in the labour market, with unemployment receding to 15.5 percent in November (2 percentage points below the rate registered at the beginning of 2013) and employment growth of 1.1 percent in the third quarter of 2013. Nonetheless, over the foreseeable future the unemployment rate remains too high, particularly for younger cohorts of the labour force where about one in three remains jobless.*

The Programme's fiscal targets have been confirmed. *Tax collection has been performing well and the yield of the special debt recovery scheme for outstanding taxes and social security contributions has been beyond expectations. On this basis, the 2013 deficit target of 5.5 percent of GDP (not accounting for the cost of bank recapitalisations) is well within reach and over-performance is not excluded. The 2014 budget was approved by Parliament with limited and broadly budget-neutral changes. Building on the public expenditure review, it includes important steps toward rationalising and modernising public administration, improving the sustainability and fairness of the pension system, and lowering costs across ministries. A rigorous implementation of the 2014 budget will be a decisive step in the transition to a post-Programme environment. In the event that some of the measures in the budget are found to be unconstitutional, the Government is committed to implementing compensatory measures of high quality to meet the agreed deficit target of 4 percent of GDP in 2014. As a prior action to the conclusion of the Tenth Review, the government has already adopted alternatives to a measure that had aimed to align the public sector pension scheme with the general system but which was ruled unconstitutional in late 2013. These measures consist of increases in the extraordinary contribution on pensions and in beneficiaries' contributions to the special public sector health insurance systems. The measures are consistent with the initial objectives of the public expenditure review and with achieving the agreed budget deficit target for 2014.*

The banking sector remains stable, amid a still challenging economic and financial environment. *Bank capital ratios have been on an upward trend since 2011 and were at an aggregate 12 percent Core Tier 1 ratio by end-September 2013. Nevertheless, the sector remains vulnerable to adverse shocks and continued vigilance by the Bank of Portugal as prudential supervisor is essential. Bank profitability*

remains generally very poor, reflecting a sharp fall in net interest income, lower trading gains and a high level of asset impairments as the NPL ratio has reached more than 11 percent. Reliance on Eurosystem funding fell below EUR 50 billion in the third quarter of 2013, but still represents about 10 percent of the aggregated system assets, which is three times the euro-area average. The private sector continues to deleverage, as the stock of outstanding loans declines across all segments, although competition among banks for lending to clients with lower risk profiles appears to have increased. Banks remain cautious and selective in their lending activity, even if lending conditions are generally becoming less restrictive with a more positive outlook going forward. As liquidity becomes less of an issue for banks, competition for deposits is diminishing and consequently deposit remuneration is slowly declining, although on average it remains relatively high given the large proportion of long-term deposits. Banco de Portugal's stress testing framework has been further strengthened with the development of a new top-down stress testing methodology. Efforts to foster financing alternatives for the corporate sector continue, including through the development of the capital market for short term corporate debt instruments. An ambitious roadmap for improving the effectiveness and governance of the National Guarantee System is being implemented, which aims at creating a more competitive, transparent and accountable environment for the allocation of guaranteed credit to SME.

In addition to continued budgetary discipline, structural reforms must be the centrepiece of a credible strategy for sustainable growth in the medium term. *The Government has already adopted a range of challenging structural reforms but, at this stage, the available evidence of their impact on the functioning of the economy is mixed. The effective implementation of these reforms is crucial to rebalance the economy and boost its growth potential. To this end, the framework for implementation – notably including independent and adequately financed regulatory authorities - must be reinforced, while progress in implementation must be continuously evaluated to ensure that reforms deliver the desired results. Further reforms will also be needed and should, against the background of an efficient and stream-lined public administration, focus on increasing competition and flexibility in product and labour markets so as to facilitate the reallocation of resources from the non-tradable to the tradable sector. Articulating credible and time-bound reforms to this end would reassure investors that improvements in Portugal's economic fundamentals are becoming entrenched.*

In line with a broader trend in the euro area, sovereign bond yields in Portugal have been on a declining trend since the combined Eighth and Ninth Reviews, when the authorities reconfirmed their intentions to meet the commitments agreed under the Programme. *Portugal successfully re-entered debt markets in December 2013 by exchanging EUR 6.6 billion of bonds maturing in 2014 and 2015 into 2017 and 2018 bonds. As yields continued to fall in early 2014, the Treasury sold EUR 3.25 billion of a June 2019 bond through a syndicated tap at an effective yield of 4.66 percent. Continued rigorous implementation of the Programme will be essential to validate the improvement in investor sentiment toward the sovereign with a view to restoring sustainable market access. The ratio of public debt to GDP remains high – with gross debt being additionally inflated by the accumulation of cash buffers - but is sustainable provided reform efforts continue over the programme horizon and beyond.*

The successful completion of the Tenth Review will release EUR 1.8 billion from the EU and EUR 0.9 billion from the IMF, subject to the approval by ECOFIN and Eurogroup for the EU loans and the IMF Executive Board for the IMF loan. *This will bring overall financing to around EUR 74 billion or 94 percent of the total envelope. The government's Programme is supported by loans from the European Union amounting to EUR 52 billion and roughly EUR 26 billion Extended Fund Facility with the IMF.*

CONTENT

Introduction 7

1. Economic Developments and Outlook 9

2. Programme Implementation 19

3. Programme Financing 55

A1. Assessment of Compliance: Monitoring Table **57**

A2. Commission Services Macroeconomic Projections 2012-2017 63

A3. Indicative Financing Needs and Sources 67

A4. Provision of Data (Reporting Requirements) 69

A5. PROGRAMME DOCUMENTS 72

A5. LETTER OF INTENT 73

A5. MEMORANDUM OF UNDERSTANDING ON SPECIFIC ECONOMIC POLICY CONDITIONALITY 76

A5. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES 102

A5. TECHNICAL MEMORANDUM OF UNDERSTANDING 114

A6. INDICATIVE TIMELINE 119

LIST OF TABLES

1.1. Selected real GDP projections 9

1.2. Macroeconomic projections of the 10th review 10

1.3. Stock of arrears January - October 2013 (EUR million) 13

1.4. Soundness indicators 17

2.1. Artihmetic of the government deficit: from the deficit in one year to the next 20

2.2. Fiscal targets and structural adjustment 2012 - 2015 21

2.3. Discretionary measures in the Budget 2014 22

LIST OF GRAPHS

1.1. State budget execution - Revenues: Direct and indirect taxes (cash-data) 11

1.2. Central administration budget execution - Expenditure items: Cost of employees, acquisition of goods and services and investment (cash-data) 11
1.3. Budgetary outturn for Social Security in 2013. January - November (cash-data) 12
1.4. General Government consolidated accounts (cash-data): Effective revenue, primary expenditure and interest costs. 12
1.5. 10 year sovereign yields and banks' issues 14
1.6. ECB borrowing by banks located in Portugal 14
1.7. Interest rate for new loans, evolution per segment 15
1.8. Nominal interest rate earned by loan stock segment and average loan mark-up 15
1.9. Loan stock evolution per segment 15
1.10. Yearly growth per loan segment 16
1.11. Lower deposit remuneration slowly brings down the cost of funding 16
1.12. Deposit growth by segment 16
1.13. Non-Performing Loan Ratio Development 17
2.1. Job finding and separation rates 40
2.2. Number of collective agreements and workers covered 43
3.1. 10-year Government bond yield 55
3.2. 2-year Government bond yield 55
3.3. Geographical allocation of June 2019 bond tap 55
3.4. Allocation by type of investor of June 2019 bond tap 56
3.5. Short-term auctions issuance amounts 56
3.6. Short-term auctions weighted average yield 56

LIST OF BOXES

2.1. The Reform of the Corporate Income Tax 24
2.2. Government Debt and Fiscal Sustainability in Portugal 27
2.3. Roadmap for Improving the Effectiveness and Governance of the National Guarantee System 36
2.4. The Growth Impact of Structural Reforms in Portugal 38
2.5. How much more Wage Adjustment is Needed in Portugal? 41
2.6. Programme Reforms in the Education Sector are Expected to Yield Positive Results 45
2.7. Summary of compliance with policy conditionality for the 10th Review 52

INTRODUCTION

1. The report assesses compliance with the terms and conditions set out in the Memorandum of Understanding, as updated following the combined Eighth and Ninth Reviews 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 4 to 16 December 2013 ([1]). In accordance with the Council Implementing Decision amending Implementing Decision 2011/344/EU on granting EU financial assistance to Portugal ([2]), the mission assessed compliance with the conditionality associated with the respective disbursement and progress towards the key objectives of the Programme in terms of sound public finances, restoring competitiveness and putting Portugal's economy back on the path of sustainable growth and job creation. In line with these key objectives, the mission also revised more specific policy conditionality.

2. The Economic Adjustment Programme was agreed by the Ecofin Council on 17 May 2011 and by the IMF Executive Board on 20 May 2011. The Programme, which covers the period 2011-2014, entails external financing by the European Union, the euro-area Member States and the IMF of some EUR 78 billion ([3]), 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 Tenth Review will pave the way for the release of the next loan instalment of around EUR 2.7 billion. This instalment will bring EU and IMF financing to around EUR 74 billion, representing roughly 94 percent of total available financial assistance.

([1]) The cut-off date for the macro-economic and fiscal projections of this report is 16 December 2013.
([2]) OJ L 269 of 14.10.2011
([3]) The IMF share of the Programme was set in Special Drawing Rights (SDR). Due SDR rate fluctuations, the projected pay-out by the IMF in Euro has become higher, so the current projected Programme total is around EUR 79 billion.

1. ECONOMIC DEVELOPMENTS AND OUTLOOK

MACROECONOMIC OUTLOOK

4. The positive momentum in the economy was confirmed in the third quarter of 2013, with real GDP growing by 0.2 percent quarter-on-quarter (q-o-q). This is the second successive quarter with positive real GDP growth. A less negative evolution in domestic demand offset the somewhat lower-than-expected contribution to growth from net exports. The improvement in domestic demand was generated by more positive private consumption expenditure and better-than-expected gross fixed capital formation (GFCF). Export volumes declined slightly on a q-o-q basis, but the year-on-year (y-o-y) growth rate remained strong. Preliminary economic indicators for the last quarter of 2013 suggest a continuation of positive real GDP growth, supporting the projection of an economic turnaround in 2014.

Table 1.1: Selected real GDP projections

	2013	2014	2015
COM 10th Review (December 2013)	-1.6	0.8	1.5
Banco de Portugal (December 2013)	-1.5	0.8	1.3
Consensus (December 2013)	-1.8	0.4	n.a.
EIU (December 2013)	-1.5	0.6	1.2
OECD (November 2013)	-1.7	0.4	1.1

Source: Commission services, Bank of Portugal, Ministry of Finance, The Economist, Consensus Economics and OECD

5. Real GDP growth in 2013 was revised upwards by 0.2 percentage point to -1.6 percent on an annual average. This revision is in line with the latest release of quarterly official data for the third quarter. The projections for the following years remain unchanged, with real GDP growth rates of 0.8 percent in 2014 and 1.5 percent in 2015. Revisions in the demand components of GDP for 2013 reflect the impact of the latest available data. In particular, private and public consumption and GFCF are expected to contract by less than was assumed in previous projections. The positive effect of higher domestic demand on GDP growth will be partially offset by an associated expansion in imports, which will reduce the growth contribution from net exports. Against a background of broadly unchanged external assumptions, the modifications of the macroeconomic projections for 2014 and 2015 are overall negligible and limited to an adjusted profile of public consumption and slightly higher imports (see Table 1.2 for a comparison with the estimates of the combined Eight and Ninth Reviews).

6. Recent labour-market developments have surprised on the positive side. In the third quarter, employment increased by 1.1 percentage points q-o-q, while the labour force remained unchanged. However, the increase in employment was concentrated in the tourism and transport sectors, which indicates that seasonal factors might have played a role. The monthly unemployment rate declined to 15.5 percent in November 2013 (Eurostat definition), the lowest rate since May 2012 and clearly below its peak of 17.6 percent at the beginning of 2013. At 36.8 percent, the youth unemployment rate remains among the highest in the euro area, even though it is now nearly 4 percentage points below its peak of 40.5 percent in February 2013. Taking into account the latest developments, the revised labour market projections imply an upward revision of employment growth by 0.7 percentage point to -3.2 percent in 2013, while the projections for 2014 and 2015 have remained broadly unchanged (at -½ percent and +½ percent, respectively). Accordingly, the profile of the unemployment rate has been revised downwards by close to 1 percentage point to 16.5 percent in 2013, 16.8 percent in 2014 and 16.5 percent in 2015.

7. Net exports will continue to contribute positively to economic growth, despite an expected stabilisation of exports and an acceleration of imports. The volume of exports decelerated in third quarter of 2013, with q o-q growth of -0.2 percent, while y-o-y growth remained high at 6.6 percent. As for imports, the acceleration in the second quarter has continued in the third quarter, implying an upward revision of the annual growth rate by almost 2 percentage points in 2013, to 2.6 percent. Higher import volumes in the third quarter reflect both an increase in private consumption and a better performance of investment. The current account balance is nevertheless projected to turn positive in 2013, at around ½ percent of GDP, and to improve further to about 1 percent of GDP in 2014.

8. Inflation is expected to remain low but to accelerate moderately in 2014 and 2015 in line with the upturn of activity. Inflation as measured by the HICP recorded a yearly average rate of 0.4 percent in 2013, its lowest value since 2009 when it was negative. Inflation is likely to remain below the euro area average rate in 2014

Table 1.2: **Macroeconomic projections of the 10th review**

	10th Review (December 2013)				8th and 9th Review (September 2013)			
	2012	2013	2014	2015	2012	2013	2014	2015
	year-on-year volume change							
Gross domestic product	-3.2	-1.6	0.8	1.5	-3.2	-1.8	0.8	1.5
Private consumption	-5.3	-1.8	0.1	0.8	-5.4	-2.5	0.1	0.7
Public consumption	-4.7	-2.0	-2.5	-1.9	-4.8	-4.0	-2.8	-2.2
Fixed investment	-14.4	-8.0	1.2	3.7	-14.3	-8.5	1.2	3.7
Exports of goods and services	3.2	5.8	5.0	5.3	3.2	5.8	5.0	5.3
Imports of goods and services	-6.6	2.6	3.0	3.8	-6.6	0.8	2.5	3.7
	contributions to real GDP growth							
Domestic demand excl. inventories	-6.9	-2.8	-0.1	0.7	-6.9	-3.7	-0.3	0.7
Change in inventories	0.2	0.0	0.1	0.0	0.3	0.0	0.0	0.0
Net trade	3.8	1.2	0.8	0.7	3.8	2.0	1.0	0.8
Employment (y-o-y change)	-4.2	-3.2	-0.4	0.4	-4.2	-3.9	-0.5	0.4
Unemployment rate (level)	15.9	16.5	16.8	16.5	15.9	17.4	17.7	17.3
HICP (y-o-y change)	2.8	0.5	0.8	1.2	2.8	0.6	1.0	1.2
Current external balance (% of GDP)	-1.9	0.4	0.8	1.1	-1.9	0.9	0.9	1.0
General government net lending (% of GDP)(1)	-6.0	-5.5	-4.0	-2.5	-6.0	-5.5	-4.0	-2.5
General government consolidated gross debt (% of GDP)	124.1	129.4	126.6	125.8	124.1	127.8	126.7	125.7

(1) For the purposes of the Programme, the budget deficit in 2012 excludes the impact of CGD recapitalisation (about 0.5% of GDP), and in 2013 BANIF recapitalisation (about 0.4% of GDP).
Source: Commission services

and 2015, although a moderate acceleration to slightly above 1 percent is expected in the latter year. These projections correspond to a slight downward revision for 2013 and 2014 compared with the combined Eight and Ninth Reviews, reflecting the declining trend evident during the last months of 2013.

9. While the baseline projection implies that the recovery becomes gradually more entrenched, downside risks remain significant. Despite high-frequency indicators suggesting continued positive growth in the fourth quarter of 2013, the outlook for the economy remains fragile as the pace of the recovery will be constrained by the high level of private and public debt and the resulting need to continue the deleveraging process in the medium term. In addition, the pace of the recovery will depend on developments in the broader euro-area and, in particular, in Portugal's main trading partners. If the euro area economic recovery is slower or less broad-based than expected, there will be an inevitable negative impact on growth prospects for Portugal. Downside risks also relate to the financing conditions for the Portuguese sovereign, insofar as the improvement in yields is dependent on both domestic factors and broader trends in the euro-area sovereign debt market. Economic operators still face high borrowing costs which makes Portugal vulnerable to any significant deterioration in investor sentiment, linked either to uncertainties in domestic policy implementation or developments outside the country.

FISCAL DEVELOPMENTS

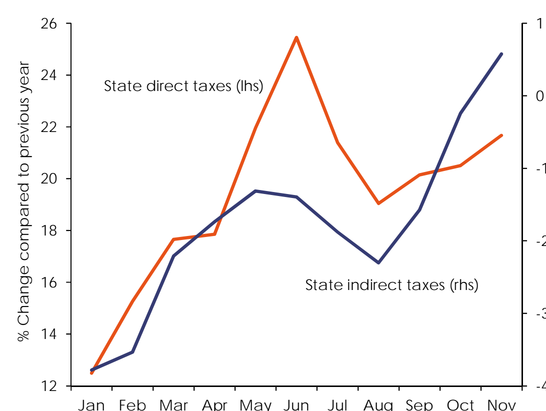
10. The general government cash balance improved in 2013 (up to November) due to revenue growth outpacing expenditure growth. Budget execution up to November recorded an improvement in the government cash deficit (net of extraordinary factors) of about 0.25 percent of GDP as compared with the same period of last year. Revenue growth amounted to 8.2 percent, when compared with the same period of last year, which more than compensated for expenditure growth of 6.4 percent. The central administration (including all of the three subsectors, i.e. State, Autonomous Services and Funds and reclassified SOEs) and the regional administrations have recorded some improvement in their underlying cash positions vis-à-vis the same period of last year, while the Social Security and municipalities' balances deteriorated, once adjusted for one-offs.

11. The acceleration of State tax revenues towards the end of the year supported the cash deficit reduction in 2013. Direct taxes recorded a sharp increase up to November (21.7 percent compared with the same period of last year), but also indirect taxes have recently reversed the

negative trend and showed a positive y-o-y growth rate of 0.6 percent for the first time in the last twelve months (see Graph 1.1). The collection of Personal Income Tax (PIT) - +30.9 percent y-o-y increase up to November - and Corporate Income Tax (CIT) - +9.2 percent - benefitted from increased withholding taxes on labour and capital income, as well as from improved efficiency in the tax administration via cross-checks of the information received with the unified monthly tax returns (Declaração Mensal de Remunerações), compulsory since the beginning of 2013. The improvement in the collection of indirect taxes (e.g. 1.4 percent y-o-y growth in VAT revenues up to November) reflects the recovery of economic activity in recent months and the more effective fight against fraud based, inter alia, on the e-invoicing reform which was fully implemented in 2013. The second Supplementary Budget (SB) approved in early November had revised upwards the State tax projection for 2013 by about 0.4 percent of GDP, which resulted from the better-than-expected macroeconomic developments and the special regularisation scheme for outstanding taxes and social security contributions launched in late 2013. Some of the taxes were however revised downwards in the second SB, notably the stamp duties due to the low revenues expected from the tax on high-value properties introduced in 2013, which some taxpayers have challenged on legal grounds (the government had initially estimated additional revenue of about 0.1 percent of GDP from this tax). Moreover, the second SB also revised downward non-tax revenues, whose underperformance was already visible at the combined Eighth and Ninth Reviews. Up to November, the majority of the State taxes were either in line or substantially above the targets as revised by the second SB, whilst execution of non-tax revenue is likely to miss the revised annual target.

12. At the central administration level, the wage bill is growing compared with last year, while investment is contracting. As of November 2013, wage costs at the consolidated central administration level were up by 11.4 percent compared with the same period of last year. This reflects the reinstatement of the two bonus salaries to public employees and the incomplete or delayed implementation of some of the measures contained in the initial budget and the first SB. For example, for fixed-term contracts, the initial budget target of a 50 percent reduction will not be achieved while the savings expected from the redesign of the requalification programme will only materialise in 2014. By contrast, investment and other capital expenditure continued to decline sharply, mainly at the level of some SOEs inside the General Government (e.g. Parque Escolar and Metro do Porto).

Graph 1.1: State budget execution - Revenues: Direct and indirect taxes (cash-data)



Source: Ministry of Finance and Commission services

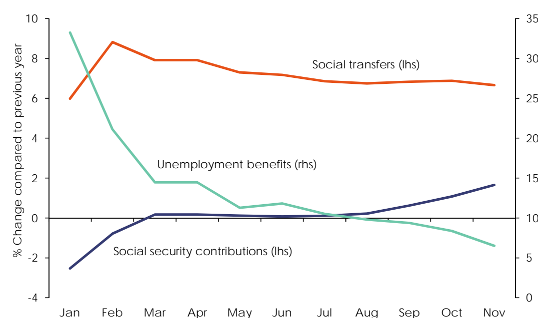
Graph 1.2: Central administration budget execution - Expenditure items: Cost of employees, acquisition of goods and services and investment (cash-data)

(1) Acquisition of goods and services excluding debt settlement in the health sector.
Source: Ministry of Finance and Commission services

13. Social Security execution is fully in line with the revised projections of the second SB. The second SB amended the Social Security budget mainly to take into account the impact of the special debt regularisation scheme for outstanding social security contributions and of

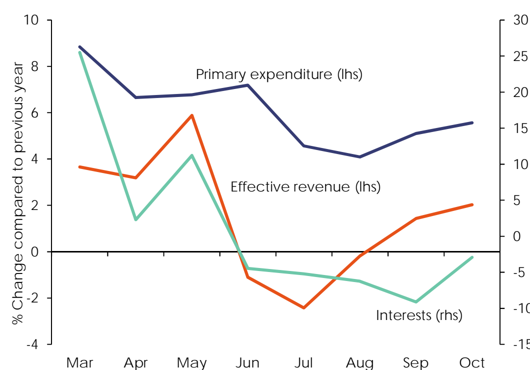
lower expenditure on unemployment benefits and employment support resulting from the improved labour-market situation. The execution of the main social security items up to November 2013 reflects the relevant policy changes and macroeconomic developments during the year, with no substantial deviations from the latest projections. For social contributions, the positive trend that had started earlier in the year has accelerated on the back of higher revenue from the "extraordinary solidarity contribution" (CES) on pensions, the effect of the special debt regularisation scheme and increased collection efficiency. On the other hand, the measure that introduced social contributions from unemployment and sickness benefits above minimum income levels yielded less than initially expected (with the yield now expected to reach EUR 30 million at most by year-end). On the expenditure side, unemployment benefits and subsidies to employment support continued the downward trend due to lower pressures from the labour market. Social transfers were about 6.7 percent higher than last year, mainly due to the reinstatement of the bonus pension payments, but this effect was budgeted in the first SB and performance was roughly in conformity with the projections. Several social programmes, such as sickness and maternity/paternity benefits were revised down with the second SB and are performing in accordance with expectations.

Graph 1.3: **Budgetary outturn for Social Security in 2013. January - November (cash-data)**



(1) Including non-consolidated data for Social Security.
Source: Ministry of Finance and Commission services

Graph 1.4: **General Government consolidated accounts (cash-data): Effective revenue, primary expenditure and interest costs.**



Source: Ministry of Finance and Commission services

14. Other sectors of the general government are performing broadly in line with the annual targets.

- Recent data shows that the indebtedness levels of SOEs inside GG increased by 8.6 percent by Q3-2013 when compared with end-2012. The accumulation of debt was concentrated in companies operating in the transport sector and was due mainly to the financial needs arising from the unwinding of toxic derivative contracts. With an average discount of 31 percent in terms of Mark-to-Market, the unwinding of the derivative contracts contributed positively to the aggregated SOEs operational balance. The latter was positive by Q3-2013 and even improved compared with Q3-2012 despite a deterioration of revenues and increases in personnel costs due to the reinstatement of the 13th and 14th bonus salaries. Financial costs by the end of Q3-2013 decreased significantly y-o-y which is also reflected in the better net balance of those companies although still posting losses in aggregate terms.

- In the health sector, reforms produced important savings through increased efficiency with almost all cost categories showing a consistent reduction. The only exception is staff costs, which, following their earlier reduction, saw an increase with the reinstatement of the two bonus salaries.

- At the regional level, up to November the budget balance of the Autonomous Region of Açores deteriorated slightly compared with last

Table 1.3: **Stock of arrears January - October 2013 (EUR million)**

	2013 (1)									(2)	(3)=(2)-(1)	
Subsector of the General Government	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Δ *Oct-Jan*	% total
Central Government excluding NHS	54	57	54	61	56	53	55	53	52	55	1	2%
NHS classified in General Government	23	28	26	48	14	20	32	30	29	23	0	1%
Reclassified entities	19	18	18	19	19	18	18	18	17	17	-2	1%
Local Government	1,244	1,159	1,132	1,084	990	950	904	846	791	767	-478	30%
Regional Government	938	938	944	1,066	1,053	1,058	904	765	661	602	-336	24%
Total	2,277	2,201	2,174	2,277	2,133	2,100	1,912	1,712	1,549	1,463	-814	58%
Total Consolidated	2,202	2,128	2,102	2,210	2,068	2,040	1,858	1,662	1,502	1,414	-788	56%
Other entities outside General Government												
Enterprises excluding NHS	40	45	49	50	51	56	74	82	90	91	52	4%
NHS incorporated hospitals	727	784	773	817	858	917	951	984	1,016	1,022	295	40%
p.m.: health sector inside + outside GG	750	812	799	864	872	937	982	1,014	1,045	1,044	294	41%
TOTAL	2,969	2,956	2,923	3,077	2,978	3,013	2,882	2,728	2,608	2,527	-442	
p.m.: percent of GDP	1.8	1.8	1.8	1.9	1.8	1.8	1.7	1.7	1.6	1.5		

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

year, whereas the Autonomous Region of Madeira improved its cash position (excluding the effect of the arrears payments), supported among other factors by a good performance of corporate income tax and strict expenditure control.

- Local governments' cash budget balance deteriorated compared with the same period of last year (up to November), even excluding the effect of the arrears payments in the context of the "Support Programme for the Local Economy" (PAEL). This resulted from the growth in cost of employees and capital expenditure and the underperformance in the collection of local taxes, particularly the recurrent property tax (Imposto Municipal sobre Imóveis, IMI). Even taking into account that 2013 is the first year in which the IMI was collected in three instalments instead of two, which makes the accurate intra-annual collection profile difficult to assess, the additional revenue from this tax has been revised down substantially from the initially expected amount of EUR 340 million (i.e. the estimates in the 2014 Budget reduced the expected additional yield of this tax to EUR 129 million in 2013 compared to 2012).

15. Budget execution is on track to meet the year-end deficit target in national account terms. The general government deficit in the first three quarters of 2013 reached 5.9 percent of GDP (EUR 7165.6 million), which represents an improvement by 0.2 percentage points of GDP compared with the same period of last year. In the light of this outcome and the information available up to November, which shows no additional deviations vis-à-vis the second SB, the attainment of the deficit target of 5.5 percent of GDP in 2013, excluding bank recapitalisations, is within reach.

Arrears

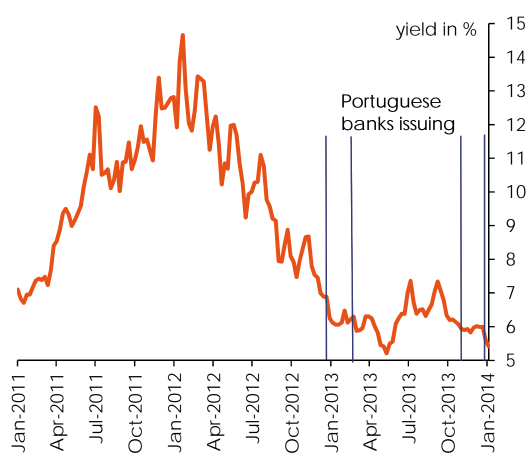
16. Whereas the stock of arrears is lower than at the beginning of 2013, progress in preventing the accumulation of new arrears is mixed. The implementation of the 'Support Programme for the Local Economy' (PAEL) explains the large reduction in the stock of local government arrears. The overall envelope of the programme amounts to about EUR 800 million, which is below the EUR 1 billion initially envisaged. The Court of Auditors already cleared most of the programmes submitted by the municipalities and an amount of about EUR 530 million was transferred in 2013. The ten municipalities with more financial distress still await approval by the Court of Auditors, which means that an amount of up to EUR 300 million is likely to be disbursed in 2014. All in all, local government arrears were about halved by the end of 2013 compared with the EUR 1.3 billion outstanding in January 2013. The Autonomous Region of Madeira repaid, until September 2013, EUR 912 million of debt from previous years with EUR 805 million drawn from a EUR 1.1 billion State-guaranteed loan and the other EUR 107 million financed by own resources and the Programme loan. In the health sector, the second debt settlement programme - worth EUR 432 million - was launched in October, after the conclusion of negotiations with the pharmaceutical industry in September, which is expected to have substantially reduced the stock of arrears by end-

year, to the lowest level since December 2010. Nevertheless, new arrears are still being accumulated, particularly in SOEs hospitals, in spite of the Commitment Control Law. For instance, SOEs hospitals accumulated about EUR 31 million of new arrears per month in 2013, which compares with about EUR 75 million in 2012. Although the reduction in accumulated new arrears is significant, more efforts are needed to reach the overall objective of preventing any further accumulation. An IMF-led technical assistance mission in December 2013 analysed the functioning of the Commitment Control Law, particularly in problem areas such as SOE hospitals. The mission has identified technical problems, as well as shortcomings in the monitoring and enforcement of the law. The main recommendations of the mission are to set up a monitoring unit in the Ministry of Finance, install reporting procedures, fix technical glitches, and address the problem of structural underfunding of main hospitals.

FINANCIAL SECTOR DEVELOPMENTS

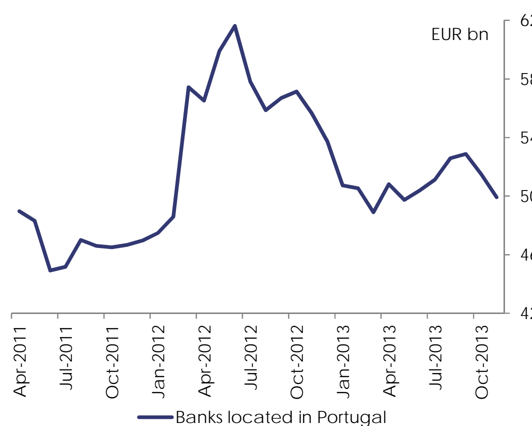
17. Funding conditions for banks have improved since the last Review. Some Portuguese banks have issued bonds in recent months, including a subordinated debt issue (November 2013), a covered bond and a senior debt issue took place just before the sovereign tapped the market (January 2014). Also, the international repo market shows signs of re-opening for some of the larger banks. Eurosystem funding has fallen below EUR 50 billion (Graph 1.6), a decline of about EUR 2 billion since the combined 8th and 9th Reviews. Longer-term refinancing operations represent about 85 percent of Eurosystem funding. Since summer 2013, the evolution in banks' access to Eurosystem funding has varied, with some banks recording an increased reliance and others recording a reduction. As banks continue to deleverage, the weight of Eurosystem borrowing remains at 10 percent of total assets, well above the euro area average of about 3 percent. Total mobilised collateral amounts to nearly EUR 80 billion implying a 55 percent over-collateralisation of ECB funding obtained.

Graph 1.5: 10 year sovereign yields and banks' issues



Source: Bank of Portugal

Graph 1.6: ECB borrowing by banks located in Portugal

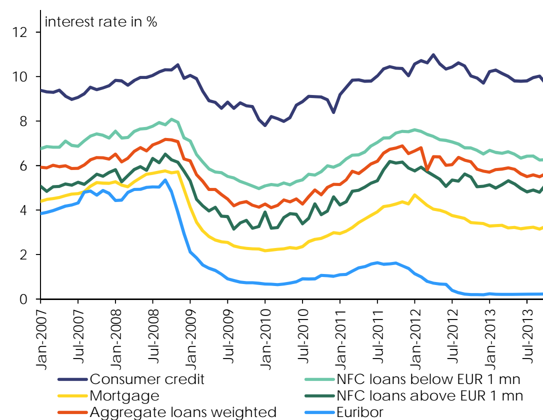


Source: Bank of Portugal

18. Despite a decline in interest rates, the stock of outstanding loans continues to fall for the overall corporate, mortgage and consumer segments. The volume of new bank lending to corporates during the past 12 months was around 11 percent below the average annual level in the past 10 years - while credit standards and terms applied by banks to company lending remained broadly unchanged in 2013. Large differences in the evolution of bank lending across industrial sectors persist, with lending to the construction and real estate sectors contracting rapidly while lending to exporting companies grows. The volume of new loans under EUR 1 million was only 72 percent of the annual average of the past 10 years, whereas new loans above EUR 1 million

slightly exceeded the 10-year average. In the household segment, new mortgage lending per month has amounted to about one sixth of the 10-year average, which is largely explained by the weak domestic economy and a much higher margin over EURIBOR of mortgage rates compared with pre-crisis years (Graph 1.7). A prolonged period of declining mortgage lending has led to a decline in the outstanding stock by EUR 4 billion (i.e. 3.6 percent) between October 2012 and October 2013. The outstanding stock of loans to the non-financial corporate sector fell by EUR 7 billion or 6.6 percent during the same period. The growth rate in consumer lending is about half the annual average of the past 10 years and the stock of outstanding consumer loans has fallen by EUR 2 billion or 8 percent over the same period (Graphs 1.5 and 1.6). The latest bank lending survey points to a continuation of the decrease in credit restrictiveness, particularly in the case of loans to SMEs and short-term loans, while household lending criteria remain unchanged with the trend to stronger risk profile differentiation ongoing.

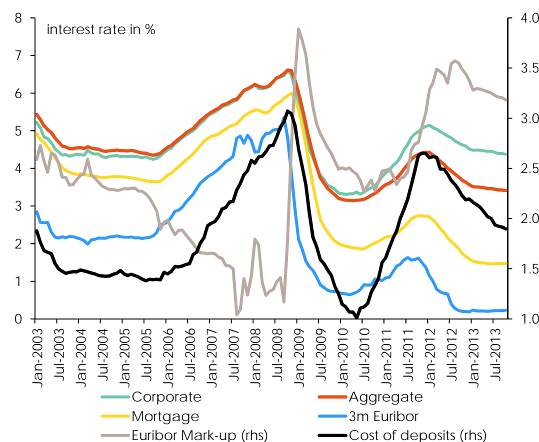
Graph 1.7: Interest rate for new loans, evolution per segment



Source: Bank of Portugal

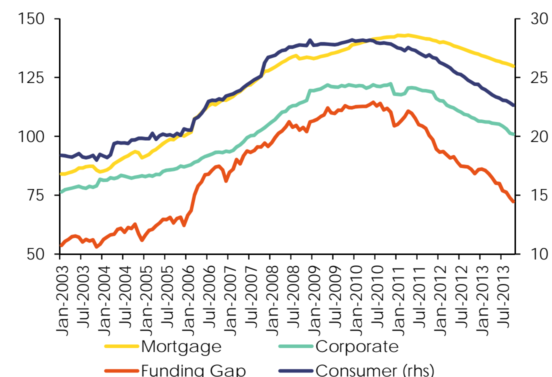
19. Improved liquidity conditions and lower funding costs are slowly feeding through to lower lending rates. The improved funding situation for banks appears to have led to increased competition for lending in recent months, in particular to firms with lower risk profiles (including SMEs) resulting in slowly declining lending rates (Graph 1.8). During pre-crisis years, the pricing of loans was benchmarked against EURIBOR so that Portuguese lenders were able to refinance close to EURIBOR rates. As deposits are the main source of financing, newly-granted loans are priced based on the average funding cost, notably of deposits.

Graph 1.8: Nominal interest rate earned by loan stock segment and average loan mark-up



Source: Bank of Portugal

Graph 1.9: Loan stock evolution per segment

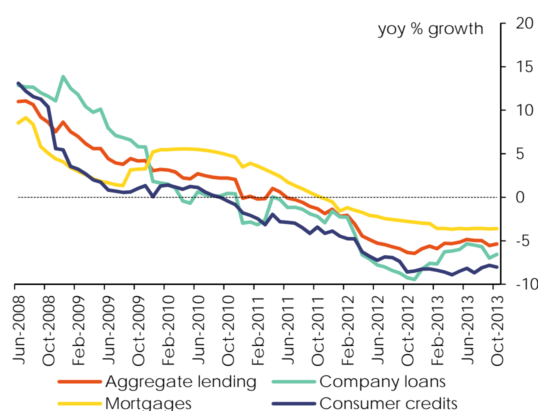


Source: Bank of Portugal

20. The better liquidity situation of banks and pressure on profitability have resulted in reduced competition for deposits. The need to maintain net intermediation margins has led to lower deposit interest rates (Graph 1.11). Deposit interest rates declined through 2013, although the remuneration of deposits appears relatively high because the share of longer term deposits in the deposit base in Portugal is higher than in other euro-area Member States. Consequently, it takes relatively longer for the flow of new deposits to influence the stock's average interest rate.

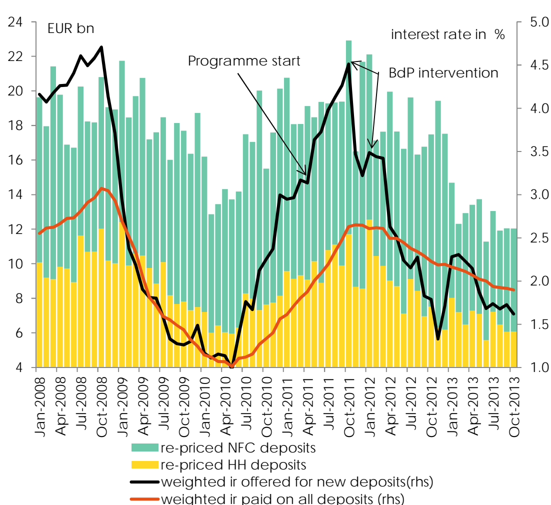
Nonetheless, the effect of fierce competition for deposits in the second half of 2011 and early 2012 continues to dissipate and the weighted average deposit remuneration now stands at 1.9 percent. Meanwhile, the deposit base remains relatively resilient and the overall volume of deposits recorded positive growth in October 2013, for the first time since October 2012 (Graph 1.12).

Graph 1.10: **Yearly growth per loan segment**



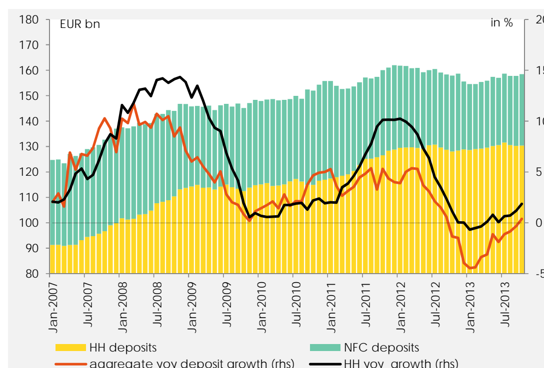
Source: Bank of Portugal

Graph 1.11: **Lower deposit remuneration slowly brings down the cost of funding**



Source: Bank of Portugal

Graph 1.12: **Deposit growth by segment**



Source: Bank of Portugal

21. The banking sector has recorded substantial losses in 2013. From January 2013 to September 2013 the banking system accumulated over EUR 1.3 billion of losses highlighting the strains under which banks operated through the year. Lower y-o-y results are mostly explained by a fall in the gross operating profit and in particular by a fall of 25 percent in net interest income. Trading gains on the sovereign bond portfolio and on repurchases of own debt, which had boosted revenue in 2012, materialised only to a limited extent in 2013. The deterioration in the cost-to-income ratio reflects the strong reduction in revenues in that period (see Table 1.4). Furthermore, although net interest income (NII) recorded a major y-o-y drop, the sequential quarterly NII showed a gradual recovery in the past two quarters: a q-o-q increase by 8.8 percent in Q2-2013 and by 9.5 percent in Q3-2013. Almost all banking groups managed to reduce their operating costs, but the high level of impairments which rose to almost 6 percent of total gross loans (from 5 percent in Q3-2012) remains a drag on overall profitability.

22. The rising amount of non-performing loans (NPL) is a significant source of vulnerability for Portuguese banks. Corporate non-performing loans are the major source of concern. The overdue loans ratio of non-financial corporations (NFC) increased further in Q3-2013 to 12.7 percent (Graph 1.13), up by 0.8 of a percentage point compared with Q2-2013. The number of companies with overdue loans reached over 68,000 in the same period, representing about 30.5 percent of firms in Portugal. On the more positive side, the NPL ratios of some segments of

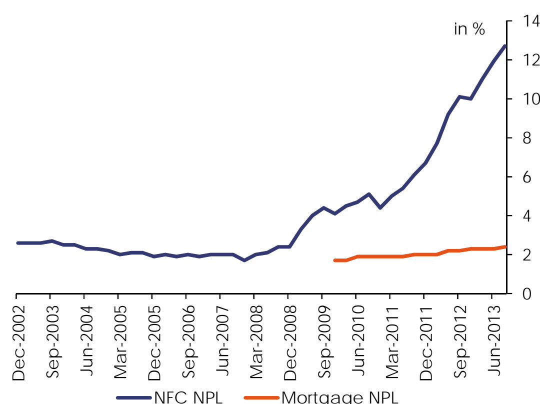
Table 1.4: **Soundness indicators**

%	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Return on Equity (1)	7.2	7.6	7.1	6.7	6.2	4.3	2.4	-3.8	6.3	1.0	-0.3	-4.2	-3.8	-7.2	-6.7
Gross Income on Assets	2.5	2.6	2.6	2.7	2.4	2.5	2.5	2.5	2.6	2.7	2.6	2.5	2.1	2.1	2.1
Cost to Income Ratio	57.7	57.1	57.2	57.6	59.1	58.3	59.0	61.4	56.1	52.9	56.5	58.9	67.5	68.9	69.6
Non-Performing Loans	5.5	5.6	5.9	5.3	5.7	6.3	6.9	7.4	8.1	9.2	9.9	9.8	10.4	10.6	11.2
Coverage Ratio	62.9	62.1	60.2	60.8	59.5	57.9	55.5	57.8	53.5	51.2	50.9	54.4	54.1	54.1	53.0
Capital Adequacy Ratio (2)	11.3	10.9	11.0	11.1	11.4	11.0	10.1	10.7	10.7	12.3	12.3	12.6	13.0	13.1	13.4
Core Tier 1 Ratio (3)	7.8	7.8	8.0	8.1	8.4	8.7	8.5	9.6	9.6	11.2	11.3	11.5	11.9	11.9	12.2
Loan-to-deposit ratio	163.4	166.6	158.4	157.8	156.7	149.7	146.2	140.2	136.9	136.3	133.3	127.9	124.0	122.6	120.7

(1) Income before minority interests/ Average shareholders' equity before MI
(2) Excluding the banks in resolution
(3) The Core Tier 1 ratio according to Programme definition and excluding the banks in resolution
Source: Bank of Portugal

the corporate sector appear to be stabilising and coverage levels have remained broadly stable (increasing slightly from 51 percent in September 2012 to the current level of 53 percent ([4])). The average NPL ratio for loans to households has remained rather stable since mid-2012 (4.3 percent in September 2013), with consumer credit in default stabilizing at 12.8 percent and mortgages' NPL steadying at 2.4 percent. While the asset-quality cycle may appear close to bottoming out, the still relatively weak macroeconomic outlook remains a key risk for Portuguese banks.

Graph 1.13: **Non-Performing Loan Ratio Development**



Source: Bank of Portugal

23. Solvency levels rise again reflecting banks' efforts to strengthen their capacity to face an adverse scenario. Notwithstanding the weak profitability and high NPL ratio, the capital level remains adequate throughout the sector with an average Core Tier 1 solvency level of 12.2 percent (Table 1.4). The degree of heterogeneity observed among the lenders remained relatively stable compared with 2012 data. Adding to the major recapitalisation efforts that took place throughout 2012 and in 2013 this positive trend in solvency levels was also associated with a decline in the amount of the sector's risk weighted assets. In order to boost and increase the quality of their own funds, banks reduced their holdings of assets with higher regulatory capital requirements and improved their capital management through risk transfer measures such as synthetic securitisations operations to mitigate their credit risk.

([4]) For the top eight banks in the system.

2. PROGRAMME IMPLEMENTATION

FISCAL POLICY

Fiscal consolidation in 2013

24. The general government cash deficit adjusted for Programme purposes reached EUR 7,757 million up to November 2013. This represents an improvement of EUR 312 million compared with the same period of last year and, given the expected monthly profiles of budgetary items, leaves room for accommodating the deficit of the month of December well within the annual deficit target. Hence, the end of the year deficit target of EUR 8,900 million, as established in the performance criteria of the Memorandum of Economic and Financial Policies (MEFP), is comfortably within reach. The achievement of this cash position was due to the performance of tax revenue, which more than compensated the expenditure growth and shortfalls in non-tax revenues during the year.

25. The general government deficit target of 5.5 percent of GDP (net of bank re-capitalisations) in 2013 is likely to be met. The headline deficit position may end up being even below the target and this over-performance could partially carry over into 2014. This results from positive risks having materialised in recent months while most negative risks have dissipated. In particular, the regular tax collection performance is expected to exceed the implicit targets in the second SB, mostly driven by a better-than-expected economic and labour-market performance and progress in tackling tax fraud and evasion. On top of that, the debt regularisation scheme for outstanding taxes and social security contributions collected EUR 1,253 million or 0.8 percent of GDP, about EUR 500 million more than envisaged. The execution of reprogrammed EU Funds is now expected to be better than at the time of the combined Eighth and Ninth Reviews (although still lower than initially planned in the first SB), therefore reducing the potential negative impact from lower revenue from this source. Furthermore, negative risks from the PPP's renegotiations have been mitigated. Although lending banks' approval and the fine-tuning of the underlying amendments to the concession contracts are delayed, implying the risk that the envisaged savings of EUR 300 million may not be reached, this risk can be compensated by additional measures which Estradas de Portugal (EP) ([5]) has undertaken on its own 2013 budget; these measures allow for savings of similar magnitude and are mainly related to lower financial costs due to the conversion of State loans into equity and the compression of investment cost. On the negative side, despite close monitoring, risks of overruns on specific expenditure items, particularly on the wage bill and pensions cannot be excluded, but they are being closely monitored.

Fiscal consolidation in 2014

26. The 2014 State Budget and other supporting legislation include discretionary measures worth 2.3 percent of GDP to achieve the 4 percent of GDP deficit target for 2014. Measures with an estimated yield of almost 2.2 percent of GDP are permanent, while the remaining part comes from one-offs. In net terms, around 65 percent of the measures are expenditure-reducing (70 percent in gross terms). In spite of the projected improvement in the macroeconomic outlook, measures of about 0.5 percent of GDP are needed to cater for a negative primary balance drift (see Table 6). This drift reflects budgetary pressures, especially in intermediate consumption and social transfers, as well as the need to rebuild the provisional budget allocation.

27. The fiscal consolidation envisaged by the State Budget 2014 is predominantly based on the savings measures identified in the framework of the public expenditure review (PER). The PER package is an important element of the broader reform of the State, with the objective of increasing equity and efficiency in the provision of public services and social transfers. The PER aimed at identifying savings and streamlining processes in the public administration with the direct involvement of line ministries. The permanent expenditure-reducing measures are estimated to yield net savings amounting to EUR

([5]) EdP is an SOE inside general government perimeter. The company is: (1) in charge of running all roads not given to private companies through concession or sub-concession contracts in mainland Portugal; (2) the sub-grantor of the sub-concession contracts in mainland Portugal; and is also (3) the Government's length arm in the renegotiation of road PPPs, with the engineering knowledge to advise on operational and investment needs in the road sector.

Table 2.1: **Artihmetic of the government deficit: from the deficit in one year to the next**

(+) means balance-improving impact; (-) means balance-reducing impact	% of GDP
2011 balance (observed)	**-4.3**
p.m. 2011 balance (without one-offs)	**-7.3**
Primary balance drift in 2012	-4.0
Change in interest expenditure	-0.3
Dissipation of one-offs and non-recurrent effects from previous year	-3.0
Consolidation measures	5.8
One-off measures	-0.6
of which Bank recapitalisation	*-0.5*
2012 balance (observed) (1)	**-6.0**
p.m. 2012 balance (without one-offs)	**-5.8**
Primary balance drift in 2013	-2.1
Change in interest expenditure	0.0
Dissipation of one-offs and non-recurrent effects from previous year	0.6
Consolidation measures	3.6
Reistatement of the 13th and 14th salary and pension	-1.5
One-off measures	-0.1
of which Bank recapitalisation	*-0.4*
2013 balance (target) (1)	**-5.5**
p.m. 2013 balance (without one-offs)	**-5.4**
Primary balance drift in 2014	-0.5
Change in interest expenditure	0.0
Dissipation of one-offs and non-recurrent effects from previous year	0.1
Consolidation measures	2.2
One-off measures	0.1
2014 balance (target)	**-4.0**
p.m. 2014 balance (without one-offs)	**-4.2**

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.
(1) For the purposes of the Programme, the budget deficit in 2012 would exclude the impact of CGD recapitalisation (about 0.5% of GDP), and in 2013 BANIF recapitalisation (about 0.4% of GDP).
Source: Ministry of Finance and Commission services

3.0 billion (1.8 percent of GDP) in 2014. The PER measures act along three main axes: (1) reduction of the public-sector wage bill; (2) pension reform and (3) sectoral expenditure cuts across line ministries and budget programmes. Measures reducing the wage bill in 2014 aim at diminishing 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 implementation of a requalification scheme that allows the skills of the workforce to be adjusted to public needs, the alignment of public-sector working hours with those in the private sector (i.e. increase from 35 to 40 hours work week), the introduction of a bank of hours, the reduction in holiday entitlements, the implementation of a mutual agreement redundancy scheme (which is estimated to generate one-time upfront costs of slightly more than 0.1 percent of GDP), the revision of the wage scale and the streamlining of wage supplements. As part of the pension reform, the increase in the retirement age and changes to the survivors' pension payments represent steps in the direction of improving the long-run sustainability of the pension system while being based on equity principles. Finally, further substantial savings shall be generated by the implementation of sector-specific reforms, mainly reducing personnel costs, intermediate consumption and investment across expenditure programmes and across line ministries. In the education sector, the rationalisation of the school network and a convergence of the teacher/student

Table 2.2: **Fiscal targets and structural adjustment 2012 - 2015**

	2012	2013	2014	2015
Deficit (1)	-6.0	-5.5	-4.0	-2.5
Budget deficit, net of one-offs	-5.8	-5.8	-4.2	-2.5
Structural balance	-4.2	-3.7	-2.6	-1.8
Primary balance	-2.1	-1.6	0.3	1.9
Structural primary balance	0.1	0.6	1.7	2.6
Fiscal adjustment	2.6	0.5	1.1	0.9
Fiscal effort (EDP definition)	2.3	0.5	1.1	0.9

Fiscal adjustment mesures as the change in the structural primary balance; fiscal effort defined as the change in the structural balance.
(1) For the purposes of the Programme, the budget deficit in 2012 would exclude the impact of CGD recapitalisation (about 0.5% of GDP), and in 2013 BANIF recapitalisation (about 0.4% of GDP).
Source: Ministry of Finance and Commission services

ratio towards levels of other EU countries will support these goals. Hospital reform and cost optimisation shall contribute to savings in the health sector.

28. Most of the legislation underpinning the PER reforms has been adopted, but some measures have suffered setbacks and/or delays. A progressive increase in the wage cuts in the public sector, which replaces the wage cut already in place since 2011, is included in the budget and entered into force in January 2014. This is planned to be complemented by a single supplement scale and a single wage scale to be implemented by June and December 2014, respectively. The 40-hour work week entered into force on 28 September of last year. The first mutual agreement redundancy scheme for the less qualified public employees attracted less attention than initially targeted. Other schemes for teachers and for high-skilled workers are currently open for applications and a further scheme for low-skilled workers is planned to be launched in Q2-2014. The requalification scheme, which had been redesigned after the Constitutional Court judged some aspects of it unconstitutional, also entered into force as of 1 December 2013. However, the implementation of the scheme will only start as of 1 April 2014, which represents a one-quarter delay. The amendments necessary to increase the retirement age via the adjustment of the demographic sustainability factor were approved by the Parliament and have entered into force as of 1 January 2014. For the new rules on the sustainability factor to effectively apply also to the public-sector pension regime the existing pension legislation of the CGA needs to be modified. Regulatory changes to survivors' pension entitlements were implemented by the 2014 Budget Law, and consist in adjusting the replacement rate of the survivor's pension according to the total amount of pensions received by each beneficiary (i.e. the higher the accumulation of pensions the lower the replacement rate). Further modifications strengthening the eligibility conditions for survivors' pensions are foreseen; however, these changes have not yet been specified neither in their design nor with regard to their timeline.

29. The fiscal plans for 2014 received a setback on 19 December 2013, when the Constitutional Court ruled the provision aimed at aligning the rules of the public-sector pension scheme with the general pension scheme as unconstitutional. This measure was foreseen to yield EUR 321 million (0.2 percent of GDP) in net terms (after accounting for losses in PIT revenue and for the non-accumulation of this measure with the 'extraordinary solidarity contribution' on pensions, CES). The Government has proposed to fill this gap by redesigning two measures: (i) an increase in the CES including through the lowering of the threshold below which pensions are exempted and of the thresholds from which the highest contribution rates apply (ii) by a further increase by 1 percentage point of beneficiaries'

Table 2.3: **Discretionary measures in the Budget 2014**

	Total measures	One-offs (% of GDP)	Total net of one-offs
Indirect taxes	0.2	0.0	0.2
Direct taxes (households)	0.0	0.0	0.0
Direct taxes (corporations)	0.1	0.0	0.1
Social contributions	0.3	0.1	0.2
Sales	0.0	0.0	0.0
Other current transfers	0.3	0.0	0.2
Total current revenue	***0.9***	***0.2***	***0.7***
Capital transfers received	0.1	0.1	0.0
Total revenue	***0.9***	***0.3***	***0.6***
Compensation of employees	-0.4	0.1	-0.6
Intermediate consumption	-0.3	0.0	-0.3
Social transfers in kind	0.0	0.0	0.0
Social transfers OTIK	-0.2	0.1	-0.3
Interest	0.0	0.0	0.0
Subsidies	0.0	0.0	0.0
Other current expenditure	-0.1	0.0	-0.1
Total current expenditure	***-1.0***	***0.3***	***-1.3***
GFCF	-0.2	0.0	-0.2
Other Capital expenditure	0.0	0.0	0.0
Acq less disp of non-fin non-prod assets (K2)	-0.1	-0.1	0.0
Total capital expenditure	***-0.3***	***-0.1***	***-0.2***
Total expenditure	-1.3	0.2	-1.5
Total fiscal impact (+ = improvement in the balance)	2.3	0.1	2.1

Source: Ministry of Finance and Commission services

contribution to the special public sector health insurance schemes (ADSE, SAD, ADM) with a view to ensuring the self-financing of these systems. The changes to the CES will be implemented via a Supplementary Budget. The changes to the ADSE will be implemented via a Decree Law which does not require parliamentary approval. Both of these measures should apply from the second quarter onwards. In addition, the Portuguese Government is also developing new comprehensive measures as part of the ongoing structural reform of pensions, which aim at improving the long-run sustainability of the pension system, while being based on principles of equity and income progressivity, as well as ensuring proportionality across the private and the public sector.

30. A number of further smaller-scale revenue-consolidation measures with an overall expected yield of about 0.4 percent of GDP underpin the deficit target. These measures aim at further improving the efficiency and equity in the current tax and benefit system and reducing excessive rents in some sectors. The items yielding the largest savings are an increase in the corporate tax rate on expenses related to company cars, higher excises for tobacco and alcohol and a

special levy on energy imposed to boost revenues with the additional effect of curbing excessive rents from the energy sector. Part of the revenue generated by this levy shall be used to reduce the tariff debt.

31. A number of one-off measures will also contribute to the achievement of the deficit target, more than offsetting the one-off costs related to the mutual agreement termination of public-sector employment contracts. The winning bidder for the Silopor concession has been selected and the revenues from a special dividend from the sale of excess oil reserves by a public company will be collected until end-2014. Other measures, such as the transfer of the CTT (postal service) health fund to the Government sector and the sale of other port concessions are foreseen to be implemented later this year.

32. A significant number of risks remain. Risks are first and foremost of a legal nature, as beyond the measures already ruled unconstitutional, other measures included in the Budget Law have been sent to the Constitutional Court (the wage scale revision and the changes to the survivors' pension entitlements as well as two further measures of lower yield). Other important risks relate to the implementation of various planned consolidation measures. Beyond the above-listed PER measures which suffered delays, implementation risks concern above all the cost reduction in line ministries. The planned cuts in public employment, which follows the significant reduction of close to 9 percent since 2011, represent a significant challenge in terms of implementation while ensuring an adequate provision of public services and also in terms of reintegrating the redundant work force into the private sector. In addition, the ministerial expenditure savings have been introduced by expenditure ceilings for each line ministry. In light of past significant slippages, the attainment of the estimated savings crucially hinges on the respect of the agreed expenditure ceilings, which will need to be closely monitored through regular reporting to the Council of Ministers. Beyond the PER, smaller-scale revenue measures might not yield the budgeted savings: e.g. the implemented tax increase on company cars is expected to yield less additional revenue than initially planned; the design, implementing legislation and the timeline for the sale of online gambling licences are still to be defined and lag behind the envisaged schedule. Implementation risks also related to the envisaged one-off measures as similar measures often suffered significant delays in the past. Moreover, the recording of these transactions as deficit reducing would first have to be analysed by Eurostat. On the positive side, a possibility of some positive carry-over from 2013, the improved situation in the labour market as well as a more tax-rich environment might boost revenue collection beyond the budgeted levels.

33. The Corporate Income Tax reform, which was approved with the votes of more than 85% of Members of Parliament, is expected to contribute to the recovery and competitiveness of the Portuguese economy. Supported by the most relevant social partners, the CIT reform was approved with the votes of the largest opposition party, which should provide medium-term stability to investors. The new rules will be applicable as from 1 January 2014 and are intended to improve the competitiveness of Portuguese companies in seeking business in the global landscape and to make Portugal an attractive destination for foreign investors. One of the key elements of the reform is the lowering of the standard CIT rate from 25% to 23% and a reduced 17% rate applicable to the first EUR 15,000 of taxable income for SMEs. It is also foreseen that a possible further reduction of the standard CIT rate in 2015 will be subject to the consideration of a special committee that should take into account the results of the reform and the economic and financial situation of the country. In addition to the existing surtaxes, a third state surtax of 7% will apply on taxable profits exceeding EUR 35 million. Other key provisions of the reform include the revamping of tax incentives, changes to dividends and capital gains taxation, group taxation and intangibles regime, the introduction of a participation exemption regime, an extension to 12 years of the period in which tax losses can be carried forward and further limitation to the interests' deductibility. The reform is being implemented within the existing budgetary envelope to respect the fiscal consolidation targets.

Box 2.1: The Reform of the Corporate Income Tax

Following extensive consultations with the relevant stakeholders and a parliamentary approval by 85 percent of its members, representing both the governing coalition and the main opposition party, a comprehensive reform of the Corporate Income Tax (CIT) entered into force on 1 January 2014. The authorities sought the broad social and political support to the reform so as to ensure policy certainty over the medium to long-term and raise the attractiveness of the country as a destination for national and foreign investors. According to the law, the reform is designed to "promote sustainable economic growth based on private investment and internationalisation of the economy". The CIT is considered as a key fiscal tool to stimulate investment, improve competitiveness and lift the potential growth rate. In particular, with its focus on investment, the reform is intended to stem the secular downward trend in private investment, which has even accelerated in the last years. The reform also considers the CIT a crucial element to improve competitiveness in an increasingly globalised world, even though non-tax factors play a very important role in international investment location decisions.

The reform stands on three pillars: 1) the redesign of the corporate income tax structure, which includes a gradual decrease in the tax rate, restructuring of the tax base, revamping of tax expenditures and special provisions for SMEs; 2) the simplification of tax compliance and other tax administration procedures, which should enhance legal stability, lower compliance costs and reduce litigation; and 3) new tax rules on cross-border business activities, aimed at promoting Portugal's inbound and outbound investment.

Several indicators suggest the need for a deep CIT reform. In 2011, Portugal taxed intensively capital with an implicit tax rate on capital and business income of 21.4 percent, above the Euro area average of 17 percent. ([1]) Portugal collected about EUR 5 billion from CIT in 2013 (+18.8 percent compared with 2012), or 3 percent of GDP – one of the highest levels in the EU. ([2]) CIT rates have also been relatively high: in 2013, the maximum marginal statutory nominal tax rate reached 31.5 percent (the 4th highest rate in the EU). In 2012, the effective average tax rate stood at 25.2, which is the 5th highest rate of the 21 EU Member States considered in the report of the CIT-Reform Committee and which had an average rate of 21,7 percent. However, Portugal ranked slightly better with respect to the effective marginal tax rate (EMTR), with 15 percent compared to 12.9 percent for the 21 EU Member States in 2012. ([3]) The tax expenditures associated with CIT have been substantially reduced in recent years (from 2.3 percent of GDP in 2010 to 0.8 percent of GDP in 2013). ([4])

In order to reduce the high level of corporate taxation, one of the key elements of the reform is the lowering of the standard CIT rate in 2014 from 25 percent to 23 percent and a reduced 17 percent rate applicable to the first EUR 15,000 of taxable income for SMEs. According to the approved law, a possible further reduction of the standard rate to 21 percent in 2015 and further downward to a range between 17 and 19 percent in 2016 will be subject to the consideration of a special committee, which should take into account the results of the reform and the economic and financial situation of the country. In addition to the existing surtaxes (a municipal surtax up to 1.5 percent, a state surtax of 3 percent on profits exceeding EUR 1.5 million and a 5

([1]) *2013 Taxation Trends Report*. The implicit tax rate is the result of the tax revenues divided by its underlying economic base.
([2]) According to the *2013 Taxation Trends Report* Portugal ranked 6th in the EU in 2011 in the share of corporate tax as percentage of GDP.
([3]) Data from the report of the CIT-Reform Committee, available at http://www.portugal.gov.pt/pt/os-ministerios/ministerio-das-financas/documentos-oficiais/20130730-seaf-reforma-irc.aspx. The EATR measures the total tax over before-tax profits and is the relevant indicator driving locational decisions by multinationals. The EMTR measures the increase in the cost of capital due to the tax in a country and in theory drives the decision of how much to invest, as it measures the return of an investment project by comparing capital cost to marginal revenue.
([4]) 2013 Tax expenditures report, available at http://www.portugal.gov.pt/media/856397/Relatorio_Despesa_Fiscal_2012.pdf

(Continued on the next page)

Box (continued)

percent surtax on profits exceeding EUR 7.5 million), a third state surtax of 7 percent will apply on taxable profits exceeding EUR 35 million as from 2014 (which is expected to fall mainly on the non-tradable sector). In the aggregate, the new rate structure implies a maximum marginal rate of 31.5 percent. Furthermore, since a progressive rate structure in corporate taxation can be a source of distortions and has no relation with the shareholders' ability to pay tax, it should only be a temporary fiscal measure to address the current fiscal constraints and phased out over time.

The reform also impacts on the effective tax rates via its tax base effects and it has base-broadening and base-narrowing elements. At this stage, in the absence of an assessment by the authorities of the relative weights of these elements, it remains unclear whether the statutory-rate reduction is accompanied by a simultaneous net widening of the tax base. The base narrowing provisions include: the introduction of a general participation exemption regime with a 5 percent threshold which covers dividends and capital gains; the optional regime for exemption of foreign branch profits; the extension of the tax losses deduction period from a 5-year to a 12-year period; the partial exemption of profits derived from exploiting patented inventions and other innovations protected by intellectual property rights (patent box regime); the changes to the group taxation regime, which among others reduces from 90 percent to 75 percent shareholding the threshold for group taxation eligibility; the deductibility for expenses incurred for purchasing intangible assets not subject to amortisation. Base-broadening provisions include the repeal of some tax incentives that were considered not effective; ([5]) limitation to deductibility of carry-forward tax losses to 70 percent of taxable profit; the increase to 24 months of the required holding period to benefit from the participation exemption regime; and the review of the interest barrier rule, which strengthens the limits for the deductibility of net financial expenses. The latter, besides protecting the CIT base, aims at addressing the high debt-bias of the Portuguese CIT regime (the 4th strongest in the EU in 2012, as evidenced by the wide gap between the EMTR on equity and debt-financed new corporate investment ([6])). Furthermore, at a macro level, the rate reduction is likely to induce an endogenous broadening of the CIT base through multiplier effects (see below).

The objective of simplification is of primary importance and one of the strongest elements of the reform. Available indicators on the time involved to comply with tax obligations ([7]), the value of pending cases in tax courts and the duration of tax disputes, tend to rank Portugal among the countries where tax compliance is more burdensome and with a high rate of tax-related litigiousness. Through several simplification measures the CIT reform helps to reduce the tax compliance burden for taxpayers, which can even have a more significant impact than tax rate reductions and possibly reduce tax avoidance. The simplification of tax obligations is achieved through the removal of several situations of pre-clearances with tax authorities; changes on the formalities for application of tax treaty benefits; and the harmonization of CIT rules with the new international accounting standards in force in Portugal since 2010. The introduction of an optional simplified CIT regime for SMEs is also consistent with best practices, though it needs careful monitoring to ensure the intended simplification.

The reform package also includes a number of new tax rules on cross-border business activities, aimed at removing some barriers to investment in and from Portugal, notably by addressing international double taxation. These rules include the amendment of the income tax exemption for dividends and capital gains received by a Portuguese company (inbound) and withholding tax exemption for distribution of dividends by a Portuguese company (outbound); an optional exemption method for foreign branch profits; and the revision of the international tax policy through the (re)negotiation of double taxation treaties. These measures are accompanied by anti-abuse provisions to ensure the protection of tax bases from tax planning, especially the use of tax havens.

([5]) The CIT-related tax expenditures will go down after the reform to 0.2 percent of GDP, though a large share of the reduction, from the 0.8 percent of GDP in 2013, is due to definitional issues related to the *SGPS* regime.
([6]) *Tax Reforms in EU Member States*, 2013.
([7]) 275 hours in Portugal vs. the 267 world average, according to the 2013 PwC Study on *Paying Taxes*.

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Box (continued)

The European Commission's QUEST model ([8]), calibrated for Portugal, has been used to assess the macroeconomic impact of the reform, assuming future changes in taxation are announced now and fully credible. In the simulation, the tax burden of firms is decreasing in the first year by about 0.2 percent of GDP as a result of tax rate and tax base changes. ([9]) In addition, a gradual lowering of the statutory tax rate to 19 percent in 2018 together with the elimination of the municipal and state surtaxes is considered. Compared with a baseline scenario without CIT reform, real GDP would be 0.3 percent higher after three years and investment would be around 3 percent above the initial level. Multiplier effects resulting from increased output and consumption levels dampen the initial fiscal revenue loss, but the reform would not be self-financing in the short to medium term implying budgetary costs of about 0.15 percent of GDP per year in the first three years (assuming a 2 pps CIT rate reduction each year). ([10]) ([11]) However, the authorities maintain that the improved CIT collection of about 0.2 percent of GDP resulting from the e-invoicing reform will cover the remaining budgetary costs. The Government is thus committed to implementing the reform within the existing budgetary envelope to respect the fiscal consolidation targets.

([8]) QUEST is a global *macroeconomic* model developed by the European Commission for macroeconomic policy analysis and research. Information on the model features and publications using QUEST can be found at http://ec.europa.eu/economy_finance/research/macroeconomic_models_en.htm.
([9]) The initial budgetary effect of 0.2 percent of GDP revenue loss takes into account the two percentage points statutory rate reduction (EUR 100 million or 0.06 *percent* of GDP loss in CIT revenue from each percentage point reduction of the statutory CIT rate, according to the report of the CIT-Reform Committee), other changes to the CIT rates (eg third state surcharge) and quantified changes to the tax base (e.g. from the participation exemption regime, limits to the deductibility of interests, etc). The increase of autonomous taxation is not considered in these simulations, as it is not part of the CIT reform objectives.
([10]) Over time, the reduced CIT rate would widen the tax base through higher investment and profits. According to the report of the CIT reform committee, this dynamic effect would reinstate between 1/3 and 1/6 of the initial revenue loss. Therefore, accounting for some early dynamic effects, the budgetary cost of the approved reform is expected to amount to 0.15 percent of GDP in 2014, although most of it would be felt when the CIT liabilities are declared by companies in 2015.
([11]) Only reducing the firms' tax burden in the first year by 0.2 percent of GDP without further rate reductions in future years would have qualitatively the same macro-fiscal effects, albeit at a smaller scale.

Fiscal consolidation over the medium term

34. Sustained fiscal consolidation beyond the Programme period should bring the deficit below 3 percent of GDP in 2015. Under the current macroeconomic scenario, permanent fiscal consolidation measures amounting to about 1.2 percent of GDP will be necessary to reach the 2.5 percent deficit target in 2015. This translates into a fiscal effort, as measured by the change in the structural balance, of 0.9 percent of GDP and an improvement in the structural primary surplus from 1.7 percent of GDP to 2.6 percent of GDP (see Table 7). Going further, the government is committed to fulfilling the requirements of the fiscal compact of a structural deficit of 0.5 percent of GDP by 2017 .

35. The 2014 Fiscal Strategy Document will provide details of the medium-term budgetary plans, in compliance with the EU budgetary framework requirements. The strategy to achieve the fiscal targets in 2015 and beyond is however not yet defined. First steps go in the direction indicated in the Reform of the State document, which focuses on social security sustainability, public administration reform, greater efficiency in health and education and environmental taxation. Broad-based consultations with political and social partners to advance and define reforms are ongoing. The progress in this process will be analysed at the Eleventh Review and identified measures will be reflected in the 2014 Fiscal Strategy Document.

Debt developments

36. The debt-to-GDP ratio is expected to peak at 129.4 percent in 2013 and to decline thereafter. In spite of the better-than-expected budget execution, the debt ratio in 2013 was revised upwards, which is largely explained by a substantial increase in the Treasury's cash balance at the end of the year as well as the postponement to 2014 of some debt reducing operations on the part of the Social Security Financial Stabilisation

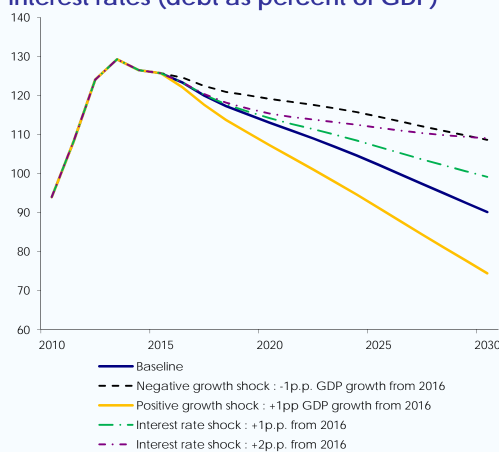
Box 2.2: Government Debt and Fiscal Sustainability in Portugal

Under the programme scenario, government debt is projected to peak at 129.4 percent of GDP in 2013 before starting a gradual decline. The baseline long-term calculations shown below incorporate the programme scenario up to 2017. The programme scenario includes fiscal consolidation measures up to 2015 and showing no-policy-change for the outer years. More details on these figures are shown in Table 7 in the annex. The turning point in 2013 is the result of achieving a small primary surplus, combined with a positive, albeit still modest, GDP growth rate. After 2017, 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 4.5 percent; (iii) nominal GDP growth fluctuates between 3.5 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 are factored into the analysis.

Full compliance with the programme's consolidation path ensures a gradual decline of the debt ratio over the longer term. Nevertheless, for a significant 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.

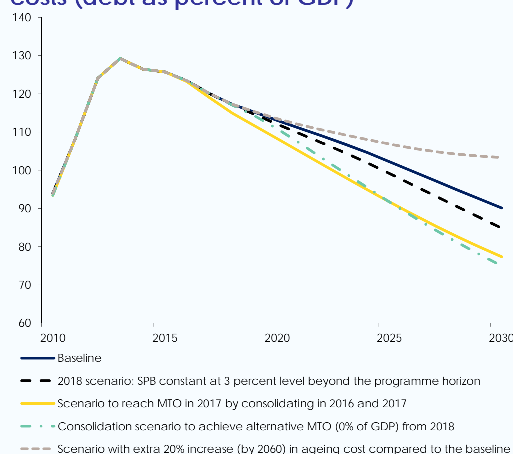
Graph I illustrates the sensitivity of the debt trajectory to macro-economic assumptions by considering a shock to real GDP growth and hikes in interest rates as from 2016. In line with the results of the last review, the analysis suggests that a lower GDP growth rate by one percentage point or a higher interest rate on maturing and new debt by two percentage points could put at risk the declining trend over the medium term. An interest shock of 1 percentage point would slow down the pace of debt reduction but keep the declining trend. Conversely, a positive shock to medium and long-term growth on account of the structural reforms undertaken would result in visibly lower debt-to-GDP ratios and a faster pace of debt reduction. ([1])

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



Source: Commission services

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



Source: Commission services

([1]) Not taking into account the positive indirect effects of the higher GDP growth on the fiscal balance.

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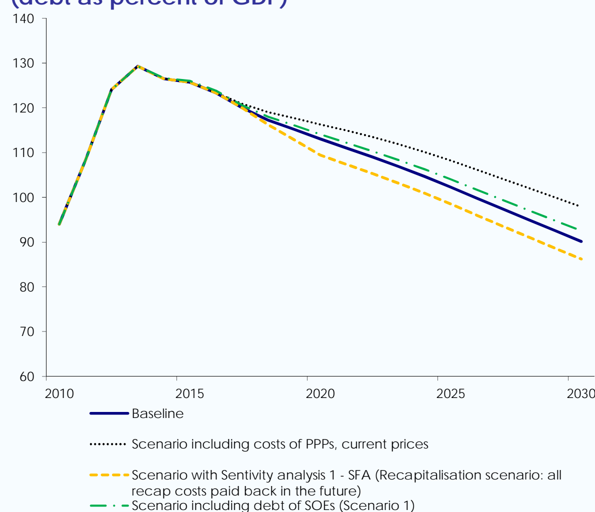
Box (continued)

Additional fiscal consolidation beyond the programme horizon would clearly accelerate the debt reduction path (Graph II). In particular, reaching the Medium Term Objective (MTO) of a structural deficit of 0.5 percent in 2017 as per Fiscal Compact requirements would require a cumulative fiscal effort of about 1.3 percent in 2016 and 2017 and reaching a primary surplus of nearly 4.0 percent. Maintaining the MTO over the longer term horizon will require primary surpluses of up to 3.9 percent up to 2020, declining gradually to close to 3.0 percent over the following decade. Under these assumptions, the debt to GDP ratio would accelerate its decline already in 2016, falling below the pre-crisis ratio around the middle of the next decade and maintaining the sustainable downward path thereafter. A slower pace of consolidation but aiming at a more ambitious MTO of 0 percent would also bring down the debt-to-GDP ratio in the long run. On the other hand, if ageing costs are allowed to rise significantly (simulated as a 20 percent increase) (2), 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 percent 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 an increase in the level of the government debt and delay its decline, 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. The envisaged 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 accelerate 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 number of plausible scenarios. However, the solid reduction path crucially hinges on medium and long-term economic growth, pointing to the necessity of persevering with the implementation of structural reforms, and it is only attainable if fiscal responsibility is maintained also after the end of the programme period.

(2) 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.

Fund. Accordingly, net debt – i.e. excluding Central Government deposits - is projected to peak at about 120 percent of GDP in 2013 and 2014, which is slightly below the level estimated at the previous review. The expected decline in the general government debt-to-GDP ratio starting from 2014 is expected to be supported by the projected economic recovery as well as by further use of cash deposits and the realisation of the Social Security's short-term debt-reducing operations. Assuming further that the Medium Term Objective (MTO) of a structural deficit of 0.5 percent of GDP will be reached from 2017 on, the debt-to-GDP ratio would be on a steeper downward path falling below 100 percent in the second half of the next decade.

FISCAL STRUCTURAL REFORMS

Fiscal policy framework

37. Further improvements to Public Financial Management (PFM) are necessary to ensure sound fiscal policymaking. The report prepared by the Working Group for the Reform of the Budget Framework Law (BFL) – created within the Ministry of Finance – identifies the main shortcomings of the Portuguese PFM system and proposes various reforms to address them together with a streamlined structure for the BFL. The reform proposals include, among others, a budget calendar consistent with the EU surveillance cycle, the transmission to Parliament of most of the planning documents in a single package by mid-April to provide guidance for the budget preparation, a stricter definition of expenditure ceilings to cover all expenditure – and not just those financed out of general revenues –, a substantial reduction in the number of budget appropriations and an improvement of accounting and cash management practices by developing a single treasury account. Given the scope of the required reforms a broad-based consultation with all the relevant stakeholders and further technical work is needed and should proceed during the first quarter of 2014 so that the key aspects and the structure of the new law can be announced in April 2014. Progress is to be assessed at the Eleventh Review. A change to the law is still expected to be adopted by March 2014 to clarify some aspects of the transposition of the fiscal compact and the six-pack, which were identified in the report of the Working Group. An IMF Fiscal Transparency Evaluation will be undertaken and published by mid-2014.

Revenue administration

38. With the aim to improve taxpayer compliance over time, reforms towards a modern compliance risk management model continue. A new Risk Assessment Unit has been recently established and will become operational in early 2014. Its initial purpose will be to focus on improving compliance of certain groups of taxpayers, such as self-employed professionals (e.g. doctors or lawyers) and high wealth individuals, which are often perceived as not currently paying their fair share of tax. Another reform to be undertaken early next year, which was part of the organisational reforms of tax administration that started some time ago, is the creation of a Taxpayers' Services Department. This service will unify all services related to taxpayers within the tax administration and aims at improving the relationship with taxpayers.

39. The reduction of local tax offices, which is part of the revenue administration reform agenda since the beginning of the Programme, has not yet started. The target of closing 25 percent of local tax offices by end-2013, which had been already postponed by a year with respect to initial plans, was unachievable and has been further postponed. The government is committed to closing 25 percent of local tax offices by Q1-2014 and a cumulative 50 percent by May 2014. Portugal is one of the countries with highest number of local tax branches per inhabitant (about 34 local offices per 1 m inhabitants which compares to the average 17 at the EU-27 level, OECD, 2011).

40. The e-invoicing reform implemented in 2013 has proved successful in improving control on taxpayers and efficiency in tax collection. Approximately 4 billion invoices are expected to have been submitted by companies up to December, allowing the tax administration to cross-check information between the amounts companies issued and declared for tax purposes and triggering targeted audits when mismatches are detected. Additional investment and specialised staff will be required now to process this information and use it in the best way to further improve the fight against fraud and boost revenue collection. Part of the 1000 tax auditors to be hired in the coming months - following a recent competition - will be allocated to this task. Enhanced monitoring and strengthened compliance deriving from the e-invoicing reform partly explain the increase in VAT revenue in 2013 (other part is explained by the one-off debt recovery scheme): until December, the VAT collection increased by 3.5 percent y-o-y in cash terms, which compares to the 1.3 percent estimated fall in private consumption in 2013. Efficiency gains in tax collection have also improved and are expected to further improve CIT and PIT revenue in forthcoming years. The authorities maintain that companies' taxable income has been enlarged by about 5% thanks to the recent e-invoicing reform,

leading to a positive budgetary impact of about 0.2 percent of GDP.

41. Further necessary reforms shall be launched in the revenue administration. A recent IMF-led technical assistance mission on revenue administration has focused on further necessary reforms. These include, in particular, the Portuguese anti-money laundering framework and improvements in the tax administration's access to financial information of taxpayers (or data transmission from the financial sector) in accordance to international standards, whilst respecting bank secrecy rules. The Portuguese authorities are committed to further reflecting on the issues Regional and local governments

42. Public finance at local level continues to improve. The stock of arrears has come down from EUR 1.7 billion at end-2010 to EUR 767 million in October 2013 with a significant improvement last year also thanks to the already implemented settlements under the programme for arrears clearance at local level (PAEL). The total debt of municipalities decreased from about EUR 8 billion at end-2010 to EUR 6.6 billion up to October 2013, essentially resulting from aggregate budget surpluses in the years 2010-2012.

43. Budget execution and public sector reforms in the two autonomous regions are generally on track. The authorities' 7th evaluation report on the economic and financial adjustment programme for the Autonomous Region of Madeira regarding implementation until the third quarter of 2013 concludes that "the Region has made considerable progress in its adjustment, having implemented a significant number of measures foreseen in the programme, while there are still a number of important measures ongoing or delayed". ([6]) At the end of September 2013, the regional budget (in terms of public accounts) had a surplus of EUR 85.6 million compared to a programme target of EUR -102.7 million. Drawing mainly on bank loans with a central government guarantee of up to EUR 1.1 billion for this purpose, the regional government repaid EUR 912 million of arrears, even though at the same time liabilities increased by EUR 107 million. A report assessing the possibility of ongoing public works is still delayed, and negotiations on the two motorway PPPs with the aim of achieving important savings are not yet concluded. Privatisation has made progress with the sale of the Madeira airport concession to ANA, but several privatisation procedures still remain to be concluded. As for the Azores, at the end of November 2013 the budget of the regional government showed a small surplus of EUR 3.1 million. Autonomous services and funds and other entities within general government had a joint surplus of EUR 32.1 million.

Public administration reform

44. Public administration reform continues to make progress, in addition to the related measures in the context of the public expenditure review (see above). The process of staff reduction is still well ahead of the Programme objective of a staff reduction across all layers of government by 2 percent per year in 2012-14. An 8.7 percent reduction relative to end-2011 was achieved by September 2013 (from 611,801 to 558,746), decreasing by 9.9 percent at central level and by 5 percent at regional and local level. From January to September 2013, the number of fixed-term contracts was reduced by 24.3 percent (from 73,385 to 55,578). The General Public Administration Labour Law is still to be approved by the Parliament, but some important elements (40 hours week, requalification scheme) are already in force through separate laws. The authorities presented to EC/ECB/IMF staff a preliminary report, of which a final version was published at the end of 2013, on the main results of the survey on wage supplements in the public administration. More than 280 different supplements and more than 410,000 supplement payment events were observed, with a total value of about EUR 700 million or 5% of the total wage bill. ([7]) In the central administration they are highly concentrated in the ministries of internal administration, defence, health, finance, and justice which together account for 86 percent of

([6]) Contrary to what is stipulated in the Memorandum ("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"), the report was not made available to EC/ECB/IMF staff ahead of the Tenth Review mission and only published on 20 December.

([7]) This does not include the meal allowance, which accounts for about EUR 520 million per year, and overtime work, which accounts for about EUR 120 million per year.

the total annual pay of supplements. Out of 328 identified careers, 38% receive only one type of supplement while the remainder have access to more than one supplement of which 24% receive five or more types of supplement. 87% of the supplements are paid on a monthly basis throughout the year. Guiding principles of a possible reform are to simplify the catalogue of supplements, to pay supplements on the basis of function rather than status, and to improve the allocation of risks currently compensated by supplements. The authorities' objective is to establish a single scale of supplements, for which draft legislation will be presented by the eleventh review with a view to its implementation by mid-2014, among others by reducing their number, establishing fixed amounts, and organising them along broader categories.

SOEs, PPPs and privatisations

45. The new framework law for state-owned enterprises (SOEs) ([8]) entered into force on 3 December 2013. It encompasses a set of changes, including the Ministry of Finance's enhanced shareholder role (and similarly municipalities' role vis-à-vis local SOEs). At the end of December, the Government approved a diploma creating the Technical Unit for the monitoring of SOEs providing technical support to the Minister of Finance. At the same time, SOEs' indebtedness is now subject to specified limits for long-term debt and risk derivative instruments, with the public debt agency (IGCP) assuming a key monitoring role as well as the SOEs' cash management. SOEs, in particular in the transport sector, have been undergoing a comprehensive restructuring programme including the optimisation of services, an update of tariffs (prices and system) and a significant reduction in personnel since the beginning of the Programme. However, the reinstatement of the 13th and 14th bonus salaries in the public sector is posing significant new challenges to expenditure reduction and the objective of meeting operational balance in 2013 and beyond. On the other hand, the unwinding of derivative contracts has had a positive impact in the transport sector companies' EBITDA. ([9]) At the same time, the government continues to work on strategies to deal with the heavy indebtedness of several SOEs.

46. Privatisation continues, even though the Programme target in terms of proceeds has already been exceeded. 70 percent of the postal service company (CTT) was privatised through an IPO in early December 2013, with the share price at the top of the price corridor (EUR 5.52 per share). The launch of the privatisation of the waste management company (EGF) will occur during the first quarter of 2014 pending changes in the regulatory framework that are underway. The delay in unbundling the rail freight terminals from CP Carga is stalling its privatisation. The privatisation of TAP is still considered, although without concrete deadlines and dependent on market conditions. Both CP Carga and TAP are using the delays in the privatisation to strengthen their operational balances. Public transport services in Lisbon and Oporto (Carris and Metro de Lisboa; STCP and Metro do Porto) are being restructured with a view to opening their concessions to private operators.

47. Renegotiations of several PPPs were not yet concluded at the time of the Tenth Review. The renegotiations of the road PPPs' are well advanced, but the fine-tuning of amendments to the concessions contracts that also require the approval/waiver of lending banks have been delaying the completion of the process. The materialisation of the planned savings in the 2013 budget is therefore not yet assured although they will, in any case, be compensated by alternative fiscal measures within Estradas de Portugal ([10]) (see fiscal part for more detail). An audit of a PPP in the emergency and security sector is ongoing and renegotiations of the contract are expected to start in 2014. Following the Government decision not to award the new Hospital Lisboa Oriental (HLO) PPP tender ([11]) launched in 2008 but suspended before awarding, the Ministers of Finance and of Health are creating a joint project

([8]) Decree-Law 133/2013, of 3 October 2013.
([9]) EBITDA – earnings before interest, taxes depreciation and amortisation.

([10]) *Estradas de Portugal* is an SOE inside general government perimeter. It is in charge of running all roads not given to private companies through concession or sub-concession contracts in mainland Portugal.
([11]) Joint Executive Order 15799/2013, by the Ministers of Finance and Health, taken in 13 November 2013 and published in the 4 December official gazette.

team by end January 2014 ([12]) that will assess the best way to develop the project. For the Physical Rehabilitation Centre in Algarve (CMFRS - Centro de Medicina Física e de Reabilitação do Sul), whose PPP contract expired in October 2013, the Ministry of Health will launch a new tender on the basis of the PPP framework law.

Healthcare sector

48. Reforms have produced important savings in the sector through important efficiency gains. Indeed, for the National Health System (NHS) as a whole, expenditure in 2013 is likely to be about 14 percent lower than in 2010 (EUR -1.3 billion), while overall revenues have decreased by about 9 percent. Indeed, in a context of reduced revenues where budget transfers were reduced by 11 percent since 2010, almost all cost categories show a consistent reduction. The only exception is staff costs which, following an important reduction, have again increased with the reinstatement of the 13th and 14th bonus payments. Importantly, the consolidated deficit for the sector (Central Government and SOEs together) shows a significant reduction since 2010: from about EUR 800 million to an expected EUR 150 million in 2013), and in spite of the reduced budget transfers and the consequent reduction in transfers to SOE hospitals. In addition, an important stock of overdue debt has been paid through the debt settlement programme (about EUR 1.9 billion). While arrears have not been fully eliminated (a stock of about EUR 500 million remains to be paid), their accumulation rate and payment time have been reduced. These efforts resulted in a stock of arrears in December 2013 which is the lowest since December 2010.

49. The existence of an important stock of arrears is strongly (though not solely) related to the consistent underfunding of SOE hospitals vis-à-vis their service provision. This is especially the case with respect to a few large hospitals, where actual production consistently exceeds that of the stipulated contract. The proposed hospital reforms can contribute to further improving efficiency in the sector and therefore bringing EBITDA to balance by 2015. However, reform outcomes will take some time to materialise and will not allow for the clearing of arrears in the short term. Moreover, the additional budgetary cuts for 2014, resulting in SOEs seeing their budgets cut in almost 200 million, coupled with an increase in staff costs due to the reinstatement of the subsidies, will make it difficult for SOE hospitals to reduce the stock of arrears in the short term. Despite these budgetary pressures it is important to underline that the NHS has benefited from about EUR 2.3 billion overall injection of additional funds since 2011: about EUR 1.9 billion that was used for the debt settlement program and EUR 452 million used to reinforce SOE statutory capital.

50. Regarding pharmaceuticals, authorities continue to fine-tune policy measures. These measures are leading to important savings in the outpatient sector: a reduction of more than EUR 500 million in public spending and more than EUR 400 in private spending from 2010 up to October 2013. Savings on public spending on hospital pharmaceuticals have been lower but these often comprise the most expensive pharmaceutical products in the market and products without generics. Compared with 2012, public spending on hospital medicines in 2013 decreased by 2.6 percent. Total public spending on pharmaceuticals will be above the set target of 1 percent of GDP. Therefore, the target will be achieved with the collection of about 90 million from the payback agreement with the pharmaceutical industry and some additional administrative measures applied to the companies and products not covered by the payback agreement.

51. With regard to the compulsory INN (active substance) prescription, there are concerns about the observed increase in the use of exemptions, which have reached about 8 percent of all prescriptions. As a result, a number of inspections have been conducted comparing prescription and dispensing of doctors and pharmacies. The authorities will also conduct more detailed analysis by therapeutic group. Furthermore, the increase in the share of NHS reimbursed generics has slowed down. It stands now at 40 percent of overall prescriptions. This target is set at 60 percent for 2014. As a result of the analysis so far, the authorities are considering an additional set of measures. The measures include a communication campaign, a closer

([12]) Joint Executive Order 16933-A/2013, by the Ministers of Finance and Health, published in the 30 December official gazette.

monitoring and identification of doctors and pharmacies having a high number of exceptions to prescription and dispensing rules, and the benchmarking pharmacies' shares of generics and incentives for lower price generics. Regarding inpatient generic medicines, reinforcing centralised purchasing and the implementation of the national formulary are some of the measures planned.

52. The authorities continue to take steps to improve the billing and collection process of moderating fees (co-payments) and fees charged to cross-border/ foreign patients and have set a goal of 90 percent collection for SOEs.

53. Regarding primary care, after the cleaning of patient registration lists, regional authorities will now distribute patients among existing doctors to reduce the number of patients without a family doctor (now at 11.6 percent of residents). However, the number and especially the distribution of family doctors may still be insufficient to cover all patients at this time. The authorities are, therefore, considering additional measures such as the possibility of creating smaller USFs ('Unidades de Saúde Familiares'). A survey on patient satisfaction with primary care is being prepared at the beginning of 2014. Efforts continue to develop the system of electronic medical records and its coverage of the population.

54. Further progress has been observed regarding centralised purchasing. The authorities have presented the on-going tenders which now cover a substantial list of goods, but also services and IT. Also, SOE hospitals are now obliged to use central procurement structures for horizontal services (electricity, fuel, security, etc.) and important savings are expected. The uniform coding for medical devices is advancing faster than planned and, as this develops, more tenders become possible. This is important as medical devices constitute an important share of hospital costs. Some hospitals are already using the codes for monitoring their use and inventory. In addition, the authorities are considering the use of a price observatory system to help hospitals in purchasing medicines and medical devices. Centralised purchasing is expected to play an important role in reducing expenditure in 2014.

55. While the authorities will need to continue to implement reforms in the hospital sector, the system funding may need to stabilise as the room for significant short-term savings is limited. The authorities reconfirmed their commitment to continue to implement hospital reform and increase the efficiency in the sector. The priority is to finalise the 3-year strategic plans for all hospitals. These are to deliver important cost reductions from now to 2016 (now expected to be about EUR 230 million). These additional savings will be the result of further merging, restructuring, closing or redistribution of departments and the consequent reduction of beds and reallocation of staff. At the same time, the system funding may need to stabilise at this stage if the stock of arrears related to underfunding is to be addressed and as the room for significant short-term savings is limited. Regarding the pharmaceutical area, another agreement with the pharmaceutical industry may also be crucial to control spending in this area while allowing for some innovation.

FINANCIAL SECTOR

56. Banks continue to improve their capital ratios. Building on the positive trend of core capital improvements in recent years, the banking system's core capital ratio increased in Q3-2013 to 12.2 percent. While the adverse operating conditions resulted in a reduction of the amounts of core capital for some of the largest banking groups, they were more than compensated by the decline in risk weighted assets (RWA). Given banks' limited earning power in the current economic situation, the sizeable amount of NPLs on balance sheets and the ongoing restructuring in some of the biggest institutions, an adequate solvency ratio is and will remain paramount in assuring financial stability. In that context, the phasing-in of the CRD IV capital standards is progressing smoothly. From January 2014 all banks are requested to hold a minimum 7 percent of Common Equity Tier 1 (CET1). In that transition context, 2014 will entail a thorough balance sheet review and stress test for some of the larger banks, led by the ECB before the SSM becomes operational in November. The largest banks are expected to maintain a CET1 add-on of 1 percentage point.

57. Banco de Portugal's (BdP) stress testing framework has undergone major improvements. BdP's stress testing framework is designed as a constrained bottom-up exercise, under which participating banks apply their own models to evaluate the impact of macroeconomic scenarios specified by the EC/ECB/IMF during the Programme Review one quarter earlier. In 2013, BdP recalibrated the credit risk model used to guide the methodology applied by banks in their quarterly bottom-up stress tests. BdP has also implemented a new top-down stress testing methodology, which it plans to use as a basis to more systematically benchmark and challenge banks' quarterly submissions.

58. To widen the range of financing alternatives for the corporate sector, notably SMEs, a development financial institution (DFI) will be set up. The DFI is planned to be operational by the second half of 2014, with a view to concentrating the efforts aimed at streamlining and centralising the management of the financial instruments of EU structural funds for the 2014-2020 programming period and fostering financing alternatives for the corporate sector. The sole purpose of the DFI shall be to address market failures in the financing of private non-financial companies, notably SMEs. Some of the main features of the undertaking have already been decided and are reflected in the feasibility report of October 2013 of the Inter-Ministerial Working Group on the DFI . This work benefited from the technical assistance of KfW, the German development institution. According to the report, the financing of the corporate sector will be provided through new financing instruments, preferably those targeting the capitalisation of companies. The DFI will not accept deposits or other repayable funds from the public, nor will it engage in direct lending. It will be a direct counterpart to multilateral institutions, such as the European Investment Bank, the European Investment Fund and other developments banks such as the KfW. It is expected to obtain funding from these institutions. Its final structure and by-laws will reflect in-depth consultation with EC, ECB and IMF staff and will be designed to ensure no additional burden on, or risks to, the public finances.

59. To facilitate short-term financing alternatives for companies, the regulatory and tax environment of commercial paper was revised. A legislative proposal to modify the regulatory environment applicable to the commercial paper was submitted in early December 2013 and subsequently adopted by the Council of Ministers in early January 2014 in the form of a Decree-Law. . Also, in December a law entered in force foreseeing concrete tax incentives for the investment in commercial paper. Under the new taxation regime, non-resident investors in commercial paper issued by resident companies will be exempt from corporate and personal taxation on interest income and capital gains, following similar terms to those already applicable to bonds and treasury bills. It is expected that this set of changes will foster the use of commercial paper as a financial instrument in Portugal, thus facilitating the short-term financing of the corporate sector and the development of the capital market.

60. New debt restructuring and recovery tools directed at households are in place for more than a year. The legal framework was approved in late 2012 and early 2013 for financial

institutions to engage in out-of-court debt restructuring for households and the authorities are now focussed on assessing the implementation of the measures contained therein. With these instruments, loan holders who are unable to meet their financial commitments may benefit from a simpler way to sort out their default problems without having to engage in judicial procedures. The general regime for households' debt restructuring requires banks to develop risk management systems to monitor and prevent the risk of default by borrowers, as well as guidance on a standard negotiation procedure between the credit institution and the bank client, aiming at the non-litigious settlement of debts. Credit institutions concluded procedures worth EUR 7.2 billion for non-litigious debt settlement between January and September 2013. 42 percent of such procedures ended with the payment of the overdue amount to the bank or with an agreement between the parties, while for the majority of cases no agreement was found between the parties. Mortgage borrowers in extremely difficult financial situations are protected by an extraordinary regime which is very restrictive. Between December 2012 and September 2013, the outstanding amount of the credits renegotiated under this regime was worth EUR 13.8 million. The figures available thus far are still preliminary and subject to revisions. BdP is of the view that a more complete and accurate assessment of the implementation of the general and the extraordinary regimes will only be possible once information covering the entire year 2013 will be available, which is expected by mid-February 2014. A more thorough assessment of the regimes will be a key tool in monitoring the impact of the household debt restructuring processes which contribute to the smooth deleveraging of the private sector debt overhang. In addition to these new tools, a network of consumer protection advising entities to advise households under financial distress and prevent the recurrence of over indebtedness is now fully operational.

61. **The impact of the corporate insolvency and recovery law is being assessed.** The legislation which entered into force in 2012 put in place in-court and out-of-court corporate debt restructuring and recovery mechanisms for companies, to help the recovery of companies in financial difficulties and to prevent bankruptcies when the companies continue to be economically viable in spite of their temporary financial problems. These mechanisms (PER and SIREVE) are now operational for some months and authorities' quarterly reports and a survey of insolvency stakeholders revealed that there is still room for improvement regarding the rate of successfully concluded cases. One critical element may be the fact that companies arrive too late to the procedure, i.e. already in a technical bankruptcy state which is very hard or impossible to reverse. The reform of the insolvency law is accompanied by ancillary measures, such as to ensure that a sufficient number of qualified insolvency administrators is made available to the system. The Ministry of Justice launched a recruitment procedure for the admission of 60 new professionals.

62. **The tracking of restructured loans is being eased. The regulation on the Central Credit Registry (CCR) was recently revised and will allow for the identification of non-performing loans as of January 2014.** Furthermore, as of July 2014, the CCR will also provide information on government guarantees and will allow the identification of overdue and written-off loans disputed in court. Banks' IT systems were updated accordingly. Some further enhancements to the CCR are envisaged, such as the enlargement of the set of financial products that are reported through the CCR and the broadening of access.

63. **The Recapitalisation Law has been updated.** The legislative process introducing the necessary amendments to the Recapitalisation law to reflect the recent Communication from the European Commission on the application of the state-aid rules to support measures in favour of banks in the context of the financial crisis has been concluded. The amendments include, inter alia, rules on capital raising measures by the bank, on measures to prevent the outflow of funds prior to a restructuring decision, and on burden sharing.

Box 2.3: Roadmap for Improving the Effectiveness and Governance of the National Guarantee System

The Portuguese National Guarantee System (NGS) is a two-fold guarantee system to support the financing of SMEs, composed of four mutual guarantee companies (SGMs) and, at an upper level, a state-backed counter guarantee fund (FCGM).

The four SGMs cover distinct regions of the country and one is specialised in the agricultural sector. These companies operate on a PPP model having as shareholders both private entities (non-financial corporations and credit institutions) and public bodies (including the holding company of the FCGM and the IAPMEI). The SGMs share risk with commercial banks through the provision of guarantees to SME credit extended by banks. The guarantee varies, but as a rule covers 50-75 percent of the total loan.

The FCGM is a fully state-funded endowment managed by a management company (SPGM) that provides a counter-guarantee to the guaranteed part of the loans. The guarantee varies but on average covers 82 percent of the guaranteed part of the loans extended by the SGMs. The counter-guarantee fund absorbs the losses incurred by the state associated with defaulted loans.

The management company of the FCGM is currently owned by state bodies (mainly the IAPMEI), although private institutions, notably commercial banks, hold minority stakes. Both credit institutions, the SGMs and the SPGM are subject to the financial supervision of Banco de Portugal. The oversight of the FCGM is carried out by the audit council of the Banco de Portugal. According to the financial statements of the FCGM of 2012, the state portfolio of outstanding counter-guarantees totalled EUR 2.427 billion, whereas the total amount of guarantees extended by the SGMs to firms was EUR 2.968 billion. The counter-guarantee fund had assets of EUR 419.7 million.

Following an audit of the NGS concluded in end-2013, the authorities are implementing a revised roadmap containing measures to improve the governance of the NGS and the allocation of government-sponsored credit lines to SMEs. The roadmap contains measures in five major areas: a) reviewing the schemes' objectives and investment selection processes; b) implementing measures to further enhance loan and guarantee pricing in favour of end users, including through the development of competitive bidding mechanisms for the allocation of guaranteed credit to the banks for SME lend-on; c) reviewing the governance structure and operating model; d) upgrading risk management capabilities and practices at SGMs level; e) improving the supervision, monitoring and management of the state-backed counter guarantee fund (FCGM) exposure; and f) ensuring that mechanisms exist to offset FCGM losses.

The pricing mechanism of the loans allocated by participating credit institutions is being revised to foster price competition among participant financial institutions and transparency towards end users of the guaranteed credit lines. The new mechanism being conceived includes the following elements, which should be in place by end-January 2014: i) the setting of maximum interest rate caps that participating institutions can charge on guaranteed credit lines per major groups of SME risk on the basis of a methodology fed with market data on costs and assumed expected profit inputs; its application will start with the 2014 credit line PME Crescimento; ii) ways to improve the price discovery mechanisms are being considered, notably, if appropriate, the disclosure of statistical data on actual interest rates of the guaranteed loans charged to the beneficiaries by risk class (in this case proposals are to be presented by end-February); iii) close monitoring of the rates effectively charged to ensure that appropriate competition among institutions is in place; and iv) rules governing marketing communication of the guaranteed loans by credit institutions.

Other measures, already in the implementation phase, regard the upgrade of risk management capabilities and practices. At the SGMs level, a new rating model to assess corporate credit risk is being implemented (at IT

(Continued on the next page)

Box (continued)

level) on the basis of a methodology devised with the assistance of an external consultant («the rating project»). Also on the basis of the findings of the previously mentioned audit to the NGS, a project to modify the internal procedures of the SGMs was started, which aims at updating internal procedures and at harmonising procedures across SGMs, including on debt restructuring and recovery processes. A standard reporting across all SGMs is also being implemented. These measures are expected to provide a stronger backing to the decision-making process to award guaranteed credit to individual companies.

As a way to reduce the risk of conflict of interest, the shareholder structure of SPGM, the management company of the state-backed counter guarantee fund (FCGM) will be modified to eliminate the participation of private participants from its shareholder base. The authorities continue to clarify the supervision of the counter-guarantee fund, in particular from a public accounting perspective, and decided to make the annual report and audit report publicly available from 2013 onwards, for increased transparency of the NGS. On the basis of the new rating model adopted, new portfolio tools will be set up to improve the monitoring of the exposure of the FGCM. The combination of these measures, together with the new rating model applicable in the SGMs, is expected to deliver a better monitoring and control of the risks taken by the state and to minimize the inherent exposure by taxpayers, while realising the objectives of the NGS.

The Portuguese NGS continues to be an active party of the European Mutual Guarantee Association (AECM). In 2014, a macroeconomic study will be carried out to assess the macroeconomic impact of the NGS.

Box 2.4: The Growth Impact of Structural Reforms in Portugal

This box presents a quantitative model-based assessment of the potential impact of structural reforms in Portugal, applying the benchmarking methodology described in EC (2013) ([1]). The benchmarking methodology in EC (2013) is based on structural indicators of labour and product markets, and applies a distance-to-frontier approach to quantify the potential for reform by assuming a gradual and partial closure of the gap vis-à-vis the average of the three best EU performers. In order to avoid setting unrealistic and/or unattainable targets, the scenarios involve only half of the gaps being gradually closed. Assuming that the results are roughly linear, more ambitious reforms closing the full gap would double the effects.

In this exercise, reform shocks are based on an updated set of structural reform indicators covering a wide range of areas, including market competition and regulation, R&D expenditure, skill structure, tax structure, labour market participation, unemployment benefit 'generosity' and active labour market policies. The indicators used in this exercise are based on the most recent available data (see Sources, Table I). In some cases, these may not reflect reforms that have recently been adopted and any effects of these will be included in the simulations. We assume that reforms are implemented gradually and phased in over a longer period of 5 years, and considerably longer periods for skill enhancing reforms. However, the overall results may still overestimate how quickly reforms can have an impact in the short term, in particular at the current juncture characterised by depressed demand and tight credit conditions due to public and private deleveraging.

Table I. Structural indicators

		PT	Average 3 best EU performers
Market competition	Final goods sector markups	0.23	0.13
Market regulation	Entry costs	2.3	0.13
Tax reform	Implicit consumption tax rate	18	28.6
	Implicit labour tax rate	25.5	n.a.
Skill enhancing reforms	Share of high-skilled	4.1	10.7
	Tertiary education expenditure (% of GDP)	1.1	2.2
	Share of low-skilled	62.4	7.5
	Secondary education expenditure (% of GDP)	2.5	3.1
Labour market reforms	Female non-participation (25-55ys):		
	- low-skilled	22.4	26.4
	- medium-skilled	8.7	10.5
	- high-skilled	4.6	4.3
	Preschool expenditure (% of GDP)	0.5	1.1
	Low-skilled male non-participation (25-55ys)	9.3	7.7
	Pension related non-participation (55-64ys):		
	- low-skilled	13.8	13.4
	- medium-skilled	4.0	4.8
	- high-skilled	4.6	3.3
	ALMP (% of GDP over unemployment share)	6.9	37.4
	Benefit replacement rate*	58.8	53.7
R&D measure	R&D tax-credit rates	0.49	0.41

* For benefit replacement rate: EU average

Sources:
Final goods mark-ups, 1996-2007: Commission services; Entry costs: starting business costs in percent of income per capita, 2012: Doing business database. www.doingbusiness.org; Implicit consumption tax rate, 2011: European Commission, Taxation trends in the European Union, 2013 edition, Luxembourg, 2013.; Skill-shares, non-participation rates and education expenditure statistics, 2012 or latest available: EUROSTAT; ALMP: 2011 or latest available: EUROSTAT; Benefit replacement rates, 2011: OECD, Benefits and Wages Statistics. www.oecd.org/els/benefitsandwagesstatistics.htm; average of net replacement rates over 60 months of unemployment, 2011; R&D tax-credit rates, average over large and small firms OECD (2013), OECD Science, Technology and Industry Scoreboard 2013: Innovation for Growth, OECD Publishing.

([1]) European Commission (2013), "The growth impact of structural reforms", Chapter 2 in *Quarterly report on the euro area.* No. 4. December 2013. Brussels.

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Box (continued)

A detailed breakdown of the macroeconomic impact of the reform shocks is shown. The table shows GDP and employment effects for each of the reform shocks, assuming all Member States undertake similar reform measures in these areas, after five and ten years and in the long term.

- The model simulations show that large potential gains could be reaped from structural reforms in Portugal. GDP could be up to 3 percent higher after 5 years and 4.6 percent after 10 years relative to the baseline. In the short-run, the largest contribution comes from product market reforms reducing mark-ups. In the medium term, active labour market policy (ALMP) and a tax shift from labour towards consumption taxes also have significant effects on GDP. Skill-enhancing measures have a major impact on GDP in the very long run and account for more than half of the long-term GDP effects. Further contributions stem from decreasing the benefit replacement rates and raising the participation rate of the inactive population (women, low-skilled and older workers). Entry cost reductions and R&D-promoting policies have small effects in the short term but more significant positive GDP effects in the long term.

- In terms of employment gains, product market reforms and ALMP measures have the largest potential to increase employment in the short to medium run. Shifting the burden of taxation from labour towards consumption taxes also has a significant effect on employment, while benefit reforms and reforms aimed at raising the participation rate of the inactive population yield smaller but still significant positive employment effects. In the long-run, skill-enhancing measures account for half of the positive employment gains.

Table II. Breakdown of potential GDP and employment effects (percent difference from baseline)

	GDP			Employment		
	5 years	10 years	50 years	5 years	10 years	50 years
Benefit Replacement Rates	0.1	0.1	0.3	0.1	0.2	0.2
ALMP	0.5	0.6	0.7	0.8	0.8	0.8
Entry Costs	0.0	0.0	0.3	0.0	0.0	0.0
High-Sk. Share	0.0	0.1	3.2	0.0	0.0	0.2
Medium-Sk. Share	0.0	0.3	10.3	0.0	0.1	3.1
Markup	2.0	2.8	5.8	1.0	0.9	1.3
Female Part. Rate	0.0	0.1	0.3	0.0	0.0	0.0
Low-Sk. Part. Rate	0.1	0.1	0.2	0.2	0.2	0.2
Pension Reform	0.0	0.2	0.6	0.1	0.1	0.2
R&D Tax-Credit	0.0	-0.1	0.6	0.0	0.0	0.0
Taxshift	0.2	0.3	0.7	0.4	0.5	0.6
Total	3.0	4.6	23.1	2.6	2.9	6.6

Source: QUEST simulations.

This shows that structural reforms can lead to substantial gains in potential output and employment. The simulations also suggest positive budgetary effects (not reproduced here), with a significant improvement in the fiscal position in the medium run of more than 1 percent of GDP, thus alleviating the need for further consolidation measures and contributing to long-term debt sustainability.

STRUCTURAL REFORMS

Structural reforms are the centrepiece of a credible strategy for sustainable growth in the medium term as they can lead to substantial gains in potential output and employment in Portugal (see Box 2.4). The Government has already adopted a range of challenging structural reforms. The effective implementation of these reforms is crucial to rebalance the economy and boost its growth potential. To this end, the framework for implementation must be reinforced, while progress in implementation must be continuously evaluated to ensure that reforms deliver the desired results. Further reforms will also be needed and should focus on increasing competition and flexibility in product and labour markets so as to facilitate the reallocation of resources from the non-tradable to the tradable sector.

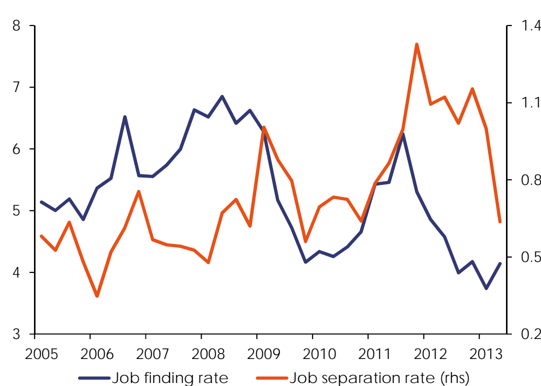
Reform of labour, goods and services markets

Labour market

64. Unemployment started to decline in mid-2013, but it is too early to judge the role of recent reforms in this process. The recent evolution of unemployment is mostly linked to a moderation in job dismissal rates, while job finding rates remain depressed (Graph 2.1). The Portuguese authorities have stressed that net job creation has been taking place especially in the tradable sector, a development in line with the rebalancing of the economy, but it is not clear whether this is of permanent nature. The analysis of new hires by type of contract does not (yet) allow drawing conclusions on the impact of labour market reforms on segmentation, particularly in light of the temporary extension of the maximum duration of existing fixed-term contracts which according to the authorities concerned about 16 percent of workers employed on fixed-term contracts.

65. Revisions of dismissal rules are being prepared in view of the unconstitutionality of some of the previous amendments. Three changes in the Labour Code affecting the definition of fair dismissals were ruled to be in conflict with the Constitution: (i) the replacement of a tenure rule by an objective reason presented by the employer (in case of redundancies); (ii) the end of the obligation for the employer to offer possible available jobs in the same professional category (in case of redundancies); and (iii) the end of the obligation for the employer to offer possible available jobs in the same professional qualification (in case of unsuitability). The authorities are working on proposals to replace these measures. The revisions will be discussed with social partners and submitted to Parliament after agreement with EC/ECB/IMF.

Graph 2.1: Job finding and separation rates



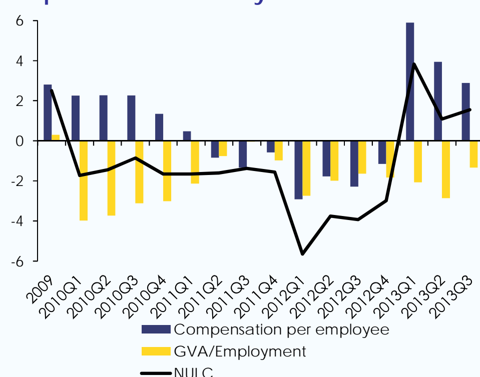
(1) Values refer to the probability of finding or losing a job over a horizon of one month.
Source: Eurostat and Commission services

66. A growing incidence of nominal wage freezes is observed, amid stagnating collective bargaining. Recent analysis and evidence presented by the authorities on the basis of social security micro-data point to a rising share of workers experiencing base wage freezes. Such evidence could be either linked to wage levels hitting wage floors and/or to a falling number of collective agreements concluded. From January to June 2013, 45 collective agreements were concluded. This contrasts with 230 collective agreements concluded in the same period of 2010 and 170 in 2011 (Graph 2.2). The decline in collective agreements also affected firm-level agreements, even though to a lesser extent, despite recent reforms aimed at fostering the decentralisation of collective bargaining.

Box 2.5: How much more Wage Adjustment is Needed in Portugal?

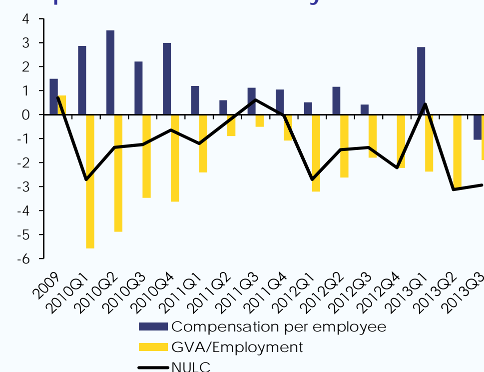
Since 2010, Portugal has recorded a significant adjustment in nominal unit labour costs (NULC). NULC declined by 5.3% between the first quarter of 2010 and the third quarter of 2013 (Graph I). In the business economy, NULC declined by almost 6%. The evolution of NULC for the total economy in 2012 and 2013 is related to the cut of the 13th and 14th wage for public servants in 2012 and the reinstatement of these bonus payments in 2013.

Graph I: Total economy



Source: Eurostat

Graph II: Business economy



Source: Eurostat

Wage developments and external equilibrium

The current account (national accounts definition) recorded a significant adjustment in recent years, moving from a deficit of 12.6% of GDP in 2008 to a surplus of 0.9% of GDP in 2013. Adjusting for cyclical effects, one obtains a balanced underlying current account in 2013 (based on DG ECFIN's methodology ([1])). In light of the large negative Net International Investment Position (NIIP), a relevant current account benchmark is the current account balance that stabilises the NIIP/GDP ratio. The NIIP/GDP ratio in 2013 is -114.3%. The current account balance that stabilises the NIIP/GDP over the medium term at -114.3% of GDP is 0.3% of GDP. On the basis of a current account semi-elasticity of -0.6 in 2013, the required adjustment in the real effective exchange rate (REER) to close the gap between the underlying current account and the NIIP-stabilising current account is about 0.5%.

Given the very high level of the NIIP, a stabilisation may not be sufficient to ensure the reduction of vulnerabilities linked to the external position. As the NIIP is one of the key monitored indicators in the context of the MIP, a steady reduction of the NIIP needs to be ensured in the medium term. On the basis of the above methodology one could gauge the size of the needed REER adjustment to bring about a decline of the NIIP. For example, to reduce the NIIP by one half over a period of ten years (i.e. by 2023) - assuming average real GDP growth of 1.6% and an inflation of 1.8% - would require a cumulative REER adjustment of about 4.5%.

REER misalignment can be translated into wage misalignment. Under the assumption that the NULC of the main competitors are in equilibrium, the REER overvaluation translates into a NULC overvaluation. The wage level necessary for external equilibrium depends on an estimate of the REER misalignment and an assumption on productivity. The exercise assumes that (i) the gap between the underlying current account and

([1]) Matteo Salto and Alessandro Turrini (2010) "Comparing alternative methodologies for real exchange rate assessment" European Economy, Economic Papers 427.

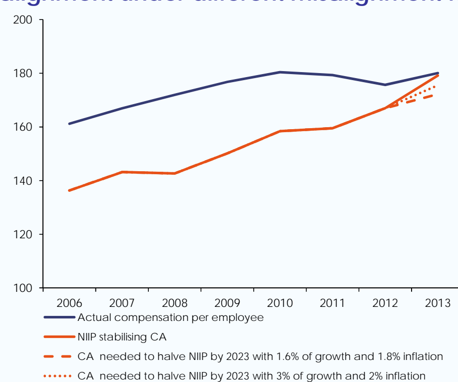
(Continued on the next page)

Box (continued)

the target current account is closed fully as a result of a change in domestic NULC and (ii) the change in NULC is the outcome of a change in wage developments, while productivity is assumed to grow according to actual or forecast values.

The gap between the actual compensation per employee and the level of compensation needed to stabilise the NIIP has been narrowing in recent years. In 2013, compensation per employee was broadly consistent with the stabilisation of the current NIIP (Graph 3). However, to reach the alternative benchmark of reducing the NIIP by one half by 2023 wages are still overvalued by about 2% and 5% (assuming nominal GDP growth of 3.4% and 5% respectively). These estimates are very sensitive to the measure of productivity used. Moreover, further downward adjustment in the NULC of Portugal's main competitors would increase the required wage reduction.

Graph III: Actual nominal compensation per employee and compensation per employee consistent with zero misalignment under different misalignment measures (1995=100)



Note: The wage series were rebased with respect to a year corresponding to external equilibrium. For Portugal, the year with the lowest current account was 1995, while the NIIP was below 25% (and was assumed to be zero).
Source: Eurostat and Commission services estimations

Wage adjustment and internal equilibrium

Besides the need to adjust to external imbalances, Portugal needs to deliver sufficient wage moderation to absorb unemployment. To assess the adjustment needs of real wages it is necessary to estimate the elasticity of labour demand to real wages. The elasticity of the labour demand equals the negative of the product of the elasticity of substitution between capital and labour and one minus the wage share -e(1-s). With a Cobb-Douglas (e=1), the elasticity equals (1-s). Using the average wage share for the last three years (about 56 percent) the implied elasticities of the labour demand is about 0.41. This implies that a reduction of 1 pp. of the unemployment rate requires a reduction of real wages of about 2.4 percent. Using these elasticities, a decline of real wages of 5 percent would be required to close the gap between the unemployment rate and the NAWRU in 2013 (equal to 2.2 pps.).

However, since the NAWRU partly incorporates cyclical elements, alternative measures of structural unemployment built on the basis of policies and institutions would point to a higher share of cyclical unemployment in Portugal ([2]). Using such measures of structural unemployment would lead to a significantly higher real wage adjustment needed to decrease unemployment.

([2]) European Commission (2013) "Labour Market Developments in Europe 2013" European Economy, 6/2013.

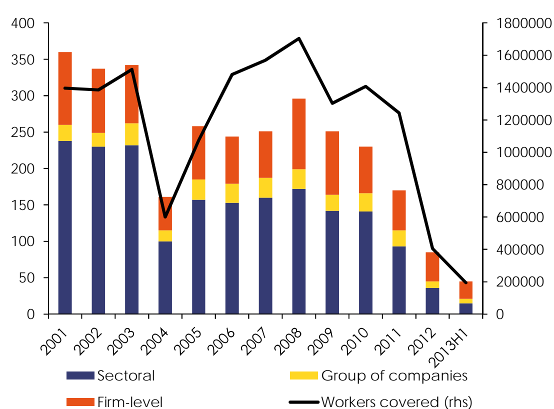
(Continued on the next page)

Box (continued)

These results are broadly in line with those above for external imbalance. The needed wage adjustment in view of external and internal imbalances does not seem very high. However, these results point to the need to preserve the adjustment carried out over recent years and continued wage moderation over the medium term.

The findings presented here need to be taken with caution. First, the needed real wage adjustment depends heavily on real wage elasticity of labour demand. A high degree of uncertainty surrounds these estimates. Second, it is important to take into account that the estimated required real wage adjustment is made under the assumption of no change in output growth, productivity or participation rates.

Graph 2.2: Number of collective agreements and workers covered



Source: Portugal's Directorate General for Employment and Labour Relations

67. Looking forward, wage formation needs to be monitored with a view to assessing whether the necessary leeway is available for the adaptation of wages to changing conditions at sectoral and firm level. Wage moderation on aggregate is necessary but not sufficient to ensure a durable rebalancing of the economy towards the tradable sector and create employment incentives (see Box 2.5). Sectors and firms may have different needs in adjusting wages both upward and downward, depending on developments in productivity and competitive conditions. Monitoring the extent to which such needs are satisfied will be key in assessing the effectiveness of recent reforms aimed at fostering wage decentralisation.

68. Active Labour Market Policies are being implemented to increase the job placement rates of the unemployed. The authorities plan to begin cooperation between the Public Employment Services (PES) and the private sector for placing the unemployed into jobs. The PES intensified job offers to the unemployed as a means of assessing their availability to take up work. Actions are being taken to improve the profiling of the unemployed through better screening and improved personal employment plans. Cooperation between different public institutions will be strengthened to tackle irregular situations in the labour market. The authorities are also committed to implementing a youth guarantee scheme, which is expected to cover people up to 30 years old. The programme "Vida Activa", which aims at improving employability through short training courses and on-the-job training, involved the participation of about 129,800 unemployed from January until October 2013. The programme "Impulso Jovem" counted with the participation of 77,500 people, about 49,800 people on vocational training and 20,700 in traineeships. The take up rate of the wage subsidy scheme "Estimulo" increased from 10,300 individuals in 2012 to 22,800 in 2013. The participation of people below 25 years old on dual training has also increased (about 32,000 students were involved in these courses in 2013, an increase of about 70 percent on the previous year).

Education

69. Progress in the area of education continues to be satisfactory. Efforts to improve efficiency, quality and equity of education continue in different areas, notably in monitoring, autonomy and outcomes of schools, educational offer, evaluation and technology transfer. The IT monitoring tool, which contains now very rich information on the educational network of Portugal, has been further improved. A system of monthly monitoring of the education expenditure has been introduced recently and will allow an early identification and correction of possible budgetary slippages. The number of autonomy agreements signed with public schools is increasing and has now reached 232 (from 22 in 2010 and much beyond the 150 initially foreseen for the school year 2014-2015), about 27 percent of the total. This will help increase the effectiveness of Portugal's education system, since autonomy is considered to be positively correlated with the educational results of the school. As regards a result-oriented financing framework, the authorities did not consider a further widening of the scope of this tool useful since most education expenditure is fixed due to the predominant component of wages (more than 90 percent of total spending) and this aspect is already covered by the Portuguese education system, in the so called crédito horário scheme,

70. The diversification of the educational offer has been enhanced, in particular through the provision of educational and vocational training. The authorities plan to set up a programme of 2-year vocational training providing relevant skills in mostly technological and scientific areas (with compulsory internship of at least half a year in firms) giving either direct access to the labour market or the possibility to continue with a higher education. It is intended to address about 5 000 persons every year and will be financed by the European Social Fund. The external evaluation system of schools is being improved through several initiatives, including the establishment of a central team to evaluate procedures and ongoing training programs for inspectors in order to provide a full evaluation map and enhance school outcomes. Finally, a protocol to set up the first Professional School of Reference (in the area of electronics) was signed at the end of October, with the aim of developing institutions with technology focus and supporting technology transfer between school and business.

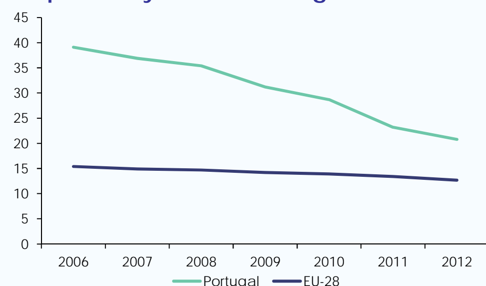
Box 2.6: Programme Reforms in the Education Sector are Expected to Yield Positive Results

Portugal suffers from a very significant part of the population with low educational attainment, which is one of the major explanatory factors of the poor productivity performance of the country. However, the country has been able to gradually close the gap relative to the EU average since the beginning of last decade.

The reduction of early school leaving rates has been significant (Graph I). Early school leaving has been gradually declining over the last decade from 39.1 percent in 2006 to 20.8 percent in 2012, a decrease of 18.3 percentage points (well above the reduction in the EU evolution by 2.7 pps). However, the early school leaving rate in Portugal remains among the highest in the EU and significantly above the EU average.

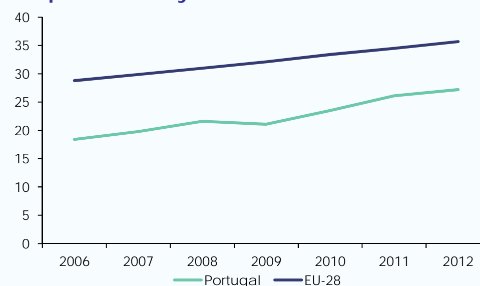
The level of tertiary education (Graph II) in the cohort of people aged 30-34 is gradually increasing. It reached 27.2 percent in 2012, up from 18.4 percent in 2006, i.e. an increase by 8.8 percentage points (above the EU trend of 6.9 percent). It remains significantly below the EU average and target.

Graph I: Early school leaving



Source: Eurostat

Graph II: Tertiary education attainment



Source: Eurostat

Expenditure of the General Government on education in Portugal has been persistently higher than the EU average since the beginning of the last decade. In 2011, public spending in education was 6.3 percent of GDP, 1 percentage point higher than the EU average (5.3 percent of GDP). This gap compared with the EU is fully explained by compensation of employees, that is the number of teachers and the salaries paid to them. Indeed, it amounted to 4.5 percent of GDP (over 70 percent of the total expenditure, around EUR 7.5 billion) compared with an EU average of 3.5 percent of GDP. The ratio of students to teacher is still among the lowest in primary and secondary education in the EU (8.9 against 12.5 in primary education, 7.9 against 11.5 in secondary). Recent studies also suggest that salaries of teachers in public schools are about 40 percent higher than in private schools in primary and secondary education. While early school leaving is still decreasing and the share of tertiary educational attainment has significantly improved, the recent results in performance of students (Graph III) do not show major progress since 2009, in line with most other EU Member States. In the three areas under scrutiny (math, reading and science), Portuguese students received an average classification of 488 points (two point lower than 2009) just below the 497-point OECD average, in line with countries like Italy (490) and Spain (489) and above United States and Sweden inter alia. As shown by some research published by international organisations, results in education are highly related to the allocation of available resources (efficiency in expenditure) and to the kind of qualitative measures adopted.

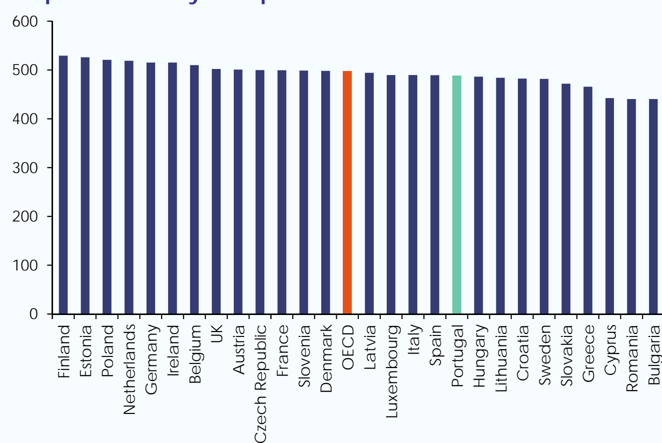
Some key measures, which are expected to fully pay off in the future in terms of better results in performance of student, have been devised and are being implemented in the context of the Economic Adjustment Programme. For instance, a sophisticated IT tool to monitor conditions and results in every school of the country has been developed and is expected to reliably track learning, teaching and student outcomes. A wide range of autonomy agreements with schools have been signed and a system of external evaluation of schools

(Continued on the next page)

Box (continued)

has been set up. Managing greater school autonomy and accountability will bring improvements in learning outcomes. PISA results show that in higher-performing systems, schools have more autonomy, with incentives and the capacity to improve ([1]). In addition, improvements to the amount and quality of vocational and educational training have been introduced with the view to (i) better aligning educational policies and market needs, (ii) further involving business in the provision of education and training, (iii) increasing the participation in educational and vocational training. Action Plans on secondary education and Vocational and Educational Training (VET) have been devised and are being implemented and will contribute to create employment and decrease school drop-out Despite the considerable progress made and the early signs of improvements, education must remain a priority in the policy agenda of Portugal for the coming years, as it will be one of the major drivers of economic growth and productivity.

Graph III: Country comparison of PISA results in 2012



Source: OECD PISA 2012.

([1]) PISA 2012 Results: What Makes Schools Successful? Resources, Policies and Practices, OECD 2013.

Energy

71. A new levy on energy operators was introduced in 2014. Two aspects of this levy need to be closely monitored. First, the risk that operators pass on the costs of the levy to end-users has to be minimised. Second, a crowding out of other cost-reducing measures foreseen to address the sustainability of the electrical system has to be avoided.

72. Rent-reducing measures implemented so far to eliminate the tariff debt by 2020 and ensure the sustainability of the system appear to be insufficient. The new update of the energy tariff debt dynamics up to 2020 shows some improvement relative to the forecasts presented in June 2013 given the new figures on consumption reported by the regulator for 2013 and 2014. However, the elimination of the tariff debt by 2020 would require real electricity price increases of close to 2 percent per year, ½ of a percentage point above initial projections and raising further concerns about the impact of the tariff on competitiveness. The report also shows that the increase in the real electricity price would not be sufficient to eliminate the tariff debt and additional measures, already discussed in the previous Review, would need to be taken despite the fact that the government has already implemented most of the measures agreed by the Council of Ministers in May 2012. The most significant additional measure envisaged by the government is the introduction of a contribution on energy generators, preventing windfall profits resulting from the increase in electricity prices in the MIBEL market caused by the levy on the Spanish generators. This measure, though welcome to counter a perverse effect on wholesale prices, is not a cost-reducing and sustainability-enhancing measure. Following the identification by the government of the problem of distortion in the system services market and the recommendation by the relevant regulators, new measures are expected to be implemented in line with the recommendation concerning the risks of overcompensation in the adjustment calculations (revisibilidade) of the CMEC scheme. The details of this cost-reducing measure are not known. Finally, the report on the CMEC scheme and the process for extension of the concession of the public hydro resource was delivered. Further analysis on the implication of the report and the need for potential measures to address the points identified as sources of distortion will be discussed at the next Review.

Telecommunication and Postal Services

73. Two universal service providers were selected following tender procedures. In October 2012, the Portuguese government launched three tenders for the designation of the companies to provide the Universal Service for: (i) the connection to a public telecommunications network at a fixed location and provision of public telephone services through that connection (Tender 1); (ii) the publicly available telephones offer (Tender 2); and (iii) a comprehensive directory and a directory inquiry service (Tender 3). Services related to tenders 1 and 2 were granted in October 2013, on the basis of the criterion of the lowest price and for a period of five years in line with the technological neutrality principle. No applications to Tender 3 were submitted and, as a consequence, the procedure has to be re-launched. In addition, the authorities have decided on the revision of the existing contractual relationship with PT Communications to comply with the Universal Service Directive. In October 2013, the authorities decided to revoke the concession of public service telecommunications and the early termination of services under the existing concession agreement, due to terminate in March 2025, and to compensate PT Communications for damages resulting from such termination. Finally, the infringement proceeding on the designation of the universal service provider(s) through an efficient, objective, transparent and non-discriminatory mechanism is still ongoing.The Commission is still assessing whether the progress made, in particular through the public tenders for the provision of the universal service, fulfils the obligations of the Portuguese government under EU law, before a final decision on the breach of EU legislation is made.

74. Further regulatory measures have been taken to open the postal sector and provide higher quality and more customer-oriented postal services through competition in the market. An amended decree-law to the Law n. 17/2012 was published on 19 November 2013 primarily aimed at laying down the framework of the concession contract with CTT, the designated national provider of the universal postal service.

The amended legislation will help to ensure a more competitive market, since the current concession period has been confirmed to last until 31 December 2020. The national provider has to ensure that other postal service providers access, the universal service network under transparent and non-discriminatory terms. The incumbent has also to keep separated analytical annual accounts between the activities under universal service obligations and those related to commercial sectors, in order to avoid any possible illegal cross-subsidies. Higher quality and customer friendly criteria, which are also conditions for granting new contracts, are ensured by the obligations to develop, qualitatively and quantitatively, the postal network and to report regularly to the national postal regulator (ANACOM). In case of failure to comply with service commitments, contractual fines are envisaged, as safeguards for higher quality, equality and transparency of access.

Transport

75. Significant scope remains to increase the sustainability and efficiency of the transport sector. In the port sector, the authorities have prepared an Action Plan with a set of clear measures and deadlines to undertake a comprehensive reform of ports aimed at reducing port's invoice. The Plan, which is not yet public, includes, inter alia, new guidelines for the concessions, including the renegotiation of the existing ones, and a new tariff model. Strong commitment by the Government will be critical in order to fully implement the Action Plan by the end of 2014, as planned. In the area of railways, the financing situation of the state-owned infrastructure manager (REFER) remains an issue of concern in view of its high indebtedness (around EUR 7 billion) and the uncertainty regarding the achievement of operational balance by 2015. An additional reduction of operational costs is necessary. The transfer of the terminals owned by the freight branch of the state-owned railway company (CP Carga) to REFER is still delayed and is now expected to be completed before the end of the Economic Adjustment Programme. This is an important measure to increase competition in the freight rail sector. The launch of the five concessions (three in Lisbon and two in Porto) for the metropolitan passenger transportation services is under preparation and will take place during the first half of 2014. Some final arrangements of the concessions, such as the responsible administration (municipalities or the Central Government) and the responsibility regarding the rolling stock, are not yet decided. The bylaws setting the new legal framework of the transport regulator (AMT) are under consultation with the relevant stakeholders and should be adopted in the coming weeks.

Services and professions

76. Work on the improved sector-specific legislation has progressed but the adoption of the regulatory framework for the construction sector is delayed. The construction laws were originally foreseen to be sent to Parliament by the end of 2012 and the final draft has recently been shared with the Commission. The fees charged for authorisations and certificates as well as the value of the yearly regulatory taxes in the construction sector will be revised in order to ensure their proportionality in time for the adoption of the construction laws. Concerning the other sector specific legislative amendments, progress in aligning legislation with the principles of the Services Directive has continued steadily, however some concerns remain with regards the Universities diploma. 63 out of 68 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 the first quarter of 2014.

77. The submission to Parliament of the amended professional bodies' bylaws and internal rules following the adoption of the horizontal framework law on public professional associations is delayed. The law was 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 amended professional bodies' statutes and internal rules will be approved by the government and subsequently submitted to Parliament with the aim of bringing them in conformity with the principles laid down in the law and removing requirements that are not justified or proportionate. However, the revised bylaws are being discussed with the Commission and its

submission to the Parliament is experiencing delays and is now expected by beginning of 2014.

78. Progress has been made on the work to improve the functioning of the Point of Single Contact ("Balcão do Empreendedor"). A clear roadmap and work programme is in place and updated monthly. The operational deliverables needed for this reform ensuring conformity with the services Directive is expected to be completed by the next Review. However adapting the content at the PSC for the case of the Professional Qualifications Directive might have further delays. The usability and user-friendliness of the Point of Single Contact could be further improved.

Reform of framework conditions

Housing market

79. The urban lease reform is proceeding, but its impact still needs to be fully assessed. The new legal framework is now being fully implemented. According to the information provided by the authorities, about 44,000 out of the existing 250,000 old contracts have been updated, which appears to be rather low. Eviction requests amount to 3,142 of which 1,382 have been rejected mainly because of notification procedure issues. Only a small number of cases (196) ended in a judicial procedure, but this is not the result of more efficient alternative dispute resolution mechanisms (ADR) which are still not in place. Monitoring, reporting and evaluation of the reform need to be further strengthened and include more precise and relevant data on key drivers of the market, such as evolution of rents, average duration of new contracts, number of contracts terminated, shadow economy, etc. To this end, any available tools, including civil register, income statement and cadaster should be used and data from different sources and databases (e.g. tax administration, property register, utility companies) should be cross-checked.

80. The authorities have agreed to step up efforts to fight tax evasion in the Portuguese rental market. Within the scope of the overall fight against tax evasion undertaken by the Government, a study will be carried out with a view to identifying any form of shadow economy in the Portuguese rental market and enabling potential future fiscal structural measures to underpin the transparency and efficiency of the housing market in Portugal.

Competition and sectoral regulators

81. Following the adoption of the framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs) the bylaws of the NRAs are being amended accordingly. The framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs), including those relating to their independence and autonomy, was published in August 2013. The proper and timely implementation of the new by-laws of the respective regulators is essential to confirm that the new legal framework is a significant step forward. The corresponding amendments to the bylaws of the NRA have been prepared and shared in November with the Commission with whom some bylaws are under discussion; they are expected to be approved by the government in January 2014. Ensuring independent and adequately financed NRAs will be essential to effectively implement the government's reform agenda.

82. Following the adoption of the 2012 executive order (portaria) concerning the transfers of payments from regulators to the Competition Authority for 2012 and 2013, a new executive order should have been published setting the contributions of the regulators for 2014 but has not been published yet. In order to address the recurrent problem of previously annual executive orders adopted with some delay and to bring financial stability during the next years, these contributions will be set in the new Competition Authority bylaws as from 2015. Nevertheless for the year 2014, the financing of the Competition Authority has not yet been assured and, therefore, the implementation of the financing model will be assessed at the next Review. It is essential that the funding to the Portuguese Competition Authority reflects its budgetary needs taking into account the reduction of some other sources of own resources and the need to step up or take up additional tasks.

Judicial system

83. Reforms of the judicial system proceed according to schedule. Portugal continues the progress in judicial reforms particularly in advancing the implementation of the Judicial Organisation Act to streamline the court system. The new Judicial Organisation Act, approved in June 2013, will enter fully into force during 2014. The law sets out a major streamlining of the judiciary, reducing the number of courts and improving efficiency through the creation of court clusters to allow for greater economies of scale and professional specialization. It also sets workload standards and performance targets for courts and judges, and makes it possible to allocate resources, including judges, where bottlenecks occur. The law constitutes a significant change in the organisation and management of the judiciary with a greater focus on performance accountability and service delivery.

84. The new law strengthening the authority and financing structure of the oversight body for enforcement agents and insolvency administrators, known as the CAAJ, has been published. Together with the new fee structure that incentivises speedy enforcement, it will significantly strengthen the discipline and efficiency of the enforcement profession, and hasten the clean-up of long-pending cases. The clearance rate of the enforcement cases continues to rise. In the second quarter of 2013 the rate has increased to 190.3 percent.

85. Procedimento Extrajudicial Pré-Executivo, PEPEX, creating a pre-trial triage which will, in particular, be able to identify cases to be settled out of court is in the final stages of preparation. The procedure is expected to be approved by the Council of Ministers and submitted for Parliamentary approval shortly.

86. The Competition Court, set up in 2012 has been properly resourced and is fully operational.

Public procurement

87. Monitoring and reporting of public procurement procedures should be further improved. In November 2013, the authorities submitted a second amended report which did not provide comprehensive details on the implementation and the enforcement of the revised Public Procurement Code as well as on the compliance with European public procurement rules. In particular, 750 direct awards (out of 120,000 according to the authorities' data), amounting altogether to around EUR 70 million, were granted from August 2012 to August 2013. Ascertaining their compliance with European and national public procurement rules was not possible, during the mission, due to the lack of data. However, the authorities agreed to provide detailed information on those direct awards, including the reasons underlying them, the type of contracts, the breakdown per sector and the average amount, with the aim of introducing adequately safeguards against strategic division of contracts intended to avoid the applicability of the European public procurement Directive. The additional details provided at the beginning of January 2014 highlighted still many possible illegal awards (around 250), which require further attention and a dedicated monitoring to be carried out in a systematic manner by the competent entities. A comprehensive list of direct awards has been made available to the Court of Auditors and the National Auditor (IGF) and their assessment and conclusions will bring further clarity on this phenomenon.

Business environment

88. Further efforts are necessary to align national legislation with the New Late Payments Directive. The Decree Law 62/2013 of 10 May adopted by the government is not fully in line with the New Late Payments Directive 2011/7/EU. The main provision which is considered not to be in line with the Directive is Article 12 of the Decree Law, which provides that the deadline of a maximum of 60 calendar days to proceed to the payment of commercial transactions involving public entities providing healthcare will not be fully applicable until 31 December 2015. Micro-corporations and small firms are, however, outside the scope of this exception. The Directive states that, as from 16 March 2013, Member States must ensure that in commercial transactions in the health sector the period of payment does not exceed 60 days following the receipt of the invoice by the debtor. The argument provided by the Portuguese authorities for such an exception is that full compliance both with the Directive and with

the ongoing strategy for the settlement of arrears, which was agreed in the context of the Programme, would entail a very significant cash disbursement with a very negative fiscal impact. The Commission rejected Portuguese's argument and could launch an infringement procedure in the coming months for non-compliance.

Licensing

89. Further steps must be taken to reduce administrative burdens and improve licensing environment. The "one in- one out rule"(when creating a new regulation generating costs for business an existing regulation with equivalent cost must be eliminated) is expected to be adopted by mid-February 2014 and will be followed by the resolution of the Council of Ministers on the guidelines/methodology for implementing the rule. An inventory of most significant administrative burdens is ongoing and will be followed by a cost analysis study and a roadmap on regulatory simplification during the first quarter of 2014. The authorities have involved business confederations in the inventory, which includes a survey among companies (300 questionnaires completed). On territorial planning, the Base Law on Soil and Urbanism is going to be approved by Parliament. In addition, the review of the legal regime for urbanism and building (RJUE) will be submitted to the Council of Ministers in the coming weeks. This new legal framework is a step forward in terms of simplification and reduction of administrative procedures. It is expected to reduce the time and costs for construction permits and will devolve enhanced management powers to the local governments. A legal provision for the regularisation of economic activities is also about to be adopted with a potential number of 3,000 entities/operations to be regularised. On industry, most legislation regarding the Zero Authorisation has been adopted with an approach of just prior communication instead of prior authorisation gradually in place. On commercial licensing, draft legislation is already underway. The elimination of some administrative procedures assigned to local authorities in order to ensure a better implementation of the zero authorisation and reduce the amount of fees charged to business is being negotiated with the municipalities' representatives. In fact and although the authorities underlined that the implementation of the new paradigm (zero authorisation) by the municipalities has not met all expectations, the scope of the procedures to be eliminated is yet to be defined. Finally, the government adopted a new legal provision which simplifies and streamlines licensing in the area of tourism and aims to facilitate the settlement of new businesses in this sector.

Box 2.7: **Summary of compliance with policy conditionality for the 10th Review**

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

Fiscal policy	Budget execution in 2013 is in line with the revisions of the second supplementary budget. The 2013 general government deficit target of 5.5 percent of GDP, excluding bank recapitalisations, is likely to be met. The achievement of this deficit position was possible due to the strong performance of tax revenue (including the special scheme for debt recovery), that more than compensates expenditure growth and the under-performance of the non-tax revenues. The State Budget 2014 is consistent with a deficit target of 4 percent of GDP predominantly underpinned by measures identified in the public expenditure review and some smaller-scale revenue increasing measures.
Fiscal-structural	Public finance management: The Working Group for the Reform of the Budget Framework Law (BFL) prepared a report proposing a large number of improvements to the Portuguese Public Financial Management system as well as a new structure for the BFL. Given the scope of the necessary reforms, the mission decided that more technical work was needed and invited the government to engage in a broad-based consultation with all relevant stakeholders with the aim of announcing the key aspects of the new law in April 2014. A smaller change to the law clarifying some elements of the transposition of the fiscal compact and the six-pack will take place earlier, by March 2014. Revenue administration: The reforms implemented in 2013 on e-invoicing and unified monthly tax returns are improving efficiency in the fight against tax evasion and supporting tax collection. To strengthen tax compliance management a Risk Management Unit has been recently created and will become fully operational in the short term. A Taxpayer Services Department will also be created within the tax administration to improve relationships with the taxpayers. The reduction of the local tax administration network is not progressing as planned and so far no local tax office has been closed since the beginning of the Programme. Regional and local administration reform: Budget execution in municipalities, as well as in Madeira and Azores is in line with expectations. Public administration reform: The process of staff reduction is ahead of the Programme objective (reducing staff across all layers of government by 2 percent per year from 2012 to 2014) as an 8.7 percent reduction relative to end-2011 was already achieved by September 2013. The General Public Administration Labour Law has been presented to Parliament mid-October 2013 and awaits parliamentary approval. The results of a survey on wage supplements were presented. The 2014 Budget includes a revision of wages which, after further analysis, will be replaced by a single wage scale. Public Private Partnerships: The Ministry of Finance PPP task force (UTAP) was in charge of delivering the annual PPP report in 2013 in co-operation with the Bank of Portugal in respect of credit flows. The goal was to provide a comprehensive assessment of the fiscal risks stemming from PPPs and concessions by Q3-2013 and use that information as input to the fiscal risks assessment for the budget. Despite not meeting the Tenth Review dead-line, the report has been recently approved and published. State-owned enterprises (SOEs): The new legal regime for SOEs was published (Decree-Law 133/2013, 3 October) and entered into force on 3 December. The shareholder's role is given to the Ministry of Finance and a new dedicated taskforce will be appointed to carry out the tasks that are now centrally monitored by the Ministry. Debt management, risk derivative instruments and cash position of SOEs shall be centrally managed by the treasury agency. Health: Policy implementation continues and reforms have produced important savings through increases in efficiency in the sector: The consolidated deficit for the sector (Central Government and SOEs together) shows a significant reduction since 2010 and an important stock of overdue debt has been paid. The existence of an important stock of arrears is strongly (though not solely) related to the consistent underfunding of SOE hospitals vis-à-vis their service provision. Due to the remaining stock of arrears, the tight budget line and the reinstatement of the two bonus salaries, the authorities have been forced to speed up the of existing reforms. The authorities reconfirmed their commitment to implement the ongoing hospital reform and to continue to fine-tune the set of measures concerning pharmaceuticals, centralised procurement and primary care.

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Box (continued)

Financial sector	Monitoring banks' potential capital shortfalls: To ensure that current and future capital requirements are respected, the BdP continues to monitor closely the Portuguese banking system with on-site thematic inspections and thorough off site stress testing. The BdP has set up a new top-down stress testing methodology, which will be used to more systematically challenge banks' submissions in the current and future stress testing exercises. Furthermore, the BdP monitors the banks' transition to the new capital rules, as laid down in the Capital Requirements Directive IV package (CRD IV), ensuring that the banking system meets a Common Equity Tier 1 (CET1) capital ratio of 7 percent from 1 January 2014, consistent with the CRD IV package. In the context of the ECB's forthcoming asset quality review, the largest banks are expected to maintain a CET1 add-on of 1 percentage point. Supervisory organisation: Building on previous experience of thematic inspections, the BdP finalised - jointly with a consultant - a special assessment programme to assess banks' policies and procedures to handle distressed credit. A new supervisory function was set up within the BdP and steps have been taken to reinforce supervision in the area of impairment assessment. Early intervention and resolution: After concluding the analysis of the recovery plans of the banks, the BdP made individual recommendations to the banks to adjust their plans. On-site visits that cover specifically the key aspects of the recovery plans are ongoing with a medium term aim to fully integrate the recovery plans review into the overall supervision process. Financing alternatives for the corporate sector: A revised draft of the amendments to the rules governing the commercial paper market was submitted in December and adopted in early January 2014 in the form of a Decree-Law. Furthermore, in December new legislation entered into force foreseeing tax incentives for investors in the commercial paper market. Government-sponsored credit lines: Following an external audit of the National Guarantee System (NGS) a roadmap was revised and is being implemented containing measures to improve the governance, efficiency and risk management practices within the NGS. Proposals to determine interest rate caps applied to guaranteed loans were submitted.
Reform of labour, goods and services markets	Labour market: The authorities have prepared a preliminary assessment of the reform of employment protection legislation. A revision of dismissal rules is being prepared in view of the fact that earlier measures were ruled unconstitutional. The authorities have also presented a description of the system of "sobrevigencia." Education: In the area of education, the existing monitoring tool has been further enriched and the number of trust agreements signed has been increased. The setting up of the professional schools of reference is being implemented and a protocol to establish the first professional school (in the area of electronics) was signed at the end of October 2013. Energy: The 2014 Budget law sets a new levy on energy operators. This levy might have two consequences in the system: a) it could result in some pass-through to end users and b) it could crowd out other measures therefore reducing the anticipated effect on the tariff debt of such measures. Therefore, the impact on the tariff debt and end user prices will need to be monitored. Implementation of the electricity costs reduction and tariff debt elimination by 2020 is on-going. The new update report of the energy tariff debt dynamics shows a slight improvement, however the elimination of the tariff debt by 2020 would require real electricity price increases of 1.9 percent per year Concerning the problem of distortion of the system services market, new measures tackling the risks of overcompensation in the adjustment calculations (revisibilidade) of the CMEC scheme, including an independent audit on risk of overcompensation will be implemented. Following the submission of the report on the CMEC scheme and the process for extension of the concession of the public hydro resource, further analysis of the potential for correcting measures will continue in the next review. Telecommunications: Actions to make the provision of the universal service in line with EU legislation have been advanced. Two universal service providers have been selected following two tender procedures and the contracts are expected to be signed in January 2014, while the third tender has to be re-launched due to the lack of offers. Moreover, the authorities have decided on the revision of existing contractual relationship with the incumbent PT Communications.

(Continued on the next page)

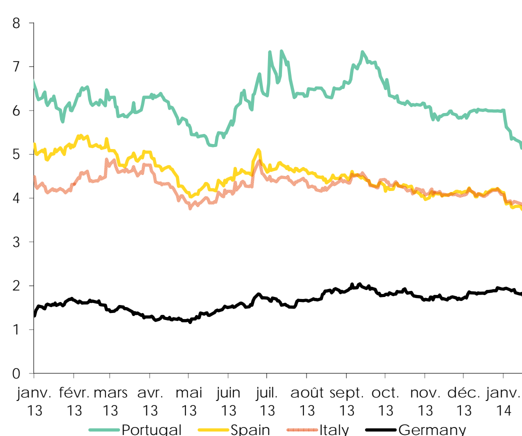
Box (continued)

Reform of labour, goods and services markets	Postal services: Important steps have been taken towards higher openness, quality and more customer-oriented postal services. An amended decree-law to the Law no. 17/2012 was published on 19 November 2013, aimed at laying down the framework of the concession contract with CTT, the national provider of the universal postal service. The designation period has been shortened to 2020 and returns on investment are taken into account when determining the designation period, in line with Programme requirements. Transport: Despite implementing important measures such as the new port labour law or reducing the port tariffs such as TUP Carga, progress in transport reforms is proceeding at a slower pace than expected. Policy reforms in ports are urgently required to increase their efficiency and ability to be competitive in international markets. During the Tenth Review mission, the authorities shared with staff an action plan aimed at reforming the ports sector. The plan has not yet been made public yet, but the authorities committed to publishing it following consultation with the concerned parties. Its disclosure would ensure high transparency and underscore the commitment of the government. Further progress is required to ensure operational balance of the rail infrastructure manager by 2015, which is an issue of concern given its high and rising indebtedness. A clear long-term strategy for the transport sector is still missing. The transfer of the CP Carga terminals to REFER has been delayed: a phased approach is now planned and the full transfer is expected to be concluded before the last Review of the Economic Adjustment Programme. The launch of the five concessions for the metropolitan passenger transportation services is under preparation and will take place during the first half of 2014. Finally, the new legal framework for the transport regulator is expected to be adopted by the end of January 2014. Services and professions: Progress on the adoption of the legislative amendments to align legislation with the principles of the Services Directive has continued steadily. However, the Construction laws and the public and private higher education diploma have further delays. The submission of the revised bylaws to the Parliament, following the adoption of the horizontal framework law on public professional associations, is delayed. Some progress is observed in making the Point of Single Contact fully operational.
Reform of framework conditions	Housing market: The process of updating rental contracts signed before 1990 and their gradual transition to the general system is proceeding very slowly (so far only 44,000 out of existing 250,000 old contracts have been updated, according to landlords and tenants data) The Monitoring Committee in charge of supervising the impact of the reform has already delivered its first quarterly report, which falls short in respect of providing precise and relevant data on various aspects of the market, including the evolution of rents and the duration of new contracts. Competition and sectorial regulators: Following the framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs), the Government is preparing the corresponding amendments to the bylaws of the NRA, which should have been approved by early December. New draft bylaws are being discussed with the Commission. The problem of the financing of the competition authority already raised in previous Reviews has not been solved yet. Moreover, in November 2013, the Portuguese government presented a draft law on Strategic assets envisaging an investment screening mechanism which is under discussion in the Parliament. The final text will need to be compliant with the free movement of capital and EU law. Judicial system: Remarkable progress has been achieved in implementing the ambitious programme of judicial reform. Significant headway has also been made in reducing the backlog of court cases. Business environment: The recently introduced VAT cash accounting regime is expected to improve the financial and cash flow situation of businesses. The Commission considers that Decree Law 62/2013 adopted by the government on 10 May is not fully in line with the New Late Payments Directive 2011/7/EU. Licensing: An inventory of the administrative burden is ongoing and most of the legislation on zero licensing procedures for industries has been adopted. However, many legal reforms envisaged to ease licensing requirements on territorial management system, urbanism and building, geology, are behind schedule compared to plans .The "one in-one out rule" has been delayed and is expected to be adopted by the end of January 2014.
Data	Requirements under the Programme have been observed. Work is ongoing to improve further data submission.

3. PROGRAMME FINANCING

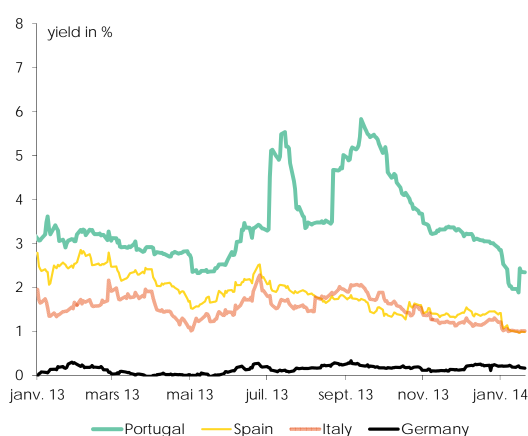
90. Market sentiment towards Portugal improved with the government's continued commitment to fiscal consolidation and structural reforms. Amid a generalised improvement in investor sentiment towards the peripheral euro area sovereign debt market, reduced uncertainty in the domestic sphere and positive economic data has allowed more active trading in Portuguese bonds to resume. By early 2014, the consequences of the 2013 summer domestic political crisis and adverse Constitutional Court rulings had faded out and Portuguese bonds traded at levels similar to May 2013.

Graph 3.1: 10-year Government bond yield



Source: Bloomberg

Graph 3.2: 2-year Government bond yield

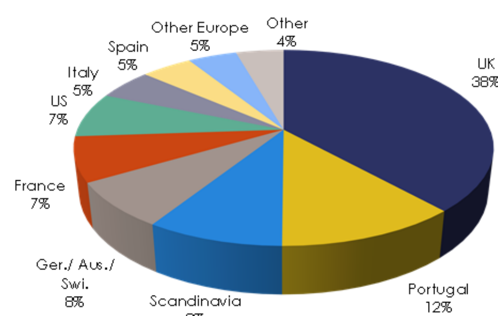


Source: Bloomberg

91. The Portuguese Treasury conducted a debt exchange operation in early December 2013, reducing the refinancing burden in the coming years. The Treasury exchanged EUR 6.6 billion of bonds into longer maturities, notably EUR 2.5 billion maturing in 2014 and EUR 4.2 billion maturing in 2015 into EUR 2.7 billion of October 2017 bonds and EUR 4 billion of June 2018 bonds. The 2017 bonds were sold at a yield of 4.7 percent and the 2018 bonds at a yield close to 5 percent. The markets perceived the operation positively with yields tightening in benchmark maturities also.

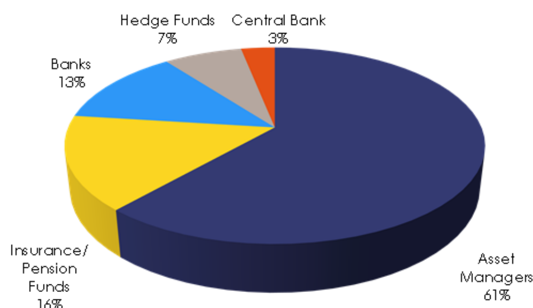
92. The Treasury used the positive momentum in the markets to issue medium-term bonds in early 2014. On January 9, EUR 3.25 billion were raised at a yield of 4.66 percent by reopening the June 2019 bond. The issuance was made through syndication and was more than three times oversubscribed, allowing the Treasury to select more buy-and-hold type investors. The bond was sold mainly to foreigners (88 percent of the total), a geographical diversification broadly in line with previous issuances.

Graph 3.3: Geographical allocation of June 2019 bond tap



Source: IGCP

Graph 3.4: **Allocation by type of investor of June 2019 bond tap**



Source: IGCP

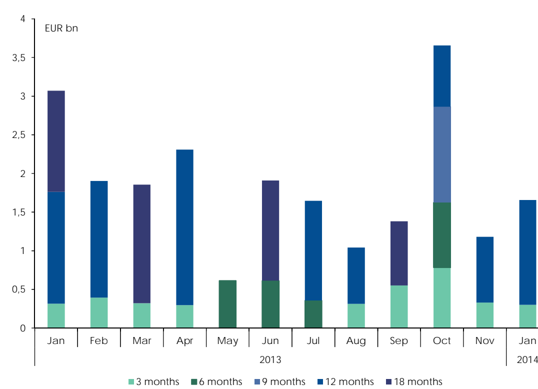
93. The Treasury introduced a new medium-term product for the domestic retail market in the last quarter of 2013. In October, the Treasury started selling a new treasury certificate with a five-year maturity. The new product attracted a lot of interest and nearly EUR 650 million were sold until the end of the year. These certificates constitute a competitive source of financing, particularly during the initial years: the interest rate is set at 2.75 percent in the first year, increasing to 3.75 percent and 4.75 percent in the following two years and to 5 percent in the fourth and the fifth year, with an added premium in the last two years depending on the growth performance of the economy. While retail products have limited scope in size, this is nevertheless a welcome step forward, allowing the Treasury to diversify the investor base and attract a more stable investor segment.

94. The Treasury continued to be active in issuing short-term debt. The Treasury continued to organise T-bill auctions in each month of 2013, except December. The T-bill stock as of end-2013 stood at EUR 19 billion.

95. Privatisation proceeds continued to be an important source of financing. In September, the remaining EUR 1 billion from the privatisation of ANA (concession part) reached the Treasury's account. In December, the initial public offering of CTT (the postal company) yielded nearly EUR 500 million for the state.

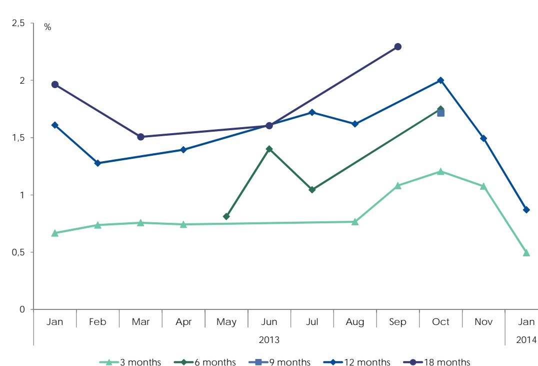
96. Portugal has built a substantial cash buffer. As of end 2013, the cash buffer stood at around EUR 15 billion (it must be noted that the buffer was artificially boosted by EUR 6.4 billion of funds earmarked for banking support of which EUR 2.4 billion are kept in the BSSF account while the transfer of the remaining EUR 4 billion from the single Treasury account to the BSSF account is still pending). Including the remaining undisbursed Programme funds and the bond sold in January, it is estimated that Portugal could cover its sovereign funding needs until end 2014.

Graph 3.5: **Short-term auctions issuance amounts**



Source: IGCP

Graph 3.6: **Short-term auctions weighted average yield**



Source: IGCP

ANNEX 1
Assessment of Compliance: Monitoring Table

Actions for the tenth review (to be completed by end Q3 -2013 or by the Tenth Review)		*Status*
Financial Sector	**[2.8]** The BdP is conducting a special assessment programme of banks' operational capacity. This exercise includes a survey of the Portuguese regulatory framework.	**Observed.** The BdP presented the findings of a thematic review of banks' operational capacity in the area of loan restructuring and asset recovery. It subsequently issued a new instruction fine tuning the definitions for loans in "financial difficulties", defaults and laying down conditions for the unmarking of such loans in an effort to converge towards the classification criteria included in the EBA's implementation technical standard on restructured loans. Guidelines per bank have also been issued and the BdP has taken steps to reinforce supervision in the area of impairment assessment.
	[2.9] The BdP introduces a new top-down stress test to support its bottom-up results. These will be included in the new round of quarterly stress tests.	**Observed.** BdP has set up a new top-down stress testing methodology which it used to more systematically challenge banks' submissions during the Q4-2013 stress test exercise.
	[2.13] The BdP reviewed and issued recommendations on the recovery plans of the largest banks and expects the submission by the remaining banks.	**Observed.** The BdP made recommendations to the banks to adjust their plans and plans specific on-site visits to cover the key aspects of recovery plans. The aim is to integrate the review of recovery plans into the overall supervision process.
	[2.18 iii] Prepare a draft of the necessary amendments of the rules governing the commercial paper market.	**Observed.** A revised draft was submitted and a decree-law was approved.
	[2.19 ii] Implementing measures to further enhance loan and guarantee pricing in favour of end users.	**Partially observed.** The authorities submitted proposals to set the maximum interest rate caps to be applied to guaranteed loans in a more objective and transparent way.
Fiscal Structural	**[3.3]** Reduce the number of budget entities.	**Delayed**. The ongoing work to improve the BFL has identified a number of reform areas. These would, among other things, lead to a reduction in the number of budget entities and to the review of the classification of own revenues. Progress will be assessed at the Eleventh Review.
	[3.13] The annual PPP report will provide a comprehensive assessment of the fiscal risks stemming from PPPs and concessions. Utilise the	**Delayed**. The PPP task force (UTAP) and the Bank of Portugal have worked together and presented the report to the Ministry of Finance but it was not approved until the end of the

	annual PPP report as input to the fiscal risks assessment for the budget.	Tenth Review. The deadline was postponed by one quarter.
	[3.26] Include the rules adjusting the single wage scale in the public administration and the monthly compensation paid in the 2014 Budget Law.	**Partially observed**. The 2014 Budget includes a revision of wages, but the single wage scale will be further analysed through the year and implemented by specific legislation by December 2014.
	[3.28] Revise the proposal of the Requalification Law.	**Observed.** Following the initial negative ruling by the Constitutional Court, the Requalification Law was revised, adopted by the Parliament and entered into force as of 1 December 2013.
	[3.29] Present to Parliament a new public administration law to simplify and compile the existing rules of public sector employment along the structure of private labour code.	**Observed.** The proposal of a new General Public Administration Labour Law was presented to Parliament end-October 2013. It awaits parliamentary approval.
Health care system	**[3.31]** Reduce the employer's contribution rate by 1.25 percent in 2014 and adjust the scope of health benefits.	**Observed**: the 2014 Budget assumes an increase in the contribution rate by employees and pensioners to 2.5% and a decrease in the contribution rate of the State by 1.25%. The supplementary Budget will include a further increase in the contribution of employees and pensioners to 3.5%.
	[3.44] Make the web-portal with publicly available information on hospital services fully operational.	**Observed.**
	[3.46] Define the service portfolio for NHS hospitals and the detailed strategic 3-year plans for hospitals.	**Ongoing:** the adoption of the 3-year strategic plans is due for a few hospitals. The process is therefore ongoing and is due to be finalised by Q1-2014
Labour Market	**[4.2]** Report assessing the effectiveness of the reform of EPL.	**Observed**. A report has been prepared. Th authorities need to continue to monitor the effectiveness of the reform of EPL in tackling labour market segmentation.
	[4.3] Alternative reform option in view of the Constitutional Court ruling of 26 September 2013.	**Delayed**. A first draft on changes of the dismissal rules has been presented, but the authorities are still working on a final proposal to be presented to the EC/ECB/IMF.
	[4.4 iii] The government will present a summary of the system of survival	**Observed.**

	of collective agreements.	
Goods and services markets	**[5.2]** Present any additional cost reduction measures that might be necessary to eliminate excess rents and the tariff debt by 2020, ensuring a balanced burden sharing across the stakeholders.	**Observed. N**ew revised medium-term tariff debt projections were provided and several additional measures were proposed, some of them need to be implemented. However the measures presented will not suffice to eliminate the tariff debt by 2020.
	[5.3] Analyse the consequences of the report on the CMEC scheme and the hydro power plants related issues; assess the need for potential measures.	**Ongoing**
	[5.5] Provide a report on action with regard to new contracts in renewables and alternative mechanisms for mature technologies, also on future investments in renewables.	**Ongoing**
	[5.6] Finalise the conclusion of the universal service contracts awarded through the tenders.	**Partially observed/ongoing.** Following a decision of the Council of Ministers published on 18 October 2013, two universal service providers were selected following two tender procedures. The contracts have not yet been signed as the text is awaiting final approval from the regulator ANACOM. The ministry expects its conclusion by the end of January 2014. No applications to tender n. 3 were submitted with a consequent need to re-launch the procedure.
	[5.8] Follow the transposition of the Third Postal Directive by further liberalising the postal sector and renegotiating the contract with CTT.	**Observed.** The relevant decree law was published on 19 November 2013 and it fulfils the Programme requirements. In particular, the designation period has been shortened to 2020 and returns on investment are taken into account when determining the designation period (already envisaged by Article 17 of the Decree 17/2012).
	[5.9 iv] Reform the transport and infrastructures' regulatory framework to gain effectiveness, efficiency and independence.	**Delayed/ongoing.** The relevant legislation is currently being discussed with the Commission and has not been adopted yet
	[5.11 i] Ensure that the rail regulator enjoys the independence required under the EU rail Directives and strengthen its capacities to fulfil its	**Delayed/ongoing.** The relevant legislation is currently being discussed with the Commission and has not been adopted yet

	regulatory mandate effectively.	
	[5.11 vi] Guarantee that the main terminals owned by CP Carga are transferred to another entity that will guarantee non-discriminatory access to all rail freight operators.	**Delayed/ongoing.** The Government appointed a taskforce combined of CP, CP Carga and REFER to execute the transfer of CP Carga terminals to REFER. According to the information provided during the Tenth Review mission, the full transfer is now expected to be completed by the last Review of the Economic Adjustment Programme.
	[5.12 ii] Ensure that the regulator for ports enjoys sufficient financial resources and administrative capacity to effectively carry out its function.	**Delayed/ongoing.** The relevant legislation is currently being discussed with the Commission and has not been adopted yet
	[5.12 iii] Deliver policy decisions and take actions, including those that foster the renegotiation of the existing port operation concessions.	**Delayed.** Negotiations are expected to begin during the first quarter of 2014 to discuss with existing port concessionaires common interest measures to introduce more efficiency in the port operations and the tariffs structure, ensuring cost-savings are passed to port costumers.
	[5.12 iv] Present an exhaustive action plan assessing the forthcoming steps in the reform of ports.	**Partially observed/ongoing.** IMT requested an external, independent consultant analysis of the Portuguese ports sector. The consultant report and the IMT's proposed roadmap of reforms were shared with staff during the Tenth Review mission. The road map has not been published yet and new conditionality related with its monitoring was added.
	[5.13] Complete the adoption of Construction Laws and the others outstanding sectorial amendments necessary to fully implement the Services Directive and submit them to Parliament where necessary.	**Partially observed.** 63 out of 68 legal regimes have been completed under the Services Directive. The laws on construction and reserve of activities have further delays.
	[5.15 i] Adapt the content and information available at the PSC in line with the Services Directive and make available online forms and procedures for these regimes.	**Partially observed**. Some progress has been made. 48 regimes are published online on the PSC (3 of them are still to be dematerialised)
	[5.15 ii] Adapt the content and information available at the PSC for the outstanding regimes approved to ensure conformity with the Professional Qualifications Directive and make available online	**Partially observed.** Lack of sufficient resources was mentioned as a reason for delays. There is still a gap between the regimes published and those submitted and dematerialised in the PSC online platform.

	forms and procedures.	
Judicial system	**[7.1]** Publish quarterly reports on recovery rates, duration and costs of corporate insolvency cases from Q3-2011 and on the clearance rate of enforcement court cases from Q3-2013, within four months after the end of the relevant quarter.	**Observed:** Reports on corporate insolvency cases and on the clereance rate of enforcement court cases regarding Q2-2013 were presented in November 2013. Both reports were publiclly disclosed at www.dgpj.mj.pt by October 31 2013.
Public procurement and business environment	**[7.5]** Complete the already submitted report with more up-to-date on the revised Public Procurement Code and further assessment of the role of the Court of Auditors in ensuring compliance with public procurement rules.	**Observed/ongoing** A second amended report was submitted in November 2013. Additional information on direct awards provided in January 2014 requires further monitoring.
	[7.8] Establish an optional VAT cash accounting regime.	**Observed.** The measure entered into force on 1st October 2013 and applies to companies from all sectors of the economy with a turnover of up to EUR 500,000.
Licensing	**[7.11]** Adopt a rule that makes mandatory when creating a new regulation generating costs for businesses to eliminate existing regulation with equivalent cost.	**Delayed.** The decree-law that will include this rule is in the final process of being approved. Technical meetings with all relevant ministries are being held and a proposal will be presented to the Council of Ministers in January2014.
	[7.12 ii] Adopt and make operational a Risk Sectorial Plan	**Delayed**
	[7.12 iii] Review the legal regimes of the Territorial Management Instruments (RJGT) and of the related regulations.	**Delayed.** The relevant regulation is likely to be implemented by end of February 2014 after the approval by Base Law for Soils (expected by the end of January 2014).
	[7.12 iv] Adopt a legal provision for the regularisation of activities not in accordance with Territorial Management Instruments.	**Delayed.** The relevant regulation is likely to be implemented by end of February 2014 after the approval by Base Law for Soils (expected by the end of January 2014).
	[7.12 v] Harmonise the Regional Plans.	**Delayed**
	[7.12 vi] Review the Legal Regime for Urbanism and Building (RJUE).	**Delayed**
	[7.14 i] Approve regulations on zero licensing procedures on licensing procedures for Type 1 and 2	**Observed.** The relevant legislation was published in October 2013

	industries.	
	[7.14 ii] Define and establish the Zones of Responsible Enterprises (ZER).	**Observed.** The relevant legislation was published in October 2013
	[7.16 i] Review the legal regime concerning the licensing of mining and geological production and investment in line with international best practices.	**Delayed**
	[7.16 ii] Simplify the legal and bureaucratic procedures pertaining to mining and geological investments.	**Delayed**
	[7.17 i] Eliminate or transform into a voluntary regime the mechanism of prior communication in the Regime for Urbanism and Building and simplify the legal regime for touristic establishments.	**Observed.** The relevant legislation has been approved by the Council of Ministers and it is expected to be published in January 2014.
	[7.17 ii] Expand the range of ex post control mechanisms in urban operations.	**Observed.** The relevant legislation has been approved by the Council of Ministers and it is expected to be published in January 2014.
	[7.17 iii] Simplify and increase transparency of the requirements on the classification of the several types of touristic establishments.	**Observed.** The relevant legislation has been approved by the Council of Ministers and it is expected to be published in January 2014.
	[7.17 iv] Review the sanction legislation, giving more powers to ASAE.	**Observed.** The relevant legislation has been approved by the Council of Ministers and it is expected to be published in January 2014.

ANNEX 2
Commission Services Macroeconomic Projections 2012-2017

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

Annual % change	2012	2013	2014	2015	2016	2017
1. Private consumption expenditure	-5.3	-1.8	0.1	0.8	0.9	1.0
2. Government consumption expenditure	-4.7	-2.0	-2.5	-1.9	-0.7	-0.3
3. Gross fixed capital formation	-14.4	-8.0	1.2	3.7	4.1	4.2
4. Final domestic demand	**-6.8**	**-2.8**	**-0.2**	**0.7**	**1.1**	**1.3**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**-6.7**	**-2.8**	**-0.1**	**0.8**	**1.1**	**1.3**
7. Exports of goods and services	3.2	5.8	5.0	5.3	5.6	5.6
7a. - of which goods	4.1	5.7	5.1	5.4	5.6	5.6
7b. - of which services	0.7	6.3	4.9	5.1	5.5	5.6
8. Final demand	**-4.2**	**-0.4**	**1.4**	**2.1**	**2.5**	**2.7**
9. Imports of goods and services	-6.6	2.6	3.0	3.8	4.4	4.6
9a. - of which goods	-6.4	3.0	3.1	3.9	4.5	4.7
9b. - of which services	-7.7	0.2	2.5	2.9	3.7	4.0
10. Gross domestic product at market prices	**-3.2**	**-1.6**	**0.8**	**1.5**	**1.7**	**1.8**
Contribution to change in GDP						
11. Final domestic demand	-7.1	-2.8	-0.2	0.7	1.1	1.2
12. Change in inventories + net acq. of valuables	0.0	0.0	0.1	0.0	0.0	0.0
13. External balance of goods and services	3.8	1.2	0.8	0.7	0.6	0.6

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

Annual % change	2012	2013	2014	2015	2016	2017
1. Private consumption expenditure	-4.0	-1.3	1.1	2.0	2.3	2.6
2. Government consumption expenditure	-11.6	3.7	-4.5	-4.3	-0.2	0.4
3. Gross fixed capital formation	-14.0	-8.5	3.1	6.5	7.0	7.4
4. Final domestic demand	**-7.2**	**-1.6**	**0.3**	**1.6**	**2.6**	**3.0**
5. Change in inventories	--	--	--	--	--	--
6. Domestic demand	**-7.0**	**-1.5**	**0.4**	**1.6**	**2.7**	**3.0**
7. Exports of goods and services	4.6	5.5	6.1	6.4	6.7	6.8
8. Final demand	**-4.0**	**0.4**	**2.1**	**3.0**	**3.9**	**4.2**
9. Imports of goods and services	-5.3	1.1	3.1	4.4	5.2	5.4
10. Gross national income at market prices	-2.6	0.7	0.9	1.9	3.0	3.3
11. Gross value added at basic prices	-3.4	0.7	1.6	2.3	3.3	3.7
12. Gross domestic product at market prices	**-3.5**	**0.1**	**1.7**	**2.5**	**3.4**	**3.7**

Table 3: Implicit price deflators

% change in implicit price deflator	2012	2013	2014	2015	2016	2017
1. Private consumption expenditure	1.5	0.5	1.0	1.3	1.4	1.6
2. Government consumption expenditure	-7.3	5.8	-2.1	-2.4	0.6	0.7
3. Gross fixed capital formation	0.5	-0.6	1.9	2.6	2.9	3.1
4. Domestic demand	**-0.4**	**1.3**	**0.5**	**0.8**	**1.5**	**1.6**
5. Exports of goods and services	1.4	-0.3	1.0	1.0	1.1	1.1
6. Final demand	**0.1**	**0.8**	**0.7**	**0.9**	**1.4**	**1.5**
7. Imports of goods and services	1.4	-1.5	0.1	0.6	0.8	0.8
8. Gross domestic product at market prices	**-0.3**	**1.7**	**0.9**	**1.0**	**1.7**	**1.8**
HICP	**2.8**	**0.5**	**0.8**	**1.2**	**1.5**	**1.5**

Table 4: Labour market and cost

Annual % change	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
1. Labour productivity (real GDP per employee)	1.0	1.7	1.1	1.1	1.2	1.3
2. Compensation of employees per head	-2.0	2.7	-0.8	1.0	1.3	1.3
3. Unit labour costs	**-3.1**	**1.0**	**-1.9**	**-0.1**	**0.1**	**0.1**
4. Total population	-0.4	-0.7	-0.1	-0.1	0.0	0.0
5. Population of working age (15-64 years)	-1.3	-0.3	-0.1	0.0	0.0	0.0
6. Total employment (fulltime equivalent)	-4.2	-3.2	-0.4	0.4	0.6	0.6
7. Calculated unemployment rate - Eurostat definition (%)	**15.9**	**16.5**	**16.8**	**16.5**	**16.0**	**15.5**

Table 5: External balance

levels, EUR bn	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
1. Exports of goods (fob)	47.7	50.2	53.3	56.8	60.6	64.7
2. Imports of goods (fob)	55.4	56.2	58.0	60.6	63.9	67.4
3. Trade balance (goods, fob/fob) (1-2)	**-7.7**	**-6.0**	**-4.7**	**-3.9**	**-3.3**	**-2.7**
3a. p.m. (3) as % of GDP	***-4.7***	***-3.6***	***-2.8***	***-2.2***	***-1.8***	***-1.5***
4. Exports of services	16.2	17.2	18.2	19.3	20.6	22.0
5. Imports of services	9.5	9.4	9.7	10.0	10.4	10.9
6. Services balance (4-5)	**6.7**	**7.7**	**8.5**	**9.3**	**10.2**	**11.0**
6a. p.m. 6 as % of GDP	***4.0***	***4.7***	***5.1***	***5.4***	***5.7***	***6.0***
7. External balance of goods & services (3+6)	**-1.0**	**1.8**	**3.8**	**5.5**	**6.9**	**8.3**
7a. p.m. 7 as % of GDP	***-0.6***	***1.1***	***2.3***	***3.2***	***3.9***	***4.5***
8. Balance of primary incomes and current transfers	-2.7	-1.1	-2.4	-3.5	-4.4	-5.5
8a. - of which, balance of primary income	*-4.5*	*-3.7*	*-5.1*	*-6.1*	*-7.1*	*-8.1*
8b. - of which, net current Transfers	*1.8*	*2.6*	*2.6*	*2.6*	*2.6*	*2.6*
8c. p.m. 8 as % of GDP	*-1.6*	*-0.7*	*-1.4*	*-2.0*	*-2.5*	*-3.0*
9. Current external balance (7+8)	**-3.7**	**0.7**	**1.4**	**2.0**	**2.5**	**2.9**
9a. p.m. 9 as % of GDP	***-2.2***	***0.4***	***0.8***	***1.1***	***1.4***	***1.5***
10. Net capital transactions	3.5	3.1	3.2	3.3	3.4	3.5
11. Net lending (+)/ net borrowing (-) (9+10)	**-0.2**	**3.7**	**4.6**	**5.2**	**5.8**	**6.3**
11a. p.m. 11 as % of GDP	***-0.1***	***2.3***	***2.7***	***3.0***	***3.3***	***3.4***

Table 6: Fiscal accounts

	2012	2013	2014	2015	2016	2017
	% of GDP					
Indirect taxes	13.7	13.3	13.4	13.5	13.5	13.4
Direct taxes	9.3	11.2	11.1	11.1	11.0	11.0
Social contributions	11.6	12.0	11.6	11.3	11.1	10.9
Actual	9.1	9.5	9.2	9.1	9.0	8.8
Imputed	2.5	2.6	2.4	2.2	2.1	2.1
Sales and other current revenue	4.9	5.6	5.5	5.7	5.6	5.7
Sales	2.8	2.9	2.7	2.7	2.7	2.7
Other current revenue	2.1	2.7	2.8	2.9	2.9	2.9
Total current revenue	**39.4**	**42.1**	**41.7**	**41.6**	**41.3**	**40.9**
Capital transfers received	1.5	1.2	1.1	1.1	1.1	1.1
Total revenue	**40.9**	**43.2**	**42.8**	**42.7**	**42.5**	**42.1**
Compensation of employees	10.0	10.6	9.4	8.8	8.5	8.3
Intermediate consumption	4.5	4.8	4.6	4.4	4.3	4.2
Social transfers in kind via market producers	4.5	4.5	4.3	4.1	4.0	3.8
Social transfers other than in kind	18.0	18.7	18.5	18.1	17.8	17.5
Interest paid	4.3	4.3	4.4	4.4	4.4	4.5
Subsidies	0.6	0.7	0.8	0.8	0.7	0.7
Other current expenditure	2.6	2.7	2.8	2.6	2.5	2.5
Total current expenditure	**44.5**	**46.4**	**44.7**	**43.1**	**42.3**	**41.7**
Gross fixed capital formation	1.7	1.9	1.8	1.7	1.6	1.6
Other capital expenditure	1.3	0.9	0.3	0.4	0.5	0.5
Total expenditure	**47.4**	**49.1**	**46.8**	**45.3**	**44.4**	**43.8**
General Government balance (ESA95)	**-6.4**	**-5.9**	**-4.0**	**-2.5**	**-2.0**	**-1.7**
General Government balance (Programme)	**-6.0**	**-5.5**	**-4.0**	**-2.5**	**-2.0**	**-1.7**
	% change					
Indirect taxes	-4.1	-2.7	2.9	3.5	3.0	2.6
Direct taxes	-9.5	21.2	0.9	2.1	3.2	3.3
Social contributions	-9.1	3.9	-1.6	-0.4	1.8	1.6
Sales and other current revenue	4.2	13.5	0.5	5.3	3.0	4.2
Total current revenue	**-6.0**	**6.9**	**0.8**	**2.3**	**2.7**	**2.7**
Capital transfers received	-68.0	-22.3	-4.8	6.0	4.8	5.3
Total revenue	**-12.3**	**5.8**	**0.6**	**2.4**	**2.6**	**3.0**
Compensation of employees	-15.0	6.2	-9.8	-3.4	0.0	0.9
Intermediate consumption	-6.4	6.3	-1.3	1.0	1.5	1.5
Social transfers in kind via market producers	-5.9	-0.9	-1.8	-3.5	0.5	0.5
Social transfers other than in kind	-0.5	4.5	0.2	0.6	1.7	2.0
Interest paid	4.1	0.5	1.9	3.1	4.6	5.5
Subsidies	-17.4	20.1	5.0	1.9	2.5	1.0
Other current expenditure	-4.8	4.9	7.3	-2.6	2.5	3.2
Total current expenditure	**-5.4**	**3.8**	**-1.5**	**-1.4**	**1.6**	**1.9**
Gross fixed capital formation	-38.6	12.4	-3.3	-3.0	0.9	3.5
Other capital expenditure	-11.0	-27.6	-64.8	42.9	7.8	9.3
Total expenditure	**-7.3**	**3.2**	**-2.9**	**-1.2**	**1.6**	**2.0**
Nominal GDP, EUR bn	165.1	165.3	168.1	172.4	178.2	184.8

Table 7: Government debt developments

	2012	2013	2014	2015	2016	2017
ESA95 deficit (% of GDP)	**-6.4**	**-5.9**	**-4.0**	**-2.5**	**-2.0**	**-1.7**
ESA95 gross debt (% of GDP)	124.1	129.4	126.6	125.8	123.4	119.9
	levels, EUR bn					
ESA95 deficit	**-10.7**	**-9.8**	**-6.8**	**-4.4**	**-3.5**	**-3.1**
Gross debt	204.8	213.9	212.9	216.8	220.0	221.6
Change in gross debt	19.6	9.1	-1.0	3.9	3.1	1.6
Nominal GDP	165.1	165.3	168.1	172.4	178.2	184.8
Real GDP	170.3	173.0	171.7	169.1	166.2	163.1
Real GDP growth (% change)	**-3.2**	**-1.6**	**0.8**	**1.5**	**1.7**	**1.8**
Change in gross debt (% of GDP)	11.9	5.5	-0.6	2.3	1.8	0.9
Stock-flow adjustments (% of GDP)	5.4	-0.4	-4.7	-0.2	-0.2	-0.8
	% of GDP					
Gross debt ratio	**124.1**	**129.4**	**126.6**	**125.8**	**123.4**	**119.9**
Change in gross debt ratio	15.8	5.3	-2.8	-0.8	-2.4	-3.5
	Contribution to change in gross debt					
Primary balance	2.1	1.6	-0.3	-1.9	-2.5	-2.8
"Snow-ball" effect	8.2	4.1	2.2	1.2	0.2	0.1
of which						
Interest expenditure	*4.3*	*4.3*	*4.4*	*4.4*	*4.4*	*4.5*
Real growth effect	*3.5*	*1.9*	*-1.0*	*-1.9*	*-2.2*	*-2.3*
Inflation effect	*0.4*	*-2.2*	*-1.2*	*-1.3*	*-2.0*	*-2.1*
Stock-flow adjustments	**5.4**	**-0.4**	**-4.7**	**-0.2**	**-0.2**	**-0.8**
Implicit interest rate	*3.9*	*3.5*	*3.4*	*3.5*	*3.6*	*3.8*

ANNEX 3

Indicative Financing Needs and Sources

Table 8: Financing needs and sources (EUR billion)

	2011 Jun-Dec	2012 Year	2013 Year	2014 Year	2011-2014 Total
Public sector deficit	**11.5**	**13.3**	**11.7**	**14.7**	**51.2**
Treasury balance [1]	7.1	8.9	8.0	7.4	31.4
Other public sector cash needs [2]	4.4	4.4	3.7	7.3	19.8
Amortization [3]	**9.5**	**27.8**	**17.2**	**12.3**	**66.8**
Medium- and long-term debt (incl debt exchange)	4.9	16.6	13.1	10.7	45.3
Other debt (retail, repos, incl SOE), net	4.6	11.2	4.1	1.6	21.5
Banking support [4]	**1.0**	**7.5**	**1.6**	**0.5**	**10.6**
Financing needs	**22.0**	**48.6**	**30.5**	**27.5**	**128.6**
Market financing	**-6.4**	**8.9**	**13.3**	**12.8**	**28.5**
Medium- and long-term debt	0.0	3.6	12.0	12.9	28.4
T-Bills, net	-6.4	5.3	1.3	-0.1	0.1
Own resources [5]	**-5.7**	**12.3**	**7.3**	**6.9**	**20.8**
EU-IMF loan	**34.1**	**27.5**	**10.0**	**7.8**	**79.4**
EFSM/EFSF	21.0	19.3	6.6	5.1	52.0
IMF [6]	13.1	8.2	3.4	2.7	27.4
Financing sources	**22.0**	**48.6**	**30.5**	**27.5**	**128.6**

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 entities.

6/ Numbers do not add up to EUR 26 bn due to changes in EUR-SDR rate compared to beginning of programme; table reflects nominal values in EUR; SDR exchange rate of 9 January 2014 applied to 2014 disbursement forecast.

Table 9: Planned quarterly disbursements (EUR billion)

Review	Period covered by disbursement	Approximate disbursement period	Loan disbursements[1]	of which IMF[2] (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	8.0	2.8	5.2
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 & 9	Q3/Q4-2013	Nov-13	5.6	1.9	3.7
10	Q1-2014	Feb-14	2.7	0.9	1.8
11	Q2-2014	Apr-14	2.5	0.9	1.6
12	Q3-2014	Jun-14	2.6	0.9	1.7
	TOTAL		79.4	27.4	52.0

[1] *Data is subject to revision due to EUR - SDR fluctuations.*

[2] *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.

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
Data on the cash balances of the other parts of General Government (Autonomous Funds and Services, Social Security and Other entities, including Incorporated State-owned enterprises (ISOEs) or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government; [Regional and Local Governments (*Administrações Regionais and Locais*); Regional and local government-owned enterprises or companies, foundations, cooperatives, and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government, as defined in paragraph 4 of the TMoU) – progressively enlarged	Monthly, as soon as the data are available and no later than 7 weeks after the end of the month
Accrual data on budget execution of the National Health System (NHS)	Monthly, 3 weeks after the end of each month
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
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 45 days after the end of the quarter
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)
Data on the past and projected financing needs of SOEs, including	Monthly, 4 weeks after the end of

for the major SOEs details on the financing needs for the operational balance, capital expenditure, interest payments and debt principal repayments	the month
Data on arrears of: - the General Government, detailed by subsector - the incorporated (SOEs) government-owned hospitals that are not part of the General Government - other non-financial SOEs that are not part of the General Government	Monthly, 7 weeks after the end of each month (as of September 2011)
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
To be provided by ESAME	
Report on progress with fulfilment of economic policy conditionality on a quarterly basis. In addition, a short summary report should be sent on a monthly basis	Quarterly (report), two weeks after the end of each quarter. Monthly (short summary report) two weeks after the end of each month for which a report is not due.
To be provided by the Debt Management Office	
Accrual data on interest spending of the State	Quarterly, 7 weeks after the end of the quarter

To be provided by the Ministry of Labour

Data on labour market as follows: - 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	Every six months, 6 weeks after the end of each semester

To be provided by Ministry of Justice

Publishing quarterly reports on recovery rates, duration and costs of corporate insolvency cases	Quarterly, starting in the first quarter of 2011, within four months after the end of each quarter.

ANNEX 5
PROGRAMME DOCUMENTS

ANNEX 5
LETTER OF INTENT

Lisbon, 19 February 2014

Mr Jeroen Dijsselbloem

President

Eurogroup

Mr Giannis Stournaras

Minister of Finance

Greece

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 have made further progress towards the Programme objectives. The end-September deficit and debt performance criteria were met, and preliminary information suggests that we are also on track to comfortably meet the end-year targets, reflecting our firm commitment to fiscal discipline. We continue to take steps to fight tax evasion and mitigate fiscal risks, including through the recent creation of the Compliance Risk Management Unit. As part of our structural efforts, we have recently made further progress in the services sector, with steps aiming at eliminating entry barriers and increasing competition. Moreover, to secure the resilience of the banking sector amidst a still challenging operating environment, Banco de Portugal has proactively stepped up its supervisory activity.

Nevertheless, further efforts are still needed to anchor growth on a sustainable basis, complete our ambitious fiscal consolidation plan in line with our European commitments, and vigilantly monitor the resilience of the financial system in the context of the ongoing deleveraging and rebalancing of the economy. In particular,

- Many of the structural reforms originally envisaged in the Programme are now in place, and are beginning to have an impact, as evidenced by the gradual improvement in the macroeconomic outlook, underpinned by a solid export performance and improved market conditions. Yet, despite recent signs of economic stabilisation, unemployment remains high, calling for renewed efforts to promote an adjustment more favourable to growth and employment. To this purpose, we are assessing necessary policy actions to further promote the dynamism and efficiency of the labour market, while continuing to reduce excessive rents in product markets and supporting a business-friendly environment.

- The 2014 budget law was approved by Parliament, with measures largely drawn from our ambitious Public Expenditure Review, targeting a general government deficit of 4 percent of GDP and ensuring a consolidation strongly tilted towards permanent spending measures. Moreover, in response to a recent adverse Constitutional ruling on a key provision of the pension reform, we have identified offsetting measures of comparable size and quality. These include the frontloading of the planned increase in the beneficiaries' contributions to the special health insurance schemes (ADSE, SAD and ADM) and a recalibration of the parameters of the existing extraordinary solidarity contribution on pensions (CES). Submission to Parliament of the revised CES through a supplementary budget and approval by the Council of Ministers of the decree law on the change in contributions to the special health insurance schemes are *prior actions* for completion of this review. We are now in the process of developing new comprehensive measures as part of the ongoing structural reform of pensions, in line with the Court ruling. Stocktaking of this process will be made during the next review. More generally, we are determined to advance further our comprehensive reform of Public Administration, underpinning our commitment to the fiscal sustainability rules in the European Treaty on Stability, Coordination, and Governance.

- To support our medium-term fiscal objectives and ensure a more equitable adjustment, we remain determined to make further progress in streamlining the public sector, curbing tax evasion, and strengthening our budget control. In particular, we are determined to halt any new accumulation of arrears through targeted programs and full enforcement of the Commitment Control Law.

- We are committed to preserving financial stability and supporting an orderly deleveraging of balance sheets. Efforts to promote adequate funding conditions for the dynamic segments of the economy continue. In anticipation of the European Central Bank's comprehensive assessment, to be conducted this year in the context of the Single Supervisory Mechanism, Banco de Portugal will continue to vigilantly monitor the banking system, ensuring its supervisory standards remain in line with international best practice.

We trust that our continued commitment to fiscal discipline and structural reforms will further support investors' confidence in the Portuguese economy and secure our successful return to capital markets on a durable basis.

On the basis of the strength of the policies outlined in this letter, and in light of our performance under the Programme, we request the completion of the tenth review under the Economic Adjustment Programme.

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

This letter is copied to Ms Christine Lagarde.

Sincerely yours,

/s/	/s/	/s/
Paulo Portas	Maria Luís Albuquerque	Carlos da Silva Costa
Deputy Prime Minister	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

Ninth Update – **7** February 2014

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 ninth 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. ([13])

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 tenth quarterly review assessed compliance with the conditions to be met by end-September and the need and scope for additional policy steps. This ninth update of the MoU reflects the findings of the tenth 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.

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

1. Fiscal policy

Objectives

Reduce the government deficit to 5.5 percent of GDP in 2013, 4 percent of GDP in 2014 and 2.5 percent of GDP in 2015 by means of high-quality permanent measures, while minimising the impact of consolidation on vulnerable groups. In the medium term, the fiscal consolidation process will be maintained until a balanced budgetary position is reached, notably by containing expenditure. Growth-friendly tax policy will be pursued through, among other actions, a comprehensive reform of corporate taxation to promote investment and competitiveness.

Fiscal policy in 2013

1.1. The Government will achieve a general government deficit target of no more than 5.5 percent of GDP on an ESA95 basis ([14]) [Q4-2013].

1.2. Progress in achieving the year-end fiscal target will be assessed against the ceiling 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 the full-year ESA-95 deficit target [Q4-2013].

Fiscal policy in 2014

1.3. The Government will achieve a general government deficit of no more than 4 percent of GDP in 2014 and arrest the accumulation of domestic arrears. ([15])

1.4. Within the year, progress will be assessed against the (cumulative) quarterly ceiling 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 the full-year ESA-95 deficit target [Q1 -2014].

1.5. The Budget Law for 2014 and other supporting legislation will be consistent with a general government deficit ceiling of 4 percent of GDP. The measures defined below, worth 2.3 percent of GDP, will be implemented with the 2014 Budget Law [Q4-2013] and other supporting legislation. Measures are primarily of permanent nature and expenditure reduction will account for about 80 percent of the consolidation.

Public Expenditure Review

1.6. The 2014 Budget builds on the public expenditure review carried out over the last year with the objective of enhancing the efficiency and equity of public spending. In particular, it aims at addressing inefficiencies within public sector functions and entities, reallocating resources towards growth-friendly spending areas and ensuring social equity of the expenditure programmes and the sustainability of public finances.

1.7. The package of permanent consolidation measures from the public expenditure review amounts to around 1.8 percent of GDP (net of income tax and employers' and employees' social contribution

([14]) In 2013 operations related to the banking sector support and restructuring strategy under the programme will not be considered for the assessment of compliance with the programme target for the general government deficit.

([15]) In 2014 operations related to the banking sector support and restructuring strategy under the programme will not be considered for the assessment of compliance with the programme target for the general government deficit.

reduced collections). One-off costs from the mutual agreement termination schemes limit the savings to 1.7 percent of GDP in 2014. The package draws on the following three pillars:

i. Limiting outlays on the public wage bill by (i) reducing the size of the public sector workforce —addressing excessive employment in particular sub-sectors— while tilting its composition towards high-skilled and better-trained civil servants; (ii) ensuring convergence of the public sector work rules and regulations towards private sector standards, including regarding working hours, working time arrangements and holiday entitlements; and (iii) revising the wage scale and simplifying the remuneration policy by implementing single wage and supplements' scales. The reduction in the workforce will be achieved through a combination of policies, including lower replacement of retirees, mutual agreement termination schemes and enhanced use of the requalification programme. In particular, following the recent programmes of mutual agreement terminations offered to low-skilled workers and teachers, other programmes shall be launched to address over-employment in specific sectors. Regarding the remuneration policy, the revision of the wages enshrined in the Budget Law has been made in a progressive way, ensuring the protection of lower income earners.

The savings for the wage bill from these measures should achieve around EUR 1.2 billion in gross terms (EUR 700 million taking into account the losses of government revenues from income taxes and social contributions).

Also, as part of these horizontal measures, the beneficiaries' contributions to the special health insurance schemes (ADSE, SAD and ADM) will be raised to a 3.5% contribution rate (from employees and pensioners) ([16]). This measure, that aims at frontloading the self-financing of these schemes, will raise additional revenues in 2014 by at least EUR 290 million.

ii. Limiting the public pension expenditure, given the need to reassess its sustainability on the back of demographic developments, while at the same time aiming at protecting those who earn the lowest pensions, by (i) the effective increase by one year of the retirement age to 66 years (implemented by adjusting the demographic sustainability factor); (ii) the continuation of the progressive "extraordinary solidarity contribution" on pensions, redesigned to lower both the threshold from which the progressive contribution starts applying (i.e. down from EUR 1350/month to EUR 1000/month) and the thresholds from which the highest contribution rates are applied. ([17]) This measure will enter into force as from April; (iii) streamlining survivors' pensions of both CGA and the general pension regime, in particular in cases where these accumulate with other pensions. In addition, lifelong grants to politicians will also be reduced. These pension reforms will achieve expenditure cuts and increased revenue of around EUR 450 million in gross terms in 2014 (around EUR 380 million net savings).

In addition, a medium to long-term measure on the pensions' systems will be developed during 2014, in line with the Constitutional Court ruling. Stock tacking on this process will be made during the [eleventh review].

iii. Other savings will be generated through a combination of sector-specific reforms, which were identified by line ministries in the bottom-up budgeting process. These mainly include targeted personnel reductions (notably, through non-renewal of fixed-term contracts), further savings in intermediate consumption and investment and a reduction of transfers. In the education sector, the rationalisation of the school network and a convergence of the teacher/student ratio towards levels of other EU countries will support these goals. Hospital reform and cost optimisation will contribute to savings in the health sector. The expenditure cuts and increased revenue from the sector-specific reforms will attain around EUR 1.87 billion (EUR 1.67 billion in net terms).

([16]) Approval by the Council of Ministers is a *prior action* in the MEFP for completion of the Review.
([17]) Submission to Parliament of a Supplementary Budget to enact the revised CES is a *prior action* in the MEFP for completion of the Review.

1.8. The attainment of these savings crucially hinges on respecting the defined expenditure ceilings for each line ministry. This will be closely monitored through monthly reporting to the Council of Ministers, in particular regarding the targets of the public sector workforce reduction by ministry.

1.9. In addition to the Budget Law, the legislative processes necessary to underpin the public expenditure review reforms will be advanced according to the following timelines. The ordinance on mutual agreement terminations for teachers is already in force and other programmes will be launched by [January 2014]. The draft Public Administration General Labour Law that consolidates several measures aimed at aligning the current public employment regime to the private sector rules was submitted to Parliament and is expected to be published in [Q1-2014]. The implementation of a single supplements scale is expected by June 2014 and of a single wage scale by the end of 2014. The amendments necessary for the increase in the retirement age were submitted to Parliament in October 2013 and the changes entered into force on 1 January 2014. The existing pension legislation of the CGA shall be modified by January 2014 to ensure that the new rules on the sustainability factor and thus the increased retirement age effectively apply also to this regime.

Other fiscal measures

1.10. The Government implements through the Budget Law or supporting legislation the following permanent revenue consolidation measures, worth about 0.4 percent of GDP:

- Tax and social contribution measures (EUR 515 million): increase in the tax rate of the autonomous taxation of company cars within the framework of the corporate income tax; base broadening and increased rates of excises on tobacco and increased rates on alcoholic drinks; surcharge on car tax on diesel passenger vehicles; reduction of fiscal exemptions in property taxation for pension funds and real estate funds; increased levy on financial institutions (banking system); tax and licensing fees for online gambling; increase of social security contributions by members of statutory bodies, by eliminating the cap on the calculation base.

- Other revenues: a special levy on the energy sector (yielding government revenue of EUR 100 million and channelling any excess in collection from that amount to reduce the electricity tariff debt) and a fee on media spectrum utilisation (EUR 10 million).

1.11. In addition, a number of one-off deficit-reducing measures (worth about 0.2 percent of GDP) will contribute to achieving the headline deficit target, more than offsetting the one-off costs related to the mutual agreement terminations of public sector employment contracts. These include the transfer of the CTT health fund to the government sector (EUR 180 million), the sale of a port and a silos company concession (EUR 170 million) and special dividends from the sale of excessive oil reserves (EUR 60 million).

1.12. The Government has put forward a comprehensive reform of the corporate income tax aimed at promoting simplification as well as boosting internationalisation and competitiveness of Portuguese companies. The main features of the reform include the redefinition of the tax base, the lowering of the statutory rate and the revamping of tax benefits. It also envisages a special taxation regime for small businesses, the simplification of ancillary tax obligations, the strengthening of the territoriality principle, extension of the tax losses deduction period and further reduction of the debt bias. It will be implemented within the existing budgetary envelope to respect the fiscal consolidation targets.

1.13. The standstill rule for tax expenditures at central, regional or local level will be maintained.

1.14. Efforts to fight tax evasion, fraud and informality for various types of taxes will be further strengthened, inter alia by increasing means available for audits and the monitoring of the new e-

invoicing system. A study on the shadow economy in the housing market will be carried out by the [twelfth review] with a view to seeking ways to reduce rental tax evasion.

1.15. Should adverse legal or other budgetary execution risks materialise, the Government will implement, having consulted with EC/ECB/IMF staff, compensatory measures of high quality in order to meet the agreed deficit target.

Fiscal policy towards 2015 target

1.16. The Government will achieve a general government deficit of no more than 2.5 percent of GDP in 2015 and arrest the accumulation of domestic arrears.

1.17. The strategy to achieve the target will be underpinned by the Reform of the State document which focuses on social security sustainability, public administration reform, greater efficiency in health and education and environmental taxation. Broad-based consultations with political and social partners to advance and define reforms are ongoing. The progress in this process will be analysed at the [eleventh review] and identified measures will be reflected in the 2014 Fiscal Strategy Document. In order to comply with the EU budgetary framework requirements, this document should also provide details of the medium-term budgetary plans.

2. Financial sector stability, regulation and supervision and financing of the economy

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. 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]. In parallel, the BdP will continue to explore new initiatives supporting the system's liquidity including through mechanisms allowing banks to securitise their high quality mortgages and SME credit.

Deleveraging in the banking sector

2.2. Banks' funding and capital plans and broader credit developments will continue to be monitored closely. The banking system should in the medium run eliminate its funding imbalances and reinforce its long-term viability. The BdP monitors the banks' implementation of the funding and capital plans aimed at achieving a stable market-based funding position. It is important to ensure that the pace and composition of the 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.

Capital buffers

2.3. Ensure that current capital requirements by the BdP are respected including through the monitoring of the restructuring plans of banks having received public capital support [ongoing]. Monitor the banks' transition to the new capital rules as laid down in the Capital Requirements Directive IV package (CRD IV) ensuring that the banking system is ready to meet a Common Equity Tier 1 (CET1) capital ratio of 7% from 1 January 2014, consistent with the CRD IV package. In the context of the ECB's forthcoming asset quality review, the largest banks are expected to maintain a CET1 add-on of 1 percentage point. Additional measures will be in place to preserve banks' capital buffers, ensuring that they remain commensurate with the challenging operating environment. The implementation of the above framework will also need to be in accordance with the requirements currently envisaged in the EBA Recommendation on the preservation of capital for the banks that are subject to them. BdP ensures that the framework will also comply with any future regulatory initiatives at European level.

2.4. The BdP closely monitors the banks' compliance with the capital requirements and EBA recommendations 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 the recently amended 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].

2.8. In addition, the BdP steps up the monitoring of banks, including via ad hoc audits [ongoing]. As a follow-up to the special assessment programme of banks' operational capacity to effectively deal with loan restructuring and asset recovery, the BdP will monitor the timely implementation of the recommendations issued. The BdP will revise the standards on non-performing loans in order to achieve convergence with the criteria included in the relevant EBA technical standard in line with the timeframe set at the EU level.

2.9. The BdP continues to monitor on a quarterly basis the banks' potential capital needs with a forward looking approach under stress conditions. Banks reflect the On-site Inspections (OIP) findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies [ongoing]. Moreover, to support the bottom-up stress test results the BdP integrates the new top-down stress testing framework into the quality assurance process, which allows for a review of the key drivers of the results. This framework will be used in the next round of quarterly stress tests, to be finalised in [February 2014]..

2.10. The 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 the firms selected through the bidding process with a mandate to gradually recover the assets over time. 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. Following the review of the recovery plans of the largest banks in the system, the BdP will review the remaining banks' submissions [ongoing]. In parallel the BdP prepares resolution plans based on the reports provided by the largest banks. The BdP will issue guidelines on recovery plans in line with the relevant (draft) EBA technical standards and with the forthcoming EU Directive on the recovery and resolution of credit institutions.

2.14. Closely follow the process of adoption of the EU Directive on the recovery and resolution of credit institutions and swiftly revise the national resolution framework once the Directive has been 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. A revised legal framework of the CCR will be implemented given the approval by the Portuguese Data Protection Authority (CNPD) to allow financial institutions to have access to companies' historical information as well as to the corporate balance sheet database, reducing information asymmetries, especially for smaller companies. .

Corporate and household debt restructuring framework

2.16. Finalise the implementation of the framework for financial institutions to engage in out-of-court debt restructuring for households and smoothen the application of the framework for restructuring of corporate. Prepare quarterly reports on the implementation of the new restructuring tools [ongoing]. Align the reporting content of SIREVE with that already in place for PER [ongoing]. On the basis of the findings of the survey of insolvency stakeholders 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 quarterly reports [ongoing]. Given the scale of the debt overhang, particularly in the corporate sector, monitor the implementation of the new framework to ensure that it is working as effectively as possible [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. Implement the pilot grouped issuance of corporate debt to obtain capital market financing and/or explore similar initiatives to facilitate financing to SMEs including through the innovative risk sharing instruments currently under discussion at EU level [ongoing];

iii. In line with the relevant EU legislation, submit to the Council of Ministers a proposal for the necessary amendments of the rules governing the commercial paper market in order to facilitate its expansion among a wider investor and issuer base and to increase the use of this alternative funding option by the corporate sector [ongoing];

iv. Building on the agreement on a State guarantee for existing and future exposures of the EIB to the Portuguese economy, the authorities will strive to facilitate the financing of the corporate sector, in particular the economically viable SMEs operating in the tradable sectors [ongoing].

2.19. Improve 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, while remaining in line with EU State-aid rules. In that context, implement the recently revised roadmap for improving the governance of the National Guarantee System (NGS) and making these schemes more efficient while minimising risks for the State. The steps to improve the competitiveness and transparency of the current pricing system include (i) a refinement of the methodology of determining the maximum interest rates (caps) that participating institutions can charge on guaranteed credit lines, updated on a quarterly or semi-annual basis, reflecting their funding and administrative costs, and differentiated by various risk profiles of firm groups; (ii) full disclosure by participating institutions of the caps per risk class in the marketing material; (iii) a close monitoring of the rates effectively charged to ensure that appropriate competition among institutions is in place. Moreover, explore, by end-February 2014, additional steps to be taken by individual participating institutions, to further enhance the transparency of their pricing practices through additional disclosure of actual interest rates charged per risk class if appropriate. Prepare a report to take stock of the impact of these enhancements on actual interest rates and, if needed, to propose remedies and policy alternatives including a competitive bidding system, in order to ensure that guaranteed loans will be priced in a competitive and transparent manner, in favour of end-users. Regularly report on progress

Prepare quarterly reports on the allocation of the government sponsored credit lines aimed at facilitating access to finance to SMEs, including by monitoring the balance sheet performance of the firms benefiting from these credit lines.

2.20. Establish a development financial institution (DFI) aiming at streamlining and centralising the management of the reimbursable part of the financial instruments of EU structural funds for the 2014-2020 programming period. The DFI's sole purpose shall be to address market failures in the financing of private non-financial companies, notably SMEs, and in doing so it will not accept deposits or other repayable funds from the public, nor engage in direct lending. Its final structure and by-laws will reflect in-depth consultation with EC, ECB and IMF staff and will be designed to ensure no additional burden on or risks to public finances.

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 EU/IMF technical assistance missions.

Public Financial Management framework

Reporting and Monitoring

3.1. Publish a tax expenditure report 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.

3.2. Reduce the number of budget entities 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 with support from IMF technical assistance to enlarge central government revenues by the [eleventh review].

Arrears

3.3. 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]. For selected public entities—including some of the large hospitals—that face structural financial imbalances targeted programmes to underpin their financial sustainability will be developed [by end-February]. The Commitment Control Law will be enforced in full, with some technical adjustments, to all public entities—including entities under targeted programmes—so as to bring to zero the net accumulation of arrears in line with the continuous indicative target under the programme. A dedicated unit with the Ministry of Finance, reporting directly to the State Secretary of the Budget in charge of the expenditure arrears for the public sector, will be established [by end-February].

3.4. 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

3.5. 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.

3.6. The Budget Framework Law (BFL) will be reviewed to fully transpose the relevant EU legislation by [Q1-2014]. The technical group reviewing the BFL will publish a report assessing the strengths and weaknesses of the law and provide suggestions for new legislation [Q4-2013]. In January 2014, the authorities will engage in a broad-based consultation with all relevant stakeholders to discuss the key elements of the new legislation, notably the streamlining of the budget appropriation structure, strengthening of accountability relations, and imparting a medium-term to long-term focus to public

finance. The key aspects and the structure of the new law will be announced by [April 2014]. As part of these efforts, an IMF Fiscal Transparency Evaluation will be undertaken by the end of the programme, which will be made publicly available.

3.7. 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].

3.8. 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

3.9. 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 while ensuring a sustainable reduction in government liabilities [ongoing].

3.10. The Government will continue to work towards implementing the PPP framework law, ensure the proper functioning of the new technical unit in the Ministry of Finance (UTAP) and develop the tools for managing and monitoring all PPPs. PPP tenders will only be launched following the required studies on their costs and benefits, and in full compliance with the PPP framework law. EC/ECB/IMF staff will be consulted throughout the first complete process of this kind. 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].

3.11. 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, in liaison with the Banco de Portugal, on credit allocation and crowding-out effects. The report will serve as input to the fiscal risks assessment for the budget [Q4-2013].

State-owned enterprises

3.12. State-owned enterprises (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].

3.13. Following the comprehensive review of wage and supplements' scales in the general government, in-depth studies for SOEs in different sectors will follow in a phased approach: Transport SOEs plus REFER and Estradas de Portugal in [Q1-2014] and other SOEs by the [twelfth review].

3.14. 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].

3.15. 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

3.16. The Government continues to implement the privatisation programme under the new framework law for privatisation. The programme target of privatisation proceeds of about EUR 5.5 billion was already achieved. The sale of GALP and the small remaining stake in REN will be completed when the market conditions improve. The privatisation or concession of the freight subsidiary of CP (CP Carga) will be carried out after the completion of the unbundling of freight terminals and as soon as further steps have been taken to increase its market value while restoring its operational balance. The tender for the privatisation of the national air carrier (TAP) will be carried out as soon as market conditions improve. The sale or concession of a television channel and radio station belonging to RTP will be subject to the company's ongoing restructuring process and the improvement of market conditions. The sale of the waste management company (EGF) will be launched once changes underway in the regulation of this sector are implemented [Q1-2014]. The Government will further consider expanding the privatisation programme to include additional assets for sale or concession in 2014.

Revenue administration

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

i. Reduction of the number of municipal offices by at least 25 percent in 2013 [Q1-2014] and 25 percent in May 2014;

ii. Increase in the resources devoted to auditing in the tax administration to at least 30 percent of the total staff, mostly through reallocations of staff within the tax administration and other parts of the public administration. The threshold should be attained by [Q4-2013];

iii. Publication of quarterly reports on duration and costs of tax cases starting from [Q4-2013] within four months after the end of the relevant quarter;

iv. Creation of a Taxpayer Services Department aimed at centralising different services for taxpayers and at improving their relationship with the tax administration, as foreseen in the AT Strategic Plan.

3.18. The reform of the e-invoicing system that aims at curbing fraud and evasion has been put fully in place in 2013. An evaluation report of the measures for the different economic sectors will be prepared by [Q4-2013]. The operational capacity to analyse in a timely and efficient manner all the data gathered from the transmission of invoices to the tax administration will be further enhanced [ongoing]. The analysis of the information will allow better targeted audits when irregularities are detected, including for past fiscal years,

3.19. Exchange of information between the tax and the Anti-Money-Laundering authorities will be strengthened in line with international best practices.

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

(i) 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 unified monthly tax returns and the unified forms on Independent Workers' annual revenue [ongoing]. An assessment report will be prepared by [Q4-2013];

(ii) 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 making fully operational the recently established Risk Management Unit [Q1-2014] that will initially focus on targeted projects to improve compliance of high net wealth individuals and self-employed professionals.

Public administration

Central, regional and local administration

3.21. On the basis of Law 64/2013 regulating the obligation of transparency on benefits granted by the public administration to the private sector and defining monitoring and reporting mechanisms, the authorities will review public financial support to private associations [Q1-2014].

3.22. The Inter-ministerial Group on Territorial Affairs will present a report with the following objectives:

i. Identify potential overlaps of services and jurisdictions and other sources of inefficiencies between the central and local levels of government, as well as new opportunities for decentralisation and outsourcing of services by the central government by the [eleventh review]

ii. Reorganise the network of decentralised services of ministries, aiming at increasing efficiency in the public sector and the quality of services for citizens and businesses. These shall be reorganised mainly through mergers of “lojas do cidadão” and other approaches, encompassing more efficient geographical areas and intensifying the use of digital government by the [eleventh review].

Shared services

3.23. 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) in central and regional administrations [Q4-2013];

ii. complete the implementation of the strategy of shared services in the area of human resources (GeRHuP) in the Ministry of Finance’s entities by concluding the roll-out to the Tax Authority by [May 2014];

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

Human resources

3.24. Limit staff admissions in public administration to achieve decreases in 2012-2014 of at least 2 percent per year (in full-time equivalents) in the staff of central administration and 2 percent per year 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].

3.25. Following the comprehensive review of wage scales in the public administration by the [twelfth review], a single wage scale aimed at the rationalisation and consistency of remuneration policy across all careers will be developed in the first half of 2014 and finalised by the end of 2014.

3.26. Following the survey on cash supplements, a report on the comprehensive reform of wage supplements is expected by [Q4-2013]. Draft legislation for a single supplement scale will be presented by the the [twelfth review] with a view to its implementation by June 2014.

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

3.28. A new general Public Administration Labour Law, simplifying and compiling the existing rules of public sector employment along the structure of the private labour code, will be effective by [Q1-2014]. Whilst important subsets of this legislation are already in force (e.g. 40 hours working week, requalification programme rules), the law includes other elements such as the revision in the number of days of annual leave and the application of bank of hours.

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 and 2014; 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

3.29. 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].

3.30. The plans to achieve a self-sustainable model for health-benefits schemes for civil servants were accelerated and are on track. The employer’s contribution rate was effectively reduced to 1.25% on 1 August 2013, when the employee's and retiree’s contribution rate was increased to 2.25%. The current plan foresees that the employer’s contribution rate will remain at 1.25% in 2014 though in the overall budgetary cost of existing schemes - ADSE, ADM (Armed Forces) and SAD (Police Services) – it will be nullified through the transfer of resources both to the NHS (in exchange for the provision of services, namely pharmaceuticals) and to the State. The employee's and retiree’s contribution rate will be further increased to 3.5% in 2014. This measure will further speed up the process of self-financing.

Pricing and reimbursement of pharmaceuticals

3.31. 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 and 2014 [ongoing].

3.32. 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 off-

patent medicines which have had a market authorisation for 15 years and are currently not subject to generics competition in the Portuguese market [ongoing].

Prescription, monitoring of prescription and guidelines

3.33. 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].

3.34. Continue to devise and enforce a system of sanctions and penalties, as a complement to the assessment framework [ongoing]. Assess the application of NHS prescription rules in the public sector and in the private sector, for patients treated under the public subsystems financing, to harmonise and ensure equal quality of treatment in accordance with best accepted practice.

3.35. 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].

3.36. 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 [ongoing].

3.37. 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

3.38. 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 developed by INFARMED [ongoing]. Establish an observatory for prices and acquisitions [Q2-2014].

3.39. INFARMED shall continue to develop the national medicines formulary (hospitals and outpatient) including 4 new therapeutic areas per quarter, starting in the second quarter 2013 to be finished by the [twelfth review]. Ensure the compulsory use of the formulary in all hospitals to monitor the stock and flows of hospital medicines and medical supplies and monitor compliance with central purchasing. Continue to work with professional associations and enforce the implementation of therapeutic prescription guidelines in outpatient settings to reduce treatment variation and ensure treatment complies with best accepted practice [twelfth review].

3.40. 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

3.41. 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

3.42. 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].

3.43. 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]..

3.44. 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 improve the management of the enterprises and the quality of the financial oversight by the general government. The implementation of a common financial platform to all SOEs will be developed until the end of 2013. Reporting in the new accounting standard will be available at the end of 2013 through existing accounting systems. SOEs will test and progressively implement a central accounting platform: 10 in [Q1-2014]; 20 by the [twelfth review]; and the remaining SOEs will adopt a new central platform for the ACSS to gather real time information on hospital accounting.

3.45. 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 finalisation of all detailed strategic 3-year plans for hospitals [Q1-2014]. The

"Contratos Programa" for SOE hospitals for 2014 should be negotiated and signed until the end of [Q1-2014].

3.46. 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 [Q4-2013].

3.47. 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

3.48. 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 [December 2013].

Cross services

3.49. 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 changes to the dismissal rules as stated in laws n. 53/2011, n. 23/2012 and n. 69/2013, the Government will monitor and report on the effects of the reforms, in particular in tackling

labour market segmentation, taking also into account those areas of Employment Protection Legislation that have not been recently reformed [ongoing].

4.3. Following the Constitutional Court ruling of 26 September 2013 the Government will find alternative reform options with similar effect while respecting the ruling. After consultations with social partners, the alternatives will be discussed with EC/ECB/IMF staff and submitted to Parliament by end-January 2014.

4.4. The Government will present a report assessing policy options to reduce incentives to challenge dismissals in court [Q4-2013]. The need for further steps will be assessed in the context of the [eleventh review].

Wage setting and competitiveness

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

i. commit that, over the programme period, any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of the programme review [ongoing];

ii. ensure wage moderation 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 [February 2014];

iv. present by [Q4-2013] a report assessing policy options for ensuring more effective decentralisation of wage bargaining and promoting wage flexibility.

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 will present specific measures to strengthen the role of the job counselling and job search assistance as well as the activation and sanctions systems in facilitating the transition from unemployment to employment. [Q4-2013]

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). [ongoing];

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 funding framework comprising performance and evaluation criteria for public schools, including those under autonomy agreements [Q4-2013]; (iii) following the assessment of the new inspection model, report on possible further improvements of the model [Q4-2013];

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" [Q4-2013].

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. 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 [Q1-2014].

Ensure sustainability of the national electricity system

5.2. In the context of the measures to reduce excess rents and to address the sustainability of the national electricity system, and following the update on the tariff debt path based on the implications of regulator's access tariffs calculations and the revised impact of the measures already adopted, present additional cost reduction measures that might be necessary to (i) eliminate excess rents and (ii) eliminate the tariff debt by 2020, ensuring a balanced burden sharing across the various stakeholders in the sector.

Provide information on the exact assumptions and parameters used in September 2011 and the last two updates (September 2013 and December 2013) of the tariff debt path [Q4-2013]. Following the identification by the Government of the problem of distortion on the system services market and highlighted in the reports of the relevant regulators, implement the necessary measures in line with these reports concerning the risks of overcompensation in the adjustment calculations (revisibilidade) of the CMEC scheme, including an independent audit on risk of overcompensation and the amount of past overcompensations. In particular, notify the exact terms of the measure adopted to eliminate the distortion on the system services market and how it will be implemented in the scope of the CMEC annual adjustment procedure, as well as the associated result in terms of cost reduction [Q1-2014]. Take the necessary action to ensure that the impact of the energy sector levy, in any circumstance, will not be passed on to end-users [Q4- 2013].

5.3. 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 the potential for correcting measures [eleventh review]; take the necessary measures to comply with EU regulations and decisions [ongoing].

5.4. 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 [Q4-2013]. Ensure through annual audits that plants not fulfilling the requirements for co-generation do not receive the support, and report on the progress [ongoing].

5.5. 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, contributing to the sustainability of the national electricity system. The above mentioned revision must be implemented through the legal regulations that remain to be adopted under the framework of the transposition of the Third Energy Package [Q1-2014]. For more mature technologies develop alternative mechanisms (such as feed-in premiums). Report on action taken will be provided by [ongoing]. 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. The use of cooperation mechanisms to finance future renewables investment shall be explored. Report on action taken will be provided by [ongoing].

Telecommunications

Objectives

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

5.6. 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].

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

5.7. 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, at least, 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 [Q4-2013].

5.8. 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 [Q4-2013].

Railways sector

5.9. 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 by [Q4-2013];

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 [Q4-2013];

iv. present an assessment of the impact of the extended performance schemes on infrastructure charges in different traffic categories [Q1-2014];

v. continue to prepare the privatisation of the freight branch of the state-owned rail operator, by further implementing measures towards full operational balance by 2015 and assessing the investment plan on rail to fully enhance economic value of the company [twelfth review];

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 [twelfth review].

Ports

5.10. Take further steps to improve the governance model, the economic regulation and the operation of the maritime ports with the objective to enhance the competitiveness and the efficiency of ports in line with the Strategic Plan of Transport 2011-2015; the 5+1 Plano de redução de custos portuários, in particular:

i. Present a review of the port work law, in particular its impact on port usage cost and the overall savings generated by [Q1-2014].

ii. Deliver and enforce policies that ensure strong integrated policy-making, strategic planning and surveillance functions common to all ports in the country. Ensure that the regulator relevant for ports enjoys sufficient financial resources and administrative capacity to effectively carry out its function [Q1-2014];

iii. On the basis of the action plan presented at the tenth review, launch the renegotiation with the relevant operators by [Q1-2014] with the objective of concluding the renegotiation on the scope and the structure of the existing port concessions in the course of 2014. The new port operation concessions should ensure that (i) efficiency gains and cost-savings are passed on to port customers; and (ii) minimum performance criteria are respected in order to foster competition in the sector.

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

5.11. Further to the adoption of a significant number of amendments to the sector specific legislation, complete the adoption of Construction Laws and the others outstanding sectorial amendments necessary to fully implement the Services Directive and submit them to Parliament by [Q4-2013] in view of approval by [February 2014]. The proportionality of fees linked to construction activities will be ensured by the date of adoption of the Construction Law [February 2014].

Regulated professions

5.12. 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 access to and exercise of activity which are not justified or proportional, such as those restrictions to the use of commercial communication (advertising), reserves of activity and legal form and shareholding requirements under 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 [Q4-2013].

Administrative burden

5.13. Continue the simplification reform effort by:

i. adapting the content and information available at the Point of Single Contact (PSC) for the missing regimes to ensure conformity with the Services Directive and make available online forms and procedures for these regimes by the [eleventh review]. Constantly adapting the content and information available at the PSC to the remaining sector-specific regimes that are about to be adopted to ensure conformity with the Services Directive (see 5.13 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 implementing online 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 outstanding regimes approved to ensure conformity with the Professional Qualifications Directive by and make available online forms and procedures by the [eleventh review]. 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 implementing on-line forms and procedures for each profession no later than 2 months after adoption of amendments;

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

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

5.14. Provide a monthly update of the detailed work programme of AMA to fulfil 5.15.

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 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

6.2. 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 is undertaking and will publish a comprehensive review of the functioning of the housing market. 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 [Q4-2013].

7. Framework conditions

Judicial system

Objectives

With the entry into force of the new Code of Civil Procedure and the adoption of the Judicial Organization Act in Parliament, all measures under the Memorandum of Understanding have already been implemented or are about to enter into force, and various of these are already bringing positive results. Improvement of 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 is well underway. The oversight body for enforcement agents and insolvency administrator (CAAJ) will be established shortly. Equally, stepping up efforts to raise public awareness of the successful reforms in the judicial sectors would add value and recognition to these efforts and results.

In addition to the above, the Government will:

7.1. Publish quarterly reports on recovery rates, duration and costs of corporate insolvency cases starting from Q3-2011 and on the clearance rate and disposition time of enforcement court cases starting from Q3-2013, 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

7.2. 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].

7.3. 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].

7.4. Following the recently published framework law on regulators – which aims at (i) establishing a regulatory environment that protects the public interest and promotes market efficiency, (ii) guaranteeing 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) strengthening the overreaching role of the Competition Authority in enforcing competition rules, therefore supporting and complementing the effect of the recently adopted competition law – the Government will approve the corresponding amendments to the bylaws of the National Regulatory Authorities [Q4-2013]. Take the necessary actions to ensure the effective functioning of the Competition Authority financing model in compliance with (ii) and avoid disruptions in the transitory period up to the entry into force of the corresponding provisions in the forthcoming bylaws by enforcing the necessary transfers from the contributing regulators [Q4-2013].

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:

7.5. Building on the reports already submitted, (i) identify the direct awards granted above the legal thresholds after the revision of the Public Procurement Code as well as the legal exception under which such awards were granted, (ii) provide a summary of the contracts rejected by the Court of Auditors, including information on their number, the reason for the rejection, break-down by economic sector, and the financial amounts involved. [Q4-2013].

Business environment

7.6. 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].

7.7. Follow up any EU decision taken regarding compliance with the Directive 2011/7/EU on Late Payments Directive transposition.

7.8. Assess the impact of the optional VAT cash accounting regime by [Q1-2014].

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 disproportionally 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

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

7.10. To deal with the legacy of excessive licence procedures and other administrative burdens, the Government will 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) [Q1-2014]. On the basis of the analysis the Government will devise a roadmap for regulatory simplification.

7.11. To prevent future growth in excessive licenses and regulations, the Government will adopt a rule that makes mandatory for all levels of Government, when creating a new regulation generating costs for businesses, to propose the elimination of an existing regulation or regulations with an equivalent cost [Q4-2013].

Environment and territory planning

7.12. 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, the authorities will :

i. Following the submission to Parliament of the Base Law of Soil and Territorial and Urbanism Planning (Lei dos Solos), in view of its adoption by the Parliament by [Q4-2013] ensure that will be aligned with the new Industrial Licensing regime (measure 7.14) ;

ii. Adopt and make operational a Risk Sectorial Plan by the [Q4-2013];

iii. review the legal regimes of the Territorial Management Instruments (RJIGT) and of the related regulations by the [eleventh review];

iv. adopt a legal provision for the regularisation of activities not in accordance with Territorial Management Instruments by the [Q4-2013];

v. harmonise the Regional Plans – new generation will be included within the new legal regime of RJIGT by the [Q4-2013];

vi. review the Legal Regime for Urbanism and Building (RJUE), that should be aligned with, the new Industrial Licensing regime (measure 7.14) by the [Q4-2013].

7.13. Increase a nationwide land registration system (registo cadastral) to allow a more equal (perequitativa) 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 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.

Commercial licensing

7.14. Review the commercial licensing regime. Approve the new legal regime for commercial actives and establish the Programme 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 [Q4-2013].

Geology

7.15. Review the geological licensing regimes, including:

i. the legal regime concerning the licensing of mining and geological production and investment in line with international best practices in this field by the [Q4-2013];

ii. simplify the legal and bureaucratic procedures pertaining to mining and geological investments, especially in terms of assessment, search, development, and production activities by the [Q4-2013].

ANNEX 5
MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

January 27, 2014

Macroeconomic Outlook

1. Recent Macroeconomic Developments. Economic activity is recovering. In the third quarter of 2013, output grew by 0.2 percent, thereby registering, for the first time in three years, two consecutive quarters of growth. This growth is underpinned by a modest recovery in domestic demand and robust exports, with the latter growing 6.6 percent year-on-year. The unemployment rate has fallen further to 15.6 percent in the third quarter, from 16.4 percent in the second quarter and 15.8 in the third quarter of 2012, driven by the expansion of employment, in particular in tourism-related activities, while the labor force remained broadly stable following previous declines.

2. Outlook. High-frequency indicators point to a continued moderate expansion in activity, and sentiment is gradually approaching its long-term average. Accordingly, we expect output to contract by 1.6 percent, compared with a contraction of 1.8 percent projected at the time of the last review. Growth in 2014 is still expected to pick up to 0.8 percent, supported by an increase in investment, a continued strong export performance, offset in part by higher imports, recovery in domestic consumption, and with unemployment projected to peak at 16.8 percent. Headline inflation averaged 0.3 percent in 2013, reflecting still weak domestic demand. Despite recent improvements, uncertainty remains elevated, as the negative impact of private sector deleveraging and of fiscal consolidation on growth may turn out to be stronger than expected, particularly if the competitiveness adjustment achieved to date is not sustained.

3. External adjustment. The current account adjustment continues, albeit at a slower pace, and is estimated to have registered a small surplus of about Ут. percent of GDP in 2013, to be followed by a surplus of about 1 percent this year. This is lower than projected at the time of the last review, mainly due to an upward revision in domestic demand and imports. Nevertheless, strong export growth continues to underpin the external adjustment, supported by robust demand from non-EU trading partners with export market share gains in most markets. In addition, exports within the EU appear to have troughed, with exports to Spain—Portugal's main trading partner—growing by 10 percent in the first eleven months of 2013. In the short term, however, weaker demand from trading partners remains the main downside risk to external adjustment. Most importantly, while the structural reforms envisaged in the program have largely been implemented and are starting to bear fruit, maintaining robust export growth over the medium term will require continued improvement in external competitiveness.

Fiscal Policy

4. 2013 Budget. The end-September quantitative performance criteria on the general government cash balance and debt were met by a comfortable margin, in the context of solid revenue performance. Moreover, the budgetary overruns and revenue shortfalls identified at the time of the previous review were addressed through additional measures -including use of the provisional budget allocation, reduction of funds available to line ministries, and recourse to a one-off (tax and social security contribution) debt recovery scheme—approved in a second supplementary budget of November 2013. While final figures are not yet available, preliminary data indicate that we are on track to achieve our general government deficit objective of 5.5 percent of GDP (excluding the BANIF recapitalization costs of 0.4 percent of GDP). This is consistent with an underlying structural primary adjustment of around 0.5 percent of GDP in 2013.

5. 2014 Budget. We remain committed to achieving our 2014 deficit target of 4 percent of GDP in 2014—consistent with a structural primary adjustment of 1 percent of GDP. To achieve these objectives while arresting the accumulation of domestic arrears, the 2014 budget law, approved by Parliament last November, and its supporting legislation identify around 2.3 percent of GDP in measures. Specifically,

- Public Expenditure Review (PER). Most of the budget measures were drawn from our ambitious public expenditure review, aimed at ensuring the sustainability, effectiveness, and social equity of the state expenditure programs, through (i) a wage bill reform; (ii) a pension reform; and (iii) sector specific savings, in line with the understandings reached at the time of the eighth and ninth reviews. As a result of the Parliamentary discussion of the budget law, key wage bill and pension measures have been amended to better protect lower income earners and ensure more equitable savings, with necessary compensating measures already identified in the budget. Moreover, in response to an adverse Constitutional ruling on December 19th on a key provision of the pension reform, aligning the rules and benefits of the public sector pension funds, CGA, to the general pension regime, we have identified offsetting measures of comparable size and quality to ensure the attainment of the fiscal deficit target of 4 percent of GDP. These include the frontloading of the planned increase in the beneficiaries' contributions to the special health insurance schemes (ADSE, SAD and ADM), with corresponding savings for the State, and a recalibration of the parameters of the existing extraordinary solidarity contribution on pensions (CES). Submission to Parliament of the revised CES through a supplementary budget and approval by the Council of Ministers of the decree law on the change in contributions to the special health insurance schemes are prior actions for completion of this review. The existing pension legislation of the CGA will be also modified to ensure that the new rules on retirement age effectively apply also to this regime. We are monitoring closely the attainment of the defined budget objectives for each line ministry, through monthly reporting to the Council of Ministers, in particular on the targeted reduction in the size of the public sector workforce. In this context, following the conclusion of the first voluntary separations scheme, we have recently launched two new schemes on teachers and other qualified employees, respectively, and other schemes targeting excessive employment in the public administration are currently under preparation. In the design of any new programs aimed at reducing over-employment in specific sub¬sectors, we will continue to aim at a change in the composition of the public sector workforce towards high-skilled and better-trained civil servants.

- Additional measures. The approved budget law and supporting legislation also included additional measures to offset upward expenditure pressures. The supporting legislation necessary to implement these measures is being finalized. In particular, we have approved the ministerial order defining the contribution for the media spectrum, as well as the decree law on the remaining measures on survivors' pensions. We will approve the ministerial order defining the levy on financial institutions by end-March 2014. The final proposal for the measure on online gambling is expected to be sent to the Council of Ministers for approval by end-February 2014. The port concession tender and real estate sale is expected by end¬September 2014, while the winning bidder for the Silopor concession has been selected. The transfer from the CTT health fund and the sales of excess oil reserves will take place by end- year.

- CIT Reform. In parallel, we have also approved in December a comprehensive reform of the Portuguese corporate income tax (CIT) regime aimed at boosting investment and growth. The reform includes measures to simplify the CIT regime through a broadening of the tax base, the gradual lowering of the rate (frontloaded for SMEs), and the rationalization of surcharges and incentive schemes. The reform also includes steps aimed at lowering compliance costs, reducing litigation, improving international competitiveness, as well as reducing policy-induced debt bias. The measures envisaged in the reform for 2014 and the outer years will be implemented within the existing fiscal target commitments.

Should any risks to the execution of the budget materialize, we remain committed to implement, following discussion with EC/ECB/IMF staff, compensatory measures of equivalent size and quality to meet the agreed deficit target.

6. Medium-term fiscal consolidation. We will advance our fiscal consolidation efforts in 2015, with a targeted deficit of 2.5 percent of GDP, consistent with a structural primary adjustment of around 1% percent of GDP, securing a successful exit from the EU Excessive Deficit Procedure. Moreover, further

fiscal effort of about Ут. percent of GDP will be needed in the outer years to keep public debt on a downward trajectory, in compliance with the medium-term fiscal sustainability requirements in the European Treaty on Stability, Coordination, and Governance. To this end, the following initiatives are currently ongoing:

• The new Public Administration law—aiming at aligning the current public employment regime to private sector rules—was submitted to Parliament and is expected to be approved by end-March 2014. Building on the principles identified in the law, we are conducting a comprehensive review and reform of wage supplements, with a draft law expected to be submitted to Parliament by end-June. In parallel, we have also started a comprehensive review of public sector remunerations and careers, which we expect to finalize in the second half of 2014. We are also in the process of developing new comprehensive measures as part of the ongoing structural reform of pensions, in line with the recent Constitutional Court ruling on the CGA convergence reform. Stocktaking on this process will be made during the next review.

• The above-mentioned steps to reform the Public Administration are part of our far-reaching Proposal for the Reform of the State, whose general principles were approved by the Council of Ministers last October. The reform will aim at achieving efficient and sustainable public sector policies, underpinning the balanced budget objectives and fiscal sustainability rules in the recently-ratified European Treaty on Stability, Coordination, and Governance— which now ranks higher than ordinary legislation. Broad-based consultations with political and social partners are ongoing to seek consensus on specific reforms. Following this first round of consultations, we will submit a new document to the Council of Ministers by end¬March 2014 with draft proposals, preferably with broad-based political and social consensus, on different reform areas, which should ideally include social security sustainability, flexibilization and requalification of the public sector workforce, rationalization of general government entities, as well as greater efficiency in health and education. Progress with this process will be discussed at the time of the next review.

• Moreover, in order to comply with EU budgetary framework requirements, the 2014 Fiscal Strategy Document will provide details of the medium-term budgetary plans, to be discussed at the time of the eleventh review.

7. Debt Path. Under the programmed fiscal path, gross debt is set to have peaked below 129У percent of GDP in 2013. The increase in the debt peak vis-à-vis the eighth and ninth reviews is largely explained by the higher Treasury cash balance at end-2013. Accordingly, net debt—excluding IGCP's deposits—is projected to smoothly peak at close to 120 percent of GDP in 2013 and 2014, slightly below the previous review. The decline in the general government gross debt-to-GDP ratio starting in 2014 is expected to be partly supported by further use of cash deposits as well as the ongoing reallocation of the Social Security portfolio from foreign assets to government securities.

Containing Fiscal Risks

8. Public Financial Management. We have made further progress in advancing our Public Financial Management reform, but stricter compliance with the commitment control law is needed to prevent any new accumulation of domestic arrears, particularly in the health sector.

• Important steps have been taken in transposing the EU economic and governance fiscal framework. We remain committed to complete this process in our Budget Framework Law (BFL) by end-March 2014. In parallel, on the basis of the report of the technical group charged with revising the BFL, we will work, in close consultation with IMF staff, on developing the key principles and elements that will be reflected in the new legislation crystallizing reforms undertaken so far and underpinning an effective public financial management system. As the next step, we will consult in the early part of 2014 with key stakeholders to discuss the key elements of the legislation, notably imparting a medium-term focus to public finance, streamlining the budget appropriation structure, and strengthening accountability

relations. We will aim at reaching an agreement on the key aspects and structure of the new law and completing the underlying technical work by end-April 2014. As part of these efforts, we will undertake an IMF Fiscal Transparency Evaluation by the end of the program, which will be made publicly available. In line with the above, we have already published for the second year a tax expenditure report as well as providing information on the fiscal risks along with the Budget.

- We remain committed to preventing any accumulation of new domestic arrears, the stock of which amounted to €2.7 billion at end-August 2013. We have identified, with support from IMF/EC/ECB staff, selected public entities—including some of the large hospitals—that face structural financial imbalances. As a next step, we will develop, by end-February, targeted programs to underpin the financial sustainability of these entities. The Commitment Control Law will be enforced in full to all public entities—including entities under targeted programs—so as to bring to zero the net accumulation of arrears in line with the continuous indicative target under the program. We will also establish by end-February a dedicated unit with the Ministry of Finance, reporting directly to the State Secretary of the Budget in charge of the expenditure arrears for the public sector. The second settlement program in the health sector—in the value of €432 million— following the same procedures as envisaged in the March 2012 strategy document, was finalized last December.

9. Revenue Administration. To bolster revenue performance in support of our medium¬term fiscal objectives, we remain determined to make further progress in curbing tax evasion. Recent steps in this direction included hiring 1000 new tax auditors, besides making fully operational the Large Taxpayer Unit and conducting successfully an e-invoice reform. The Compliance Risk Management Unit, created last November, is expected to become fully operational by end-March 2014. This unit aims at strengthening tax compliance by (i) phasing in of a modern compliance risk model; (ii) strengthening PIT compliance management, through the pilot projects on the High Net Wealth Individuals and the Self-employed Professionals; and (iii) enhancing control of the monthly PIT withholding information. Consistent with our ongoing efforts to curb tax and social security fraud, we have increased sanctions for criminal offenders. Moreover, we are planning to establish by end-2014 a dedicated Taxpayer Services Department, unifying most services related to taxpayers and improving their relationship with the tax administration. As part of the reorganization of the tax administration, we are committed to close 25 percent of local tax offices by end-March and additional 25 percent by end-May 2014. Moreover, we will also further strengthen the exchange of information between the tax and the AML authorities, in line with international best practices.

10. State-Owned Enterprises. Cost-reduction efforts and voluntary separation programs have helped improve the consolidated operational balance of state-owned enterprises (SOEs), although some of them are expected to have remained in negative territory in 2013, also as a result of the reinstatement of the 13th and 14th month salaries. We will retain formal cost- reduction objectives for loss-making firms, while requiring other firms to continue improving operating balances with a view to reducing debt burdens and financial costs. We also continue to manage the high debt burdens of some firms, ensuring that any treasury support remains within the envelope of budgeted transfers. Moreover, we have further strengthened governance with the entry into force of the new framework law for SOEs last December. The law enhances financial and operational reporting requirements, concentrates all shareholder functions in the Ministry of Finance, and envisages the creation of a dedicated Technical Unit - which is expected to be operational by end-April 2014. The law also reinforces the monitoring of SOE debt by centralizing borrowing decisions at the Debt Management Agency (IGCP).

11. Privatization. The privatization program remains on track. The initial public offering for 70 percent of the shares of the postal company CTT was successfully completed in early December, with shares priced at the upper end of the range. The sale of the airline, TAP, however, is on hold, after the initial privatization plan fell through at end-2012 due to inadequate financial assurances by the final bidder. We continue to actively seek buyers for the group as a whole and expect to re-launch the process in the course of this year. The privatization of the rail cargo firm, CP Carga, has been postponed pending

the unbundling of its terminals, expected to take place by June 2014. We have prepared a strategic plan for the water and waste sectors, with a view to improving their efficiency, including by introducing private capital and management in the system. Binding offers for the sale of the waste management company, EGF, are expected by mid-May 2014. Opening water concessions to private capital and management is expected to take longer. The restructuring of transport SOEs in Lisbon and Porto is ongoing, with five concessions expected to be launched by end-March 2014. The government will further consider expanding the privatization program to include additional assets for sale or concessions.

12. Public-Private Partnerships (PPPs). We continue taking steps to achieve a fiscally responsible PPP model. We are finalizing a major renegotiation of road contract PPPs with all concessionaires, generating additional structural accumulated savings of more than €2.5 billion over the life cycle of these concessions. Moreover, the renegotiation of the Security Integrated System (SIRESP) PPP contract is proceeding as envisaged, with the objective of generating further permanent savings in 2014 via a reduction on its internal rate of return and scope optimization. The revision of the regulatory framework for the road and rail sectors, reducing operation, maintenance, and major repair requirements, in line with EU standards and with the objective of minimizing fiscal risks is nearly finalized. Furthermore, the Ministry of Finance PPP unit continues working towards enhancing fiscal transparency, improving reporting on PPPs, expanding its field of action to other sectors, namely health and security, and advising the autonomous region of Madeira.

13. Regional and Local Governments. We remain committed to fiscal discipline in local and regional governments. The program for local governments' arrears settlement (PAEL) supported 95 municipalities with disbursements of €534 million as of end-December 2013. The remaining 10 municipalities will be supported, for an amount of up to €300 million, pending clearance by the Court of Auditors. With the Regional Finance Law and Local Finance Law (LFL), both approved by Parliament and published last September, we have created a coordination council between the central and subnational governments, which will be operative by end-February. The council is expected to enhance exchange of information in order to support budgetary planning. The LFL also introduced an insolvency procedure for local governments, including an early warning system for debt accumulation and a Municipality Resolution Fund. The rules and procedures of this fund are being designed by a group of specialists and are expected to be submitted to Parliament in a separate draft law by end-March 2014. In terms of regional governments, Madeira's program with the State (PAEF) remains broadly on track, but we will continue to closely monitor budgetary risks.

Safeguarding Financial Stability

14. Bank Supervision. While compliance of the banking system with regulatory requirements has continued to be satisfactory, the Banco de Portugal (BdP) remains vigilant amidst a challenging operating environment.

- Management of Distressed Loans. The BdP, supported by an external advisor, has finalized the Special Assessment Program (SAP) that sought to review the policies and procedures of the eight largest banks in the area of distressed loan management. The results of the SAP have been discussed with the banks and the BdP is monitoring the timely implementation of the recommendations issued.

- Credit Impairment. Guidelines on measuring credit portfolio impairment and disclosure of asset quality and risk management practices will be published by mid-February, incorporating best practices identified during the three impairment reviews that have been conducted since May 2011. Additional disclosure requirements envisaged in the impairment guidelines will be reflected in banks' financial statements as of June 30, 2014. Where needed, banks have made substantial progress in enhancing their collective impairment models in line with recommendations made as part of the Special Inspections Program. High priority items have been addressed satisfactorily by end-December 2013.

- Loan Classification. The BdP has amended its instruction on the identification and marking of restructured loans due to financial difficulties of the client, incorporating definitions of forbearance that have been developed by the European Banking Authority (EBA). The BdP will review its standards on nonperforming loans, in line with the timeframe set at the EU level for the implementation of relevant technical standards. The BdP will continue to rigorously enforce prudent loan classification by the banks.

- Real Estate. The BdP is promoting the development of a consistent and common set of criteria for real estate appraisers for the Portuguese financial system, under the aegis of the National Council of Financial Supervisors. The new standards impose strict rules on appraisers' fit and properness—including remuneration rules and code of conduct, among others. In addition, real estate valuation requirements, applicable to all financial institutions, have been tightened to ensure that institutions' collateral valuations remain sufficiently conservative. Banks have updated valuations of all real estate assets that have been obtained in lieu of payment and whose last valuation was done before July 31, 2012. The BdP will verify compliance with these requirements by the second quarter of 2014.

15. Stress Test Exercise. To ensure the rigor of the quarterly stress test exercise, the BdP has further enhanced its quality assurance and review process of the bottom-up results. In particular, the BdP enhanced its credit risk model. Moreover, the BdP has further developed its top-down stress testing framework, which now can allow for an estimation of key drivers of the results of the bottom-up exercise. The BdP expects to integrate the top-down stress testing framework into the quality assurance process in the next round of quarterly stress tests, to be finalized in February 2014.

16. Transition to CRD IV. As of January 1, 2014, banks are expected to maintain, at a minimum, a common equity Tier 1 (CET1) capital ratio of 7 percent, consistent with the CRD IV package considering all the transitional provisions related to the definition of capital. In the context of the ECB's forthcoming asset quality review, the largest banks are expected to maintain a CET1 add-on of 1 percentage point. Additional measures will be in place to preserve banks' current capital buffers, ensuring that they remain commensurate with the challenging operating environment. We will also ensure compliance with the requirements envisaged in the EBA Recommendation on the preservation of capital and any future regulatory initiatives at European level.

17. BSSF. 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 the recently amended EU State-aid 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.

18. Recovery and Resolution Plans. The BdP has issued recommendations on the recovery plans of the largest banks, and is currently reviewing the plans from all the other banks. The BdP has received the data submission on the resolution plans for the largest banks and initiated on- site visits to these institutions, with a view to validating the data received and enhancing their resolution preparedness. The necessary amendments to the recapitalization law, reflecting the recent updated Banking Communication, issued by the European Commission in July 2013, on the application of the State-aid rules to support measures in favor of banks in the context of the financial crisis, were approved by Parliament in December 2013 and entered into force in January 2014. Moreover, we remain committed to swiftly transposing the new EU Directive on bank recovery and resolution once it has been adopted.

19. Funding and Liquidity Conditions. Deposits have remained stable in an environment of gradually decreasing remuneration rates. Furthermore, banks' access to money market funding is improving. Nonstandard measures by the ECB to restore the proper transmission of monetary policy have helped ease liquidity pressures and continue to play a pivotal role in absorbing remaining funding

constraints, while strengthened collateral buffers provide an important shield against potential adverse shocks. In parallel, we continue to explore with our European partners further initiatives to support funding conditions, including potential mechanisms to securitize banks' high quality mortgage and SME credit.

20. Initiatives to Facilitate Access to Finance. Notwithstanding some improvements, the credit situation remains challenging, especially among SMEs. In this context and consistent with their funding and capital plans, banks continue to ensure that the deleveraging process takes place in an orderly manner to achieve stable market-based funding positions, while adequate and sustainable financing is provided to the economy. Furthermore, we've stepped up our efforts to promote more efficient financing allocation to the productive segments of the economy through further enhancements to our existing government-guaranteed credit instruments as well as the promotion of an efficient use of EU structural funds and alternative private funding options for SMEs. Specifically,

• Government-Guaranteed Credit Instruments. To make these schemes more efficient, we have implemented the key policy recommendations from the recent external audit of the National Guarantee System (NGS) and also other measures that resulted from the assessment of the Ministry of Economy. In particular, we have taken steps to improve the competitiveness and transparency of the current pricing system. These include (i) a refinement of the methodology of determining the maximum interest rates (caps) that participating institutions can charge on guaranteed credit lines, updated on a semi-annual basis, reflecting their banks' funding and administrative costs, and differentiated by various risk profiles of SMEs; (ii) a full disclosure by participating institutions of the caps per risk class in the marketing material; (iii) a close monitoring of the rates effectively charged. Moreover, we will explore, by end-February 2014, additional steps to be taken by individual participating institutions to further enhance the transparency of their pricing practices. A report will be prepared by May 15, 2014 to take stock of the impact of these enhancements on actual interest rates and, if needed, to propose remedies and policy alternatives including a competitive bidding system, in order to ensure that guaranteed loans will be priced in a competitive and transparent manner, in favor of end users. Moreover, to support viable firms in financial difficulties and to encourage these firms to go through the debt restructuring process at an early stage, a new guaranteed credit line has been designed, in line with the EU State-aid rules, for viable firms that have successfully completed a corporate debt restructuring process and effectively reduced nominal debt level. We will finalize the general guidelines and start a pilot test within the existing budgetary envelope by end-March 2014. We will continue to monitor the balance sheet performance of the firms benefiting from government-guaranteed credit lines through our quarterly monitoring framework.

• Development Financial Institution. The Council of Ministers has approved the establishment of a development financial institution (DFI) aiming at streamlining and centralizing the management of the reimbursable part of the financial instruments of the EU structural funds for the 2014-2020 programming period. The DFI's sole purpose shall be to address market failures in the financing of private nonfinancial corporations, notably SMEs, and in doing so it shall not accept deposits or other repayable funds from the public, nor engage in direct lending. Its final structure and by-laws will reflect in-depth consultation with EC, ECB and IMF staff and will be designed to ensure no additional burden on or risks to public finances.

• Development of SMEs Commercial Paper. The necessary amendments to the existing rules regulating the commercial paper market were approved by the Council of Ministers and will become effective by end-January, aiming at facilitating the expansion of the commercial paper market among a wider investor base and increasing the use of this alternative funding option by the corporate sector, notably SMEs.

21. Central Credit Registry. We are on track to complete the enhancements in our credit registry, as agreed in the combined eighth and ninth reviews. IT systems have been updated in order to receive additional information, allowing for the earmarking of loans that are classified as nonperforming or have

been restructured due to financial difficulties of the borrower. The proposal from the BdP for revising the legal framework of the Central Credit Registry has been sent to the Ministry of Finance for consideration and in consultation with the Portuguese Data Protection Authority, and will be sent to the Council of Ministers for approval by end-April 2014. The proposed legislation allows financial institutions to have access to companies' historical information as well as to the corporate balance sheet database, reducing information asymmetries, especially for smaller companies. We expect to complete the implementation of these changes by end-June 2014.

22. BPN SPVs. The gradual recovery of the assets from Banco Português de Negócios (BPN), held by three state-owned Special Purpose Vehicles (SPV), is progressing. Contracts with external service providers for the management of part of the credit portfolio of Parvalorem have been signed, and the disposal of the participations and assets held by the other two state-owned SPVs is continuing. 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.

Boosting Employment, Competitiveness, and Growth

23. Overall Reform Strategy. The ultimate objective of our structural reform agenda is to enhance competitiveness and improve the business environment, so as to engineer a sustainable rebalancing of the economy toward the tradable sectors and boost medium-term growth and job creation prospects. Reforms initiated at the beginning of the program are drawing to a close. Significant steps were taken on the labor and product market fronts, where reforms were designed to alleviate nominal rigidities, facilitate adjustment, and foster a reallocation of resources toward the tradable sector. Important steps were also taken to reduce red tape and raise the efficiency of the judicial system. We are now refocusing our efforts on assessing the impact of the reforms already implemented and ensuring that the initial objectives are being achieved. In this context, an outcome-based accountability framework is being prepared to draw more concrete links between notional reforms and actual outcomes. Concurrently, we are working toward identifying the remaining policy distortions and other potential priority areas which will be tackled in the next phase of reforms.

24. Labor Market Institutions. Significant steps have been taken over the past couple of years to make the labor market more dynamic and efficient—including reforming the Employment Protection Legislation, streamlining unemployment benefits and reforming the wage-setting mechanism. In view of the still high unemployment, notwithstanding recent signs of stabilization, we have launched an analysis of policy options to promote an adjustment more favorable to employment. In this context, the government has prepared by end-December 2013 a report assessing policy options in three main areas (i) ensuring more effective decentralization of wage bargaining, (ii) ensuring more wage flexibility, and (iii)study proper alignment of incentives to challenge dismissals in court. The report findings and policy proposals will be discussed in the context of the eleventh review. In light of the recent Constitutional Court ruling against legislative provisions that made it easier for firms to lay off employees in case of redundancy or unsuitability, the government's immediate priority will be to enact alternative measures. In particular, specific economic criteria to select employees in case of redundancies (including performance and cost-related) will be introduced in the law. Regarding dismissals for unsuitability, employers will be required to assess the possibility of finding an alternative position in the same professional category. We will submit these legislative amendments to Parliament by end-January 2014.

25. Energy. We continue our efforts to improve the sustainability of the national electricity system. Steps have been taken in the past year to reduce excessive rents, mainly through renegotiation. Nonetheless, our revised medium-term tariff debt projections clearly show strong upward pressures on the system's debt, reflecting partly downward pressures on the demand for electricity. Since we are concerned about the potential impact on competitiveness of the large electricity price increases necessary to eliminate the system's debt by 2020, we are preparing other options to better balance the burden of

adjustment between the various stakeholders of the electricity sector, notably by eliminating remaining excess rents. These options will be discussed with the IMF/EC/ECB at the time of the eleventh review. Following the identification by the government of the problem of distortion on the system services market and highlighted in the reports of the relevant regulators, we will implement the necessary measures in line with these reports concerning the risks of overcompensation in the adjustment calculations (revisibilidade) of the CMEC scheme, including an independent audit on risk of overcompensation and the amount of past overcompensations. Finally, we will ensure that the energy sector levy introduced in the context of the 2014 budget will not be passed through to end-users.

26. Ports. We are taking steps aimed at reducing costs for exporters. Following reductions in fees on port use (TUP-Carga) and a revision of the Ports Work Law, we are now seeking further transmission of lower labor costs to end-users of port services. We have prepared detailed timetable for other measures ensuring cost reduction and enhanced performance of both port authorities and port operators. The immediate priority will be to engage with concessionaires with a view to modifying existing concession contracts so as to foster price reduction. However, in view of the ongoing discussions on implementation of the new Port Work Law, negotiations will start in the first quarter of 2014. 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 cost savings for exporters generated by the Port Work Law is being conducted, the result of which will be discussed at the time of the eleventh review.

27. Competition/Regulation. A framework law for the functioning of regulators was recently enacted. The law: (i) establishes a regulatory environment that protects the public interest and promotes market efficiency, (ii) guarantees the independence and the financial, administrative and management autonomy of the National Regulatory Authorities in the exercise of their responsibilities, including the necessary conditions to safeguard 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. We will redouble efforts to finalize the amendment of the corresponding bylaws of the National Regulatory Authorities, with the last revised drafts expected to be approved (by the parliament or the government) by end- February 2014. Once the regulators bylaws and internal regulations are in place, the regulators will continue to pursue the adoption of best international regulatory practices, including by organizing international peer review exercises. We are taking the necessary steps to ensure the effective functioning of the Competition Authority financing model and avoid disruptions in the transitory period up to the entry into force of the corresponding provisions in the forthcoming bylaws by enforcing the necessary transfers from the contributing regulators.

28. 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 by Parliament of the remaining necessary amendments—including to the Construction Law—by end-February 2014. The related ordinance, ensuring appropriateness of fees linked to construction activities, will be adopted under the same timeline. The new legal framework aiming at improving the functioning of the regulated professions for which regulation involves a professional body (such as accountants, lawyers, notaries) was published in early 2013. The professional bodies' statutes will be amended accordingly and submitted to Parliament for final approval by end-February 2014. The new legislations eliminate unjustified restrictions to activity and further improve the conditions for mobility of professionals in line with the EU Directives in the area of free movement of professionals.

29. Licensing and Administrative Burden. Tackling excessive licensing procedures, regulations and other administrative burdens—which are impeding the establishment, operation, and expansion of firms—is a government priority. The New Legal Regime on Urbanism and Building (RJUE) will be adopted by end-February 2014. To prevent future growth in excessive licenses and regulations, the government will adopt a rule that makes it mandatory to propose eliminating an existing regulation for all new regulations generating costs for businesses. We are preparing an inventory of regulations that are

likely to have higher impact in economic activity (at central, regional and local levels), selecting the most burdensome. On this basis, we will devise a cost-analysis (currently under preparation) and roadmap for a regulatory simplification to be discussed at the time of the eleventh review. We have already adopted legislation to ease licensing requirements for tourism and industrial sectors. We have also taken significant steps and will continue our efforts to make fully operational the Point of Single Contact, an e-government portal which allows administrative procedures to be conducted online.

30. Judiciary. We are making further progress in the implementation of judicial reforms. The legislation to enhance the supervision of enforcement agents and insolvency administrators (CAAJ) entered into effect on December 21, 2013. We expect CAAJ to be fully implemented by the first half of 2014. We will publish quarterly reports on the clearance rate and disposition time of enforcement cases for the third quarter of 2013 onwards (within four months after the end of the relevant quarter).

Table 1. Portugal: Quantitative Performance Criteria

(Billions of euros, unless otherwise specified)

	Mar-13		Jun-13		Sep-13		Dec-13	Mar-14
	Program	Actual	Program	Actual	Program	Actual		
1. Floor on the consolidated General Government cash balance (cumulative)	-1.9	-1.4	-6.0	-3.8	-7.3	-4.3	-8.9	-1.7
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 1/	0	Not met	0	Not met	0	Not met	0	0
3. Ceiling on the overall stock of General Government debt	182.2	178.5	187.3	184.1	188.9	184.7	191.3	193.0
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

1/ As of end-September, domestic arrears for the purpose of the program increased by close to €0.06 billion since end-June and €0.5 billion since end-December 2012, largely due to the accumulation of arrears by SOE hospitals.

Table 2. Portugal: Structural and Conditionality: Tenth Review Under the EFF

	Measure	Timing	Status
Prior Actions			
1	Submit to Parliament a supplementary budget to enact the necessary changes to the existing extraordinary solidarity contribution on pensions (CES), consistent with the general government deficit target of 4 percent of GDP (MEFP ¶5).		Met
2	Approve the decree law on the increase in the beneficiaries' contributions to the special health insurance schemes (ADSE, SAD and ADM) (MEFP ¶5).		Expected to be met by end-January
Structural Benchmarks			
A. Fiscal policy			
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.	July 15, 2013	Met with delay
2	Submit to Parliament a draft law on the redesigned mobility pool.	End-June 2013	Met
3	Submit to Parliament a legislative proposal that increases the statutory retirement age to 66 years.	July 15, 2013	Changed to prior action and met
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.	July 15, 2013	Met with delay
A. Strengthen financial stability			
5	Submit to Parliament amendments to the law governing banks' access to public capital.	End-January, 2013	Met
B. Enhance competitiveness and address bottlenecks to growth			
6	Enact the severance pay reform that reduces severance payments to 12 days per year for all new permanent labor contracts	October 1, 2013	Met
7	Update projections of the medium-term energy tariff debt path and identify policy options to eliminate the tariff debt by 2020 .	June 15, 2013	Met
C. Strengthen fiscal institutions and reduce fiscal risks			
8	Revise and submit to Parliament the draft regional and local public finance law.	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.	End-Dec 2012	Met

ANNEX 5
TECHNICAL MEMORANDUM OF UNDERSTANDING

January 27, 2014

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. ([18])

- The General Government, as measured for purposes of Program monitoring in 2014, shall not include entities nor operations (including pension funds) that are re-classified into the General Government during 2014, but shall include those reclassified in 2012-13.

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 ([19]) 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.

([18]) An operation refers to part of a legal entity that is involved in the production or delivery of goods and services—including government services provided on a nonmarket basis. As such, it does not include transactions relating to the assets or liabilities of an entity. For example, should an entity handle a number of PPPs, reclassifying only one PPP would be considered as reclassifying an operation. In contrast, taking over part of an entity's debt by the government would not qualify for the exclusion. On this issue, see also paragraph 13.

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

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 and 2014 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), (i) local government arrears settled through the €1 billion credit facility created in May 2012, and (ii) 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 and 2014, 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. For 2014, 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 ([20])

Actions for the eleventh review (to be completed by end Q4-2013 or by the eleventh review)	
Financial sector	**[2.9]** Utilise the new top-down stress testing framework in the round of quarterly stress test. **[2.19]** Enhance the transparency in the pricing practices of participating institutions in the existing government-sponsored credit lines.
Fiscal structural	**[3.2]** Reduce the number of budget entities and review the classification of own revenues. **[3.3]** Develop targeted programmes to underpin financial sustainability of public entities. Establish a unit with the Ministry of Finance which reports to the State Secretary of the Budget in charge of the expenditure arrears for the public sector. **[3.6]** Publish a report assessing the Budget Framework Law and provide suggestions for new legislation. **[3.11]** Present the annual PPP report and utilise it as input to the fiscal risks assessment for the budget. **[3.17 ii]** Increase the resources devoted to auditing in the tax administration to at least 30 percent of the total staff. **[3.17 iii]** Publish quarterly reports on duration and costs of tax cases. **[3.18]** Prepare an evaluation report of the measures for the different economic sectors after implementing the e-invoicing system. **[3.20 i]** Prepare an assessment report on the current tax compliance situation. **[3.22 i]** Identify potential overlaps of services and jurisdictions and inefficiencies between the different levels of government, as well as opportunities for decentralisation and outsourcing of services by the central government. **[3.22 ii]** Reorganise the network of decentralised services of ministries. **[3.23 i]** Complete the implementation of the strategy of shared services in the area of financial resources (GeRFIP) in central and regional administrations. **[3.27]** Converge the system of social protection for staff in the *Regime de Proteção Social Convergente* (RPSC) to the pension rules of *Regime Geral de Segurança Social*.
Health care system	**[3.29]** The improvements in the billing and collection of revenues from NHS moderating fees, insurance companies and fees for the treatment of cross-

([20]) Square brackets identify paragraph numbers in the MoU as signed on 19 February 2014.

Actions for the eleventh review (to be completed by end Q4-2013 or by the eleventh review)	
	border/foreign patients, will result in additional revenues of €50 million **[3.35]** Publish a follow up report on INN prescription. **[3.40]** Take further measures to increase competition among private providers and between private and public providers in the areas of service provision and implement measures to ensure competition in the pharmacies sector. **[3.46]** Annually update the inventory of all health staff and prepare the annual report presenting plans for the allocation of human resources up to 2014. **[3.47]** Reduce overtime compensation by a further 20% in 2013 through the application of new payment scales for overtime and new rules to increase mobility within and across Regional Health Authorities. **[3.48]** Finalise the implementation of new internal control procedures manual by the Regional Health Authorities.
Labour market	**[4.3]** Find alternative reform options with similar effect while respecting the ruling by the Constitutional Court of 26 September 2013. Consult with social partners and discuss with EC/ECB/IMF staff before submitting to the Parliament. **[4.4]** Present a report assessing policy options to reduce incentives to challenge dismissals in court. Evaluate the need for further steps. **[4.5 iii]** Prepare an independent review on shortening the survival of contracts that are expired but not renewed. **[4.5 iv]** Present a report assessing policy options for ensuring effective decentralisation of wage bargaining and promoting wage flexibility. **[4.6]** Present measures to strengthen the role of the job counselling and job search assistance as well as the activation and sanctions systems in facilitating the transition from unemployment to employment. **[4.7 ii (ii)]** Define and implement a simple funding framework comprising performance and evaluation criteria for public schools. **[4.7 ii (iii)]** Report on possible further improvements of the new inspection model in the secondary education. **[4.7 iii (iii)]** Establish "professional schools of reference".
Goods and services markets	**[5.2]** Provide information on the assumptions and parameters used in September 2011 and the last two updates of the tariff debt path. Take actions to ensure that the impact of the energy sector levy will not be passed on to end-users. **[5.3]** Analyse the potential for correcting measures, in line with the report on the CMEC scheme and the process for the extension of the concession of the public

Actions for the eleventh review (to be completed by end Q4-2013 or by the eleventh review)	
	hydro resource by the former CAE hydro power plants. **[5.4]** Revise further the remuneration scheme for co-generation, this will be undertaken in line with the framework of the transposition of the energy efficiency directive. **[5.7 iv]** Reform the transport and infrastructures' regulatory framework. **[5.8]** Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability. **[5.9 i]** Ensure that the rail regulator enjoys the independence required under the EU rail Directives and strengthen its capacities to fulfil its regulatory mandate effectively. **[5.9 iii]** Ensure that the new Public Service Obligation (PSO) contracts concluded on rail passenger transport respect EU legislation and provide a detailed breakdown of state contributions for each line under PSO. Develop administrative capacity to introduce competitive tendering in some PSOs. **[5.11]** Complete the adoption of Construction Laws and the other sectorial amendments necessary to fully implement the Services Directive. **[5.12]** Submit to Parliament the professional bodies' amended statutes. **[5.13 i]** Adapt the content and information available at the Point of Single Contact (PSC) for the missing regimes to ensure conformity with the Services Directive and make available online forms and procedures for these regimes. **[5.13 ii]** Adapt the content and information available at the PSC for the outstanding regimes approved to ensure conformity with the Professional Qualifications Directive and make available online forms and procedures. **[5.13 iii]** Extending PSC to services not covered by the Services Directive. **[5.13 iv]** Extending the "Zero Authorisation" project to other services sectors.
Housing market	**[6.2]** Provide a comprehensive review of the functioning of the housing market.
Framework conditions	**[7.1]** Publish quarterly reports on recovery rates, duration and costs of corporate insolvency cases and on the clearance rate and disposition time of enforcement court cases, within four months after the end of the relevant quarter. **[7.4]** Approve the corresponding amendments to the bylaws of the National Regulatory Authorities. Ensure the effective functioning of the Competition Authority financing model. **[7.5]** Identify the direct awards granted above the legal thresholds after the revision of the Public Procurement Code as well as the legal exception under which such awards were granted. Provide a summary of the contracts rejected by

Actions for the eleventh review (to be completed by end Q4-2013 or by the eleventh review)	
	the Court of Auditors. **[7.6]** Assess the impact of the procedures for requesting VAT exemptions for exporting firms. **[7.11]** Adopt a rule that makes mandatory when creating a new regulation generating costs for businesses, to eliminate existing regulations with equivalent cost. **[7.12 i]** Adopt the Base Law of Soil and Territorial and Urbanism Planning and ensure its alignment with the new Industrial Licensing regime. **[7.12 ii]** Adopt and make operational a Risk Sectorial Plan. **[7.12 iii]** Review the legal regimes of the Territorial Management Instruments (RJIGT) and of the related regulations. **[7.12 iv]** Adopt a legal provision for the regularisation of activities not in accordance with Territorial Management Instruments. **[7.12 v]** Harmonise the regional plans. **[7.12 vi]** Review the Legal Regime for Urbanism and Building (RJUE), that should be aligned with the new Industrial Licensing regime. **[7.13 i]** Implement a Legal Regime of Land Registration. **[7.13 ii]** Create a diploma on Land Registration and Land Registration Experts. **[7.13 iii]** Review the cartography for plans regime and the diploma on Cartography. **[7.13 iv]** Enforce the Council of Ministers Resolution 56/2012 to collect all land registration procedures. **[7.14]** Approve the new legal regime for commercial actives and establish the Programme for the Competitiveness of Commerce and Services activities. **[7.15 i]** Review the legal regime concerning the licensing of mining and geological production and investment in line with international best practices. **[7.15 ii]** Simplify the legal and bureaucratic procedures pertaining to mining and geological investments.

Actions for the twelfth review (to be completed by end Q1-2014 or by the twelfth review)	
Fiscal structural	**[3.5]** Publish a fiscal strategy document for the general government. **[3.6]** Review the Budget Framework Law (BFL) to fully transpose the relevant EU legislation and announce the key aspects and structure of the new law. **[3.13]** Present in-depth studies for Transport SOEs plus REFER and Estradas de Portugal and also other SOEs. **[3.16]** Modify the regulation of the waste management sector with the view of launching the sale of the waste management company (EGF). **[3.17 i]** Reduce the number of municipal offices by at least 25 per cent. **[3.20 ii]** Make fully operational the recently established Risk Management Unit. **[3.21]** Review public financial support to private associations. **[3.23 ii]** Complete the implementation of the strategy of shared services in the area of human resources (GeRHuP) in the Ministry of Finance's entities by concluding the roll-out to the Tax Authority. **[3.25]** Ensure the implementation at local administration level and promote that each region presents its plan to achieve the same target of limiting staff admission at 2 percent per year (in full-time equivalents). **[3.26]** Provide a report on the comprehensive reform of wage supplements. Present draft legislation for a single supplement scale. **[3.28]** Adopt a new general Public Administration Labour Law.
Health care system	**[3.38]** Establish an observatory for prices and acquisitions. **[3.39]** INFARMED shall finish the national medicines formulary including four new therapeutic areas per quarter. **[3.44]** Implement the central accounting platform in 20 hospital SOEs. **[3.45]** Define the service portfolio for NHS hospitals and to finalise all strategic 3-year plans for hospitals**.** The "Contratos Programa" for SOE hospitals for 2014 should be negotiated and signed.
Goods and services markets	**[5.1]** Implement the plan to create a new gas and electricity logistics operator independent company. **[5.2]** Implement the necessary measures to cope with the risks of overcompensation in the adjustment calculations (revisibilidade) of the CMEC scheme. **[5.5]** Revise downward the feed-in tariffs for new contracts in renewables. This must be implemented through the legal regulations that remain to be adopted

Actions for the twelfth review (to be completed by end Q1-2014 or by the twelfth review)	
	under the framework of the transposition of the Third Energy Package. **[5.9 iv]** Present an assessment of the impact of the extended performance schemes on infrastructure charges in different traffic categories. **[5.9 v]** Continue to prepare the privatisation of the freight branch of the state-owned rail operator. **[5.10 i]** Present a review of the port work law. **[5.10 ii]** Ensure that the relevant regulator for ports has sufficient financial and administrative resources to carry out its function. **[5.10 iii]** Launch the renegotiation with the relevant operators.
Framework conditions	**[7.1]** Publish quarterly reports on recovery rates, duration and costs of corporate insolvency cases and on the clearance rate and disposition time of enforcement court cases, within four months after the end of the relevant quarter. **[7.8]** Assess the impact of the optional VAT cash accounting regime. **[7.10]** Carry out an inventory and an analysis of the costs of regulations that are likely to have a higher impact on economic activity.

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