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## The Economic Adjustment Programme for Portugal Eleventh Review

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# The Economic Adjustment Programme for Portugal

## Eleventh Review

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# EXECUTIVE SUMMARY

***A joint EC/ECB/IMF mission met with the Portuguese authorities in Lisbon between 20 February and 28 February 2014 to assess compliance with the terms and conditions set out in the Memorandum of Understanding (MoU), as updated following the 10th Review of the Portuguese Economic Adjustment Programme.*** *The objectives of the Programme are to restore sound public finances, improve competitiveness and put Portugal's economy back on the path of sustainable growth and job creation. 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 11th Programme Review.*

***The Programme has entered its final stages, with this Review being the next-to-last before the Programme ends.*** *The economy has begun to recover over the past twelve months. There has been positive quarterly GDP growth since the second quarter of 2013 and a year-on-year growth rate of 1.6 percent in the last quarter makes Portugal one of the best-performers in the euro area. On this basis, the economic growth projections for 2013 and 2014 have been revised moderately upwards. Employment has also increased since the second quarter of 2013, while the unemployment rate has declined steadily from 17.6 percent to 15.3 percent of the labour force over the course of 2013. However, the recovery remains fragile as the overhang of public and private debt is likely to weigh on the medium-term outlook, while the necessary transition from a growth model based on domestic demand to an export-driven expansion remains challenging. Accordingly, it is essential that the Portuguese government develops a solid medium-term growth strategy with a view to carrying the current momentum beyond the horizon of this Programme.*

***The 2013 budget deficit came in at 4.9 percent of GDP (4.5 percent net of bank recapitalisations), significantly below the Programme target of 5.5 percent of GDP (excluding bank recapitalisations).*** *This outcome reflects a better-than-expected revenue performance, including the proceeds from the one-off tax and social security debt recovery scheme, and a tightening of expenditure control. The 2014 budget deficit target of 4.0 percent of GDP has been confirmed and is predicated on consolidation measures totalling 2.3 percent of GDP, predominantly on the expenditure side. With last year's over-performance expected to partly carry over into 2014 and the economic outlook improving above previous expectations, the risks around the target have become more balanced. Nevertheless, downside risks to the achievement of the target remain important, not least in view of forthcoming rulings of the Constitutional Court on some consolidation measures in the 2014 Budget Law. Should any of these risks materialise, the government remains committed to implementing compensatory measures of equivalent size and quality to meet the target. Further significant consolidation efforts will be necessary in 2015 to reach the deficit target of 2.5 percent of GDP. Detailed plans regarding the measures will be presented in the Fiscal Strategy Document, which will be published by the end of April 2014. Looking ahead, sustained consolidation efforts will be required over the medium term to reach the budgetary objective of a structural deficit of 0.5 percent of GDP by 2017 in compliance with the commitments under the Stability and Growth Pact and the Fiscal Compact.*

***To ensure the effectiveness of the medium-term fiscal consolidation efforts, tight control of expenditure must be maintained while additional steps to strengthen tax compliance will be required to make the tax system fairer and bolster revenue performance.*** *To this end, further improvements in the system of public financial management will be necessary across all sub-systems of general government. This includes the timely completion of the broader reform of the Budget Framework Law, a revised accounting and reporting framework, stricter compliance with the commitment control law, streamlining of the budget appropriation structure, strengthened accountability and a longer time horizon and broader scope of the analysis of fiscal risks. Employment in the public sector needs to be further streamlined, with appointments and remuneration strictly based on merit. Cost-cutting efforts must continue in the state-owned enterprises, so as to ensure that they maintain at least a zero operational balance. More specifically, legacy debt continues to weigh on the financial results of transport SOEs suggesting the need for a comprehensive debt strategy to restore their financial sustainability. While several debt settlement programmes have substantially reduced the stock of public-sector arrears over the past two years, new* *arrears are accumulating, notably in state-owned hospitals. Ongoing reforms in the hospital sector should be accelerated to achieve the necessary cost reductions but, in the short term, new arrears would need to be cleared via the central government budget.*

***Financial stability has been preserved and efforts supporting an orderly deleveraging of banks' balance sheets continue.*** *Capital buffers are broadly adequate and liquidity conditions have further improved, while the authorities continue to scrutinise the resilience of the banking system to ensure compliance with the new regulatory requirements. However, low profitability, high NPL ratios and high corporate debt levels pose major challenges for the banks, affecting the ability of the economy more generally to grow in the future. Several large banks were able to return to the markets and the aggregate deposit base has proven resilient, allowing banks to reduce their reliance on Eurosystem borrowing. New loans to the corporate sector have been increasing and interest rates have eased somewhat, but remain still significantly above the rates charged to corporates in other parts of the euro area. In order to reduce the large corporate debt overhang, a strategic plan to facilitate debt workouts will be prepared. This plan will focus particularly on viable small and medium-sized enterprises, with a view to supporting the necessary capital reallocation towards the productive sectors of the economy.*

***Continued structural reforms are needed to reinforce and sustain the switch to a sustainable export-led economic growth model.*** *The Portuguese government has already adopted a range of challenging structural reforms but, despite some early signs, their impact on the functioning of the economy will materialise only gradually. The effective implementation of these reforms is crucial to rebalance the economy and boost its growth potential, and implementation progress must be continuously evaluated, including in areas which have been successfully completed under the Programme such as the urban lease and judiciary reform. Remaining bottlenecks which inhibit Portuguese companies from competing with their foreign counterparts on a level-playing field need to be tackled effectively. In particular, building on the reforms already carried out it is important to maintain the reform momentum through further efforts in labour markets, network industries, services and regulated professions as well as providing a more streamlined and business-friendly public service.*

***In summary, Programme implementation remains on track.*** *The government's determination to bring the Programme to a successful completion has been rewarded by falling yields and rising demand for Portuguese debt, amid a generalised improvement in market sentiment toward euro-area sovereigns. Recent bond issues combined with remaining Programme disbursements ensure that the public sector's funding needs for 2014 are covered. The ratio of public debt to GDP remains high – with gross debt being additionally inflated by the accumulation of substantial cash buffers - but is sustainable provided the reform momentum and fiscal adjustment is maintained beyond the Programme horizon. Reaching a broad-based political understanding that fiscal discipline and structural reform have to underpin Portugal's future policies would constitute an important anchor for restoring full and sustainable market financing.*

***Portugal's economic adjustment program is supported by loans from the European Union amounting to EUR 52 billion and a EUR 26 billion Extended Fund Facility with the IMF.*** *The conclusion of the 11th Review could take place in April 2014, subject to the approval of ECOFIN and EUROGROUP and of the IMF Executive Board. This would allow for the disbursement of EUR 2.5 billion (EUR 1.6 billion by the EFSM and EFSF, and about EUR 0.9 billion by the IMF). The joint mission for the last Programme Review is expected to take place in April 2014.*

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# INTRODUCTION

**1. This report assesses compliance with the terms and conditions set out in the Memorandum of Understanding, as updated following the 10th Review of the Portuguese Economic Adjustment Programme.** The assessment is based on the findings of a joint European Commission (EC)/European Central Bank (ECB)/International Monetary Fund (IMF) staff mission to Lisbon from 20 to 28 February 2014. ([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 11th Review will pave the way for the release of the next loan instalment of around EUR 2.5 billion.** This instalment will bring EFSM, EFSF and IMF financing to around EUR 77 billion, representing about 97 percent of total available financial assistance.

([1]) The cut-off date for the macro-economic and fiscal projections of this report is 28 February 2014. GDP data for 2013 was revised upwards after the cut-off date which has, however, not been taken into account in the macro-fiscal projection of this review.

([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 EUR79 billion.

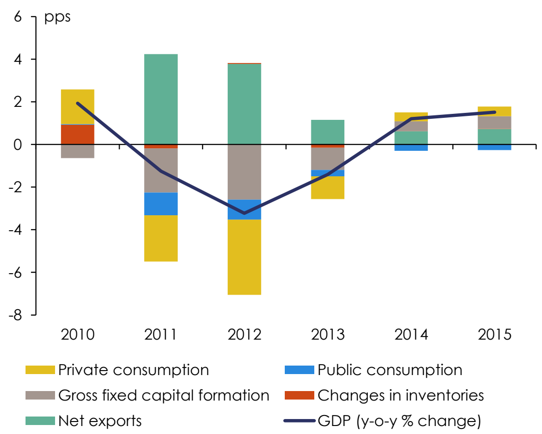
# 1. ECONOMIC DEVELOPMENTS AND OUTLOOK

## MACROECONOMIC OUTLOOK

**4. After a deep recession, the economy has returned to positive growth from the second quarter of 2013.** Following quarter-on-quarter (q-o-q) growth rates of 1.1 and 0.2 percent in the second and third quarter, output grew by another 0.5 percent q-o-q in the fourth quarter, making Portugal one of the best-performers in the euro area with year-on-year (y-o-y) growth of 1.6 percent. This outcome has resulted in an upward revision of the estimated annual GDP growth rate for 2013 to -1.4 percent (up by 0.2 percentage points compared with the 10th Review and by 0.9 percentage points compared with the projections at the beginning of the year). All GDP components contributed to this improvement in growth. Exports proved particularly dynamic and are estimated to have expanded by close to 6 percent in 2013 (compared with a projected growth rate of 0.8 percent one year ago). This dynamism of exports largely reflects gains in export market shares rather than growth of export markets.

**5. Economic growth in 2014 is expected to reach 1.2 percent, while the projections for the outer years remain unchanged.** Due to a higher than expected carry-over from the last quarter of 2013, output growth in 2014 has been upward revised by 0.4 percentage points from the 0.8 percent projected in the 10th Review. The current projections reflect broadly equal contributions to GDP growth from private consumption, investment and exports (see Graph 1.1). Revisions in GDP components relative to the 10th Review reflect the impact of the latest available data, which suggest in particular that investment will expand by more than previously projected. Investment expenditure is now expected to grow by 3.1 percent in 2014, almost 2 percentage points above previous projections. The projected investment growth in 2014 reflects to some extent the impact of the planned purchase of new civil aircraft by the national air carrier, but the downturn in investment in other business sectors is also expected to gradually bottom out, heralding more sustainable investment growth rates of about 4 percent in 2015 and 2016.

Graph 1.1: **Contributions to GDP growth**




***Source:*** Commission services

**6. Private consumption picked up in the second half of 2013, amid a recovery in household income driven by rising employment and low inflation.** The trends supporting real household income are expected to continue in 2014 and release some pent-up demand, notably for durable consumer goods. Private consumption is thus expected to pick up moderately to positive growth of 0.7 percent, which represents an upward revision by 0.6 percentage points relative to the last review. However, the need for further deleveraging and a moderate re-acceleration of inflation will limit any recovery in consumer spending over the medium term. Against this background, growth in private consumption is expected to remain unchanged in 2015 and to accelerate only marginally in the outer years. The household saving rate is expected to see a modest decline to about 11½ percent of disposable income in 2014 before rising again to around 12 percent thereafter.

**7. Conditions in the labour market have significantly improved since the second quarter of 2013.** Nevertheless, for the year as a whole employment is estimated to have fallen by 2.9 percent in 2013 which compares with 3.2 percent projected in the 10th Review. The unemployment rate at the end of 2013 stood at 15.3 percent, more than 2 percentage points below the rate recorded at the beginning of the year. This deceleration in overall job losses was due mainly to the increase in permanent job contracts. Taking these developments into account, projected employment

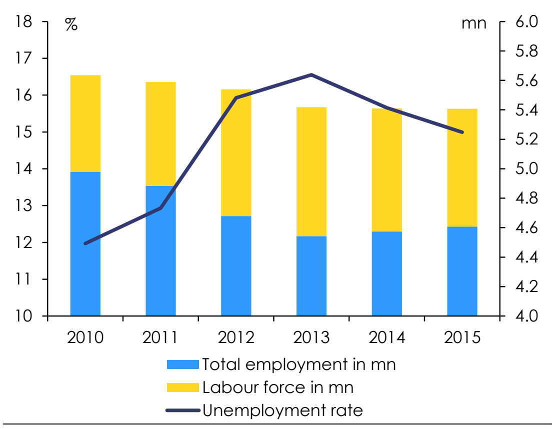
Table 1.1: **Macroeconomic projections of the Eleventh Review**

| | 11th Review (February 2014) | | | | 10th Review (December 2013) | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2012 | 2013 | 2014 | 2015 |
| | year-on-year volume change | | | | | | | |
| **Gross domestic product** | **-3.2** | **-1.4** | **1.2** | **1.5** | -3.2 | -1.6 | 0.8 | 1.5 |
| **Private consumption** | **-5.3** | **-1.6** | **0.7** | **0.7** | -5.3 | -1.8 | 0.1 | 0.8 |
| **Public consumption** | **-4.7** | **-1.6** | **-1.6** | **-1.5** | -4.7 | -2.0 | -2.5 | -1.9 |
| **Fixed investment** | **-14.4** | **-6.5** | **3.1** | **3.8** | -14.4 | -8.0 | 1.2 | 3.7 |
| **Exports of goods and services** | **3.2** | **5.9** | **5.5** | **5.5** | 3.2 | 5.8 | 5.0 | 5.3 |
| **Imports of goods and services** | **-6.6** | **2.8** | **4.0** | **4.0** | -6.6 | 2.6 | 3.0 | 3.8 |
| | contributions to real GDP growth | | | | | | | |
| **Domestic demand excl. inventories** | **-7.1** | **-2.5** | **0.6** | **0.9** | -6.9 | -2.8 | -0.1 | 0.7 |
| **Change in inventories** | **0.0** | **-0.2** | **0.0** | **0.0** | 0.2 | 0.0 | 0.1 | 0.0 |
| **Net trade** | **3.8** | **1.3** | **0.7** | **0.7** | 3.8 | 1.2 | 0.8 | 0.7 |
| **Employment (y-o-y change)** | **-4.2** | **-2.9** | **0.7** | **0.7** | -4.2 | -3.2 | -0.4 | 0.4 |
| **Unemployment rate - Eurostat definition (%)** | **15.9** | **16.5** | **15.7** | **15.0** | 15.9 | 16.5 | 16.8 | 16.5 |
| **HICP (y-o-y change)** | **2.8** | **0.4** | **0.7** | **1.2** | 2.8 | 0.5 | 0.8 | 1.2 |
| **Current external balance (% of GDP)** | **-2.2** | **0.3** | **0.6** | **1.0** | -1.9 | 0.4 | 0.8 | 1.1 |
| **General government net lending (% of GDP)** | -6.4 | -4.9 | -4.0 | -2.5 | -6.4 | -5.9 | -4.0 | -2.5 |
| **General government consolidated gross debt (% of GDP)** | 124.1 | 128.8 | 126.7 | 124.8 | 124.1 | 129.4 | 126.6 | 125.8 |

***Source:*** Commission services

growth has been revised upward to 0.7 percent in both 2014 and 2015 (by 1.1 and 0.3 percentage points, respectively), while the unemployment rate has been revised downward to 15.7 percent in 2014 and 15.0 percent in 2015 (by 1.1 and 1.5 percentage points respectively). Part of this improvement may reflect the implementation of active labour market programmes. Indeed, the (moderate) inward shift of the Beveridge curve in the last quarter of 2013 (see Graph 1.3), reflecting a simultaneous decline in the unemployment and job vacancy rates, suggests a slight improvement in job-matching efficiency, after the strong deterioration between Q1-2012 and Q1-2013.

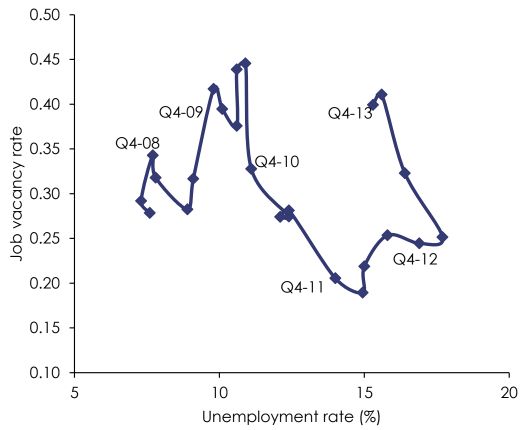
Graph 1.2: **Labour market developments**




***Source:*** Commission services

8. **Economic growth will be supported by a continued strong performance of exports.** The expected robust growth rate of exports of 5½ percent in 2014 is based on the assumption of a pick-up in external demand. Export growth should also be sustained by the expected acceleration in investment growth which will be instrumental in expanding the production capacity in the export sector. In 2015, export growth is projected to remain broadly unchanged and growth rates of somewhat more than 5 percent are expected in the outer years, in line with the stabilisation of market shares. Import volumes are expected to increase by

Graph 1.3: **Beveridge curve**




(1) Job vacancy rate = total number of vacancies/ (total number of vacancies + total employment)
***Source:*** Commission services

4 percent in 2014, reflecting the projected rise in both private consumption and investment. Import growth is expected to remain broadly stable in the outer years. The strong export performance should support a continued improvement in external sustainability, although this will happen at a slower pace than in the last few years in view of the pick-up in import growth. The current account balance is nevertheless projected to remain positive at around 0.6 percent of GDP in 2014 and to improve further to around 1 percent of GDP in 2015 and 2016.

**9. Inflation is projected to accelerate moderately, but is likely to remain below the euro-area average.** The inflation projections correspond to a minor downward revision for 2014 compared with the 10th Review. Following a decline in the first months of 2014, inflationary pressures are expected to accelerate slightly, resulting in an annual average HICP inflation rate of 0.7 percent amid still weak domestic demand and a negative contribution from energy prices. The inflation rate is forecast to reach 1.2 percent in 2015 and to accelerate to 1.5 percent in the years thereafter, in line with the acceleration of domestic demand and the expected increase in labour costs.

**10. Despite the recent improvements, the medium-term outlook for economic growth remains subject to downside risks.** The baseline forecast scenario of sustained economic growth in the medium term depends crucially on the external outlook, notably in respect of European trading partners and emerging markets. Another risk relates to the possibility of a stronger-than-expected impact of private sector deleveraging and the planned fiscal consolidation on growth. The economic outlook is also dependent on a continued implementation of structural reforms to boost growth and competitiveness beyond the end of the Programme. Financing conditions for the Portuguese sovereign remain uncertain due to both domestic and external factors. Borrowing costs are still very high relative to the outlook for nominal GDP growth, which makes Portugal vulnerable to any recurrence of turbulence in the financial markets.

## FISCAL DEVELOPMENTS

**11. Considerable progress towards the Programme's fiscal consolidation objectives was achieved in 2013.** The Programme's end-year quantitative performance criteria were met by a comfortable margin. According to the latest estimates, the general government cash-adjusted deficit for Programme purposes reached EUR 7.137 million (4.3 percent of GDP), about 1 percent of GDP below the target, which represents an improvement of about 0.8 percent of GDP compared with the 2012 cash-adjusted deficit. The 2013 deficit outturn is better than the implicit deficit planned in the first (end-June) and second (early November) Supplementary Budgets (SB). The favourable evolution of the budget execution in the second half of 2013 accelerated in the final months. The positive cash deviations are explained mainly by the better-than-expected performance of State tax revenues (including the one-off tax and social contributions debt recovery scheme) and lower-than-expected expenditure at the central government level (particularly on acquisition of goods and services, interests and investment – e.g. capital expenditure by SOEs in the government sector). By contrast, non-tax revenue underperformed due amongst other factors to lower sales of goods and services.

**12. In ESA-95 terms, the general government deficit for Programme purposes, i.e. excluding bank recapitalisations of 0.4 percent of GDP, is estimated to have fallen to 4.5 percent of GDP, 1 percent of GDP below the target.** The size of the over-performance in national accounts terms is similar to the cash outturn, as most cash deviations are translated into national accounts. The headline deficit improved by 1.5 percent of GDP (from 6.4 percent of GDP in 2012 to about 4.9 percent in 2013 and, excluding bank recapitalisations, from 6 percent of GDP in 2012 to 4.5 percent in 2013), while the deficit net of one-offs improved by about 0.5 percent of GDP (from 5.8 percent of GDP in 2012 to 5.3 percent in 2013). The overall fiscal effort, measured by the improvement in the structural balance, which excludes one-offs and the impact of the economic cycle on the budget, is estimated to have been 1 percent of GDP (which is above the 0.6 percent of GDP required by the relevant EDP recommendation).

Table 1.2: **General Government National Accounts**

| | 2012 | One-offs 2012 | 2012 net of one-offs | 2013 | One-offs 2013 | 2013 net of one-offs | 2013-2012 net of one-offs | 13/14 bonus reinstatement effect |
|---|---|---|---|---|---|---|---|---|
| **1. Total Revenue** | **67,574.3** | **283.0** | **67,291.3** | **72,409.7** | **1,279.4** | **71,130.3** | **3,838.9** | **717.0** |
| **Current Revenue** | **65,076.9** | **-40.0** | **65,116.9** | **70,907.1** | **1,279.4** | **69,627.7** | **4,510.8** | **717.0** |
| Taxes on Production and Imports | 22,538.7 | -225.0 | 22,763.7 | 22,568.3 | 330.4 | 22,237.9 | -525.8 | |
| Taxes on Income and Wealth | 15,272.5 | 185.0 | 15,087.5 | 19,522.2 | 715.0 | 18,807.2 | 3,719.7 | 536.0 |
| *of which PIT* | 9,790.1 | 185.0 | 9,605.1 | 13,145.9 | 177.8 | 12,968.1 | 3,363.0 | 536.0 |
| Social Contributions | 19,135.3 | | 19,135.3 | 20,139.6 | 234.0 | 19,905.6 | 770.4 | 181.0 |
| Sales | 4,608.8 | | 4,608.8 | 4,508.2 | 0.0 | 4,508.2 | -100.5 | |
| Other Current Revenue | 3,521.7 | | 3,521.7 | 4,168.7 | 0.0 | 4,168.7 | 647.0 | |
| **Capital Revenue** | **2,497.4** | **323.0** | **2,174.4** | **1,502.6** | **0.0** | **1,502.6** | **-671.8** | |
| **2. Total Expenditure** | **78,215.5** | **1,330.4** | **76,885.1** | **80,531.4** | **700.0** | **79,831.4** | **2,946.3** | **3,188.0** |
| **Current Expenditure** | **73,398.6** | **102.4** | **73,296.2** | **76,507.8** | **0.0** | **76,507.8** | **3,211.7** | **3,188.0** |
| Intermediate Consumption | 7,400.2 | | 7,400.2 | 7,307.9 | 0.0 | 7,307.9 | -92.3 | |
| Compensation of Employees | 16,510.0 | | 16,510.0 | 17,788.6 | 0.0 | 17,788.6 | 1,278.6 | 1,642.0 |
| Social Transfers | 37,139.3 | | 37,139.3 | 38,834.0 | 0.0 | 38,834.0 | 1,694.7 | 1,546.0 |
| *Of which Social Transfers other than in kind* | 29,644.5 | | 29,644.5 | 31,229.0 | 0.0 | 31,229.0 | 1,584.4 | 1,546.0 |
| Interests (EDP) | 7,125.9 | | 7,125.9 | 7,063.9 | 0.0 | 7,063.9 | -62.0 | |
| Subsidies | 1,008.5 | | 1,008.5 | 1,116.9 | 0.0 | 1,116.9 | 108.3 | |
| Other Current Expenditure | 4,214.6 | 102.4 | 4,112.2 | 4,396.6 | 0.0 | 4,396.6 | 284.4 | |
| **Capital Expenditure** | **4,816.9** | **1,228.0** | **3,588.9** | **4,023.5** | **700.0** | **3,323.5** | **-265.4** | **0.0** |
| Gross Fixed Capital Formation | 2,745.0 | | 2,745.0 | 2,375.8 | 0 | 2,375.8 | -369.2 | |
| Other Capital Expenditure | 2,071.9 | 1,228.0 | 843.9 | 1,647.8 | 700 | 947.8 | 103.8 | |
| **Net lending (+)/Borrowing (-) (1 - 2)** | **-10,641.2** | **-1,047.4** | **-9,593.8** | **-8,121.7** | **579.4** | **-8,701.1** | **892.7** | **-2,471.0** |
| **% of GDP** | **-6.4%** | **-0.6%** | **-5.8%** | **-4.9%** | **0.3%** | **-5.3%** | **0.5%** | **-1.5%** |

***Source:*** INE, Commission services

Table 1.3: **Net borrowing (-)/ net lending (+) ESA-95**

| | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| **General Government** | **-16,981.5** | **-7,398.3** | **-10,641.2** | **-8,121.7** |
| **Central Government** | -16,326.6 | -7,250.8 | -11,796.8 | -8,942.1 |
| **Local Government** | -1,439.6 | -586.0 | 855.9 | 408.3 |
| **Social security funds** | 784.7 | 438.4 | 299.6 | 412.1 |

***Source:*** INE, Commission services

13. **The fiscal consolidation in 2013 mainly reflects strong fiscal revenue growth (State taxes and social contributions) and expenditure control, whereas non-fiscal revenue was weaker than expected.** State tax revenue and social contributions increased by 10 percent and 5 percent, respectively, compared with their 2012 levels (see Table 1.2). Personal income taxes (PIT) are estimated to have risen by EUR 3.4 billion (2 percent of GDP), crucially supporting consolidation. Policy measures related to taxes and social contributions contributed significantly to this outcome, including actions which had not been quantified ex-ante such as reforms to tackle tax evasion and fraud. The performance of taxes and social contributions is even more impressive when seen in the light of the unfavourable macro-economic developments and their adverse impact on various tax bases (e.g. nominal wages in the private sector are estimated to have dropped by 0.9 percent and private consumption by 1.6 percent). By contrast, non-tax revenue fell, which is explained, amongst other factors, by a lower-than-projected absorption of EU Funds. On the expenditure side, consolidation is observed for numerous items, in particular for intermediate consumption, investment and interest payments. The reinstatement of the 13th and 14th bonus payments for public sector wages and pensions did not translate into an equivalent rise in compensation of employees and social transfers as they were partly offset by measures reducing the public sector wage bill and pension benefits. The State and regional governments were the sub-sectors of general government which contributed to the fiscal consolidation in 2013. By contrast, the finances of local governments deteriorated considerably compared with the year before, suggesting the need for closer monitoring and control.

Table 1.4: **Stock of arrears assessment (in EUR million)**

| Subsector | Dec-12 | 2013 Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Jan-14 | Dec 13 - Dec 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Central Government excluding HNS | 58 | 54 | 57 | 54 | 61 | 56 | 53 | 55 | 53 | 52 | 55 | 51 | 30 | 41 | -28 |
| HNS classified in General Government | 23 | 23 | 28 | 26 | 48 | 14 | 20 | 32 | 30 | 29 | 23 | 22 | 10 | 9 | -13 |
| Reclassified entities | 29 | 19 | 18 | 18 | 19 | 19 | 18 | 18 | 18 | 17 | 17 | 17 | 1 | 1 | -28 |
| Local Government | 1,274 | 1,223 | 1,138 | 1,110 | 1,062 | 969 | 928 | 881 | 824 | 769 | 747 | 734 | 661 | 659 | -613 |
| Regional Government | 938 | 938 | 938 | 944 | 1,066 | 1,053 | 1,058 | 904 | 765 | 661 | 602 | 580 | 517 | 509 | -422 |
| RAA | 3 | 5 | 5 | 5 | 3 | 4 | 3 | 3 | 4 | 5 | 6 | 8 | 2 | 3 | -1 |
| RAM | 935 | 933 | 933 | 939 | 1,063 | 1,049 | 1,055 | 901 | 761 | 656 | 596 | 572 | 514 | 506 | -421 |
| Total | 2,322 | 2,256 | 2,179 | 2,153 | 2,256 | 2,111 | 2,078 | 1,889 | 1,690 | 1,527 | 1,444 | 1,404 | 1,219 | 1,220 | -1,104 |
| **Total Consolidated** | **2,244** | **2,181** | **2,106** | **2,080** | **2,189** | **2,047** | **2,020** | **1,837** | **1,641** | **1,482** | **1,396** | **1,364** | **1,184** | **1,179** | **-1,061** |
| Memorandum items: | | | | | | | | | | | | | | | |
| Other entities outside General Government | | | | | | | | | | | | | | | |
| Enterprises excluding HNS | 33 | 40 | 45 | 49 | 50 | 51 | 56 | 74 | 82 | 90 | 91 | 97 | 103 | 111 | 70 |
| HNS (EPE hospitals) | 714 | 727 | 784 | 773 | 817 | 858 | 917 | 951 | 984 | 1,016 | 1,022 | 825 | 611 | 665 | -103 |
| **TOTAL** | **2,992** | **2,947** | **2,935** | **2,902** | **3,056** | **2,956** | **2,992** | **2,862** | **2,707** | **2,587** | **2,509** | **2,286** | **1,897** | **1,956** | **-1,094** |
| **Clearance strategy** | | | | | | | | | | | | | | | |
| HNS arrears stock adjustment related to the arrears clearance strategy | 1,388 | 1,388 | 1,478 | 1,478 | 1,478 | 1,478 | 1,478 | 1,479 | 1,488 | 1,488 | 1,715 | 1,800 | 1,901 | 1,901 | 513 |
| Local arrears stock adjustment related to the arrears clearance strategy | 20 | 28 | 115 | 158 | 211 | 280 | 294 | 346 | 381 | 420 | 439 | 456 | 464 | 479 | 444 |
| Regional (Madeira) arrears stock adjustment related to the arrears clearance strategy | | | | | | | | 117 | 257 | 365 | 387 | 388 | 389 | 424 | 389 |
| **TOTAL after HNS and Local arrears adjustment** | **4,400** | **4,363** | **4,527** | **4,538** | **4,745** | **4,714** | **4,764** | **4,803** | **4,834** | **4,861** | **5,051** | **4,930** | **4,652** | **4,761** | **252** |

***Source:*** Compiled by DGO; data from ACSS, DGTF, DGAL, DGO, Madeira and Azores; Commission services

14. **Despite the significantly better-than-expected budget outcome in 2013, only about 0.2 percent of GDP is expected to carry over into 2014.** On the expenditure side, the better performance in 2013 is not expected to carry over into 2014, mainly for two reasons: (i) a large part of the lower-than-budgeted expenditure in 2013 was in the area of investment and acquisition of goods and services which may entail backlogs in 2014 and (ii) the expenditure ceilings for line ministries on which the 2014 Budget is built remain unchanged. On the revenue side, the over-performance of tax revenues of around 0.8 percent of GDP vis-à-vis the second supplementary budget is partly due to the better results of the one-off (tax and social contributions) debt-recovery scheme implemented at the end of 2013 (about 0.3 percent of GDP). Of the remaining 0.5 percent of GDP, only about 0.2 percent of GDP are estimated to carry over into 2014. Furthermore, the authorities do not expect the underperformance of non-tax revenues to carry over into 2014.

15. **Cash execution in January 2014 was within the monthly targets for revenue and expenditure implicit in the 2014 Budget.** The January budget execution was in line with the underlying monthly targets ([4]) for most items and slightly over-performing for some of them (e.g. central government expenditure and State tax revenue). Overall, the adjusted cash balance for Programme purposes was positive in the first month of the year (EUR 639 million), which compares with the quantitative performance criterion of a cash-adjusted deficit of EUR 1,700 million for the first quarter of 2014.

*Arrears*

16. **Helped by several debt settlement programmes, the stock of arrears of the public sector declined by about EUR 1.2 billion (0.7 percent of GDP) in 2013, but new arrears are still accumulating.** With about EUR 250 million of new (consolidated) arrears in 2013, notably due to structural imbalances of state-owned hospitals and the public railroad company Comboios de Portugal, the Programme target of no accumulation of further arrears was missed:

- The stock of arrears in SOE hospitals was reduced by EUR 103 million in 2013, which is the net result of the accumulation of new arrears by EUR 410 million and the increase in payments of arrears from the debt settlement programmes by EUR 513 million (considering that a part of the 2012 debt settlement programme was paid by hospitals to suppliers only in 2013). However, the pace of accumulation of new arrears in the sector was significantly reduced (about EUR 34 million of new arrears per month in 2013, which compares with about EUR 65 million per month in most of 2012). Although the reduction of new arrears is significant, more efforts are needed to reach the overall objective of arresting any further accumulation. Other SOEs, notably the public railroad company Comboios de Portugal, have accumulated EUR 70 million of new arrears.

([4]) Monthly targets of the initial budget. The monthly profiles will need to be updated following the supplementary budget.

- Arrears at local level came down from EUR 1274 million at the end of 2012 to EUR 661 million at the end of 2013. This is mostly due to the local arrears programme ("Support Programme for the Local Economy", PAEL) from which, by the end of 2013, 95 municipalities had paid arrears of EUR 464 million. Another ten applications were still pending an approval by the Court of Auditors at the end of 2013. All in all, local government arrears were about halved in 2013 and no new arrears seem to have accumulated. A number of measures are also being taken to eliminate weaknesses in the commitment control, including a preliminary order to sanction - at a total amount of more than EUR 70 million - 41 municipalities for having accumulated arrears in the past.

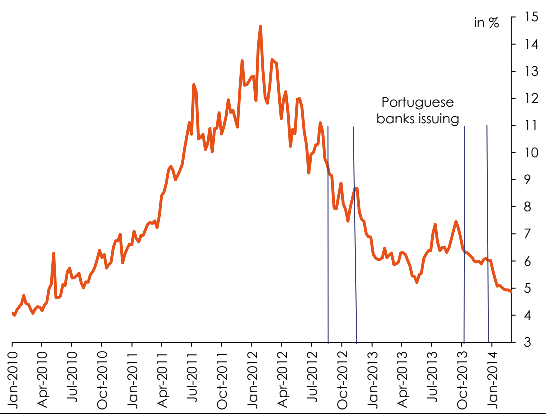
- The Autonomous Region of Madeira also nearly halved the stock of arrears during the year on the back of the arrears clearance strategy.

## FINANCIAL SECTOR DEVELOPMENTS

**17. In February 2014, the yield on 10-year sovereign bonds fell to a level close to that of March 2010.** The decline in sovereign yields through 2013 – having been interrupted in mid-year - resumed in autumn and continued in early 2014 (Graph 1.4). Amid a generalised improvement in market sentiment toward Portugal, further to the issuances at end-2013 two major Portuguese banks issued debt in the wholesale market in January 2014 and in February a third bank returned to the market with a senior unsecured bond issuance.

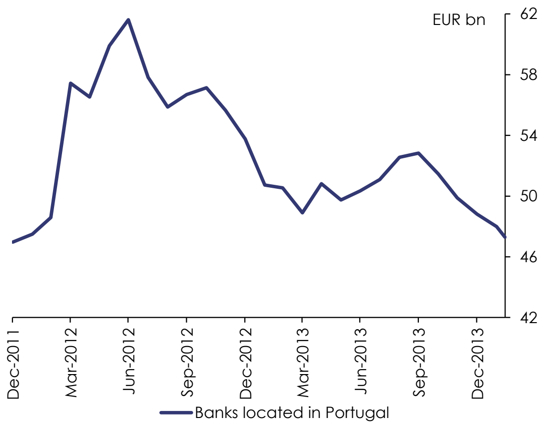
**18. Eurosystem lending to banks in Portugal has declined since mid-2012.** Long-term refinancing operations continue to represent the bulk of Eurosystem funding during the winter 2011/2012. Nevertheless, outstanding Eurosystem funding has fallen by 4 percent since the 10th Review and is now below EUR 48 billion (Graph 1.5). Eurosystem funding constitutes about 10 percent of the banking system's assets, whereas the average for the euro area is close to 3 percent. Mobilised collateral amounts to more than EUR 75 billion, implying a collateral buffer of EUR 27 billion.

Graph 1.4: **10 year sovereign yields returns to pre-crisis level**




***Source:*** Bloomberg

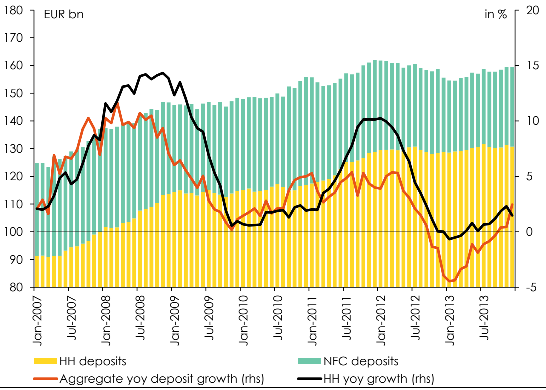
Graph 1.5: **ECB borrowing by banks located in Portugal**




***Source:*** Bank of Portugal

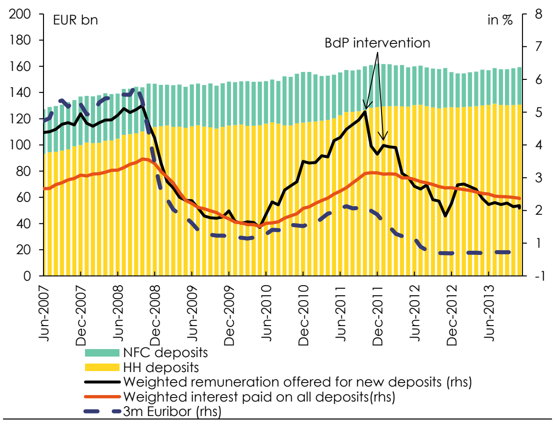
**19. The deposit base continues to show resilience.** During 2013, deposits held by the non-financial private sector increased by 2.5 percent (Graph 1.6) to EUR 159.4 billion, close to the all-time high at end-2011 (Graph 1.7). As deposit remuneration is declining faster than the interest rate on the average loan, the intermediation margin has mildly recovered in 2013 (Graph 1.8).

Graph 1.6: **Deposits grow again in all segments**



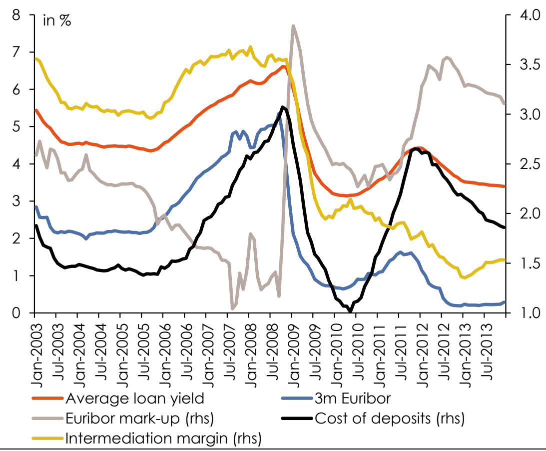

***Source:*** Bank of Portugal

Graph 1.7: **Lower deposit remuneration slowly brings down the cost of funding**




***Source:*** Bank of Portugal

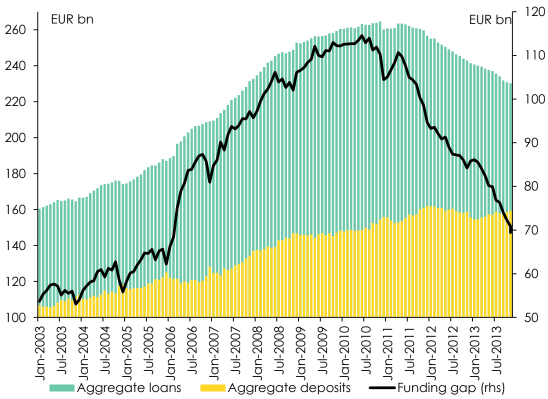
Graph 1.8: **The intermediation margin recovers mildly**




***Source:*** Bank of Portugal

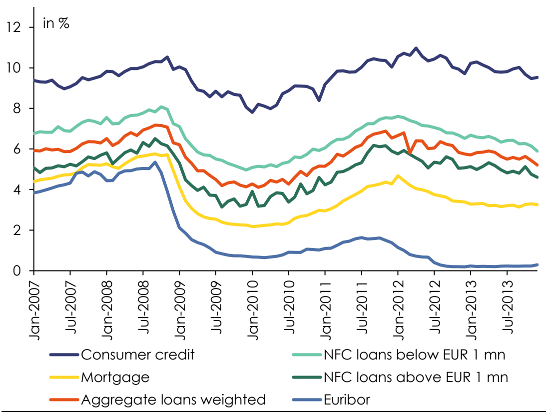
**20. The funding gap rapidly shrinks.** The decrease in the stock of bank credit extended to the private sector, in particular to non-financial corporations and mortgages, combined with stable or even slightly growing deposit base led to a rapidly shrinking funding gap which now amounts to less than EUR 70 billion, as low as at the beginning of 2006 (Graph 1.9). The loan-to-deposit ratio continued to fall throughout 2013 and a further decline is expected for most banks in 2014 and 2015.

Graph 1.9: **Rapidly shrinking funding gap**




***Source:*** Bank of Portugal

Graph 1.10: **Interest rate for new loans, evolution per segment**

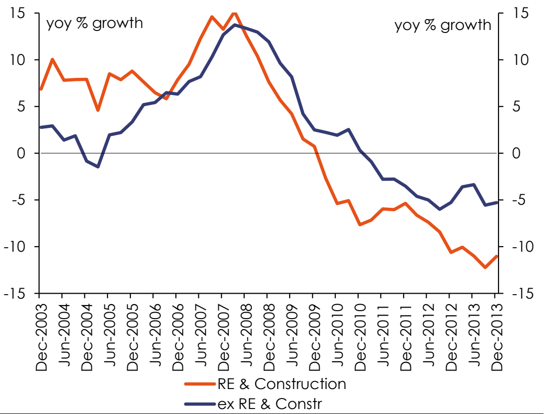



***Source:*** Bank of Portugal

**21. New corporate loans from domestic banks increased by 12 percent during the last quarter of 2013.** Amid rising demand for corporate loans banks have been competing more aggressively for clients. On an annual basis, new production of corporate loans increased by 7.7

percent in 2013. This expansion was driven by new loans above EUR 1 million (17.1 percent y/y rise) whereas new loans below EUR 1 million decreased y/y by 4.8 percent. Through 2013 the average interest rate for new loans above EUR 1 million fell by 47 basis points while for smaller loans it dropped by 63 basis points (Graph 1.10).

Graph 1.11: **Annual corporate loan stock growth per loan segment**




***Source:*** Bank of Portugal

**22. Despite new lending picking up, corporate loan stocks continue to decrease given the ongoing deleveraging process.** Aggregated net indebtedness of the corporate sector decreased by 1 percent in 2013. Disparities in the speed of deleveraging of the corporate sector persist. The outstanding bank loans to state-owned enterprises went up by 5.7 percent through 2013 whereas their exposure to debt securities fell by 3.5 percent. Privately-owned companies decreased their financing through bank lending by 2 percent and increased their financing through debt securities by 3.8 percent. However, the aggregate figure masks very different developments per corporate size. Micro-companies' bank loans retracted by 4 percent over 2013, small firms saw their loans fall by 6.2 percent, medium-sized by 0.8 percent and large companies increased their bank lending by 3.7 percent. Only the largest firms issued substantial amounts of debt securities increasing their stock by 7.4 percent last year. Their total indebtedness went up by 5 percent. These developments reflect the adjustment of the Portuguese economy. In the pre-crisis years, almost one third of bank loans was directed to real estate and construction companies, where SMEs are predominant, but this share has fallen to less than one quarter by 2013. As the Portuguese economy reorients towards the tradable sector, the real estate related firms are deleveraging twice as rapidly as the rest of the economy (Graph 1.11), thus pointing to an adjustment favourable to a more sustainable economic growth model.

**23. Interest rates on bank loans to non-financial corporations eased somewhat, but remain significantly above the rates charged to many of their euro-area competitors.** On average, in January 2014, resident banks charged 6.18 percent on new loans to SMEs (loans below EUR 1 million), which is 50 basis points below the average rate one year ago. Larger firms were paying on average 4.89 percent for new loans (above EUR 1 million), 24 basis points less than in January 2013. Moreover, there is considerable price segmentation between companies according to their risk profile and geographical focus. Exporting SMEs with good credit risk assessment are being offered considerably better credit conditions - both in terms of spreads and tenors - than companies focused on the domestic market and in sectors with generally higher credit risk indicators (e.g. construction and real estate sectors). Despite the slight improvements recorded, Portuguese firms continue to pay, on average, almost twice the interest rates charged to their euro area competitors, thus putting them at a considerable disadvantage within the single market.

**24. New household mortgages increased by 11.8 percent q-o-q in the last quarter of 2013, but the outstanding stock of mortgages continues to fall.** For the entire year, new mortgages went up by 5.9 percent when compared with 2012, but the annual new production remained only a small fraction of 2007 levels. Since 2011, the production of new mortgages has fallen very significantly, which is partially attributable to the substantial widening of spreads on mortgage loans (Graph 1.10). Housing interest rates spreads to Euribor remained stable at 300 basis points throughout 2013. The excess of reimbursements over newly granted mortgages led to a decline of the total stock of mortgage loans by EUR 5.9 billion or 3.6 percent in 2013.

Table 1.5: **Soundness indicators**

| % | 2009Q4 | 2010Q1 | 2010Q2 | 2010Q3 | 2010Q4 | 2011Q1 | 2011Q2 | 2011Q3 | 2011Q4 | 2012Q1 | 2012Q2 | 2012Q3 | 2012Q4 | 2013Q1 | 2013Q2 | 2013Q3 | 2013Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Return on Equity (1) | 6.0 | 8.2 | 7.6 | 7.1 | 6.8 | 6.3 | 4.5 | 2.5 | -3.8 | 6.3 | 0.9 | -0.3 | -4.1 | -3.8 | -7.1 | -6.7 | -10.3 |
| Gross Income on Assets | 2.8 | 2.5 | 2.6 | 2.6 | 2.6 | 2.4 | 2.5 | 2.5 | 2.5 | 2.6 | 2.7 | 2.6 | 2.5 | 2.1 | 2.1 | 2.1 | 2.1 |
| Cost to Income Ratio | 56.8 | 57.5 | 57.1 | 57.2 | 57.6 | 59.2 | 58.3 | 59.0 | 61.5 | 56.2 | 53.0 | 56.5 | 58.8 | 67.1 | 68.8 | 69.7 | 71.5 |
| Non-Performing Loans | 5.1 | 5.4 | 5.4 | 5.8 | 5.2 | 5.5 | 6.4 | 7.3 | 7.7 | 8.3 | 9.5 | 9.8 | 9.7 | 10.3 | 10.4 | 11.1 | 10.6 |
| Coverage Ratio | 65.1 | 63.2 | 62.9 | 60.8 | 61.5 | 60.7 | 55.7 | 52.7 | 54.6 | 51.6 | 49.6 | 50.5 | 54.3 | 53.9 | 53.9 | 52.9 | 56.4 |
| Capital Adequacy Ratio (2) | 11.6 | 11.3 | 10.9 | 11.0 | 11.1 | 11.4 | 11.0 | 10.2 | 10.7 | 10.7 | 12.3 | 12.3 | 12.6 | 13.0 | 13.1 | 13.4 | 13.3 |
| Core Tier 1 Ratio (3) | 7.9 | 7.8 | 7.8 | 8.0 | 8.1 | 8.4 | 8.7 | 8.5 | 9.6 | 9.6 | 11.2 | 11.3 | 11.5 | 11.9 | 11.9 | 12.2 | 12.3 |
| Loan-to-deposit ratio | 161.5 | 163.0 | 166.6 | 158.4 | 157.8 | 156.7 | 149.7 | 146.2 | 140.2 | 136.9 | 136.4 | 133.3 | 127.9 | 124.0 | 122.6 | 120.8 | 117.0 |

(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

25. **The aggregated profitability of the banking system was very weak in 2013.** The top eight banks operating in Portugal posted an aggregated loss of EUR 1.9 billion (following a EUR 1.2 billion loss in 2012) reflecting the strains under which the sector operated in 2013. Similarly to results in 2012, the performance of the biggest lenders was mixed with most of the top eight banks posting negative results for the full year. Net income loss was predominantly driven by lower gross operating profit, while impairments also remained high at 6 percent of total gross loans. Net interest income (NII) in 2013 was down by 22 percent for the top eight banking groups. Nonetheless, the intra-annual profile of NII showed a positive trend throughout 2013, pointing to a recovery in 2014. Asset quality continued to worsen in 2013, with aggregated NPLs increasing by almost EUR 1 billion, mostly in the corporate segment. However, the pace of increase in NPLs showed signs of a slowdown, raising hopes for a gradual improvement in credit risk in 2014. Banks' capital levels increased in 2013, continuing the positive trend started two years ago (Table 1.5). Although the economic environment will remain challenging and some key banks are on a tight schedule to repay the CoCos to the State, sentiment toward Portuguese banks has improved as highlighted by the positive market performance of Portuguese banks ' shares in the fourth quarter of 2013, which extended into the first months of 2014, and the tightening of Portuguese banks' bonds spreads in the credit markets.

26. **Solvency levels were broadly adequate, but organic capital generation capacity will remain a challenge.** The ongoing deleveraging and the adjustment in banks' business models will take time before being reflected in the banks' results. In 2013, banks mostly relied on reducing their risk-weighted asset (RWA) base to improve capital ratios. Almost all the biggest lenders managed to improve their solvency levels. The new capital benchmark ratio (7 percent CET1) is being successfully phased in with the top eight banks comfortably meeting the Basel III capital requirements. The banks that received State Aid in 2012 and 2013 plan to make repayments in 2014 following the schedule imposed by the restructuring plans. Portuguese banks retain a substantial stock of deferred tax assets (DTA), which were mostly generated through impairments over the past three years and the partial transfer of bank pension funds to the national social security system in 2011. The new CRD IV rules related to the deduction of DTAs envisage a phasing-in period for these DTAs starting from 2014. The Portuguese authorities are currently considering how to implement the treatment of DTAs.

# 2. PROGRAMME IMPLEMENTATION

## FISCAL POLICY

*Fiscal consolidation in 2014*

**27. The carry-over from the better-than-expected execution of the 2013 Budget and the brighter macro-economic outlook for 2014 are estimated to improve the baseline for the 2014 fiscal accounts by around 0.7 percent of GDP.** The authorities estimate that 0.2 percent of GDP of the tax over-performance in 2013 will carry over into 2014. In addition, the impact of the improved macro-economic outlook for 2014 on tax revenues and on the social security budget is estimated at 0.5 percent of GDP.

Table 2.1: **Fiscal targets and structural adjustment 2012-2015**

| | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|
| Deficit - Programme purposes (1) | -6.0 | -4.5 | -4.0 | -2.5 |
| Budget deficit, net of one-offs | -5.8 | -5.3 | -4.0 | -2.5 |
| Structural balance | -4.1 | -3.1 | -2.6 | -1.7 |
| Primary balance | -2.1 | -0.7 | 0.3 | 1.9 |
| Structural primary balance | 0.3 | 1.2 | 1.8 | 2.7 |
| Fiscal adjustment | 2.6 | 0.9 | 0.6 | 0.9 |
| Fiscal effort (EDP definition) | 2.3 | 1.0 | 0.5 | 0.9 |

Fiscal adjustment measures 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 excludes 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

**28. The Government remains committed to implementing measures totalling 2.3 percent of GDP to achieve the 4 percent of GDP deficit target and arrest the accumulation of new arrears.** Permanent measures account for close to 2.2 percent of GDP, most of which are on the expenditure side; the remaining 0.1 percent of GDP comes from one-offs. The improvement in the baseline projections will make the risks around the target more balanced. These risks stem from a potentially lower yield of some of the consolidation measures in 2014 (see below), legal challenges to some of the consolidation measures as well as newly identified budgetary pressures. Pressures are expected in particular to arise for some revenue items (e.g. property income) as well as for intermediate consumption and social transfers.

**29. Most of the permanent consolidation measures have been adopted via the State Budget 2014, a Supplementary Budget and other supporting legislation and have entered into force as of 1 January 2014.** The fiscal adjustment is predominantly based on the savings measures identified in the framework of the public expenditure review (PER), which are complemented by smaller-scale revenue-increasing measures. The PER package, which aims at increasing equity and efficiency in the provision of public services, is estimated to encompass consolidation measures worth EUR 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 by, inter alia, reducing over-employment in specific sub-sectors, while increasing the relative weight of highly-skilled and better-trained civil servants in the public-sector workforce, and a revision of the wage scale; (2) pension reform, notably by increasing the retirement age to 66 years and introducing changes to the conditions for granting survivors' pensions; and (3) sector-specific reforms mainly streamlining personnel costs, intermediate consumption and investment across expenditure programmes and line ministries. In the education sector, the rationalisation of the school network and a convergence of the teacher/pupil ratio towards levels of other EU countries will support these goals. Hospital reform and cost optimisation contributes to savings in the health sector. Beyond the PER package, the most significant items among the revenue-increasing measures are the increase in the corporate tax rate on expenses related to company cars, higher excises for tobacco and alcohol and a special levy on energy operators imposed to boost revenues with the additional effect of curbing excessive rents in the energy sector. Part of the revenue generated by this levy shall be used to reduce the tariff debt in the energy sector. Finally, a number of one-off measures are also planned to contribute to the achievement of the deficit target (about 0.2 percent of GDP), more than offsetting the one-off costs related to the mutual agreement termination of public-sector employment contracts (about 0.1 percent of GDP).

**30. Some measures have suffered setbacks and/or delays in implementation and risk yielding less than initially expected.** The pension provisions overturned by the Constitutional Court on 19 December 2013 were replaced by the

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

| (+) means balance-improving impact; (-) means balance-reducing impact | % of GDP |
|---|---|
| **2011 balance (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 | 0.1 |
| Dissipation of one-offs and non-recurrent effects from previous year | 0.6 |
| Consolidation measures | 4.0 |
| Reistatement of the 13th and 14th salary and pension | -1.5 |
| One-off measures | 0.3 |
| *of which Bank recapitalisation* | *-0.4* |
| **2013 balance (target) (1)** | **-4.5** |
| **p.m. 2013 balance (without one-offs)** | **-4.8** |
| Primary balance drift in 2014 | -1.0 |
| Change in interest expenditure | -0.1 |
| Dissipation of one-offs and non-recurrent effects from previous year | -0.3 |
| Consolidation measures | 2.2 |
| One-off measures | 0.1 |
| **2014 balance (target)** | **-4.0** |
| **p.m. 2014 balance (without one-offs)** | **-4.0** |

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 excludes 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

increase in beneficiaries' contributions to the public sector's health insurance schemes (ADSE, SAD, ADM) and the redesigned progressive extraordinary solidarity contribution on pensions (CES). The redesigned CES has been implemented via a Supplementary Budget which entered into force on 15 March. The increase in beneficiaries' contributions to ADSE / SAD / ADM has suffered some further delay due to the rejection of the decree law by the President. The conversion into law of the proposal will delay its implementation and somewhat reduce the savings initially expected in 2014. The full implementation of the requalification scheme is also lagging somewhat behind schedule and the mutual agreement termination schemes, which had attracted around 4,000 employees up to February, are below initial targets. Going forward, and to attain the employment reduction targets, the Government has extended the scheme for teachers and considers the launching of new voluntary termination programmes, depending on the results achieved from ongoing schemes and the best possible articulation with the requalification programme. Beyond the changes to the survivors' pensions that entered into force as of 1 January 2014, 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. The framework law for online gambling will be sent to the Council of Ministers for approval by April 2014; the final design of this measure might yield less revenue to the budget than initially expected.

**31. While risks to the achievement of the 2014 deficit target have become more balanced, negative risks are still important.** Beyond the already discussed potential shortfalls for some of the measures, due in particular to delays, and some newly identified pressures, negative risks are first and foremost of a legal nature: some of the measures included in the Budget Law have been sent to the Constitutional Court (more specifically the wage scale revision and the changes to the survivors' pension entitlements as well as two further measures of lower yield). In addition, the redesigned CES, contained in the Supplementary Budget, has also be contested on constitutional grounds. Other important risks relate to the implementation of various planned consolidation measures. In particular, the ministerial expenditure savings have been introduced by expenditure ceilings for each line ministry. In light of significant slippages in the past, 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. In addition, implementation risks also concern some of the envisaged one-off measures as similar measures often suffered significant delays in the past. Moreover, Eurostat is still analysing whether relevant one-off transactions can be recorded as deficit-reducing.

**32. Any accumulation of new arrears will be fully offset by transfers from the General Government without jeopardising the fiscal deficit target.** The monitoring of arrears has been recently strengthened by creating a central unit in the Ministry of Finance, which reports to the Secretary of State for the Budget and coordinates actions to enforce the strict application of the Commitment Control Law. Furthermore, specific public entities with structural financial imbalances have been identified, including twelve SOE hospitals and the railroad company Comboios de Portugal. Strategic plans to underpin their financial sustainability and arrest the accumulation of new arrears in 2014 are currently being negotiated with all these SOEs and the corresponding contracts scheduled to be finalised in April 2014. In particular, the SOE hospitals outside the General Government, albeit improving their financial position, still show negative EBIDTA; if this situation is not corrected in the future, arrears are likely to emerge. The strategy to arrest the accumulation of arrears in SOE hospitals includes the consolidation measures that are currently being negotiated for their Strategic Plans, and it also envisages increased transfers from the State to some of these entities in 2014.

*Fiscal consolidation in 2015 and beyond*

**33. The Government is committed to achieving a General Government deficit of no more than 2.5 percent of GDP in 2015.** This consolidation target 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 1.8 percent of GDP to 2.7 percent of GDP (see Table 2.1). By mid-April and as a prior action for completion of the eleventh review, the Government has identified a package of consolidation measures of sufficient quantity and quality to achieve the 2015 deficit target (see below). The detailed plans will be reflected in the 2014 Fiscal Strategy Document, which will also specify detailed expenditure ceilings by line ministries. The Fiscal Strategy Document will be published by end-April 2014.

**34. The 2015 consolidation package includes measures in the following areas**:

- savings from further reorganisation and streamlining of state-owned enterprises (SOEs), including mergers and reductions in State transfers to transport SOEs through the granting of concessions of public service operations to private companies;

- savings from further expenditure cuts across line ministries, notably in the areas of internal security, environment, agriculture and education. The expenditure-reducing items are mostly focused on the restructuring of services and cost compression (e.g. reductions in the acquisition of goods and services and investment);

- savings from the rationalisation of ICT-related costs in the public administration. Following the approval of a Global Strategic Plan to rationalise and decrease ICT costs in the public administration in 2012, which contains 25 key measures, each ministry has developed a sectoral strategy to implement these measures. The government has presented the "bottom-up" estimates of the envisaged savings detailed by ministries accountable for the implementation of the plan;

- additional employment reductions which will be attained mainly by attrition (i.e. partial replacement of new retirees) and non-renewal of some contracts in areas with over-employment. This would allow for a continuation of the public employment reduction of about 2% per annum in line with the Programme target which was, however, substantially exceeded in previous years;

- savings from the reduction in contracted studies, consulting and other projects. By reducing these costs by 30% the government expects to return to the expenditure levels of the years 2012-2013 years for these items;

- small-scale revenue measures, namely the extension of the expanded Portuguese gambling framework (to online gambling) and the sale of a concession (Oceanário).

The planned savings will be translated into a reduction of the expenditure ceilings of the respective line ministries. In addition, the package includes the budgetary impact in 2015 of two consolidation measures already adopted in 2014 but which will take effect only later in the year. In particular the increased beneficiaries' contributions to the public sector's health systems (expected to enter into force in May 2014) and the mutual agreement terminations of teachers' contracts (a majority of which will take effect in September 2014).

**35. In order to reduce the arrears in the health sector a package of measures was presented for 2015, worth about 0.2% of GDP.** This aims at achieving a balanced budget of the public health sector (notably the SOE hospitals) and halting therefore the accumulation of new arrears in this sector. From 2014 onwards, in accordance with commitments made at the eleventh review, the Government will prevent the accumulation of any new arrears in this sector via continuous transfers from the general government budget. Meanwhile, the Government has also committed to eliminate the underlying deficit and the accumulation of such arrears on a structural basis via a mix of measures, mainly expenditure-reducing, defined in the strategic plans for hospitals currently under discussion and which are to be finalised by the twelfth review. The expenditure-reducing measures will include hospital reforms and devolution, as already legislated, centralisation of purchases and public procurement, accomplishment of the MoU goal of 1% of GDP in overall public spending on pharmaceutical products (ambulatory and hospital care) also for 2015, increased competition among providers and compulsory electronic prescriptions. As the expenditure reductions from these measures are expected to materialise only over time the Government will, in the interim, implement alternative measures - including via increased revenues in the health sector and health impacting industries - to reduce the budgetary cost of the arrears. The total measures, planned expenditure savings, including public subsystems, and alternative revenue measures to be implemented in 2015 are expected to allow for a reduction of the transfers from the general budget and thereby to have a positive impact on the 2015 budget balance of EUR 300 million. The health sector budget balance, the issue of arrears in the specific context of the 2015 Budget and also the specification of structural measures to prevent the accumulation of new arrears, will be discussed and finalised in close consultation with the EC, ECB and IMF in the context of the upcoming 12th Review of the Programme.

**36. The package of consolidation measures needs to be complemented by other permanent measures aimed at transforming transitory measures currently in place into structural reforms of more permanent nature so as to ensure the sustainability of the fiscal adjustment.** These mainly include the cuts in the compensation of public employees and the "extraordinary solidarity contribution" from pensions (CES). In particular, the Government envisages developing a single wage scale during 2014, which aims at the rationalisation and consistency of remuneration policy across all careers of the public sector and will be implemented in 2015. Furthermore, the single supplements scale, expected to be implemented during 2014, will have its full-year impact in 2015. In the area of pensions, a Pension Reform

Committee with the participation of specialists in constitutional law and actuarial analysis, as well as representatives of CGA and Social Security, has been assigned to develop new measures for the ongoing comprehensive pension reform. First steps of the reform include short-term measures further linking pension entitlements to demographic and economic criteria, while also respecting progressivity principles in line with the recent Constitutional Court ruling on the CGA convergence reform. The specific design of this reform is expected to be presented by the twelfth review, with a draft law to be submitted to Parliament in the first half of the year. Further pension measures will also be specified for discussion at the twelfth review. Finally, the recently increased retirement age will also effectively apply to pension requests introduced to CGA as of 2014.

**37. Going forward, the Government is committed to fulfilling the requirements of the Fiscal Compact of achieving the Medium-Term Objective, i.e. a structural deficit of 0.5 percent of GDP by 2017.** Details of the medium-term budgetary plans in compliance with the EU budgetary framework requirements will also be provided in the 2014 Fiscal Strategy Document. The medium-term fiscal strategy will build on further reforms outlined in the Proposal for the Reform of the State which aims at improving the efficiency of the public sector and the quality of its services. Areas to be addressed in such a strategy are the sustainability of social security system, the flexibilisation and requalification of the public sector workforce, the rationalisation of General Government entities as well as greater efficiency in health and education. Building on the first round of consultations with social partners, the Council of Ministers approved in March 2014 a document with draft proposals in different reform areas. Progress made with this agenda will be discussed at the 12th Review.

*Debt developments*

**38. The debt-to-GDP ratio is estimated to have reached 128.8 percent end-2013, 0.6 percentage points of GDP lower than expected at the time of the Tenth Review.** The downward revision is largely explained by the better-than-expected budget execution as well as the upward revision of nominal GDP; these were less than fully offset by the further accumulation of Central Government deposits. Debt is forecast to peak during the first half of this year and to gradually decline thereafter, with a projected debt ratio of 126.7 percent of GDP by end-2014. The decline 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. Net debt is projected to remain below 120 percent of GDP by end-2014. Under current long-term projections, the debt-to-GDP ratio is expected to fall below 100 percent in the second half of the next decade. Assuming further that the Medium Term Objective (MTO) of a structural deficit of 0.5 percent of GDP will be reached by 2017, the debt-to-GDP ratio would be on a steeper downward path, falling below 100 percent in the first half of the next decade.

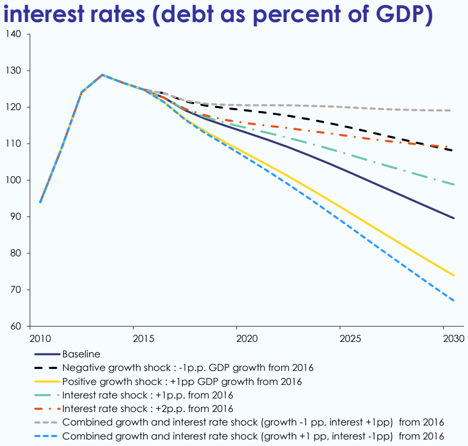
### *Box 2.1:* **Public Debt and Fiscal Sustainability in Portugal**

Under the Programme scenario, government debt is estimated to have reached 128.8 percent of GDP end-2013. Debt is expected to peak during the first half of 2014 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 2014 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. Sensitivity analyses suggest these findings to be relatively robust with respect to underlying assumptions; nevertheless, the debt path remains fragile to negative economic developments. 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.

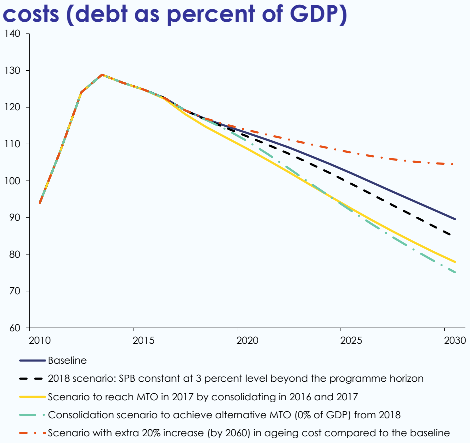
Graph I illustrates the sensitivity of the debt trajectory to macro-economic assumptions by considering a shock to real GDP growth and hikes in interest rates as from 2016. In line with the results of the last review, the analysis suggests that a lower GDP growth rate by one percentage point or a higher interest rate on maturing and new debt by two percentage points could significantly slow down the declining trend. Moreover, a combined growth and interest shock could put at risk the declining trend over the medium term. 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]) Combined with lower interest rates, the pace of the debt reduction could increase even further.

**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

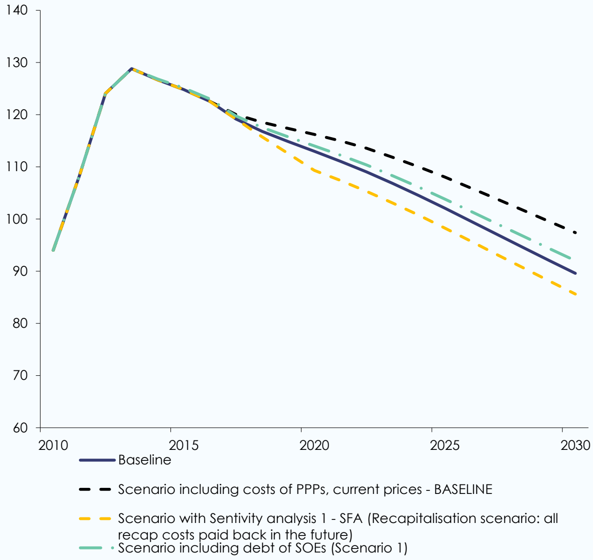
([1]) Not taking into account the positive indirect effects of the higher GDP growth on the fiscal balance.

*(Continued on the next page)*

*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 of GDP in 2017 as per Fiscal Compact requirements would require a cumulative fiscal effort of about 1.2 percent in 2016 and 2017 and reaching a primary surplus of 4.0 percent by 2017. Maintaining the MTO over the longer term horizon will require primary surpluses of over 4 percent up to 2022, 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 accelerate the debt reduction. 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.

## FISCAL STRUCTURAL REFORMS

*Fiscal policy framework*

**39. Further improvements in Public Financial Management (PFM) remain essential for ensuring sound fiscal policymaking.** In line with the recommendations of the IMF-led technical assistance missions, an accounting function will be created within the Ministry of Finance in order to improve the reporting and monitoring of fiscal cash flows of revenues, expenditures, assets and liabilities – all related to Government bank accounts, debt, and public-private partnerships. This function will also be responsible for the preparation of consolidated fiscal statements of the General Government and other public sector entities.

**40. A broad reform of the Budget Framework Law (BFL) is planned to be implemented by the end of 2014.** The BFL has been revised and submitted to Parliament end-March to ensure the full transposition of the Fiscal Compact and the six-pack regulations. Beyond these changes, a comprehensive reform of the BFL is currently under preparation. Having assessed strengths and weaknesses of the current law, the technical group responsible for the reform of the BFL presented several recommendations for new legislation at the end of 2013. These included, among others, streamlining the budget appropriation structure; reducing further budget fragmentation; strengthening accountability relations; and, last but not least, imparting a medium-term to long-term focus to public finances. Given the envisaged scope of the reform, it is crucial to ensure a broad-based support from all relevant stakeholders, which should be engaged in the reform process as early as possible. As a first step, the authorities have engaged to develop the key aspects and the structure of the new law by end-April 2014 and to complete the technical work by end-September. As part of these efforts, a "fiscal transparency evaluation" to be undertaken by the IMF by the end of the Programme will be made publicly available. Although still on track to deliver the broad reform of the BFL by end-2014, original plans have already suffered some delays and efforts need to be stepped up to respect the end-year objective.

**41. To address the accumulation of new arrears, the Government is taking additional steps.** A dedicated unit in charge of the expenditure arrears for the public sector has been recently appointed within the Ministry of Finance, tasked with an assessment of the Commitment Control law and full enforcement by the monitoring and oversight of arrears. The unit is to report monthly to the Secretary of State for the Budget on the stock of arrears and changes and coordinate actions taken to deal with the issue. This unit should collect monthly data, analyse any increases in arrears or evidence of problems, such as negative availability of funds and interact with the different relevant entities.

*Revenue administration*

**42. The new Risk Management Unit (RMU) is now operational and its capacity will be built up over time.** This represents a significant step forward in the implementation of a modern compliance risk management model with the aim of improving taxpayer compliance. The RMU is initially focusing on projects to develop and implement strategies to mitigate compliance risks concerning two important taxpayer segments: high-wealth individuals and self-employed professionals, in particular lawyers and doctors. The initial work has established clear indications that major under-reporting of income and substantial tax gaps exist for these taxpayer groups. Success in tackling the situation will require raising the level of voluntary compliance across these segments and conducting effective PIT audits by specialists. Building up a strong audit capacity in the tax administration for these and other situations is therefore a priority. Recruitment strategies to meet the targeted increase in the audit workforce (30 percent of total staff in the tax administration) are progressing albeit delayed with respect to the original Programme objective of attaining this threshold by end of 2012.

**43. The plan for closing 50 percent of local tax offices will be announced by the Twelfth Review.** The authorities are committed to identify and publish by the Twelfth Review the list of local tax offices that will be closed by end-May 2014. This reorganisation is part of the reform agenda of the revenue administration from the beginning of the Programme, but has suffered several delays due, inter alia, to the fact that it is being embedded in the overall framework of rationalisation of all public services provided at local level. 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). The closure plan should be based on a detailed study of staff numbers, workloads and productivity and reflect a longer-term vision to modernise the tax administration.

**44. Initiatives to fight tax fraud and evasion continue.** The e-invoicing system, which came into force at the beginning of 2013, is showing tentative signs of success in improving compliance management, but its effectiveness in increasing revenue collection across the different tax categories has not been evaluated yet. The scheme, which introduced tax incentives for consumers to request invoices in hard-to-tax sectors (such as restaurants and motor vehicle repair) has proven successful; this is demonstrated by the above-average growth in voluntary VAT collection in those sectors. The Government has recently introduced a new initiative, the VAT lottery, to incentivise consumers to ask for invoices and to prevent business from dodging sales tax.

**45. Further steps will be taken to strengthen the anti-money laundering (AML) legal and regulatory framework.** Notice nº 5/2013 of Banco de Portugal regulates the conditions, mechanisms and procedures needed for effective compliance of the financial institutions subject to the supervision of Banco de Portugal with the anti-money laundering and combating the financing of terrorism (CFT) obligations. Going forward, to tackle more effectively money laundering and its predicate crimes, including tax crimes, a multidisciplinary working group is carrying out a national AML/CFT risk assessment and will propose necessary amendments. Key areas of reforms to strengthen the exchange of information between the AML authorities and other competent authorities, such as the tax administration will be implemented by end 2014.

*Regional and local governments*

**46. Work towards the objective of improving budget management at local level is progressing.** A Financial Coordination Council, as envisaged in the Local Finance Law (LFL) approved last year and comprising representatives from the central and local administrations to exchange information needed for better budgetary planning, is expected to become operational by the end of April 2014. The LFL also envisages a Municipality Support Fund to provide assistance to municipalities in financial distress. Its funding, rules and procedures, on the basis of proposals by an experts group, are expected to be defined in a draft law to be submitted to Parliament by the end of April 2014.

*Public administration*

**47. The reduction of employment in public administration is exceeding the Programme target of 2 percent per year.** Employment in the public administration at the end of 2013 stood at 563,595 which is nearly 49,000 (8 percent) less than the level at the end of 2011. The reduction is strongest in the central administration (-8.6 percent), but is also above target at local level (-6.5 percent) and at regional level (Madeira: -4.8 percent, Azores: -4.5 percent). However, the target of the State budget 2013 to reduce the number of fixed-term contracts in the central administration by 50 percent was missed (reduction only by 11.2 percent). Employment in state-owned enterprises at central, regional and local levels together decreased by 10 percent from about 200,000 at the end of 2012 to about 180,000 at the end of 2013, resulting from both attrition and privatisation.

**48. In the context of the Public Expenditure Review, public employment continues to be reduced in a measured way.** About 2,500 employees adhered to the first programme for mutual agreement terminations for less qualified workers, and the schemes for teachers and senior technicians in areas with over-employment are ongoing. . Moreover, another scheme for low-skilled workers will be launched this year. The non-renewal of fixed-term contracts in targeted sectors will continue and also contribute to the further reduction of the workforce in areas with over-employment. Moreover, the new rules for the requalification programme, focusing on a re-orientation of public employees' careers, entered into force in December 2013 and are expected to become effective as of April 2014.

**49. Other significant reforms, which rationalise the public administration and underpin the consolidation strategy, have recently been implemented.** Among them, the new General Public Administration Labour Law, approved by the Parliament in March 2014 and expected to enter into force in June or July, simplifies and compiles the existing rules of public sector employment along the lines of the private labour code. Important subsets of this legislation are already in force (e.g. 40 hours working week), but it includes other elements such as the revision of the number of days of annual leave and the application of the bank of hours. The so-called "convergence law", which entered into force in March, aligns the rules for public sector pensions (CGA) with those in the general social security system. Among other modifications, it introduces an increase in the retirement age (from 65 to 66 years) via changes to the sustainability factor, changes the reference salary for pensions' calculation and its inflation index, and suspends the pensions for those pensioners who work for the State and could choose between the pension and the salary until now. The law has been modified compared to its initial version to eliminate the foreseen cuts for pensions in payment, which had been ruled unconstitutional by the Constitutional Court. Going forward, the Government is also committed to revising the remuneration policy by the development of single supplements and wage scales (expected to enter into force by end-June and end-of the year, respectively).

**50. The authorities completed the implementation of the strategy of shared services in the area of financial resources ('GeRFIP') in all structures to be covered by the initiative.** By January 2014, it was implemented in 351 entities, of which 270 are in the central administration, 44 are in the Azores and 37 are in Madeira. The completion of the strategy of shared services in the area of human resources (GeRHuP) and ICT is ongoing.

*SOEs, PPPs and privatisations*

**51. Despite the reinstatement of two bonus salaries, transport SOEs maintained operational balance in 2013.** Authorities are undertaking a comprehensive restructuring of SOEs by (i) optimisation of services, updating of tariffs (prices and system) and cost compression through significant personnel reduction since the beginning of the Programme; (ii) addressing high debt levels through the reduction of financial costs; and (iii) strengthening the balance sheet of SOEs inside the General Government perimeter by means of State loans and partial conversion of those loans into equity, as already foreseen in the 2014 Budget. Carris, Metro de Lisboa, Transtejo, STCP, Metro do Porto, CP and REFER managed to compensate for the reintroduction of the 13th and 14th monthly salaries also through additional cost compression and thus recorded again an overall positive operational balance in 2013 (measured by EBITDA adjusted for severance payments). The fact that passenger numbers increased over the last two quarters of the previous year is also reassuring. After a difficult year with strikes in the railway sector, CP Carga forecasts an improved social-labour environment until 2016. Authorities expect to bring the company into operational balance from 2015 onwards. In the same line, REFER's financial projections were disclosed and the commitment to reaching operational balance by 2015 was reaffirmed. Public service obligation (PSO) revenues are now expected to have a non-negligible two-fold increase between 2014 and 2015 for this purpose. The report regarding the wage scale review for a first set of companies is on track and expected by Q1-2014. Employment in SOEs at central, regional and local levels together declined from about 200,000 at end-2012 to about 180,000 at end-2013, resulting from both attrition and privatisation. Transport SOEs alone reduced its labour force by over 3,000 (-18.4 percent) between end-2010 and end-2013. Águas de Portugal (AdP), the water and sewerage company will use EGF privatisation's proceeds to reduce its debt and compensate for the decrease in assets due to the selling of EGF’s shares and subsequent deconsolidation of its balance sheet. AdP is also undergoing an important restructuring, including merging 19 into 4 different subsidiaries. With the exception of the southern system, the restructuring of the other three merged systems in the bulk management is expected to be finalised by end-June 2014.

**52. Privatisation efforts continue, even though the Programme target for proceeds has already been exceeded.** In a streamlining process to increase the capital base of its core banking arm, CGD (state-owned bank) sold 80 percent of Caixa Seguros for EUR 1 billion early this year, through

## *Box 2.2:* **Privatisation in the Context of the Adjustment Programme for Portugal**

*Programme objectives*

The objectives of the privatisation programme were specified in the context of the three pillars of the Economic Adjustment Programme for Portugal: fiscal consolidation, structural reforms and financial stability. Against the background of a relatively large number of companies owned by the State, either fully or partly, the Government considered that further privatisations would contribute to reducing the Government's financing needs, stimulating competition and attracting foreign capital. In the financial sector, the streamlining of the state-owned CGD group to increase the capital base of its core banking arm was also foreseen. In the area of structural reform, in order to foster competition the Government committed to eliminating 'golden shares' and all other special rights in State-owned enterprises (SOEs) and State participations (e.g. PT, EDP and REN). A target of EUR 5.5 billion for the proceeds from the sale of companies was set at the beginning of the Programme, [1] out of which EUR 5 billion were earmarked for retiring government debt.

*Implementation of the privatisation programme*

The target for the proceeds was reached in December 2012, about half-way into the Programme. By January 2014, the accumulated proceeds from privatisations amounted to about EUR 8.7 billion. Table I provides an overview of the most important privatisations over the Programme period.

### Table I: Major privatisations completed during the Programme

| COMPANY | EDP | REN | Caixa Saúde (HPP) | GALP | ANA | EDP (2) | PT Telecom | CTT | Caixa Seguros |
|---|---|---|---|---|---|---|---|---|---|
| SECTOR | Energy - Electricity & Gas | Energy - Electricity & Gas (grid manager) | Health (hospital services provider) | Oil & Gas (well-to-wheel) | Airports | Energy - Electricity & Gas | Telecommunications | Postal Services | Insurance |
| % EQUITY | 21.35% | 40% | 100% (CGD) | 1% (CGD) | 100% | 4.144% | 6.11% (CGD) | 68.5% | 85% (CGD) |
| WINNING BIDDER(S) | China Three Gorges (China) | State Grid (China) and Oman Oil Company (Oman) | AMIL (Brazilian company through a Luxembourg subsidiary) | Equity offering to qualified investors | Vinci (France; 99.98%) Workers (0.02%) | Equity offering to institutional investors | Equity offering to qualified investors | Retail (70% placed in the IPO and with institutional investors) | Fosun (Hong Kong listed company; 80-85%) Workers (0-5%) |
| DATE OF SALE | Dec-11 | Feb-12 | Nov-12 | Nov-12 | Dec-12 | Feb-13 | Oct-13 | Dec-13 | Jan-14 |
| SALE PROCEEDS (EUR) | 2,693 mn | 593 mn | 37 mn | 95.3 mn | 3,080 mn | 356.1 mn | 190.6 mn | 567 mn | 1,064 mn |
| Cumulative (EUR) | **2.7 bn** | **3.3 bn** | **3.3 bn** | **3.4 bn** | **6.5 bn** | **6.9 bn** | **7.0 bn** | **7.6 bn** | **8.7 bn** |
| ADDITIONAL FINANCING (EUR) | 2 bn | 1 bn | | | | | | | |
| INVESTMENT PLANS | EUR 2 bn (until 2015 in wind farms) | Strategic plan for national economy development (e.g. R&D centre for construction) | | | Respect concession contract investment plan; ANA as the centre for Vinci's airport activity worldwide | | | | |

The privatisation programme is coordinated by the Ministry of Finance in cooperation with the line Ministry responsible for the definition of the regulatory framework and the setting of the criteria and strategy for the appraisal of proposals. The SOE holding company (Parpública or CGD), advised by specialised financial and legal consultants, was in charge of structuring the procedures. In most cases, to raise market perspectives public or targeted consultations and international roadshows were made before the effective launch of the sale. Procedures chosen were initial public offering (CTT), equity offering (GALP, EDP(2) and PT Telecom), public tender (Caixa Saúde) and direct sale under a tender process (EDP, REN, ANA and Caixa Seguros).

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(1) The initial MoU listed the following companies for privatisation: transport – ANA, TAP and CP Carga; energy – GALP, EDP, and REN; communications – Correios de Portugal; insurance – Caixa Seguros. The gradual disposal of all non-core subsidiaries from the CGD group was also foreseen since the beginning. At the first Programme Review, the Government added RTP (television and radio stations) to the list.

(Continued on the next page)

*Box (continued)*

The Government has adapted the privatisation programme flexibly in accordance with the revised assessment of circumstances and in several cases making the timing of the sale dependent on improved market conditions. In particular, the privatisation process of the national air carrier TAP was suspended due to inadequate financial assurances by the single bidder back in December 2012. While waiting for better market perspectives to re-launch the privatisation the company strives to improve its financial results. For Águas de Portugal (AdP), instead of selling the company as a whole it was agreed to first restructure the water and waste branches before selling the waste management holding (EGF) and considering opening up water activities to private capital and management. The regulatory changes in these sectors and the on-going restructuring in the water branch are expected to increase operational efficiency and bring about investment rationalisation in these capital-intensive sectors, ensuring the full cost recovery of the services rendered, the application of the polluter-pays principle and the sustainable management of natural resources, in line with EU directives. The planned partial sale of RTP, the public broadcasting corporation, gave way to the sale or concession of a television channel and radio station belonging to RTP, subject to the company’s ongoing restructuring process and an improvement of market conditions. Private concessions for the Lisbon and Porto passenger transportation services were made subject to the restructuring of these SOEs. Although envisaged since the beginning, the sale of real estate assets has never moved to the top of the Government's agenda in view of the prevailing bearishness of the market.

*The pros and cons of privatisation*

There are often concerns that following a privatisation the State might lose control over services of general economic interest or that there will be a lack of competition as SOEs in network industries tend to have an intrinsic monopolistic position. However, these risks can be addressed by revising the sector's regulatory framework and strengthening the institutional capacity of the regulatory authorities to deal with a higher level of private participation in the sector. This was one of the reasons behind the Government's initiative to adopt a framework law for the national regulatory authorities (NRAs) and amend the NRAs' bylaws to ensure independence and the means to effectively act upon market distortions as needed. The regulatory framework of several sectors had been revised significantly ahead of the privatisations to ensure competition, define the scope of concessions, adjust their timeframes, introduce efficiency-driven incentive schemes and design medium to long-term strategic plans to bring certainty to sales either in terms of future investment requirements or public service obligations and operational standards (e.g. on airports; postal services; fixed telecommunications; waste and water management; passenger transportation services; freight railway operation – CP Carga unbundling required before the privatisation).

On the benefit side, the privatisation programme has to be judged against the objectives of maximising the proceeds from the sales, reducing budgetary risks and contingent liabilities and improving business perspectives in the sector and in the economy at large. The assessment on this score provides an overall favourable picture:

1. Privatisation proceeds have significantly exceeded the Programme target despite the difficult crisis environment. The revenue from the sale of the stakes in EDP and REN was 54 percent and 34 percent above the pre-transaction share prices. The airport concession ANA was sold with an implicit valuation of

*(Continued on the next page)*

*Box (continued)*

16 times EBITDA, ([2]) a record in recent airport transactions. Caixa Seguros was the largest ever acquisition of a European financial institution by a privately owned Chinese company. The geographic dispersion of investors (largely non-EU) demonstrates the capacity to attract foreign investors who are interested in Portugal's advantages in terms of technology and gaining access to the EU and other foreign markets, particularly Portuguese-speaking countries worldwide.

2. A reduction of budget risks and contingent liabilities was achieved through important rationalisation efforts made in the SOEs ahead of their sale. In particular, since 2011 substantial progress has been made in improving the operational balance of the transport SOEs in Lisbon and Porto which is a precondition for launching private concessions for these services in the near future. ([3])

3. Business perspectives improved due to efficiency gains achieved in the run-up to the sales as well as in the post-privatisation period, an increased financing and investment capacity, broader market perspectives and a more flexible human resources management. It can also be assumed that the privatisations produced spill-over effects in terms of promoting Portugal as an attractive destination for FDI. Moreover, a higher level of competition and a strengthened regulatory framework in strategic sectors can be expected to improve the competitiveness of the economy as a whole (see also Box 2.5).

*Conclusions*

The privatisation programme in the context of the Economic Adjustment Programme can be deemed successful. Attracting FDI in a time where companies have difficulties to finance new investment was a major achievement. The target in terms of proceeds was exceeded by over 50 percent. Several SOEs improved their financial results ahead of the privatisation, thus reducing risks for the state budget. Higher efficiency gains, more competition and better price-quality ratios of the privatised companies induced positive spill-overs for the whole economy and ensured a better protection of consumer interests. In the process, the regulatory framework has been improved and the economic reform agenda strengthened. The privatisation programme is set to continue beyond the end of the Economic Adjustment Programme and includes remaining stakes in REN and CTT, EGF, TAP, CP Carga, Lisbon and Porto transport service concessions and sub-urban railway lines.

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([2]) Amongst other methods, the multiple of EBITDA – earnings before interest, tax depreciation and amortisation – is used to assess the value of a company in comparison to its annual cash flow. A simplified interpretation of a 16 times EBITDA transaction is that with the cash flow the company produces it will take 16 years to return the money invested by the buyer. The higher the EBITDA multiple the higher are the growth prospects of the company in the eyes of the buyer. It can be assumed that the high multiple of EBITDA for the sale of ANA reflects the buyers assessment of the potential market growth of the business integrated in their own corporate growth strategy. The privatisation thus allowed the State to capture some of the potential growth in the value of the company which would not have been possible otherwise while at the same time retaining the option of regaining control of the company after the expiry of the contract.

([3]) From end-2010 to end-2013 commercial revenues in the transport SOEs increased by 11.6 percent and operational expenditure (excluding severance payments) was reduced by 21.0 percent namely due to a dismissal plan that reduced the work force by over 3,000 (-18.4 percent) in the same period.

an international tender won by Fosun, a Chinese conglomerate listed on the Hong Kong stock exchange. The privatisation of the waste management company EGF was launched on 30 January 2014. Furthermore, several major changes in the waste (and water) services' regulatory framework reinforcing the institutional capacity to better protect consumers' interests and to fine-tune the privatisation model were enacted, including (i) the ERSAR's bylaws (sector regulator authority) approved on the 24th January by the Parliament; (ii) a detailed invoice law approved in the same date; (iii) tariff regulation approved in February; and (iv) the strategic plan for the sector (PERSU 2020), which is under public consultation and expected to be approved by end-March. EGF's 11 concessions will be revised so as to terminate them all by 2034. The public tender also includes a tag-along option for the minority shareholders of EGF's subsidiaries – municipalities. Binding offers are to be submitted before the end of the first semester. Limited progress in unbundling the rail freight terminals and in defining the railway investment plans is delaying the privatisation of CP Carga. The privatisation of TAP is still under consideration, although without concrete deadlines and dependent on market conditions. Both CP Carga and TAP are using the delays in their 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. The prospective concessionaires shall start operations by the 1 January 2015. Transtejo/Soflusa will first have their management merged with Carris and Metro de Lisboa before following the same path defined for the other two Lisbon passenger services. It is envisaged that this process will be ready by the 12th Review and will be fully implemented by end-2014. Opening up to private capital and management is also being considered for other suburban railway services.

**53. Savings from the renegotiations of several PPPs will continue to materialise in 2014.** The renegotiation of the road PPPs' ex-SCUTs+2 package is progressing and savings already materialised in 2013. Lending banks reported progress in their due diligence analysis and positive feedback for two of the major concessionaires is expected by the 12th Review. The banks' waivers for the other two concessionaires are expected to go smoothly, profiting from the learning curve of the first two. The road PPPs sub-concessions' package are already accounting for EUR 70 million savings in 2014 due to the reduction of scope agreed upon back in 2012. The reduction of scope was possible because projects were still in the construction phase and allowed for significant savings (EUR 4.9 billion over the lifecycle), which implied significant reductions in potential gains for the construction companies involved (construction companies are usually the concessionaires' major shareholders) since day one. Nevertheless, building on lessons learned with banks throughout the ex-SCUTs+2 renegotiation, the second stage of renegotiations will continue throughout the year and is expected to deliver additional savings already in 2014. Those savings will derive from a lower internal rate of return for shareholders and a reduction of major repairs' obligations and operational requirements. A renegotiation committee for the emergency and security sector PPP (SIRESP) was appointed. A technical audit of SIRESP was awarded to an independent company in order to evaluate the performance of the system which will provide information for making decisions in a cost-benefit basis. The outcome of this technical audit is therefore expected to contribute to the renegotiation process that is expected to be concluded by the end of 2014. Both HLO (Hospital Lisboa Oriental) and CMFRS (physical medical rehabilitation centre for the South) are being appraised under the PPPs' framework law to define whether they should be implemented as PPPs or any other different approach should be envisaged namely traditional public tendering. These processes will finish by end-2014/beginning-2015 and only then public tenders will be launched.

*Healthcare sector*

**54. Reforms have produced important savings in the sector through increases in efficiency and combating fraud.** Expenditure of the National Health Sector (NHS) in 2013 was about15 percent lower than in 2010 (about EUR 1.3 billion). All cost categories including overtime payments show a consistent reduction. The only exception is regular staff remuneration which following an important reduction has increased again after the reinstatement of the 13th and 14th bonus salaries. In a context of reduced revenues - overall NHS revenues saw an important decline (about 9 percent for the same period) and budget transfers were reduced by 11 percent - the consolidated deficit for the sector (Central Government and SOE hospitals together) shows a significant reduction from about EUR 800 million in 2010 to about EUR 126 million in 2013.

**55. An important stock of arrears has been paid through debt settlement programmes (about EUR 1.9 billion) but arrears have not been fully eliminated (about 500 million remain to be paid).** A large share of the arrears appears to be concentrated in a few large hospitals, where financing was consistently below the actual needs over the years. The current fiscal situation and the reduction in State transfers have not provided the fiscal space for the payment of the remaining arrears. The budgetary cuts for 2014 and the reinstatement of the two bonus salaries make it more difficult to reduce the stock of arrears and risks of a renewed increase exist in the short term. Additional financing for 2014 is therefore being considered to avoid the build-up of new arrears. In 2015, efforts will have to be made to generate sufficient efficiency gains through the proposed hospital reforms.

**56. The authorities continue the fine-tuning of policy measures regarding pharmaceuticals.** These measures have led to savings of about EUR 600 million in the outpatient sector since 2010. However, in 2013 savings were lower than expected. Savings on public spending on hospital pharmaceuticals have been slower to materialise, in part because hospital medicines comprise many expensive products for which generic alternatives do not exist. Negotiations and audits of payback agreements for 2012 and 2013 are still ongoing in order to achieve the MoU targets (1.25 percent and 1 percent of GDP respectively). If negotiations prove insufficient to achieve these targets additional measures must be undertaken.

**57. Regarding compulsory INN (active substance) prescription, the observed increase in the use of exemptions is a source of concern.** In 2013, exemptions amounted to some 8 percent of all prescriptions. Moreover, the share of generics which now stands at 45 percent (in terms of units) is increasing more slowly than planned. Therefore, a number of inspections have been conducted comparing prescription and dispensing behaviour of doctors and pharmacies. The authorities are also carrying out a more detailed analysis by therapeutic group. As a result of this analysis, the authorities are considering additional measures incentivising patients, doctors and pharmacies to induce a greater use of outpatient generic medicines and thus come closer to the targeted share of generic medicines of 60 percent in 2014. Reinforcing centralised purchasing and the implementation of the national formulary are important tools to lower the price of medicines.

**58. Steps to improve the billing and collection process for moderating fees (co-payments) and fees charged to cross-border/foreign patients continue.** The authorities have set a goal of collecting 90 percent of these fees. Between 2010 and 2013, revenues from moderating fees increased from EUR 72.5 million to EUR 177.7 million. In 2013, the increase in revenues from moderating fees, insurance companies and foreign patients was below the authorities' expectations as they stabilised vis-à-vis 2012. This reflects several factors including the large number of exempted patients as a result of the economic crisis but also the fact that 2012 was exceptional in terms of collecting revenues from foreign patients and late payments.

**59. With regard to primary care, the number of patients without a family doctor has fallen from 16.7 percent to 11.4 percent following the update of patient registries and the creation of a national registry.** To further reduce the number of citizens without a family doctor, due notably to the uneven distribution of family doctors across the country, the authorities are considering a number of policy options such as the creation of smaller USFs (Unidades de Saúde Familiares) and/or increasing the ratio patients/GP (from 1,500 to 1,900) in USFs. This has already been done for the traditional primary health centres (Centros de Saúde). The ACSS (Administração Central do Sistema de Saúde) has decided to include primary care centres in its benchmarking exercise by May 2014. A satisfaction survey is also planned. The authorities continue to extend the system of electronic medical records to a wider population.

**60. The centralised procurement of medical supplies and services is progressing well.** About 30 procedures were completed in 2013 in addition to the 30 in 2012 and savings have been considerable. This is important, as it contributes to reducing hospital operating costs at a time of constrained revenues and is expected to play an important role in reducing expenditure in 2014. The authorities are considering the establishment of an observatory for prices and acquisitions to help hospitals in purchasing medicines and medical devices. The coding system for medical devices continues to be developed and now covers around 70 percent of the value of NHS expenditure in medical devices. The procurement Agency (SPMS) has started cooperating with similar agencies in other countries in order to exchange information on best practices in the area of purchasing procedures.

**61. The authorities reconfirmed their commitment to continuing the hospital reform with a view to increasing the efficiency in the sector.** The 3-year strategic plans are in the process of being finalised and are expected to be agreed with all hospitals by end-April 2014. This is expected to deliver important cost reductions (estimated at about EUR 230 million) as a result of a further merging, restructuring, closing or redistribution of departments and the consequent reallocation of staff and reduction in acute care beds, and of lower prices of medical devices and a more efficient use of pharmaceuticals.

## FINANCIAL SECTOR

**62. Portuguese firms remain significantly over-leveraged.** The outstanding debt of non-financial corporations (NFCs) in the private sector amounted to 184 percent of GDP by end-2013. The ratio of NPLs among NFCs reached 13.3 percent of total in 2013 ([5]) while the amount of restructured corporate loans reached EUR 11 billion for the eight biggest banks altogether, i.e. 11.4 percent of gross credit in Q3-2013. The financial leverage of Portuguese firms ([6]) increased from 46 percent in 2007 to 58 percent in Q3-2013 (and from 60 percent to 83 percent in the case of SOEs). Meanwhile, the interest coverage ratio (ICR) for the same firms has been declining between 2010 and 2012, with more than 40 percent of the companies displaying an ICR below 1.

**63. A strategic plan to address the high corporate debt overhang is under preparation.** The authorities are committed to further developing the implementation of the framework for the restructuring of corporate debt. The current framework does not offer sufficient possibilities to recover viable firms and to provide finance to companies undergoing restructuring. Further measures need to be taken to encourage the use of existing in and out-of court debt restructuring procedures at a stage where a company can still be recovered. Thus, further incentives need to be provided for timely action by the companies and technical filters need to be introduced for the admission of viable companies to the debt restructuring procedures. BdP is working on early-warning indicators, which will contribute to detecting weak financial situations of companies at an early stage. With regard to non-viable firms, supervisory action will continue in speed up the recognition of losses by banks, while preserving financial stability. The importance of the deleveraging efforts to unleash the economic growth potential of Portugal will also require a reconsideration of the role of institutions within the debt restructuring procedures as part of a comprehensive strategic plan to be developed by the authorities. The latter will be discussed at the Twelfth Review.

**64. The first set of enhancements to the national Central Credit Registry (CCR) was implemented.** After updating the CCR's IT systems in 2013, the first report comprising new datasets was issued in January and is presently being evaluated regarding its quality. The CCR's database was enriched with granular information on loan maturity brackets, loans classified as non-performing and loans restructured due to borrower's financial difficulties. Additional data will be made available from July 2014 and will comprise a further breakdown at the level of the loan status - enabling the identification of overdue and written-off loans disputed in court - and the type of collateral used to secure the loan such as financial assets or financial guarantees. Some further enhancements to the CCR are planned, mainly the enlargement of the set of financial products that are reported through the CCR (covering commercial paper, the full set of credit commitments and factoring operations) and the broadening of access to the registry. These however require the revision of the current CCR legal framework and the backing of the Portuguese Data Protection Authority. The BdP's proposal for revising the framework was finalised and sent to the Ministry of Finance for consideration and publication.

([5]) Banking sector consolidated statistics display an even higher figure.
([6]) Measured by Remunerated Financing/ (Remunerated Financing + Equity).

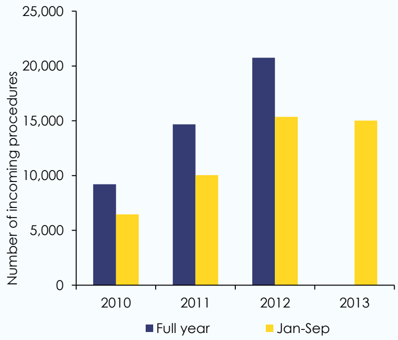
### *Box 2.3:* **Corporate Debt Restructuring in Portugal – The Way Forward**

The Portuguese authorities are developing a strategic plan aiming at addressing the corporate sector debt overhang. Given the risks to medium and long term growth prospects associated with the high level of private sector indebtedness, a well-functioning corporate debt restructuring framework is a key tool to cope with the challenge of deleveraging, especially in a context of low inflation

Portuguese firms are facing important challenges in view of their high level of indebtedness. According to Banco de Portugal (BdP), privately-owned Non-Financial Corporations' (NFCs) outstanding debt was 184% of GDP at end-2013. The NPL ratio of NFCs on gross credit was 16.1% at end-2013 and for the eight largest banks the NPL ratio of NFCs increased from 5.7% in 2010 to 16.5% in 2013. The amount of restructured corporate loans of the eight largest banks was EUR 11 billion in Q3-2013, i.e. 11.4% of gross credit. NFCs' restructured loans increased by EUR 1.5 billion between Q3 2012 and Q3 2013, a 16% y-o-y change.

The financial leverage ([1]) of Portuguese firms increased from 46% in 2007 to 58% in Q3 2013, while the Interest Coverage Ratio (ICR) has been decreasing since 2012, with more than 40% of the companies displaying an ICR inferior to 1, showing apparent lack of capacity to meet their financial commitments. 29% of the Portuguese companies had negative equity in 2012, the overwhelming majority being micro-companies. ([2])

**Graph I: Corporate Insolvencies in Portugal**




Source: Minister of Justice

In Q3 2013, the quarterly number of incoming insolvency procedures decreased y-o-y, for the first time since data records exist, which is most likely explained by the economic recovery underway. However, the quarterly number of requests for insolvency procedures quadrupled between Q3 2007 and Q3 2013, having reached 15,020 in the first three quarters of 2013 (20,757 in the full year 2012).

Portugal has implemented far-reaching judicial reforms as part of the Economic Adjustment Programme which substantially improved the judiciary, as acknowledged in the 2014 EU Justice Scoreboard. ([3]) The specific case of reform of the insolvency and restructuring legal framework enacted in 2012 is a major breakthrough in the Portuguese context. Among several merits of this reform, the introduction of new debt restructuring tools geared towards the recovery of firms as opposed to their mere liquidation are to be mentioned. Portugal is now one of the few EU countries (together with Austria, Greece, Spain and the UK) which have in place early rescue procedures combining the advantages of out-of-court and formal procedures. These procedures are potentially more successful and cheaper than formal and complex ones. ([4]) These time-bound procedures significantly changed the Portuguese regulatory landscape in the area of corporate restructuring, having increased the chances of recovery of viable firms experiencing temporary financial difficulties. They also

([1]) Measured by Remunerated Financing/(Remunerated Financing + Equity).
([2]) Unless otherwise stated the data source of corporate sector indicators mentioned in this Box is BdP.
([3]) 2014 EU Justice Scoreboard: Towards more effective justice systems in the EU; Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions COM(2014) 155 final, at http://ec.europa.eu/justice/effective-justice/files/justice_scoreboard_2014_en.pdf
([4]) Commission Staff Working Document SWD (2014) 62 final Impact Assessment accompanying C(2014) 1500 final (Commission Recommendation on a New Approach to Business Failure and Insolvency), Brussels, 12.3.2014. http://ec.europa.eu/justice/civil/files/swd_2014_61_en.pdf

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*Box (continued)*

contribute to reducing the pressure on the judicial system given their low intensity of in-court procedures. Two different mechanisms are in place. The *Sistema the Recuperação de Empresas por Via Extra-Judicial* (SIREVE, Out-of-Court Corporate Recovery System), which is fully out-of-court, is mediated by IAPMEI and targets essentially micro and small firms. The *Processo Especial de Revitalização* (PER, Special Recovery Procedure) is a hybrid procedure which works mostly out-of-court but has some court intervention. It targets larger and more complex firms, although it applies vastly also to SMEs and to natural persons. Both tools aim at resolving default situations of firms through voluntary negotiated procedures among the parties involved, with little (PER) or no (SIREVE) intervention of the judicial system, with advantages for both debtors and creditors. The tools are now operational for almost two years, in the case of PER, and one and a half year for SIREVE.

From their inception, the total number of PER incoming procedures amounted to 1,906 (until October 2013), while SIREVE recorded 317 incoming procedures (until December 2013). Data on the use and results of these new tools revealed that there is room for improvement in their implementation, most notably in SIREVE, but also in PER.

When designing a strategy to cope with the corporate debt overhang, not only but in particular where such strategy would entail the adoption of new legislation on insolvency and recovery procedures, the recent Commission Recommendation on a new approach to business failure and insolvency contains important guidance ([5]). The common principles encompassed in the Recommendation for national insolvency procedures for businesses in financial difficulties aim to shift the focus away from liquidation towards recovery of viable businesses. The main objectives are: (i) to facilitate the restructuring of businesses in financial difficulties at an early stage, before starting formal insolvency proceedings, and without lengthy or costly procedures to help limit recourse to liquidation; (ii) allow debtors to restructure their business without needing to formally open court proceedings; (iii) give businesses in financial difficulties the possibility to request a temporary stay of up to four months to facilitate the adoption of a restructuring plan before creditors can launch enforcement actions against the troubled debtors; (iv) facilitate the process for adopting a restructuring plan, which appropriately balances the interests of debtors and creditors, to increase the chances of a successfully company recovery; and (v) reduce the negative effects of a bankruptcy on entrepreneurs' future chances of launching a business, in particular by discharging their debts within a maximum of three years.

Portugal has already addressed an important part of the issues elaborated in the Commission Recommendation. The length of the procedures was shortened and the hybrid system, PER, was carefully designed to contain specific features to foster its effectiveness. It allows a majority of creditors to bind a dissenting minority of creditors («cram-down» provision) and also addresses the holdout problem. These features allow a swift adoption of the restructuring plan and enable the protection of debtors for a well-defined limited period of time which facilitates the negotiation among the parties and the restructuring itself, while protecting creditors' rights.
Considering that almost two years elapsed since the adoption of some of those reforms, more can be done at the current juncture. The Commission Recommendation is rather detailed and bringing the national system into line with it is advisable. Three specific areas of the Commission Recommendation deserve specific attention.

First, provisions to facilitate the restructuring of businesses in financial difficulties at an early stage, before starting formal insolvency proceedings, are essential. These provisions are mainly related to the the debt-restructuring tools already in place (PER and SIREVE) to achieve operational improvements in the access

([5]) Commission Recommendation C(2014) 1500 of 12.3.2014 on a new approach to business failure and insolvency available at http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf .

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*Box (continued)*

by firms and respective use of the tools. The measures could include setting up an early warning system based on economic and financial criteria to detect problematic and highly indebted (although potentially viable) firms at an early stage and direct them to the restructuring tools, thus increasing the chances of firm recovery through the voluntary legal mechanisms. To address the possible resistance from the side of company managers to adhere to the tools, incentives for companies to act soon rather than later could be devised, including financial ones. One among several possibilities would be to facilitate access to public financial instruments designed to support the firm's recovery. These improvements do not necessarily require additional regulatory changes.

The second area relates to the facilitation of new financing to support the restructuring of a viable firm when such financing is agreed upon as part of the restructuring plan. In particular, ways to improve incentives and protection for new financing during and after restructuring could be explored further.

Third, more could be done to reduce the negative effects of a bankruptcy on entrepreneurs' future chances of launching a business, in particular by shortening the period for discharging their debts from a bankrupt venture to a maximum of three years.

Demand for SIREVE is considerably lower than for PER, suggesting that SIREVE could be made more attractive, in particular for SMEs. Also, it is observed that the acceptance rate of procedures is not particularly high. Thus, reviewing the appropriateness of the checks currently in place at the entry into the procedure might be useful, while ensuring that is not at the cost of a correct assessment of the viability of the firm adhering to the procedure.

Additionally, the use of financial instruments to provide finance to support the restructuring process (e.g. turnaround finance) should continue. Given the over-indebtedness of firms entering into the restructuring procedures, it seems advisable to use public-private risk-sharing equity or quasi-equity instruments to provide additional safety to distressed but economically viable firms. In parallel, given the potentially high amount of debt/corporates to be restructured, supporting measures to foster the liquidity of the investments made in these companies, either by state or by private investors, could be considered as a way to facilitate ownership transfer subsequent to the restructuring of a firm.

Enhancements to inter-institutional cooperation arrangements among the parties involved in the restructuring process and in the identification of companies in financial difficulties, and to the definition of the respective institutional role would allow for a more effective application of the framework.

An overarching strategy to address the corporate sector debt overhang should not be limited to the recovery of firms identified as being viable. Commission staff estimates on the basis of data on recovery and insolvency requests by firms suggest that only less than one tenth of the total number of procedures to request insolvency and recovery can actually hope for a recovery of the firm. A comprehensive deleveraging strategy must therefore incentivise creditors and managers of companies in distress to enter precautionary, i.e. pre-insolvency procedures as soon as possible in order to use these procedures at a stage in which recovery is still possible and the company is viable. Non-viable firms should be channelled into proper insolvency procedures for their quick and orderly liquidation. In the case of both viable- and non-viable companies, exposures to such companies should be correctly reflected in terms of impairment recognition and provisioning in banks' balance sheets. To achieve a better allocation of economic means and of the banking system lending capacity credit should be directed to the viable and productive undertakings.

Measures to cope with the corporate debt overhang in the banking system and in the economy should be included in a multi-pronged strategy to support the deleveraging of the corporate sector. These could foresee a strengthening of the oversight of debt restructuring processes by the relevant authorities which under

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*Box (continued)*

specific circumstances could set appropriate debt restructuring targets, including debt write-offs, to be observed by the credit institutions. Given the possible budgetary consequences and implications for the banking sector, an appropriate balance would have to be found between the objectives of smooth deleveraging, preserving financial stability and avoiding an undue burdening of the tax payer.

**65. BdP is assessing the feasibility and proportionality of the measures contained in the recovery plans of the eight biggest banks.** Banks submitted the second batch of their recovery plans to the BdP in January 2014. The need for improvement persists, in particular with regard to banks' understanding of the degree of severity of a stress scenario that may lead to a major business disruption and/or non-viability of the institution. To that end, the BdP has set up a matrix to aggregate and benchmark banks' submissions against each other. It also analyses the measures' applicability, feasibility and proportionality and attempts to recalibrate these measures in order to avoid systemic contagion. Banks will also have to submit their updated information packs in May, so as to allow the BdP to update their resolution plans. Bank-specific resolution plans are being prepared for large and medium sized institutions, while waivers have been granted to smaller banks. The resolution fund is being built up to reach EUR 215 million at end-2014 against the ultimate goal to comply with the target level laid down in the BRRD (0.8 percent of covered deposits).. The capacity of the resolution function within the central bank is being expanded.

**66. The Development Financial Institution (DFI) draft by-laws and business model will be submitted for in-depth consultations at the Twelfth Review.** The Government appointed in January a group of four experts to be members of a committee setting up the DFI. This group is in charge of conceiving the founding documents of the DFI, notably the by-laws, putting up the strategic business plan and devising the structure of the new entity. The DFI is expected to operate as an umbrella structure covering four state-owned entities which have a role in the provision of finance for the corporate sector in Portugal: PME Investimentos, the National Guarantee System for guaranteed credit lines for SMEs, Portugal Ventures and Sofid. The design and modus operandi of the institution shall accommodate the following concerns: European structural and investment funds shall be used in the most efficient way; the institution shall not accept deposits or other repayable funds from the public, nor engage in direct lending, nor invest in Government debt or grant loans to the Government; and fiscal risks will be contained, including, for example, through the setting of statutory limits to leverage.

**67. The SPVs continue to gradually recover the legacy assets of Banco Português de Negócios.** Parvalorem and the two smaller SPVs Parups and Parparticipadas are fully funded by CGD and the Treasury. In 2013, the aggregated cash proceeds from asset recovery, sale of participations and securities and other income amounted to about EUR 270 million, while the total net loss generated by the three SPVs was over EUR 220 million. As agreed with EC, ECB and IMF, the Treasury continues to gradually settle the claim of CGD (in total EUR 4.1 billion) on the two SPVs inside the government perimeter. From March 2014 onward the management of 46 percent (EUR 1.9 billion) of Parvalorem's legacy loan portfolio is being outsourced to two distressed debt specialist companies for a success fee.

## STRUCTURAL REFORMS

**Reform of labour, goods and services markets**

*Labour market*

**68. A draft law revising the definition of individual fair dismissals has been sent to Parliament.** This revision deals with previous amendments made to the Labour Code and ruled unconstitutional. The draft law establishes five criteria for selecting redundant workers performing similar duties in a section of a firm: 1) a worse performance evaluation; 2) lower academic and professional qualifications; 3) higher costs of maintaining a worker for the firm; 4) lower work experience in the respective task; and 5) shorter tenure in the firm. The draft law ranks these five criteria in descending order. A preferable solution would have been a global assessment based on the full set of criteria but this was considered to be subject to constitutional risks. Other revisions that have been introduced by the draft law deal with the reinstatement of the obligation for the employer to offer a suitable position within the firm both in cases of redundancy and unsuitability. The original MoU stated that "as a rule, whenever there is an employment position available that matches the qualifications of the worker, dismissals should be avoided." However, it will be necessary to ensure that the reinstatement of the obligation for employers to offer a suitable position in the firm will not increase uncertainty of fair dismissals

**69. Additional measures to reduce the high level of segmentation in the labour market are under discussion.** Policy options are under discussion to reform the unfair dismissal legislation so as to strike a balance between limiting incentives to challenge fair dismissals in court and adequately compensating for unfair dismissals. The revision of the employment protection legislation has focused so far on fair dismissals, while the legislation on unfair dismissals has been left unchanged. However, the revision of some aspects of the legislation of unfair dismissals could give an important contribution to reducing the high level of segmentation in the labour market. One of these aspects regards the level of compensation. The current large gap between compensation for fair and unfair dismissals may create perverse incentives for fair dismissals to be challenged in court leading to uncertainty of a dismissal. Specific policy options for reforming the system will be discussed at the Twelfth Review.

**70. Specific policy options for further improvements to the wage bargaining system will be discussed at the Twelfth Review.** Some measures have already been implemented with a view to facilitating the decentralisation of wage bargaining and promoting wage flexibility. These include the introduction of a quantitative criterion for the extension of collective agreements; the reduction of the firm level threshold for unions to delegate to firms' works councils the conclusion of collective agreements; and the introduction of the possibility for sectoral collective agreements to include conditions under which firm-level agreements can deviate from the sector-level agreements. However, some of the measures have not yet been applied in practice and further measures are necessary to make collective bargaining more dynamic. The authorities are considering policy options, which will include the revision of the expiration and survival of collective agreements or, in case this option is not implementable, the introduction of the possibility of a mutually agreed and temporary suspension of collective agreements when a firm is facing economic difficulties. In addition, the authorities are studying ways to foster collective agreements, in dialogue with social partners, with a view to specifying measures including concerning the current criterion for the extension of collective agreements taking into account the representativeness of SMEs in the various sectors. Any policy option regarding the current extension mechanism will need to maintain an effective framework for wage decentralisation in line with the objectives of the MoU.

**71. Progress has been made in improving the systems of job search assistance and activation.** A set of measures is being implemented or is under development to improve job counselling/job search assistance and activation/sanction systems. These include: (i) enhanced surveillance of the unemployed that fail to comply with their obligations, which will lead to swifter sanctions in case of repeated non-compliance; (ii) a revision of the methods regarding the obligation of an unemployed person to show evidence of active job search and to detect false evidence of job search; (iii) the cooperation between Public Employment Services, Labour Inspectorate and Social Security with a view to identifying situations of undeclared work of persons who receive unemployment benefits; (iv) the reinforcement of the capacity of the Offices for Professional Insertion, including a new network of offices and broadening of their responsibilities; (iv) the improvement of personal employment plans and increase the intensity of job offers; (vi) specific training on activation techniques for job search. Cooperation with the private placement agencies is also being analysed. In addition the authorities remain committed to implementing a youth guarantee.

*Education*

**72. Substantive reforms in the education system have been implemented and will be evaluated and properly monitored.** Further initiatives have been undertaken to tackle low education attainment and improve the efficiency of the school system and the link between curricula and skill needs in the labour market. The monitoring tool on education outcomes has been further improved. Data on teacher-pupil ratios are now available at national, regional and (public) school level on the basis of full time equivalent (FTE) and will be soon extended to autonomy schools and schools with trust agreements. The action plan to improve the quality of secondary education has been fully implemented including by strengthening school autonomy and accountability. The authorities have over-achieved the target number of trust agreements established under the Programme for 2014-2015 and have started the monitoring of those agreements on the basis of merit recognition, for schools of high performance, and penalties that can compel to the exit from the school trust agreements for low performers. The formula-based funding framework and a new inspection model have been further developed to improve the quality of secondary education, create an incentive to better perform by awarding school results with teaching credits (i.e. more FTE teachers), thus fostering the educational offer. As regards the action plan to improve the quality and the attractiveness of educational and vocational training, measures to raise the quality of human capital and to facilitate labour market matching have been put forward. The Council of Ministers has recently approved a decree law creating a short cycle training course, which involves business and focuses on the job training and on competences needed by the labour market. The drafting of a decree creating the rules governing the professional schools of reference has been delayed, but is still expected to be published by the end of March 2014. Finally, by the 12th Review, the authorities will present a report on how the new monitoring and reporting tools will be used to evaluate the impact of education policies and support the related decision making processes.

*Energy*

**73. A new levy on energy operators was introduced in 2014.** The decree law was approved at the Council of Ministers on February 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, crowding out of other cost-reducing measures foreseen to address the sustainability of the electrical system has to be avoided.

**74. Rent-reducing measures implemented so far in order to eliminate the tariff debt by 2020 and to ensure the sustainability of the system appear to be insufficient in view of the objective of limiting energy price increases.** An update of the additional measures announced in the previous review was presented, in particular addressing the problem of distortion in the system services market, where new measures are being implemented in line with the recommendation concerning the risks of over-compensation in the adjustment calculations (revisibilidade) of the CMEC scheme. The details of this cost-reducing measure are published in a ministerial order with effect from 1 January 2014. Additionally, an external audit will take place and will assess both these over-compensation amounts as well as whether the present measure eliminates the distortions in the system services market. The December update of the energy tariff debt dynamics until 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. The assumptions and parameters used in the last updates of the tariff debt path were discussed and additional clarification on the inflation rate assumption has been requested. 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. Additional concrete measures to tackle remaining excess rents and to deliver cost reductions leading to lower energy prices will be presented by the authorities. Further analysis of the implications of the report on the CMEC scheme and the need for potential measures to address the points identified as sources of distortion will be discussed at the next review. Regarding the revision of the remuneration scheme for co-generation in order to accelerate the convergence towards market-based pricing, no legislation has been submitted so far, a first draft is expected in March 2014.

*Telecommunication Services*

**75. Contracts have now been signed for all components of the universal services.** As was noted in the 10th Review report, (7) tenders for two out of the three universal services (fixed telephony connections and public payphones) had been finalised in October 2013. The resulting contracts, concluded for a period of five years, have now been signed and sent to the Court of Auditors for purposes of prior approval. The third tender (for directory services) had no bidders and was therefore directly awarded for a one-year contract in which all companies who had qualified in the previous tender were invited to bid. The incumbent, Portugal Telecom, was the sole bidder and was thus awarded this one-year contract. The contract resulting from the direct award procedure, concluded in November 2013, was also sent to the Court of Auditors. The infringement proceeding on the designation of the universal service provider(s) through an efficient, objective, transparent and non-discriminatory mechanism is ongoing. The Commission is 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. Details were also provided regarding the compensation payment by the Portuguese State to Portugal Telecom for the early termination of their pre-existing universal services contract (originally intended to stay in force until 2025 but revoked in October 2013); the compensation payment will amount to a maximum of EUR 33.5 million (included in the 2014 budget). This amount was calculated based on a methodology, validated by ANACOM and an external auditing firm, aimed at compensating Portugal Telecom for investments made to provide the universal service which have not been fully amortised.[see comment in Table 5]

*Transport*

**76. Following the presentation of the prioritising of infrastructure projects, the presentation of a long term vision of the transport system is now expected by the time of the 12th Review.** Such a strategic long term vision is essential to improve the efficiency and sustainability of the transport sector by focusing on value-for-money investments and on growth-enhancing projects. As a part of this strategic vision, the authorities had already presented a report, to be adopted following a public consultation, with proposals for prioritising transport infrastructure investment projects, identifying key investments and removing bottlenecks for transport infrastructures.

**77. Advancing policy reforms in the ports sector is crucial to boost Portugal's competitiveness.** The recent abolition of port user-fees (TUP-Carga) has been a concrete step to reduce port operation costs and increase the competitiveness of the sector. An action plan/chronogram setting out the milestones of the ports reform has been published. It includes, among other elements, a new ports' tariffs modulation and the renegotiation of the existing ports concessions, which will be guided by the principles and the criteria established in a despacho recently signed by the Government and currently being assessed by the relevant Commission services. A review of the overall cost savings for exporters generated by the Port Work Law is being conducted and the final outcome will be presented at the 12th Review. Continuous strong commitment by the Government will be critical to address specific features of concessions, terminals leasing and licensing which hinder competition, to improve data collection and performance measures within the ports sector and to fully implement the action plan/ chronogram by the end of 2014 as planned (see Box 3).

(7) DG ECFIN Occasional Papers 171 (2014), The Economic Adjustment Programme for Portugal Tenth Review, p. 47.

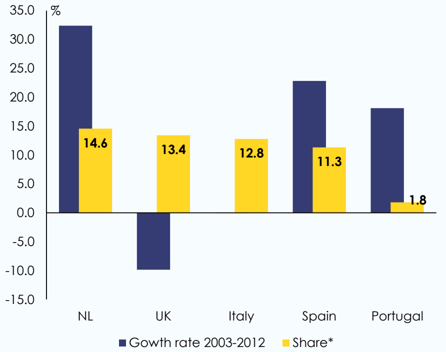
**78. The authorities need to step up efforts to strengthen financial sustainability, competition and efficiency in railway and urban transport services.** The authorities are committed to achieving operational balance for the state-owned infrastructure manager (REFER) by 2015, as required by the EU Directives (see the chapter on SOEs for further details), while recognising that the historical debt overhang is still a matter of concern and needs to be addressed, inter alia, by operational cost reduction, new access charges and a new Public Service Obligation (PSO) contract. The latter is still under discussion between the Government and REFER, as well as the PSO contracts with other SOEs which have been postponed to the time of the 12th Review. Within that timeframe, the authorities remain committed to completing the transfer of the terminals owned by the freight branch of the state-owned railway company (CP Carga) to REFER, following repeated delays in the past. In terms of efficiency, the authorities have presented an impact analysis of the performance schemes related to infrastructure charges in different traffic categories, which is currently under assessment by the Commission services. As regards the plans to launch new concessions for the provision of transport services in the metropolitan areas of Lisbon and Porto the authorities are committed to completing the process by the time of the 12th Review. A pilot project for the concession of the sub-urban Cascais line is being prepared. A public consultation on the best format and scope for this concession will start before the 12th Review. The introduction of competition on the commercial lines (Lisbon-Oporto), which could create new business and investment opportunities for new entrants, existing domestic or foreign railway undertakings, is being analysed,

**79. The legal framework of the Transport Regulator (AMT) has been finalised. The by-laws framework of the transport regulator (AMT), including provisions on proper functioning, resource endowment and financial and operational independence, was approved by the Government in March 2014.** A calendar for the implementation of the new law including the recruitment of staff and all logistic needs will be essential to underscore the strong commitment by the Government to fully and swiftly implement the framework provisions and effectively provide AMT with full independence and adequate funding. This calendar could be inserted in an explanatory memorandum or any other technical documents accompanying the by-laws.

### *Box 2.4:* Reforming the Ports Sector in Portugal

*The Portuguese ports in Europe*

**Graph I: Gross weight of seaborne goods handled in ports in selected countries**




*Note: Share compared to EU 28 in 2012
Source: Eurostat

According to Eurostat data, in 2012 1.8 percent (i.e. 67.9 million tonnes) of the total European seaborne goods was handled by Portuguese ports. In terms of growth rate, over the period 2003-2012 the Portuguese ports system showed a positive trend with an increase of around 18 percent, significantly outperforming the growth rate for the EU as a whole (7.5 percent) and for some countries with bigger maritime sectors such as the UK (-9.9 percent) and Italy (0.0 percent). National data for 2013 confirm the positive trend of previous years despite the deep economic crisis and major strikes in Portuguese ports due to the adoption of a new port labour code. The movement of goods from the seven major Portuguese ports totalled about 79.3 million tonnes, which corresponds to a year-on-year increase of around 17 percent. ([1])

*The importance of the ports sector for the Portuguese economy*

Empirical studies have concluded that port efficiency is a key determinant of transport cost which in turn is an important determinant of a country's competitiveness. Greater transport costs lead to lower levels of foreign investment, a lower savings ratio, reduced exports of services, reduced access to technology and knowledge and a decline in employment. It has been estimated that a doubling of transport costs leads to a drop in the rate of economic growth by more than half a percentage point. ([2])

The port sector has a strategic importance for the Portuguese economy and national ports constitute an essential infrastructure for the development of the economy. The great majority of Portuguese international trade is directly or indirectly linked with the Portuguese ports sector. About two thirds of incoming merchandises and around one half of exported goods are transported by sea. In terms of value, around 1/3 of incoming and outgoing goods are transported by sea. ([3]) Especially extra-EU exports rely to a large extent on the sector, with 80 percent of the merchandise exported to countries outside the EU transported by sea. ([4]) A well-functioning port sector is therefore of high importance to the entire Portuguese economy.

Historically, the performance of Portuguese ports has been affected by a combination of unfavourable factors. In terms of hinterland access, the development of some of the main ports has been slowed down by insufficient railway connections. In addition, the very restrictive port labour regime reined in the establishment of companies and the creation of new jobs. Private investment and the modernisation of cargo-handling equipment were also hindered by the existence of long-term concession contracts for terminal operators which, in contrast to international practices, had no service level agreements attached.

([1]) Instituto Portuário e dos Transportes Marítimos, IPTM, 2014.
([2]) Irish Competition authority, "Competition in the Irish Ports sector", 2013, p. 38; Sanchez R.J, Hoffman J., Micco A., Pizzolitto G., Wilmsmeier G., "Port efficiency and international trade: port efficiency as a determinant of the maritime transport cost", study presented to IAME Panama 2002, published in the Maritime economics and logistics, volume 5 Issue 2, 2003.
([3]) Universidade Autónoma de Lisboa, UAL, 2013.
([4]) Banco de Portugal, Annual report on the Portuguese economy, 2013.

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Box (continued)

*Port management models and concessions: how to increase efficiency*

There are different port organisation models depending on the role of the port authorities, i.e. *service port*, *tool port* and *landlord port*. In the *service port*, port authorities are responsible for the totality of the services while in the *tool port*, the ports authorities own the infrastructures and also the superstructure and equipment (i.e. cranes, vanes). In the *landlord port* model, the port authority owns the port infrastructure and is also in charge of its management while private companies own the superstructure and employ stevedore labour. ([5])

The State intervention in ports activities in Portugal follows the landlord port model for which concession contracts are a key component the design of which needs to be improved and modernised. A concession agreement is more complex than a license, since it involves also the adequate maintenance of assets, investments to be made and the risk allocation between the public authorities and concessionaire. Concession procedures should be adequately advertised, fair and non-discriminatory and be reviewed. Concerning the length of the concessions, their duration must be set so as not to limit open competition beyond what is required to ensure that there is a reasonable return on the invested capital, while maintaining a risk inherent in exploitation by the concessionaire. ([6])

*Reform measures taken in the framework of Economic Adjustment Programme*

The Economic Adjustment Programme envisaged deep structural reforms of the Portuguese port sector to address major challenges such as the integration of the port strategy in the overall strategic planning for the transport sector, the improvement of the governance model of the port system and the revision of the legal framework governing port work to make it more flexible. In the process, the Government presented a thorough analysis of the challenges in the port sector and proposed a comprehensive set of measures (called the "5+1 plan"). The overall aim of the reform measures is to create a model based on fair competition both at intra-port and inter-ports levels, with port authorities looking after a good business climate in the port industry and a fully independent and well-staffed regulator ensuring a level playing field. The reform also foresees a more dynamic market entry mechanism for port operators, with concession contracts providing for adequate operational risk sharing and performance clauses for the concessionaires. The reform requires a review of the existing tariff regime on vessels and cargoes - which appeared to be quite dated and too complex - and related approval procedures. In terms of overall costs, the reform measures should represent a reduction of about 20 percent to 30 percent in the total invoice of port services to Portuguese industries using ports for their trades.

A number of important milestones have already been achieved, particularly the new ports' labour law ([7]) and the elimination or freezing of some fees collected by the port authorities. Also, the absorption of the administration of the ports of Portimão and Faro by the port authorities of Sines was an important development in the ongoing merger between larger and smaller ports that started some years ago. ([8]) In order to pass through the savings generated by the new labour law and from the reduction of fees to ports users, the Government launched the renegotiations of the cargo handling concessions beyond 2020 in some major ports ([9]) and the renegotiation of the concessions for the major container terminals in Sines will follow. Another important development has been the ports' single window and logistics' single window, which has

([5]) Irish Competition authority, “Competition in the Irish Ports sector”, 2013, p. 8.
([6]) European Commission, “Communication on a European Ports Policy”, COM (2007)616, p. 10, “Ports: an engine for growth”, COM (2013) 295, p. 8.
([7]) Law 3/2013, published in the Official Gazette on the 14 January 2013.
([8]) Decree-Law 44/2014, published in the Official Gazette on the 20 March 2014.
([9]) Order 4550-A/2014, published in Part C of the Official Gazette on the 27 March 2014.

(Continued on the next page)

*Box (continued)*

introduced innovative technologies for a paperless, easy and fast flow of authorisations and taxes and custom handlings.

The authorities have recently published a chronogram/action plan for ports, ([10]) with a set of measures and clear deadlines to complete the reform agenda. At this stage, the substance and details of the new measures envisaged by the action plan have not yet been disclosed. A full and effective implementation of the action plan within the agreed timeline will be essential to further reduce the costs for ports users and attract new investment thereby ensuring the long term competitiveness of the Portuguese maritime port sector.

([10]) The chronogram is available at the following link: http://www.imtt.pt/sites/IMTT/Portugues/Noticias/Paginas/NovoModelodeGovernacaoeRegulacaodoSetorPortuario.aspx

*Services and professions*

80. **Work on the improved sector-specific legislation has progressed, but the adoption of the regulatory framework for the construction sector is delayed.** Overall, 63 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. The construction laws were originally foreseen to be sent to Parliament by the end of 2012. The draft laws were shared with the Commission in January and are currently under discussion. 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.. Legislative amendments for the remaining sectors should be adopted by May 2014.

81. **The submission to Parliament of the amended professional bodies' by-laws and internal rules following the adoption of the horizontal framework law on public professional associations has been delayed.** The law was a first step towards ensuring a more open access to 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. Half of the revised by-laws are being discussed with the Commission, while 5 out of 18 have not yet been shared. As a consequence the submission to the Parliament is experiencing further delays and is now expected by the time of the next review mission.

82. **Progress has been made in improving 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 sectorial regimes to the Professional Qualifications Directive and, consequently, their content to the PSC is taking longer than expected and might have additional delays. The usability and user-friendliness of the Point of Single Contact could be further improved.

**Reform of framework conditions**

*Housing market*

83. **The urban lease reform is proceeding, but its impact still needs to be comprehensively assessed; the new legal framework has now been fully implemented.** Information received from various private-sector stakeholder groups offers some indications that the reform is starting to show significant impact through, inter alia, a gradual increase in rent levels for pre-existing contracts (which had historically been fixed at

levels deeply below market rents), a lowering of rent levels for new contracts as a result of more properties coming on the market, and increasing tenant mobility. However, much of this information is anecdotal in nature, limited in geographical scope, and may suffer from bias to varying degrees, making it difficult to draw reliable conclusions on the Portuguese rental market as a whole. Therefore, there is a need to further strengthen monitoring and evaluation of the urban lease reform, based on more precise and consistent data on key housing market metrics, such as evolution of rent levels, average duration of new contracts and number of contracts terminated. To this end, further efforts should be made to integrate data from all available sources. Since it appears likely that data quality may prove problematic, strong consideration should also be given to commissioning a tailored integrated survey-based study at regular intervals so as to ensure continued monitoring of the impact of housing reform. This could also be helpful in the context of assessing the size of the shadow economy in the rental market.

*Competition and sectoral regulators*

**84. Following the adoption of the framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs), the by-laws 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 by-laws of the NRA have been prepared and shared in November with the EC/ECB/IMF staff and that of the Competition Authority is still under discussion. They are expected to be approved by the Government in March 2014. Ensuring independent and adequately financed NRAs will be essential to effectively implement the Government's reform agenda. Additionally, the competition authority plays a critical role in evaluating public policies. A new unit was created to assess impediments to competition/market entry in selected sectors.

**85. Following the adoption of the 2012 executive order (portaria) concerning the transfers of payments from regulators to the Competition Authority for 2012, a new executive order setting the contributions of the regulators for 2013 and 2014 has been published.** In order to address the recurrent problem of previously annual executive orders adopted with some delay and to bring financing stability during the next years, these contributions will be set in the new Competition Authority by-laws as from 2015 onwards. 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. Therefore, the financing model should leave room to accommodate growing needs in the medium term.

*Judicial system*

**86. Reforms of the judicial system continued to advance according to the agreed schedule, which allowed for closure of the judicial chapter.** The new Code of Civil Procedure, which aims to expedite the court process, became effective in September 2013. The Code has been well-received by stakeholders and has begun to yield very positive results, including in terms of more effective debt collection. The new Judicial Organisation Act, which aims to enhance the efficiency and professionalism of court management, is on course for full implementation by autumn 2014. This major reform includes a redistricting of all courts, the closure of 47 courts, of which 27 will be converted into proximity sections, the regrouping of 308 courts into 23, and a 60 percent increase of specialised sections that will lead to a national coverage of 70 percent instead of the previous 20 percent specialised sections coverage. This reform will also allow a more flexible allocation of personnel resources where bottlenecks emerge, and the introduction of a national system of workload measurement and performance targets. Both reforms change a regime, which has been in place for up to a century without significant changes. The audit of all pending enforcement cases at Programme commencement was completed, with almost 50 percent of all enforcement cases pending on 17 May 2011 closed. Better management and increased effort, together with the application of

Decree-Law 4/2013, which allows closing cases that have been dormant for three or six months (depending on several legal requirements), enabled Portuguese courts to secure a clearance rate for enforcement cases in excess of 100 percent over the last three quarters. Enforcement proceedings will be further strengthened shortly, when Parliament adopts the so-called PEPEX Law, which allows a creditor to verify pre- court whether a debtor has assets and on that basis to whether to pursue a claim. Also in terms of enforcement, the strengthening of operational and disciplinary oversight over the enforcement agents in the past year will be enhanced by new legislation (CAAJ), which will further reinforce oversight, strengthen professional requirements, and increase reporting duties of and competition between enforcement agents. CAAJ is expected to be fully implemented by end-June. Finally, new insolvency administrators that are currently undergoing training should become active in a near future.

**87. All key judicial reform legislation has now been enacted, or is close to enactment, and the authorities are committed to ensuring the proper implementation of these reforms.** The implementation process will be challenging, and it is the key to the success of these reforms. It is very encouraging that the authorities have started taking measures and are considering additional measures to strengthen the implementation process, including measures beyond those previously identified in the Memorandum of Understanding. These measures should further improve judicial procedures in civil and commercial matters, help to maintain a high clearance rate to expedite the case process, speed up corporate restructuring and insolvency proceedings, and reform the administrative and tax court system (including through modernizing administrative procedures, setting workload and performance standards, and establishing IT systems to monitor disposition time and clearance rate).

*Public procurement*

**88. Monitoring and reporting of public procurement procedures has been significantly enhanced.** The authorities have provided further details on the implementation and enforcement of the revised Public Procurement Code, as well as on compliance with European public procurement rules. In particular, information was provided on a set of direct awards listed in BASE, the Portuguese centralised public procurement portal, which had been identified as potentially irregular during previous review missions. These 250 direct awards, amounting to EUR 51.4 million in value, have been submitted to the National Court of Auditors and the Inspectorate for Finances (IGF). The National Court of Auditors has completed a preliminary assessment of those contracts and for the majority of them (around 200) did not find any legal irregularities but rather filing mistakes and data entry errors. The remaining 50 potentially uncompliant direct awards (out of a total of 120,000 awards) are of small value, and although they are still eligible for further investigation by the National Court of Auditors, the Court's preliminary view is that it is likely that these apparent irregularities can be explained by similar data errors. The authorities have committed to implementing technical improvements in the BASE portal that will enhance data reliability and enable automatic entry checks. Going forward, the National Court of Auditors will publish regular reports on public procurement, updating and complementing its 2012 audit. In the course of 2014, in addition to doing several audits in public procurement as foreseen in their annual working plan, IGF will also carry out an independent and thematic audit of direct awards granted by various public entities.

*Business environment*

**89. The streamlined online platform for requesting VAT exemptions by exporters, introduced in early 2013 as part of the Simplex Programme, is starting to yield meaningful results.** This new on-line platform allows exporters to provide full proof of their operations, with the aim of drastically reducing the time required to provide all the necessary information to apply for VAT reimbursement. Based on an assessment presented by the Portuguese authorities as part of the 11th Review mission, about 80 percent of new reimbursement applications are now conducted via this platform. This has resulted in a reduction in the average time to completion from 42 days initially to 8 days as of December 2013. The long-term target of 4 days thus seems well within reach.

### *Box 2.5:* A Robust Framework for Regulation and Competition to Support Competitiveness and Growth

*Competition and growth*

There is overwhelming evidence of the key role of competition in supporting growth and competitiveness, by incentivising firms to be more efficient, to innovate and to effectively compete across the borders. ([1]) Policies aimed at enhancing market opening and competition positively impact on both static and dynamic efficiency: ([2]) they encourage firms' efficient behaviours, stimulate innovation and productivity gains and allow the expansion of efficient firms at the cost of inefficient ones. Markets subject to competitive pressures grow faster. Competitive rivalry ensures that companies constantly strive to produce at lower costs to avoid losing customers to more efficient competitors. In addition, competition pushes firms to innovate and develop new products as part of their continuous effort to attract and retain customers. By stimulating technological advance, competition generates gains in dynamic efficiency, which in turn improves the competitiveness of the economy as a whole. Competition results in lower prices, better quality and new products. Numerous empirical studies have supported these theoretical considerations. ([3]) In particular, a positive relationship between competition and innovative activity was found by Nickell (1996), Blundell et al. (1995, 1999) and Bassanini and Ernst (2002). Other studies have provided evidence that higher competition raises firm-level productivity (Nickell, 1996; Blanchflower and Machin, 1996; Nickell et al., 1997; Disney et al., 2000). Yet another group of studies has found a positive link between competition and technical efficiency at firm level (Caves and Barton, 1990; Caves et al. 1992; and Green and Mayes 1991) or at industry-level (e.g. Porter, 1990; McKinsey Global Institute, 1997; Baily and Gerbach, 1995; OECD, 2001b). Furthermore, trade liberalisation has found to have positive effects on both the level and growth rates of productivity (e.g. MacDonald, 1994; Van Wijnbergen and Venables, 1993). According to these studies, domestic and international competition (proxied by market concentration, size of rents, import penetration rates, etc.) is crucial for productivity gains.

*The Portuguese context and needs for reforms*

Portugal enjoyed buoyant economic growth during the second half of the 1990s. However, economic imbalances started to gradually build up during this period, as reflected by a deterioration of the current account and the international investment position of the country. In the 2000s, growth slowed down significantly due to the contraction of the tradable sector, especially manufacturing, and construction. Economic growth was anaemic in this period and fuelled almost exclusively by the non-tradable sector,

([1]) European Commission, "The Economic Adjustment Programme for Portugal, Tenth Review", Occasional Papers 171, February 2014, p. 38; European Commission "Growth effects of structural reforms in Southern Europe: the case of Greece, Italy, Spain and Portugal", Economic papers 511, December 2013, p. 24; United Nations Conference on Trade and development, "Competition, Competitiveness and development: lessons from developing countries", UNCTAD 2004; Godfrey N., "Why is competition important for growth and poverty reduction", OECD 2008; UK Office of fair Trading, Competition and growth, 2011.

([2]) Static gains are related to the so-called "within-firm effect", i.e. the elimination of x-inefficiencies (difference between the most efficient behaviour of a firm and the actual observed behaviour). Dynamic gains are related to the "across-firm" effect, i.e. positive cross-firm impact on productivity as firms continue to improve their performance replacing low productivity firms and to the incentives to innovate.

([3]) For the summary of the empirical evidence described in the paragraph see Nicoletti G., Scarpetta S., "Regulation, productivity and growth: OECD Evidence", 2003, p. 8. A list of empirical studies showing the relationship between competition and growth has been indicated also by Copenhagen Economics (see European Parliament, "The contribution of Competition policy and growth and the EU 2020 strategy", 2013 p. 18). More precisely, Jorgensen and Nomura concluded that open markets and competition from abroad increase productivity (42 sectors in the US and japan from 1960-2004). Baldwin and GU concluded that competition contributes with up to 70 percent to productivity growth (28.000 Canadian production companies from 1973-1999); Aghion, Blundell, Griffith and Pranti concluded that market entry increased growth and productivity (3.827 companies in 166 different sectors from 1980-1993).

*(Continued on the next page)*

Box (continued)

notably financial services, real estate and public administration. Since the start of the crisis, a further brutal contraction of the construction sector and a significant decline of other non-tradable sector were the main factors behind the recession.

A lack of competition was identified as one of the explanatory factors behind the disappointing performance of the Portuguese economy. For example, the analysis based on the World Input-Output Database showed that mark-ups in the Portuguese final good sector were among the highest in the Euro-area suggesting competition issues such as barriers to entry, a poor legislative framework and poor enforcement of competition law. High mark-ups were mainly recorded in the non-tradable sector, particularly network industries, with the high prices increasing the costs for the tradable sector and leading to a misallocation of resources. To address these competition issues, the Economic Adjustment Programme envisaged several measures, with the ultimate goal to rebalance the economy towards the tradable sector, by fostering competition in the non-tradable sector, reducing excessive profits and rent seeking behaviour in sectors like energy, telecommunications and postal services, transport and regulated professions, and improving the general competition and sectoral regulatory framework.

*Programme measures to boost competition and regulation*

As a part of the measures foreseen under the Programme, a new competition law entered into force on 7 July 2012, replacing the 2003 Competition Act and the 2006 Leniency Act. The new law sets out a new legal framework which mainly aims at increasing legal certainty and predictability of competition enforcement, harmonising the Portuguese competition law with EU rules and international best practices, and fostering the effectiveness of the Portuguese Competition Authority (PCA)'s enforcement and advocacy powers. The new legal framework has also lead to the creation of a new specialised Court on Competition, Regulation and Supervision.

A framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs), including those relating to their independence and autonomy, took effect in mid-2013. The law aims at strengthening the powers of National Regulatory Authorities (NRAs) to enable them to efficiently protect customers through regulating natural monopolies, such as energy, telecommunications, transport, which are prone to market failures.

The Programme envisages also measures for the effective functioning of the NRAs and PCA financing models. In this respect, a continuous strong commitment by the authorities to introduce additional alternative measures to support these authorities adequately and sustainably thereby providing them with the necessary authority. Indeed, authorities responsible for regulation and competition play an important role in protecting consumers and ensuring a more competitive environment and their success and effectiveness depends on their skills and independence which in turn hinges on the resources given to them.

*Enhancing the advocacy power of the Portuguese Competition Authority: scope for further efforts*

Despite a number of measures already undertaken under the Programme, competition constraints are still present in various sectors, although to a different degree. These restrictions impact negatively on Portugal's competitiveness and growth and create incentives to protect incumbents or vested interests rather than the public interest, pointing to the need of stepping up efforts to create a more competitive environment.

Significant progress has been made in improving the competition framework and its continuous and rigorous implementation is now necessary to effectively enforce competition rules. Beyond that, further efforts are needed to foster competition advocacy to remove regulatory frameworks negatively impacting on competition and to enhance innovation and dynamic competition. In this respect, the Portuguese

(Continued on the next page)

*Box (continued)*

Competition Authority (PCA) is putting in place initiatives to strengthen its traditional advocacy role (mainly performed via studies and recommendations) and to complement it with a structured, systematic and in-depth approach of competition assessment. To this end, the PCA has recently created a special unit for the competition assessment of public policies. ([4]) This new unit is being implemented in the context of the new competition framework with a view to enlarging the activity in recommending pro-competitive reforms which has been so far of limited scope and ultimately integrating competition assessment into the policy-making process. Building on international best practices (e.g. the OECD Toolkit, other EU competition authorities, the ICN Advocacy Group), the new unit will implement competition impact assessment procedures of public legislative and regulatory activities, i.e. advising the Government and other public bodies on how to make policies more pro-competitive or less harmful to competition. Key pro-competitive actions have been envisaged to: (i) follow legislative initiatives of the Parliament or the Government with an impact on competition; (ii) address recommendations to the Government, sector regulatory authorities and other public entities on measures with an impact on competition; (iii) contribute to the diffusion of a culture of continuous competitive impact assessment of public policies; (iv) establish relations with national and international institutions under the topic of competition impact assessment.

This is in line with the reform path already followed by other competition authorities in Europe ([5]) that are increasing efforts to improve competition policies and the role of the competent authorities to increase efficiency, quality and availability in the public sector. In other jurisdictions, ([6]) enlarged advocacy powers have been enshrined in legislation by entrusting the competition authority with the duty of delivering a binding opinion on government bills and regulations which introduce access restrictions to economic activities. More precisely, the competition authority may issue an opinion indicating the specific nature of the restrictions. In the event that the public administration fails to comply with the opinion, the national competition authority may challenge the provisions in front of an administrative Court.

Strong commitment by the Portuguese Government to support efforts towards a comprehensive and effective advocacy capacity in line with European best practices would ensure that competition is a key focus in policy design and implementation and create a favourable environment for economic activity with positive effects in terms of GDP growth.

This is especially important at times of moderate economic growth and fiscal constraints, since it contributes to better use of labour and capital and increase innovation, better management and regulation. ([7]) In the case of Portugal, fostering competition will represent the opportunity to emerge stronger and more dynamic from the crisis by increasing productivity, growth and competitiveness.

([4]) For details of the new advocacy role and the special unit for competition assessment of public policy described in this paragraph, see Gomes A, "Advocacy as a driver for change: strategies and approaches for advocacy for shaping the future. The creation of a special unit for competition assessment", ICN Advocacy workshop, Rome, 12 December 2013, available at the following link: http://www.agcm.it/trasp-statistiche/doc_download/4040-advocacy-as-a-driver-for-change-gomes.html

([5]) See Report from the Nordic competition authorities, " A vision for competition. Competition policy towards 2020", 2003.

([6]) This is the case, for example, of Italy.

([7]) Office of Fair Trading UK, "Competition and growth, November 2011.

**90. Further efforts remain necessary to align national legislation with the New Late Payments Directive.** As was noted in the 10th Review report, ([8]) the Decree Law 62/2013 of 10 May 2013 adopted by the Government is not fully in line with the New Late Payments Directive 2011/7/EU. No further updates were provided in relation to this issue, but the Portuguese authorities reiterated their argument 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 significant cash disbursement with a very negative fiscal impact. The Commission continues to reject

([8]) DG ECFIN Occasional Papers 171 (2014), The Economic Adjustment Programme for Portugal Tenth Review, p. 50.

Portugal's argument in this respect and could launch an infringement procedure for non-compliance.

*Licensing*

**91. Efforts to compile an inventory of regulatory burdens are progressing steadily.** This measure is now in the interview/focus group phase, which involves collecting input from representatives from two business confederations as well as individual business owners. This will then be followed by a cost analysis of each regulation identified in the inventory, which should be finished by early April, with a roadmap to address problematic areas to be produced shortly afterwards. This roadmap will also include strategies to reduce the administrative burden of future regulations, such as a communications campaign and an online portal where proposals for administrative simplification can be submitted.

**92. Approval of the decree-law implementing the one-in/one-out rule for new regulations has experienced further delays, with adoption now planned before the next Review.** The authorities are further developing the methodological details by drawing on a similar framework in the United Kingdom. The approach to be put in place will be centred on systematic impact assessments of proposed new regulations in terms of compliance and administrative costs. There will be a specially-trained coordinator within each Ministry responsible for managing this process, with monitoring in place at the level of the Secretary of State for Administrative Simplification and by publication of regular reports on the online administrative simplification portal.

**93. Several measures in relation to environmental and territorial planning are delayed, due to the fact that the Base Law of Soil and Territorial and Urbanism Planning is still awaiting parliamentary approval, which is currently anticipated by early April 2014.** Review of the legal regimes of the Territorial Management Instruments (RJIGT) and Urbanism and Building (RJUE) as well as harmonisation of the Regional Plans, all of which are dependent on the framework provided by the Base Law of Soil, are therefore delayed as well. This new set of regulations will devolve enhanced management powers to local governments and is expected to reduce the time and costs for construction permits. The Government is also finalizing the details of the legal provision for regularisation of activities not in accordance with this new legal framework, which will provide a 2-3 year transition period for about 3,500 businesses (mostly in agriculture) that would currently be considered non-compliant; adoption is expected by April 2014. In addition, consultation is currently underway with various specialised bodies on 31 types of potential environmental and safety risks, with a decree-law to help manage some of these risks in the context of territorial planning to be adopted by April 2014. Initially, this decree-law will address 7 risk factors deemed particularly important, with the scope to be gradually extended over time to the full set of 31. Finally, a decree-law implementing the integrated nationwide land registration system is expected to be adopted before the next Review; however, in light of the uneven quality of historical data and the lack of integration between the judicial, fiscal and geological land registry databases, implementation of the new approach can be expected to pose significant operational and practical challenges.

**94. The revised commercial licensing regime has been approved.** The new regime is based on the principle of Zero Authorisation, with an approach of prior notification as opposed to prior authorisation, as well as a reduction of licensing fees. The legislation will be submitted to Parliament by end-March 2014.

**95. Review of the geological exploration and mining licensing regimes has experienced further delays.** The authorities have formulated a number of possible measures aimed at simplifying the legal and bureaucratic procedures pertaining to mining investments, with adoption anticipated by April2014.

*Box 2.6:* **Summary of compliance with policy conditionality for the 11th Review**

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

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| **Fiscal policy** | The 2013 general government deficit target was met by some margin. The ESA-95 deficit is estimated to have been reduced to about 4.5 percent of GDP (excluding the cost of bank recapitalisations), compared with a target of 5.5 percent of GDP. This reflects the strong performance of State tax revenue and expenditure control, whereas non-tax revenue was weaker than expected. The target of non-accumulation of new arrears was missed, notably due to structural imbalances of SOE hospitals. The consolidation measures in the 2014 State Budget and supporting legislation are consistent with the achievement of a deficit target of 4 percent of GDP in 2014. Consolidation measures are mostly on the expenditure side but include also some revenue increasing measures. |
| **Fiscal-structural** | Public finance management: The Budget Framework Law (BFL) is under revision to ensure the full transposition of the Fiscal Compact and the six-pack. A report by the Working Group for the Reform of the BFL presents various suggestions to improve the existing BFL as well as the Portuguese Public Financial Management system. A new working group has been set up to assess the legal implementation of these proposals. To strengthen the monitoring and oversight of arrears a central unit has been recently created in the Ministry of Finance, which reports to the Secretary of State for the Budget on the stock of arrears and coordinate actions to enforce the Commitment Control law in full.<br><br>Revenue administration: The Risk Management Unit is fully operational and is working on projects targeted at improving compliance in certain taxpayer segments (high wealth individuals and self-employed professionals). To improve the tax administration audit capability, a recruitment process is in progress but is delayed. The final plan for the closing of 50 percent of the local tax administration network will be announced by the 12th Review. A new initiative to incentivise the request of invoices by final consumers has been recently launched (VAT lottery).<br><br>Public administration reform: At the end of 2013, employment in public administration was about 8 percent below the level at the end of 2011. The Programme target of an annual employment reduction by 2 percent is thus exceeded. Significant reforms, which rationalise the public administration and underpin the consolidation strategy in the near-term, have recently been accomplished. Among these are the new General Public Administration Labour Law, the so-called "convergence diploma" that aligns the rules for public sector pensions (CGA) with those for the general social security system and measures addressing public employment, such as the mutual agreement terminations schemes and the kick-off of the requalification programme.<br><br>Public Private Partnerships (PPP): The 2012 report on the annual PPP credit flows was approved with delay. Delays in closing the report stemmed from excessive work load at the Ministry of Finance's PPP task force (UTAP), but also from data quality problems in the SIRIEF-PPP system. In order to ensure a timely and regular annually reporting by end-June, authorities will undertake a comprehensive review of the database to improve consistency and clear errors. Overall, the report fits the requirements although further efforts to include concessions that bear fiscal risks should be envisaged<br><br>SOEs: End of 2013 preliminary financial data for the transport SOEs indicate that the reinstatement of the two bonus salaries was compensated by additional cost compression measures allowing for an overall positive operational balance for the second consecutive year. Employment in SOEs at central, regional and local levels declined from about 200,000 at the end of 2012 to about 180,000 at the end of 2013, resulting from both attrition and privatisation. Transport SOEs reduced their labour force by over 3,000 (-18.4 percent) in just three years.<br><br>Health: Policy implementation continues and reforms have produced important savings through increases in efficiency in the sector. The consolidated deficit of the sector (Central Government and SOEs) shows a significant reduction since 2010 (from EUR -833 million in 2010 to EUR -126 million in 2013), in spite the reduction of budget transfers and an important stock of overdue debt has been paid (the level of the stock of arrears in December 2013 is the lowest since December 2010). The existence of an important stock of arrears is strongly (though not solely) related to a consistent underfunding of SOE hospitals vis-à-vis their service provision obligations. Due to the remaining stock of arrears, the tight budget line and the reinstatement of the two bonus salaries, the authorities were forced to speed up reforms. The authorities reconfirmed their commitment to implementing the ongoing hospital reform and continuing to fine-tune the set of measures concerning pharmaceuticals, centralised procurement and primary care. |

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| **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 considerably enhanced its top-down stress testing methodology, which is now being 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 continues to meet a Common Equity Tier 1 (CET1) capital ratio of 7 percent taking into account all transitional provisions. In the context of the ECB's on-going asset quality review, the largest banks are expected to maintain a CET1 add-on of 1 percentage point. The Portuguese authorities are considering the treatment of DTAs that were generated by Portuguese banks mostly in 2011-13 through high impairments and the partial transfer of bank pension funds to the general social security system in 2011.<br><br>Supervisory organisation: Building on previous experience of thematic inspections, the BdP finalised - jointly with a consultant - a special assessment programme (SAP) to assess banks' policies and procedures to handle distressed credit during its entire lifecycle. In January 2014, banks presented action plans to implement the SAP recommendations. The deadline for implementing the recommendations is end-June 2014.<br><br>Recovery and resolution: After concluding the analysis of the recovery plans of the banks in 2013, the BdP made individual recommendations to the banks to adjust their plans. The BdP received the updated version of recovery plans in January 2014 and is currently assessing banks' submissions in terms of applicability, proportionality and feasibility. In the medium term, the aim is to fully integrate the recovery plans review into the overall supervision process. In parallel, the banks are requested to submit data for their resolution plans. The resolution fund is expected to reach EUR 215 million by end-2014. Ultimately the fund's size will comply with the target level laid down in the BRRD (0.8 percent of covered deposits).<br><br>Financing alternatives for the corporate sector: The authorities are setting up a specialised development financial institution (DFI) to support the financing of the corporate sector, in particular SMEs. The DFI's draft by-laws and business model will be submitted for in-depth consultations with EC, ECB and IMF staff before the Twelfth Review.<br><br>Government-sponsored credit lines: Measures to improve the governance, efficiency and risk management practices within the National Guarantee System (NGS) were implemented, including, more recently, a new methodology to set the interest rate caps currently being applied to guaranteed loans.<br><br>Insolvency and restructuring frameworks: Improvements to the functioning of the corporate insolvency and restructuring framework are being explored. |
| **Reform of labour, goods and services markets** | Labour market: The Government sent to Parliament a draft law revising the definition of individual fair dismissals. Action has been taken to improve the job counselling/job search assistance and activation/sanctions systems. Reports have been prepared on policy options to reform the legislation of unfair dismissals and to foster collective bargaining and promoting bargaining decentralisation and wage flexibility, including on the expiration and survival of collective agreements.<br><br>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 formula-based funding framework and a new inspection model have been further developed. As regards educational and vocational training, a decree law creating short-cycle training courses has been approved. A decree creating the rules governing professional schools of reference is expected to be published by the end of March 2014.<br><br>Energy: The 2014 Budget law introduced a new levy on energy operators and a decree law was approved at the Council of Ministers on February 2014. However, this levy was targeted at closing an apparent budgetary gap, rather than reducing cost inefficiencies in the system. In order to reduce energy costs for the economy further concrete measures to tackle remaining excess rents will be presented by end-April. An update of the additional measures announced in the previous review was presented, in particular addressing the problem of distortion in the system services market, where new measures are being implemented. Regarding energy tariff debt dynamics up to 2020, the assumptions and parameters used will need to be further clarified. Additional measures to tackle the remaining excess rent and to deliver cost reductions leading to lower energy prices will be presented. A first draft of the legislation regarding the revision of the remuneration scheme for co-generation is expected by March 2014. [PT suggest to delete, as not linked to review] |

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| **Reform of labour, goods and services markets** | Telecommunications: Contracts have been signed with the universal service providers that had been designated through the open selection procedures concluded in October/November 2013. In light of the fact that the tender for the third universal service (directory services) did not attract any bids, a one-year contract for this service has been signed after a direct award procedure involving all candidates qualified in the original tender. The infringement procedure on the designation of the universal service provider(s) through an efficient, objective, transparent and non-discriminatory mechanism is ongoing. The Commission is 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. The compensation payment by the Portuguese State to Portugal Telecom for the early termination of their pre-existing Universal Services agreement will amount to a maximum of EUR 33.5 million, which was calculated based on a methodology aimed at compensation for the unamortised part of investments made.<br><br>Transport: Despite implementing important measures such as the new port labour law, reducing the port tariffs such as TUP Carga and a medium term strategic transport infrastructure, important measures still have to be adopted. A clear long-term vision of the transport system is still missing and is now scheduled for the 12th Review. Despite progress, further policy reforms in ports are required to increase their efficiency and ability to compete in international markets Concrete actions are necessary following the publication of an action plan aimed at reforming the ports sector, in particular as regards a new ports' tariff modulation and the renegotiations of the existing ports concessions. An executive order to initiate those renegotiations has recently been signed and is currently assessed by the relevant Commission services. Further progress is required to ensure operational balance of the rail infrastructure manager by 2015, as also required by the EU directives, which is an issue of concern given its high and rising indebtedness The transfer of the CP Carga terminals to REFER which has been delayed foresees a phased approach. The full transfer is now expected to be concluded before the 12th Review. An analysis of the performance scheme related to infrastructure charges has been presented and is currently being assessed by the relevant Commission services. The launch of the four concessions for the metropolitan passenger transportation services is expected to materialise by the 12th Review. Finally, the new legal framework for the transport regulator is expected to be adopted by the end of March 2014.<br><br>Services: Progress on the adoption of legislative amendments to align the legislation with the principles of the Services Directive has continued, albeit at a modest pace. The Construction laws and the law amending the legal regime of universities are further delayed. The submission of the revised bylaws to the Parliament, following the adoption of the horizontal framework law on public professional associations, is delayed. Progress is observed in making the Point of Single Contact fully operational. |
| **Reform of framework conditions** | Housing market: Information received from various private-sector stakeholder groups by the Monitoring Committee for Urban Rental Reform suggests that the urban lease reform is starting to show significant impact. However, reliable data on key aspects of the rental market are lacking, hindering ongoing monitoring and evaluation of the reform. In the absence of appropriate official data, considerations should be given to commission a tailor-made isurvey-based study at regular intervals so as to ensure continued monitoring of the rental market.<br><br>Competition and sectorial regulators: Following the framework law setting the main principles of the functioning of the main National Regulatory Authorities (NRAs), the Government shared in November with the Commission the corresponding amendments to the by-laws of the NRA, which should have been approved by early December. One draft by-law is still being discussed with the Commission. The new executive order setting the contributions from the different regulators for the years 2013 and 2014 has been published. 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 have to be compliant with the free movement of capital under the Treaty. This means inter alia that the relevant criteria have to be clearly defined a wide discretion to the authorities. |

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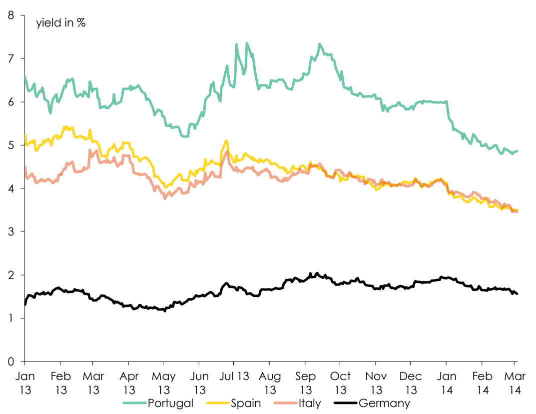
| **Reform of framework conditions** | Public procurement: Monitoring and reporting of public procurement procedures has been significantly enhanced. The 250 potentially irregular direct awards identified previously have been submitted to the National Court of Auditors and the Inspectorate for Finances and appear to be the result of data entry errors rather than actual unlawful awards. Going forward, the National Court of Auditors will publish regular reports on public procurement. In the course of 2014, the Inspectorate for Finances (IGF) will also carry out an independent audit.<br>Business environment: The streamlined online platform for requesting VAT exemptions by exporters has resulted in a reduction in the average time to completion of reimbursement applications from 42 days in early 2013 to 8 days in December 2013, bringing the long-term target of 4 days well within reach. The Commission considers that Decree Law 62/2013 adopted by the Government on 10 May 2013 is not fully in line with the New Late Payments Directive 2011/7/EU.<br>Licensing: An inventory of the administrative burden is ongoing and most of the legislation on zero licensing procedures for industries and commercial services has been adopted. However, many legal reforms envisaged to ease licensing requirements on territorial planning as well as for the mining/geological exploration sector are behind schedule. The "one-in/one-out rule" for new regulations as well as adoption of the new commercial licensing regime has also been further delayed and is now expected before the next Review. |
| **Data** | Requirements under the Programme have been observed. Work is ongoing to improve further data submission. |

# 3. PROGRAMME FINANCING

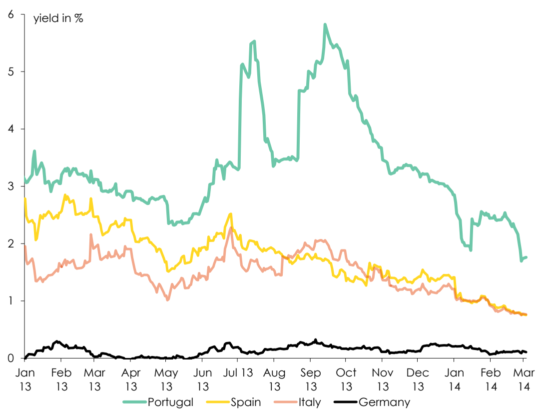
**96. The rally in Europe's peripheral bonds in early 2014 provided the Portuguese Treasury with a good opportunity to access financial markets.** The Treasury issued a 5-year bond in January and a 10-year bond in February. Both issuances were made through syndication and raised EUR 3.3 billion at 4.7 percent yield and EUR 3 billion at 5.1 percent yield. Furthermore, at the end of February the Treasury engaged in a buy-back operation, buying EUR 0.3 billion of October 2014 bonds and EUR 1 billion of October 2015 bonds, thus reducing the near-term redemptions. The authorities intend to resume regular auctions this year.

Graph 3.1: **10-Year Government bond yield**




***Source:*** Bloomberg

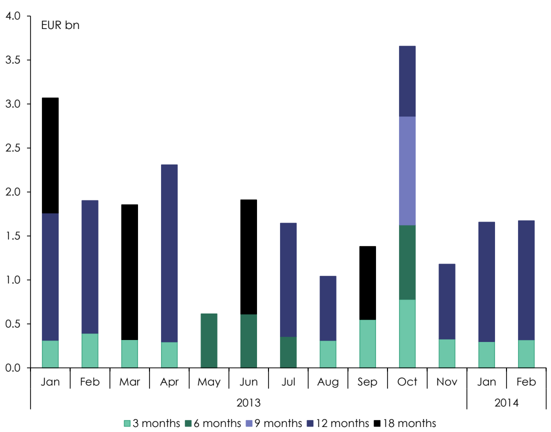
Graph 3.2: **2-Year Government bond yield**




***Source:*** Bloomberg

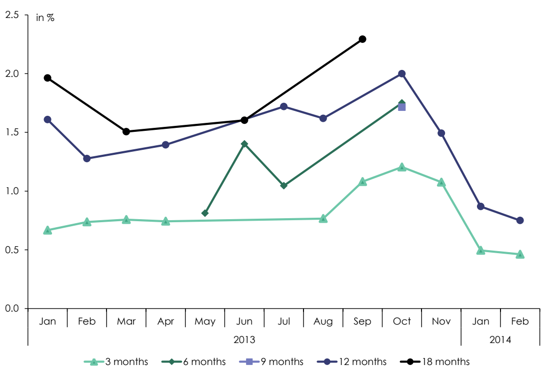
**97. Funding conditions for Portugal have been steadily improving in recent months, amid an on-going global investor search for yield.** The sovereign bond yields over the first two months of 2014 have contracted by more than 110 bps in both 10-year and 2-year segments and the liquidity in the secondary market deepened. 10-year yields are now at about 4.5 percent compared to 7 percent in September 2013.The investor base has also been broadening, with international real money investors gradually replacing more volatile investors such as hedge funds.

Graph 3.3: **Short-term auctions issuance**




***Source:*** Bloomberg

Graph 3.4: **Short-term auctions weighted average yield**




***Source:*** Bloomberg

**98. The short-term debt stock remains high.** The Treasury continued to organise monthly T bill auctions throughout 2013 (except December). Auctions also continued in the first two months of 2014 with short-term debt issuances concentrated in 3-months and 12-months maturities. Short term borrowing costs fell, following the trend in the medium and long-term segments. The T- bill stock as of end February 2014 stood at EUR 19 billion.

**99. As a result of successful debt issuances, the Treasury's cash buffer is sufficient to cover the currently projected funding needs in 2014, assuming that the remaining official support funds will be disbursed, retail debt sales will continue successfully and the Treasury bill stock remains broadly unchanged.** The Treasury has transferred the remaining EUR 4 billion to the BSSF account, which now contains EUR 6.4 billion for banking sector support if needed.

**100. The short-term outlook for Portugal's sovereign financing is favourable, but downside risks remain.** Such risks relate to an abrupt change in investor sentiment, triggered either by domestic or external developments. Vulnerability to these risks reflects the continued high public debt ratio of 128.8 percent in gross terms, as well as the continuing accumulation of arrears and debt of public enterprises. Despite the arrears settlement programmes conducted during the Programme, the accumulation of arrears, particularly in the health sector, has not been entirely halted. Another risk is associated with the need for financial restructuring of the loss making enterprises in anticipation of the private concessions process already in course, which may need recourse to treasury funding. Nevertheless, it should be noted that the stock of gross debt also reflects the Treasury's cash buffer and that the stock of net debt is expected to remain below 120 percent of GDP.

**101. High borrowing costs and subdued growth remain the key risks in the medium term. While the current contraction in yields is a positive sign, the improving borrowing costs must be assessed against historically low euro monetary policy rates.** The search for yield that motivated real money investors to acquire Portuguese debt might reverse as soon as policy rates normalise and the highest investment grade rating issuers start offering better returns. Portugal remains rated below investment grade by all three major rating agencies. Economic growth acceleration is essential to ensure Portugal's debt sustainability.

**102. Portugal's exit from the current Programme is nearing. Portugal's Programme will end on 17 May 2014.** For technical reasons the current Programme may have to be extended by six weeks in order to terminate all procedural steps necessary to enable the last EU disbursement. However, this technical extension does not entail any Programme conditionality and the next and last Programme Review will take place well before 17 May 2014.

# ANNEX 1

## Assessment of Compliance: Monitoring Table

| *Actions for the Eleventh Review (to be completed by end Q4 - 2013 or by the Eleventh Review)* | | *Status* |
|---|---|---|
| **Financial Sector** | **[2.9]** Utilise the new top-down stress testing framework in the round of quarterly stress tests. | **Observed.** In Q4 BdP significantly enhanced its top-down stress testing methodology which it used during the past round of stress tests. The outcome of the top down exercise was used to challenge banks' submissions during the Q4 2013 stress test exercise. |
| | **[2.19]** Enhance the transparency in the pricing practices of participating institutions in the existing government-sponsored credit lines. | **Observed.** Measures to improve the governance, efficiency and risk management practices within the National Guarantee System (NGS) were implemented, including, more recently, a new methodology to set the interest rate caps currently being applied to guaranteed loans. |
| **Fiscal Structural** | **[3.2]** Reduce the number of budget entities and review the classification of own revenues. | **Delayed/Ongoing.** These elements will be dealt with within the comprehensive review of the Budget Framework Law to be completed by end 2014. |
| | **[3.3]** Develop targeted programmes to underpin financial sustainability of public entities. | **Partially observed.** The strategic plans are being negotiated with SOEs and the corresponding contracts are targeted to be signed until end March 2014. |
| | **[3.3]** 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. | **Observed.** The dedicated unit in charge of the expenditure arrears for the public sector was formally appointed in February 2014. |
| | **[3.6]** Publish a report assessing the Budget Framework Law and provide suggestions for new legislation. | **Observed.** The report was presented in December 2013. |
| | **[3.11]** Present the annual PPP report and utilise it as input to the fiscal risks assessment for the budget. | **Observed.** The report was approved with delay. The collaboration between the PPP task force (UTAP) and the Bank of Portugal regarding credit flows and potential crowding-out effects went smoothly. Delays in closing the report stemmed from UTAP's excessive work load in the last half of 2013 but also the quality of data inserted in the SIRIEF-PPP system. In order to ensure a timely and regular annual reporting by end-June authorities will do a comprehensive review of the database to improve consistency and clear mistakes. Overall, the report fits the requirements although further efforts to include |

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| | | concessions that may bear fiscal risks should be envisaged. |
| | **[3.17 ii]** Increase the resources devoted to auditing in the tax administration to at least 30 percent of the total staff. | **Delayed.** The recruitment process is ongoing but attaining the threshold in the number of auditors is delayed. A new deadline was set at **Q1-2014**. |
| | **[3.17 iii]** Publish quarterly reports on duration and costs of tax cases. | **Delayed/Annulled**. The measure was withdrawn of the Programme targets due to unfeasibility. It will be implemented as from 2015 as part of a new action plan. |
| | **[3.18]** Prepare an evaluation report of the measures for the different economic sectors after implementing the e-invoicing system. | **Observed**. |
| | **[3.20 i]** Prepare an assessment report on the current tax compliance situation. | **Observed**. |
| | **[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. | **Delayed.** A new deadline was set at Q1-2014. |
| | **[3.22 ii]** Reorganise the network of decentralised services of ministries. | **Delayed.** A new deadline was set at Q1-2014. |
| | **[3.23 i]** Complete the implementation of the strategy of shared services in the area of financial resources (GeRFIP) in central and regional administrations. | **Observed.** The strategy was implemented in 351 entities, of which 270 in the central administration, 44 in Azores and 37 in Madeira. |
| | **[3.26]** Provide a report on the comprehensive reform of wage supplements. | **Observed.** The report with the results of the survey was published in December 2013. |
| | **[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. | **Observed.** Implemented by Law n° 11/2014 of 6 March 2014, with the exception of pensions already in payment on which earlier provisions were deemed unconstitutional by the Constitutional Court. |

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| **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-border/foreign patients, will result in additional revenues of €50 million. | **Partly Observed.** The authorities have implemented measures which have considerably improved revenue collection from fees, cross-border patients and insurance companies. However, 2013 additional revenues did not reach 50 million. This relates to the economic situation which has increased the number of individuals qualifying for exemption (e.g. through unemployment) plus a significant reduction in road accidents. Additionally, 2012 was an exceptional year in terms of collecting revenues from foreign patients and late payments. |
| | **[3.35]** Publish a follow up report on INN prescription. | **Observed.** |
| | **[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. | **Observed.** |
| | **[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. | **Ongoing.** The plans for the reallocation of human resources are part of the 3-year strategic programmes which are due to be being finalised and signed in March. |
| | **[3.47]** Reduce overtime compensation by a further 20 percent in 2013 through the application of new payment scales for overtime and new rules to increase mobility within and across Regional Health Authorities. | **Observed.** |
| | **[3.48]** Finalise the implementation of new internal control procedures manual by the Regional Health Authorities. | **Observed.** |
| **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. | **Observed**. A draft law has been sent to Parliament.. |

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| | **[4.4]** Present a report assessing policy options to reduce incentives to challenge dismissals in court. Evaluate the need for further steps. | **Observed**. Specific policy options to be discussed at the 12th Review. |
| | **[4.5 iii]** Prepare an independent review on shortening the survival of contracts that are expired but not renewed. | **Observed**. Results and policy options to be discussed during the 12th Review. |
| | **[4.5 iv]** Present a report assessing policy options for ensuring effective decentralisation of wage bargaining and promoting wage flexibility. | **Observed**. Specific policy options to be discussed at the 12th Review. |
| | **[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. | **Observed**. Measures have been presented to reinforce the role of job counselling/job search assistance and activation/sanctions systems. |
| **Education** | **[4.7 ii (ii)]** Define and implement a simple funding framework comprising performance and evaluation criteria for public schools. | **Observed.** A formula-based funding framework including performance criteria ("Crédito Horario") has been defined and implemented. |
| | **[4.7 ii (iii)]** Report on possible further improvements of the new inspection model in the secondary education. | **Observed.** A number of initiatives to further improve the new inspection model are being implemented. |
| | **[4.7 iii (iii)]** Establish "professional schools of reference". | **Ongoing**. A decree revising and harmonising the rules governing the professional schools of reference is expected to be published by the end of March 2014. |
| **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. | **Observed.** The Assumptions and parameters were provided; some of them need to be further clarified. At this stage there is no indication that the cost would be passed on to end users prices. |
| | **[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 hydro resource by the former CAE hydro | **Ongoing.** |

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| | 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. | **Delayed.** The new draft legislation is delayed and is expected for March 2014. |
| | **[5.7 iv]** Reform the transport and infrastructures' regulatory framework. | **Observed (with a delay).** The relevant legislation was approved in March 2014 |
| | **[5.8]** Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability. | **Delayed**. The long term vision and related strategic action to improve sustainability and efficiency of the transport sector have been postponed to the 12th Review. |
| | **[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. | **Observed (with a delay).** The relevant legislation was approved in March Q1 2014 |
| | **[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. | **Delayed.** The conclusion of PSO contracts have been postponed to the 12th Review. |
| | **[5.11]** Complete the adoption of Construction Laws and the other sectorial amendments necessary to fully implement the Services Directive. | **Partially observed.** 63 out of the initial 68 legal regimes have been completed under the Services Directive. The laws on construction and some sectoral laws have further delays and the ban on franchising for higher education remains outstanding. |
| | **[5.12]** Submit to Parliament the professional bodies' amended statutes. | **Delayed/ongoing.** More than half of the professional bodies' amended statutes are being discussed with the Commission. The rest of the bylaws have not yet been shared. |
| | **[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 | **Partially observed**. Some progress has been made. 48 regimes out of the 50 so far published have been put online on the PSC both for information and completion of procedures. |

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| | 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. | **Partially observed.** There is still a gap between the regimes published and those submitted and dematerialised in the PSC online platform. |
| | **[5.13 iii]** Extending PSC to services not covered by the Services Directive. | **Ongoing.** |
| | **[5.13 iv]** Extending the "Zero Authorisation" project to other services sectors. | **Ongoing.** |
| **Housing market** | **[6.2]** Provide a comprehensive review of the functioning of the housing market. | **Partially observed / ongoing.** Some information was collected from private-sector stakeholder groups and presented as part of a review report; however, reliable, unbiased quantitative data on key aspects of the market remain lacking. |
| **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. | **Observed.** |
| | **[7.4]** Approve the corresponding amendments to the bylaws of the National Regulatory Authorities. Ensure the effective functioning of the Competition Authority financing model. | **Partially observed.** Different bylaws are at different stages of approval. The amended bylaws of the competition authority are still under discussion. The executive order setting the contributions from the different regulators for the year 2014 has been published. |
| | **[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 the Court of Auditors. | **Observed.** The 250 potentially irregular direct awards identified previously have been submitted to the National Court of Auditors. The Court has completed its preliminary assessment and for the majority of these awards (around 200) did not find any legal irregularities but rather data entry errors. The remaining 50 potentially uncompliant direct awards are of small value, and although they are still eligible for further investigation, the Court's current view is that it is likely that they can be explained by |

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| | | similar data errors. |
| | **[7.6]** Assess the impact of the procedures for requesting VAT exemptions for exporting firms. | **Observed.** The streamlined online platform for requesting VAT exemptions by exporters has resulted in a reduction in the average time to completion of reimbursement applications from 42 days in early 2013 to 8 days as of December 2013. |
| | **[7.11]** Adopt a rule that makes mandatory when creating a new regulation generating costs for businesses, to eliminate existing regulations with equivalent cost. | **Delayed.** The decree-law that will include this rule is in its final form, and a proposal will be presented to the Council of Ministers before the next Review. |
| | **[7.12 i]** Adopt the Base Law of Soil and Territorial and Urbanism Planning and ensure its alignment with the new Industrial Licensing regime. | **Delayed.** The Base Law of Soil and Territorial and Urbanism Planning is still awaiting parliamentary approval, which is currently anticipated by early April 2014. |
| | **[7.12 ii]** Adopt and make operational a Risk Sectorial Plan. | **Delayed.** Consultation is currently underway with various specialised bodies about 31 types of potential environmental and safety risks, with a decree-law to help manage some of these risks in the context of territorial planning to be adopted by April 2014. |
| | **[7.12 iii]** Review the legal regimes of the Territorial Management Instruments (RJIGT) and of the related regulations. | **Delayed.** The relevant regulation is likely to be implemented by end of April 2014, after approval of the Base Law of Soil. |
| | **[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 April 2014, after approval of the Base Law of Soil. |
| | **[7.12 v]** Harmonise the regional plans. | **Delayed.** The relevant regulation is likely to be implemented by end of April 2014, after approval of the Base Law of Soil. |
| | **[7.12 vi]** Review the Legal Regime for Urbanism and Building (RJUE) that should be aligned with the new Industrial Licensing regime. | **Delayed.** The relevant regulation is likely to be implemented by end of April 2014, after approval of the Base Law of Soil. |
| | **[7.13 i]** Implement a Legal Regime of Land Registration. | **Delayed.** A decree-law implementing the integrated nationwide land registration system is in its final form, with adoption expected before the next Review. |

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| | **[7.13 ii]** Create a diploma on Land Registration and Land Registration Experts. | **Delayed.** Adoption expected before the next Review. |
| | **[7.13 iii]** Review the cartography for plans regime and the diploma on Cartography. | **Delayed.** Adoption expected before the next Review. |
| | **[7.13 iv]** Enforce the Council of Ministers Resolution 56/2012 to collect all land registration procedures. | **Delayed.** Adoption expected before the next Review. |
| | **[7.14]** Approve the new legal regime for commercial actives and establish the Programme for the Competitiveness of Commerce and Services activities. | **Observed (with a delay).** The decree-law implementing the new commercial licensing regime was approve by the Council of Ministers in March 2014. |
| | **[7.15 i]** Review the legal regime concerning the licensing of mining and geological production and investment in line with international best practices. | **Delayed.** The authorities have formulated a number of possible measures aimed at simplifying the legal and bureaucratic procedures pertaining to mining investments, with adoption anticipated by April 2014. |
| | **[7.15 ii]** Simplify the legal and bureaucratic procedures pertaining to mining and geological investments. | **Delayed.** Adoption anticipated by April 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 | -1.6 | 0.7 | 0.7 | 0.8 | 0.8 |
| 2. Government consumption expenditure | -4.7 | -1.6 | -1.6 | -1.5 | -0.2 | -0.3 |
| 3. Gross fixed capital formation | -14.4 | -6.5 | 3.1 | 3.8 | 4.0 | 4.4 |
| **4. Final domestic demand** | **-6.8** | **-2.4** | **0.6** | **0.8** | **1.1** | **1.3** |
| 5. Change in inventories | -- | -- | -- | -- | -- | -- |
| **6. Domestic demand** | **-6.7** | **-2.5** | **0.6** | **0.8** | **1.1** | **1.3** |
| 7. Exports of goods and services | 3.2 | 5.9 | 5.5 | 5.5 | 5.3 | 5.0 |
| *7a. - of which goods* | 4.1 | 5.7 | 5.5 | 5.5 | 5.3 | 5.1 |
| *7b. - of which services* | 0.7 | 6.2 | 5.3 | 5.3 | 5.1 | 5.0 |
| **8. Final demand** | **-4.2** | **-0.2** | **2.0** | **2.2** | **2.4** | **2.5** |
| 9. Imports of goods and services | -6.6 | 2.8 | 4.0 | 4.0 | 4.3 | 4.3 |
| *9a. - of which goods* | -6.4 | 3.3 | 4.4 | 4.4 | 4.6 | 4.5 |
| *9b. - of which services* | -7.7 | 0.2 | 1.5 | 1.5 | 2.5 | 2.5 |
| **10. Gross domestic product at market prices** | **-3.2** | **-1.4** | **1.2** | **1.5** | **1.7** | **1.8** |
| *Contribution to change in GDP* | | | | | | |
| 11. Final domestic demand | -7.1 | -2.4 | 0.6 | 0.8 | 1.1 | 1.2 |
| 12. Change in inventories + net acq. of valuables | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| 13. External balance of goods and services | 3.8 | 1.1 | 0.6 | 0.7 | 0.5 | 0.5 |

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

| *Annual % change* | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| 1. Private consumption expenditure | -4.0 | -1.2 | 1.4 | 1.9 | 2.2 | 2.4 |
| 2. Government consumption expenditure | -11.6 | 3.4 | -4.8 | -3.3 | 0.1 | 0.3 |
| 3. Gross fixed capital formation | -14.0 | -6.1 | 5.1 | 5.9 | 7.1 | 8.5 |
| **4. Final domestic demand** | **-7.2** | **-1.1** | **0.8** | **1.6** | **2.7** | **3.1** |
| 5. Change in inventories | -- | -- | -- | -- | -- | -- |
| **6. Domestic demand** | **-7.0** | **-1.3** | **0.8** | **1.6** | **2.7** | **3.1** |
| 7. Exports of goods and services | 4.6 | 5.4 | 5.2 | 6.2 | 6.1 | 5.7 |
| **8. Final demand** | **-4.0** | **0.6** | **2.1** | **3.0** | **3.8** | **3.9** |
| 9. Imports of goods and services | -5.3 | 1.2 | 2.3 | 4.3 | 4.7 | 4.6 |
| 10. Gross national income at market prices | -2.6 | 1.0 | 1.1 | 2.1 | 2.9 | 3.7 |
| 11. Gross value added at basic prices | -3.4 | 0.9 | 2.0 | 2.3 | 3.3 | 3.6 |
| **12. Gross domestic product at market prices** | **-3.5** | **0.3** | **2.0** | **2.5** | **3.4** | **3.6** |

**Table 3: Implicit price deflators**

| *% change in implicit price deflator* | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| 1. Private consumption expenditure | 1.5 | 0.4 | 0.7 | 1.2 | 1.5 | 1.5 |
| 2. Government consumption expenditure | -7.3 | 5.1 | -3.3 | -1.8 | 0.3 | 0.6 |
| 3. Gross fixed capital formation | 0.5 | 0.5 | 2.0 | 2.1 | 3.1 | 4.0 |
| **4. Domestic demand** | **-0.4** | **1.3** | **0.2** | **0.8** | **1.5** | **1.8** |
| 5. Exports of goods and services | 1.4 | -0.5 | -0.2 | 0.7 | 0.8 | 0.6 |
| **6. Final demand** | **0.1** | **0.8** | **0.1** | **0.8** | **1.3** | **1.4** |
| 7. Imports of goods and services | 1.4 | -1.6 | -1.7 | 0.3 | 0.3 | 0.3 |
| **8. Gross domestic product at market prices** | **-0.3** | **1.7** | **0.8** | **1.0** | **1.7** | **1.8** |
| **HICP** | **2.8** | **0.4** | **0.7** | **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 | 1.6 | 0.5 | 0.7 | 1.1 | 1.2 |
| 2. Compensation of employees per head | -2.0 | 3.5 | -0.9 | 1.0 | 1.2 | 1.2 |
| **3. Unit labour costs** | **-3.0** | **1.8** | **-1.4** | **0.3** | **0.2** | **0.0** |
| 4. Total population | -0.4 | -0.7 | -0.1 | -0.1 | 0.0 | 0.0 |
| 5. Population of working age (15-64 years) | -0.7 | -0.7 | -0.2 | 0.0 | 0.0 | 0.0 |
| 6. Total employment (fulltime equivalent) | -4.2 | -2.9 | 0.7 | 0.7 | 0.6 | 0.6 |
| **7. Calculated unemployment rate - Eurostat definition (%)** | **15.9** | **16.5** | **15.7** | **15.0** | **14.5** | **14.0** |

**Table 5: External balance**

| *levels, EUR bn* | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| 1. Exports of goods (fob) | 47.7 | 50.2 | 52.7 | 56.0 | 59.5 | 62.9 |
| 2. Imports of goods (fob) | 55.4 | 56.3 | 57.8 | 60.5 | 63.4 | 66.5 |
| **3. Trade balance (goods, fob/fob) (1-2)** | **-7.7** | **-6.1** | **-5.1** | **-4.4** | **-3.9** | **-3.6** |
| ***3a. p.m. (3) as % of GDP*** | ***-4.7*** | ***-3.7*** | ***-3.0*** | ***-2.6*** | ***-2.2*** | ***-2.0*** |
| 4. Exports of services | 16.2 | 17.1 | 18.1 | 19.2 | 20.3 | 21.5 |
| 5. Imports of services | 9.5 | 9.4 | 9.4 | 9.6 | 9.9 | 10.2 |
| **6. Services balance (4-5)** | **6.7** | **7.7** | **8.7** | **9.6** | **10.4** | **11.3** |
| ***6a. p.m. 6 as % of GDP*** | ***4.0*** | ***4.7*** | ***5.2*** | ***5.6*** | ***5.8*** | ***6.1*** |
| **7. External balance of goods & services (3+6)** | **-1.0** | **1.6** | **3.6** | **5.2** | **6.5** | **7.7** |
| ***7a. p.m. 7 as % of GDP*** | ***-0.6*** | ***1.0*** | ***2.2*** | ***3.0*** | ***3.6*** | ***4.1*** |
| 8. Balance of primary incomes and current transfers | -2.7 | -1.1 | -2.7 | -3.5 | -4.4 | -4.6 |
| *8a. - of which, balance of primary income* | *-4.5* | *-3.5* | *-5.0* | *-5.8* | *-6.8* | *-7.0* |
| *8b. - of which, net current Transfers* | *1.8* | *2.3* | *2.3* | *2.3* | *2.3* | *2.4* |
| *8c. p.m. 8 as % of GDP* | *-1.6* | *-0.7* | *-1.6* | *-2.0* | *-2.5* | *-2.5* |
| **9. Current external balance (7+8)** | **-3.7** | **0.5** | **1.0** | **1.7** | **2.1** | **3.0** |
| ***9a. p.m. 9 as % of GDP*** | ***-2.2*** | ***0.3*** | ***0.6*** | ***1.0*** | ***1.2*** | ***1.6*** |
| 10. Net capital transactions | 3.5 | 3.1 | 3.2 | 3.3 | 3.3 | 3.5 |
| **11. Net lending (+)/ net borrowing (-) (9+10)** | **-0.2** | **3.6** | **4.1** | **5.0** | **5.4** | **6.5** |
| ***11a. p.m. 11 as % of GDP*** | ***-0.1*** | ***2.1*** | ***2.4*** | ***2.9*** | ***3.0*** | ***3.5*** |

**Table 6: Fiscal accounts**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| *% of GDP* | | | | | | |
| Indirect taxes | 13.7 | 13.5 | 13.6 | 13.7 | 13.6 | 13.5 |
| Direct taxes | 9.3 | 11.7 | 11.2 | 11.3 | 11.2 | 11.2 |
| Social contributions | 11.6 | 12.1 | 11.7 | 11.4 | 11.2 | 11.0 |
| Actual | 9.1 | 9.5 | 9.4 | 9.3 | 9.2 | 9.0 |
| Imputed | 2.5 | 2.6 | 2.3 | 2.1 | 2.1 | 2.0 |
| Sales and other current revenue | 4.9 | 4.8 | 5.3 | 5.4 | 5.4 | 5.4 |
| Sales | 2.8 | 2.9 | 2.7 | 2.7 | 2.7 | 2.7 |
| Other current revenue | 2.1 | 1.9 | 2.6 | 2.7 | 2.7 | 2.7 |
| **Total current revenue** | **39.4** | **42.1** | **41.7** | **41.8** | **41.5** | **41.1** |
| Capital transfers received | 1.5 | 1.2 | 1.1 | 1.1 | 1.1 | 1.1 |
| **Total revenue** | **40.9** | **43.3** | **42.8** | **42.8** | **42.6** | **42.2** |
| Compensation of employees | 10.0 | 10.6 | 9.3 | 8.7 | 8.5 | 8.3 |
| Intermediate consumption | 4.5 | 4.4 | 4.6 | 4.4 | 4.4 | 4.3 |
| 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 | 18.2 | 17.9 | 17.6 | 17.3 |
| Interest paid | 4.3 | 4.2 | 4.3 | 4.4 | 4.4 | 4.4 |
| Subsidies | 0.6 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Other current expenditure | 2.6 | 2.4 | 3.3 | 2.9 | 2.9 | 2.9 |
| **Total current expenditure** | **44.5** | **45.7** | **44.8** | **43.2** | **42.5** | **41.8** |
| Gross fixed capital formation | 1.7 | 1.6 | 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** | **48.2** | **46.9** | **45.3** | **44.6** | **43.9** |
| **General Government balance (ESA95)** | **-6.4** | **-4.9** | **-4.0** | **-2.5** | **-2.0** | **-1.7** |
| **General Government balance (Programme)** | **-6.0** | **-4.5** | **-4.0** | **-2.5** | **-2.0** | **-1.7** |
| *% change* | | | | | | |
| Indirect taxes | -4.1 | -1.1 | 2.8 | 3.4 | 2.8 | 2.7 |
| Direct taxes | -9.5 | 27.3 | -3.0 | 3.4 | 3.2 | 3.2 |
| Social contributions | -9.1 | 4.6 | -1.2 | 0.0 | 1.7 | 1.7 |
| Sales and other current revenue | 4.2 | -1.6 | 12.0 | 4.0 | 3.2 | 3.8 |
| **Total current revenue** | **-6.0** | **7.2** | **1.1** | **2.5** | **2.6** | **2.7** |
| Capital transfers received | -68.0 | -22.2 | -4.4 | 2.3 | 4.8 | 5.3 |
| **Total revenue** | **-12.3** | **6.1** | **0.9** | **2.5** | **2.6** | **3.0** |
| Compensation of employees | -15.0 | 6.6 | -11.2 | -3.4 | 0.4 | 1.0 |
| Intermediate consumption | -6.4 | -0.9 | 5.7 | 1.0 | 1.5 | 1.5 |
| Social transfers in kind via market producers | -5.9 | 0.5 | -3.2 | -3.5 | 0.5 | 0.5 |
| Social transfers other than in kind | -0.5 | 4.5 | -0.5 | 0.5 | 1.7 | 2.0 |
| Interest paid | 4.1 | -2.5 | 4.9 | 4.3 | 4.0 | 3.9 |
| Subsidies | -17.4 | 13.0 | 5.4 | 1.9 | 3.7 | 3.4 |
| Other current expenditure | -4.8 | 4.9 | 7.3 | -2.6 | 3.6 | 3.2 |
| **Total current expenditure** | **-5.4** | **3.8** | **-1.5** | **-1.4** | **1.5** | **1.9** |
| Gross fixed capital formation | -38.6 | -2.4 | 12.1 | -3.0 | 0.9 | 3.5 |
| Other capital expenditure | -11.0 | -27.6 | -64.6 | 42.7 | 7.8 | 9.2 |
| **Total expenditure** | **-7.3** | **3.2** | **-2.9** | **-1.2** | **1.6** | **2.0** |
| Nominal GDP, EUR bn | 165.1 | 165.6 | 168.9 | 173.1 | 179.0 | 185.4 |

**Table 7: Government debt developments**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| **ESA95 deficit (% of GDP)** | **-6.4** | **-4.9** | **-4.0** | **-2.5** | **-2.0** | **-1.7** |
| ESA95 gross debt (% of GDP) | 124.1 | 128.8 | 126.7 | 124.8 | 122.6 | 119.1 |
| | *levels, EUR bn* | | | | | |
| **ESA95 deficit** | **-10.7** | **-8.1** | **-6.8** | **-4.3** | **-3.6** | **-3.1** |
| Gross debt | 204.8 | 213.4 | 214.0 | 216.1 | 219.3 | 221.0 |
| Change in gross debt | 19.6 | 8.5 | 0.6 | 2.1 | 3.3 | 1.6 |
| Nominal GDP | 165.1 | 165.6 | 168.9 | 173.1 | 179.0 | 185.4 |
| Real GDP | 170.3 | 172.7 | 170.6 | 168.1 | 165.3 | 162.4 |
| **Real GDP growth (% change)** | **-3.2** | **-1.4** | **1.2** | **1.5** | **1.7** | **1.8** |
| Change in gross debt (% of GDP) | 11.9 | 5.2 | 0.4 | 1.2 | 1.8 | 0.9 |
| Stock-flow adjustments (% of GDP) | 5.4 | 0.3 | -3.7 | -1.3 | -0.2 | -0.8 |
| | *% of GDP* | | | | | |
| **Gross debt ratio** | **124.1** | **128.8** | **126.7** | **124.8** | **122.6** | **119.1** |
| Change in gross debt ratio | 15.8 | 4.8 | -2.2 | -1.9 | -2.3 | -3.4 |
| | *Contribution to change in gross debt* | | | | | |
| Primary balance | 2.1 | 0.7 | -0.3 | -1.9 | -2.4 | -2.8 |
| "Snow-ball" effect | 8.2 | 3.7 | 1.8 | 1.3 | 0.3 | 0.1 |
| of which | | | | | | |
| *Interest expenditure* | *4.3* | *4.2* | *4.3* | *4.4* | *4.4* | *4.4* |
| *Real growth effect* | *3.5* | *1.7* | *-1.6* | *-1.9* | *-2.1* | *-2.1* |
| *Inflation effect* | *0.4* | *-2.3* | *-1.0* | *-1.2* | *-2.1* | *-2.2* |
| **Stock-flow adjustments** | **5.4** | **0.3** | **-3.7** | **-1.3** | **-0.2** | **-0.8** |
| *Implicit interest rate* | *3.9* | *3.4* | *3.4* | *3.6* | *3.7* | *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** | **11.4** | **13.7** | **49.8** |
| Treasury balance [1] | 7.1 | 8.9 | 7.7 | 7.4 | 31.1 |
| Other public sector cash needs [2] | 4.4 | 4.4 | 3.7 | 6.3 | 18.8 |
| **Amortization [3]** | **9.5** | **27.8** | **17.2** | **13.4** | **68.0** |
| Medium- and long-term debt (incl debt exchanges and buybacks) | 4.9 | 16.6 | 13.1 | 11.8 | 46.4 |
| Other debt (retail, repos, ECP), net [4] | 4.6 | 11.2 | 4.1 | 1.6 | 21.5 |
| **Banking support [5]** | **1.0** | **7.5** | **1.6** | **0.5** | **10.6** |
| **Financing needs** | **22.0** | **48.6** | **30.2** | **27.6** | **128.4** |
| Market financing | -6.4 | 8.9 | 13.3 | 13.4 | 29.1 |
| Medium- and long-term debt | 0.0 | 3.6 | 12.0 | 13.4 | 29.0 |
| T-Bills, net | -6.4 | 5.3 | 1.3 | 0.0 | 0.1 |
| Own resources [6] | -5.7 | 12.3 | 6.9 | 6.4 | 19.9 |
| EU-IMF loan | 34.1 | 27.5 | 10.0 | 7.8 | 79.3 |
| EFSM/EFSF | 21.0 | 19.3 | 6.6 | 5.1 | 52.0 |
| IMF [7] | 13.1 | 8.2 | 3.4 | 2.7 | 27.4 |
| **Financing sources** | **22.0** | **48.6** | **30.2** | **27.6** | **128.4** |

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 2014 onwards does not include retail debt as issuance is projected to exceed redemptions.
5/ For 2011 - payments to BSSF; for 2012-2014 includes actual banking sector needs (repayments netted out for 2012).
6/ Includes privatisation receipts, use of deposits, pension fund assets and centralisation of cash management of general government entities.
7/ 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 6 March 2014 applied to remaining 2014 disbursements.

**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 | 18.7 | 6.3 | 12.4 |
| 1 | Q4-2011 | Sep-11 | 11.6 | 4.0 | 7.6 |
| 2 | Q1-2012 | Dec-11 | 8.1 | 2.9 | 5.2 |
| 3 | Q2-2012 | Apr-12 | 14.9 | 5.2 | 9.7 |
| 4 | Q3-2012 | Jul-12 | 4.0 | 1.5 | 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 | 2.7 | 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:<br><br>- the General Government, detailed by subsector<br><br>- the incorporated (SOEs) government-owned hospitals that are not part of the General Government<br><br>- 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<br><br>Quarterly for Regional and Local Government<br><br>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:<br><br>- layoffs by type<br><br>- collective agreements by type and number of collective agreements that are extended by the Ministry of Labour to non-signatory firms<br><br>- number of collective agreements that regulate the use of the Bank of Hours working time arrangement<br><br>- proportion of unemployed receiving unemployment benefits<br><br>- 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)<br><br>- 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, 23 April 2014

Mr Jeroen Dijsselbloem

President

Eurogroup

Mr Yannis Stournaras

Minister of Finance

Greece

Mr Siim Kallas

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-December 2013 deficit and debt performance criteria were met by a sizeable margin, reflecting inter alia strong tax collection, prudent expenditure control in the second half of 2013, and one-off revenues from the (tax and social security) debt recovery scheme. Preliminary information suggests that we are also on track to meet the end-March targets. We have continued to work on boosting the competitiveness of the Portuguese economy, most recently by eliminating the port user fee and easing licensing requirements for the tourism and industrial sectors. We have also made important progress with several initiatives aimed to facilitate access to finance, including enhancements to the existing government-guaranteed credit instruments.

- Market prospects have improved, and we were able to issue long-term bonds and conduct a bond swap at favourable rates. Nevertheless, further efforts are needed to secure durable market access, generate higher sustained growth, reduce unemployment, 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:

- In the course of the Programme, significant reforms of labour and product markets were implemented in order to alleviate nominal rigidities, facilitate adjustment, and foster a reallocation of resources toward the tradable sector. To assess the impact of these reforms and ensure that the initial objectives are being achieved, we are preparing an outcome-based accountability framework to draw more concrete links between notional reforms and actual outcomes. In addition, we are working toward identifying the remaining policy distortions and other potential priority areas (notably, energy and labour markets) which will be tackled in the next phase of reforms.

- We remain committed to achieving our 2014 fiscal deficit target of 4 percent of GDP. To this end, we are carefully assessing progress toward the attainment of the defined budget objectives by line ministries; we are also finalising supporting legislation necessary to implement the compensating measures adopted in January. Furthermore, should any risks to budget execution materialise, we stand ready to implement compensatory measures of equivalent size and quality. As part of our strategy to arrest any accumulation of new domestic arrears, we have identified specific public entities with structural financial imbalances and developed targeted programs to underpin their financial sustainability.

- We will advance our fiscal consolidation efforts in 2015, with a targeted deficit of 2.5 percent of GDP. Measures deemed to be consistent with achieving this deficit target have been specified as a prior action for completion of this review. The 2014 Fiscal Strategy Document will provide detailed spending ceilings by line ministries and underlying adjustment measures on, inter alia, supplements and wage scale reform and pension reform.

- We are committed to preserving financial stability and supporting an orderly deleveraging of balance sheets. Banco de Portugal (BdP) continues to scrutinise the resilience of the banking system amidst a challenging operating environment and to ensure compliance with new capital requirements. We are also reviewing our strategies to facilitate corporate debt restructuring and to support the necessary capital reallocation towards the productive sectors of the economy. The BSSF resources—which amount to EUR 6.4 billion—have been set aside for banking sector support and deposited in a dedicated account at the BdP.

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

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

This letter is copied to Ms Christine Lagarde.

Sincerely yours,

| | | |
|---|---|---|
| /s/ | /s/ | /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

Tenth Update – 28 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 tenth 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. ([9])

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

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

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

## 1. Fiscal policy

Reduce the government deficit to 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,

([9]) 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.

and arrest the accumulation of new arrears. In the medium term, the fiscal consolidation process will be maintained until a balanced budgetary position is reached, notably by containing expenditure.

Fiscal policy in 2014

1.1. 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. ([10])

1.2. Progress will be assessed against the 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].

1.3. The fiscal adjustment in 2014 will be underpinned by the measures included in the Budget Law, the Supplementary Budget and other supporting legislation, totalling 2.3 percent of GDP altogether. The consolidation measures, which will be rigorously implemented, are primarily of permanent nature and mostly on the expenditure side.

Public Expenditure Review

1.4. The 2014 Budget builds on the public expenditure review aimed at 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.

1.5. 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 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 to address over-employment in specific sectors, and enhanced use of the requalification programme. In particular, following the recently closed programme of mutual agreement terminations offered to low-skilled workers and the extension of the ongoing programme for teachers, a new scheme for low-skilled workers will be launched during the second quarter of 2014. Regarding the remuneration policy, the revision of the wages enshrined in the Budget Law was made in a progressive way, ensuring the protection of lower income earners.

([10]) 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.

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). This measure, that aims at frontloading the self-financing of these schemes, will raise additional revenues in 2014 by at least EUR 260 million.

ii. Limiting the public pension expenditure, given the need to reinforce 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. from EUR 1350/month to EUR 1000/month) and the thresholds from which the highest contribution rates are applied. This measure will enter into force as from mid-March; (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 former political office holders 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).

iii. Other savings will be generated through a combination of sector-specific reforms, identified by line ministries in their 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 1.9 billion (EUR 1.7 billion in net terms).

1.6. 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.

Other fiscal measures

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

- Tax and social contribution measures: increase in the tax rates 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 (EUR 515 million).

- 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.

1.8. 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 excess oil reserves (EUR 60 million).

1.9. The Government implements the comprehensive reform of the corporate income tax, aimed at promoting simplification as well as boosting internationalisation and competitiveness of Portuguese companies, within the existing budgetary envelope to respect the fiscal consolidation targets.

1.10. To comply with the fiscal target on arrears and as part of the newly established targeted programmes to arrest the accumulation of arrears, should any new arrears emerge, they will be fully offset by transfers from the general government.

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

1.12. 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.

1.13. 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

1.14. 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.

1.15. The Government will specify the measures necessary to achieve the deficit target in 2015. ([11]) The detailed plans will be reflected in the 2014 Fiscal Strategy Document, which will also specify detailed expenditure ceilings by line ministries. In order to comply with the EU budgetary framework requirements, this document should also provide details of the medium-term budgetary plans. The Fiscal Strategy Document will be published by end of April 2014.

1.16. The 2015 consolidation strategy will be underpinned, among others, by the following measures:

i. Supplements and wage scale reforms: the supplement scale will be standardised and the number of supplements rationalised by key categories building on the results of the recently published comprehensive review of wage supplements. This measure is expected to enter into force in the second half of 2014, with full year impact in 2015. A single wage scale, aimed at the rationalisation and consistency of remuneration policy across all careers will also be developed by end-2014.

ii. Pension reform: as part of the ongoing comprehensive pension reform, new measures will be undertaken to improve the sustainability of the pension system. A Pension Reform Committee has been appointed to develop the specific details of these measures. Short-term measures include further linking pension entitlements to demographic and economic criteria while respecting progressivity principles, in

([11]) Prior action in the MEFP for the completion of the eleventh review.

line with the recent Constitutional Court ruling on the convergence of the public workers' pension regime (CGA) to the general system. The final design of this reform will be presented by the [twelfth review] and a draft law will be be submitted to Parliament in the first half of 2014. Other pension measures contributing to put pension spending on a more sustainable path will also be specified by the [twelfth review]. In addition, the recently increased retirement age will also effectively apply to the pension requests made by CGA pensioners as of 2014.

iii. Additional areas that are being considered include, amongst others, a further reduction in the number of management positions and administrative units in the central administration, the use of European funds for vocational and professional training, concessions in the transport sector, further reorganisation of SOEs (including mergers and additional privatisations) and green taxes.

1.17. The medium-term fiscal strategy will build on further reforms outlined in the Proposal for the Reform of the State which aim at improving the efficiency of the public sector and improving the quality of its services. Building on the first round of consultations with social partners, the Council of Ministers has approved at end-March 2014 a document with draft proposals in different reform areas, including social security sustainability, flexibilisation and requalification of the public sector workforce, rationalisation of general government entities, as well as greater efficiency in health and education. The progress of this agenda will be discussed at the [twelfth review].

## 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; recover the assets transferred from BPN to the three state-owned SPVs; continue to closely monitor the implementation of the measures agreed in the restructuring plans of banks having received public capital support; complete the bank resolution framework; monitor the impact of 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 [ongoing]. In parallel, the BdP will continue to explore new initiatives supporting the system's funding conditions 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 (Common Equity Tier 1 (CET1) capital ratio of 7%) are respected in line with the Capital Requirements Directive IV package (CRD IV). In the context of the ECB’s 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 EU-State aid rules to further support viable banks, subject to strict conditionality. Avoid subsidising private shareholders and prevent migration of private liabilities to the public sector balance sheet [ongoing].

State-aided financial institutions

2.6. Continue to closely monitor the implementation of the measures agreed in the restructuring plans of banks having received public capital support [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 continues the monitoring of banks, including via targeted audits of provisioning levels for exposures that relate to a selected number of large non-financial groups [ongoing]. The BdP reviews action plans for enhancing operational capabilities in the area of distressed loan management drawn up by the eight largest banks in response to the Special Assessment Programme that reviewed banks' operational capacity to effectively deal with loan restructuring and asset recovery.

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]. The recently improved stress testing framework is being used in the quarterly stress tests [ongoing]. Their results will be used as a basis to require, if necessary, banks to take measures that result in a strengthening of their capital position, also in the light of the forthcoming EU-wide stress test.

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. Ensure timely disposal of the subsidiaries and the assets in all three state-owned SPVs including through the two selected service providers. Ensure finalisation of the business plans of the two selected service providers for the management of part of the credit portfolio of Parvalorem.

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 and continues on-site visits to validate the input received. 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. The Ministry of Finance finalises the legislation of the CCR legal framework with the support of the BdP and in consultation with the Portuguese Data Protection Authority (CNPD). The revised framework will allow financial institutions to have access to companies' historical information as well as to the corporate balance sheet database, reducing information asymmetries.

Corporate and household debt restructuring framework

2.16. Monitor 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 debt. Prepare, in consultation with the Banco de Portugal, a strategic plan, to be discussed with EC, ECB and IMF staff during the 12th review, aiming at addressing the corporate debt overhang and supporting the capital reallocation towards the productive sectors of the economy, while promoting financial stability [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. 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. Evaluate the impact of the improvements in the government-guaranteed credit instruments on actual interest rates. Stand ready to pursue policy alternatives, if deemed necessary, in order to ensure that government guaranteed loans will be priced in a competitive and transparent manner in favour of end-users. Regularly report on progress.

2.20. Establish a development financial institution (DFI) aiming at streamlining and centralising the management of the reimbursable part of the financial instruments of European structural and investment 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, nor invest in Government debt or grant loans to the Government. The DFI's draft business model and by-laws will be submitted for in-depth consultations with EC, ECB and IMF staff prior to the [12th review] 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 2014 budget by [Q1-2014]. This report will build on the methodology developed in the 2013 report to estimate and to evaluate tax expenditures, in line with international best practices. The report will cover central, regional and local administrations.

3.2. Improve the public sector accounting and reporting framework by ensuring adequate accounting for revenues, expenses, assets and liabilities related to government bank accounts, debt, investments, tax revenues and public private partnerships. An accounting function in the Ministry of Finance will be set up by end-June 2014 for this and other purposes, such as preparing consolidated financial statements of general government and other public sector entities.

### 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 with the commitment control system through a risk-based approach [ongoing]. For selected public entities—including twelve State-Owned Enterprise hospitals as well as the railroad company Comboios de Portugal—that face structural financial imbalances, targeted programmes that underpin their financial sustainability will be finalised by the [twelfth review]. The programmes identify measures to reduce the operational expenditure of these entities and/or to increase their revenues. The strategy to arrest the accumulation of arrears in SOE hospitals includes the consolidation measures negotiated in their Strategic Plans and envisages the use of additional budgetary funds in 2014 to close the operational imbalances and fully fund the investment needs of these hospitals. 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 within the Ministry of Finance, reporting directly to the State Secretary of the Budget and in charge of the expenditure arrears for the public sector, has been established.

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. Subsequent revisions of the medium-term forecasts need to be clearly identified and attributed to policy changes, changes in the macroeconomic environment or other factors.

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 has published a report assessing the strengths and weaknesses of the law and provide suggestions for new legislation. The authorities will engage in a broad-based consultation with all relevant stakeholders to discuss the key elements of the new legislation, notably streamlining the budget appropriation structure, reviewing the classification of own revenues, deepening the reduction of budget fragmentation, strengthening accountability relations, broadening the focus and analysis of fiscal risks and imparting a medium-term to long-term focus to public finances. The key aspects and the structure of the new law will be developed by [end-April 2014] and the technical work will be completed by end-September upon consultations with key stakeholders. 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].

State-owned enterprises

3.11. 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 and transport SOEs [ongoing].

3.12. 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].

3.13. 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].

3.14. 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

3.15. 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 exceeded. 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 including the approval of the rail investment plan, 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), following the implementation of several changes in the legal and regulatory framework of this sector, was launched through the formal approval by the Council of Ministers of the privatisation Decree-Law with a view to receiving binding offers in the first half of 2014. The Government will further consider expanding the privatisation programme to include additional assets for sale or concession.

Revenue administration

3.16. 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 50 percent by May 2014. The final plan underpinning this reduction will be announced before the [twelfth review].

ii. Increase in the resources devoted to auditing in the tax administration to at least 30 percent of the total staff. The recruitment process is ongoing and the threshold should be attained by the [twelfth review];

iii. 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.

3.17. The reform of the e-invoicing system that aims at curbing fraud and evasion was put fully in place in 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.

3.18. 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].

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 is initially targeting high net wealth individuals and self-employed professionals. Effective audits on individuals considered at higher risk of misreporting will be strengthened and voluntary compliance promoted.

3.19. Following up on the publication of Notice nº 5/2013 of Banco de Portugal, the Anti-money laundering (AML) legal and regulatory framework will be strengthened to tackle more effectively money laundering and its predicate crimes, including tax crimes. A multidisciplinary working group is carrying out a national AML/CFT risk assessment and will propose necessary amendments. Key areas of reforms to strengthen the exchange of information between the AML authorities and other competent authorities, such as the AT, will be implemented by end 2014.

## Public administration

### Central, regional and local administration

3.20. 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].

3.21. 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 [Q1-2014];

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 [Q1-2014].

### Shared services

3.22. 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. continue 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 [ongoing];

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

Human resources

3.23. 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 terminations. 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].

3.24. Following a 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.

3.25. Following the survey on cash supplements and the report on the comprehensive reform of wage supplements, draft legislation for a single supplement scale will be presented by the [twelfth review] with a view to its implementation by June 2014.

3.26. 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 percent of GDP by end 2012 and to about 1 percent 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

3.27. The plans to achieve a self-sustainable model for health-benefits schemes for civil servants were accelerated and are on track. The beneficiaries' contribution rate has been increased to 3.5 percent as from May 2014. The current plan foresees that the employer's contribution rate will remain at 1.25 percent 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 in case the beneficiaries' contribution ensures the self-financing of the respective scheme.

Pricing and reimbursement of pharmaceuticals

3.28. The Government will monitor monthly pharmaceutical expenditures and ensure that the overall public pharmaceutical expenditure does not exceed the target of 1.25 percent of GDP in 2012 and 1 percent of GDP in 2013 and 2014 [ongoing].

3.29. If public expenditure diverges from the objective that has been set for 2014, 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 percent 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

3.30. 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].

3.31. Continue to devise and enforce a system of sanctions and penalties, as a complement to the assessment framework. 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 [ongoing].

3.32. Enhance the monitoring of 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 [ongoing].

3.33. 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].

3.34. The above measures should aim at gradually and substantially increasing the share (in volume) of generic medicines reaching 60 percent of all NHS reimbursed medicines in the outpatient setting by end of 2014 [ongoing].

Centralised purchasing and procurement and competition

3.35. 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].

3.36. 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].

Primary care services

3.37. 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 by:

i. reviewing 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 percent for the USF;

v. organising opening hours of USF and UCSP so as to cover patient and family needs and also to offer alternatives to hospital emergency departments.

Hospital services

3.38. 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].

3.39. Continue to improve the existing IT structure and software systems to improve the quality of the financial oversight by the general government. SOEs will test and progressively implement a central accounting platform: ten in [Q1-2014]; twenty 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.

3.40. 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. 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].

3.41. Annually update the inventory of all health staff for the period up to 2014 [ongoing]. The 3-year strategic plans specify plans to reallocate qualified and support staff within the NHS [Q1-2014].

Cross services

3.42. 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. With a view to specifying measures by the time of the [twelfth review] the Government will explore, in dialogue with social partners, some reduction in the level of compensation for unfair dismissals so as to strike a balance between limiting incentives to challenge fair dismissals in court and adequately penalising unfair dismissals.

Wage setting and competitiveness

4.4. The Government will promote wage developments consistent with the objectives of fostering job creation and improving firms' competitiveness, notably via an effective framework for wage decentralisation. 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. following the analysis of 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), present policy options, in dialogue with social partners, on the expiration and survival of collective agreements; in case this option is not implementable the government will study and present a proposal regarding the mutually agreed and temporary suspension of collective agreements [twelfth review];

iv. study ways to foster collective agreements, in dialogue with social partners, with a view to specifying measures by the time of the [twelfth review] including concerning the current criterion for the extension of collective agreements taking into account the representativeness of SMEs in the various sectors.

Active labour market policies

4.5. 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 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 [ongoing].

Education and training

4.6. 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. present in a report how the monitoring, assessment and reporting tool, developed over the last two years, will be used to evaluate the impact of education policies and support the related decision making processes [twelfth review];

ii. in line with the action plan on vocational and educational training (VET) the Government will report on (i) 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 and involve businesses in the provisions of traineeships [ongoing]; (ii) the establishment of "professional schools of reference" [ongoing].

## 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. Following the measures in excess of EUR 3.4 billion taken by the Government in order to achieve an elimination of the tariff debt by 2020, the government will now focus on limiting energy price increases. To this end, the government commits to presenting additional concrete measures by [end-April] to tackle remaining excess rents and to deliver cost reductions to be reflected in energy prices . In addition, 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, pursue the actions to implement the measure to eliminate the distortion on the system services market and present an estimation of 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 [Q1- 2014].

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 [twelfth 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 [Q1-2014]. 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 and strengthen 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 continuation of the renegotiation of PPP and concession contracts 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. building on the report published in January 2014, 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 [Q1-2014].

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 [twelfth review].

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 [Q1-2014];

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 [twelfth review];

iv. follow up on the conclusions of the assessment of the impact of the extended performance schemes on infrastructure charges in different traffic categories [ongoing];

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 [Q1-2014] in view of approval by [May 2014]. The proportionality of fees linked to construction activities will be ensured by the date of adoption of the Construction Law [May 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 [Q1-2014].

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 [twelfth 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 5.11 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 [twelfth 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 [ongoing];

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

5.14. Provide a monthly update of the detailed work programme of the Agência para a Modernização Administrativa to fulfil measure 5.13.

## 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 [twelfth review].

## 7. Framework conditions

Competition 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

7.1. 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].

7.2. 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].

7.3. 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 [Q1-2014]. Take the necessary actions to ensure the effective functioning of the Competition Authority financing model in compliance with (ii) and, while ensuring stability of the financing model, leave room to accommodate growing needs in the medium term [Q1-2014].

Business environment

7.4. Follow up any EU decision taken regarding compliance with the Directive 2011/7/EU on Late Payments Directive transposition [ongoing].

7.5. 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

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

7.7. 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.

7.8. 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 [Q1-2014].

Environment and territory planning

7.9. 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 [twelfth review], ensure that it will be aligned with the new Industrial Licensing regime;

ii. Adopt and make operational a Risk Sectorial Plan by the [twelfth review];

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

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

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

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

7.10. 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) [twelfth review];

ii. create a diploma on Land Registration and Land Registration Experts [twelfth review];

iii. review the cartography for plans regime and the diploma on Cartography [twelfth review];

iv. enforce the Council of Ministers Resolution 56/2012 by [twelfth review], to collect all land registration procedures, currently scattered in various departments.

Geology

7.11. 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 [twelfth review];

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 [twelfth review].

# ANNEX 5
# MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

March 28, 2014

## Macroeconomic Outlook

1. Recent macroeconomic developments. The economic recovery is gaining traction. Exceeding expectations, output grew by 0.5 percent in the last quarter of 2013. Compared with the last quarter of 2012, output grew by 1.6 percent, the first positive yearly growth in three years. This, together with the upward revisions of the historical quarterly data, resulted in a 1.4-percent contraction in output in 2013, compared with the 1.6-percent decline projected at the time of the last review. The recovery is underpinned by improved domestic demand (in particular investment) and strong exports, which are estimated to have increased by close to 6 percent in 2013 in real terms. Employment growth has exceeded expectations, while the labor force has remained stable. Consequently, the unemployment rate has declined from 15.6 percent in the third quarter to 15.3 percent in the last quarter of 2013, resulting in an unemployment rate of 16.3 percent for 2013 as a whole, compared with 16.5 percent projected at the time of the last review. Inflation, at 0.4 percent in 2013, has remained below the euro area average.

2. Outlook. High-frequency indicators point to a continued expansion in activity, and economic sentiment is now close to its long-term average. Buoyed by a stronger-than-expected carry-over from the last quarter of 2013, growth in 2014 is expected to reach 1.2 percent, compared with 0.8 percent projected at the time of the last review. This growth will be supported by the continued recovery in investment and the strong export performance. The unemployment rate is expected to average 15.7 percent in 2014 vis-à-vis 16.8 percent envisaged in the 10th review. Inflation will increase slowly to 0.7 percent, in line with a still-large slack in the economy. Risks surrounding this baseline are related to the negative effects of private sector deleveraging and of the envisaged fiscal consolidation on growth; these effects may turn out to be stronger than expected.

3. External adjustment. The adjustment in the current account is expected to moderate, as the recovery in domestic demand gathers momentum. Having reached an estimated surplus of about ½ percent of GDP in 2013—an improvement of 2½ percentage points relative to 2012—the current account is expected to register a surplus of about 1 percent this year, in line with what was projected at the time of the 10th review. Export growth is expected to be supported by continued gains in market share amid the recovery in demand from other EU economies—notably Spain that alone contributed to a half of merchandise export growth in 2013—as well as continued robust demand from non-EU trading partners . Nevertheless, weaker external demand remains the main downside risk to external adjustment. More importantly, notwithstanding reforms already implemented, continued competitiveness gains will be needed to sustain robust export growth over the medium term.

## Fiscal Policy

4. 2013 Outcome. In 2013, we made significant progress towards our fiscal consolidation objectives. The end-December quantitative performance criteria on the general government cash balance and debt were met by a sizable margin (Table 1). The ESA95 general government deficit was successfully reduced to around 4.5 percent of GDP (excluding the BANIF recapitalization costs of 0.4 percent of GDP), compared to a 5.5 percent of GDP target. This over-performance reflects strong tax collection, on the back of positive macroeconomic developments and continued efforts to strengthen tax compliance, as well as prudent expenditure control and one-off revenues from the (tax and social security) debt recovery scheme. The underlying structural primary adjustment in 2013 is estimated at about 0.8 percent of GDP. Nevertheless, the continuous indicative target on arrears was missed, with 0.2 billion in new arrears accumulated in 2013, notably due to structural imbalances in state-owned hospitals.

5. 2014 Budget. We remain committed to achieving our 2014 deficit target of 4 percent of GDP—consistent with a structural primary adjustment of about 0.7 percent of GDP. New additional pressures arising from lower social security revenues as well as higher transfers to state-owned hospitals—as part

of the targeted programs to halt arrears (see ¶9)—are expected to be offset by the positive 2013 carryover (0.2 percent of GDP) and improved macroeconomic outlook (0.5 percent of GDP). We are monitoring closely budget implementation. Specifically,

- Public Expenditure Review (PER). We are carefully assessing progress towards the attainment of the defined budget objectives by line ministries, through monthly reporting to the Council of Ministers, with a special focus on the Public Expenditure Review measures in the budget. In order to achieve the targeted reduction in the size of the public sector workforce, another scheme for low-skilled employees will be launched during the second quarter of 2014. We have extended the term of the ongoing schemes for teachers, with effects from March 2014. 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. Supporting legislation necessary to implement some of the additional measures in the budget is also being finalized. In particular, we have approved the ministerial order defining the levy on financial institutions. The framework law for online gambling has been sent to the Council of Ministers, for approval by end-April 2014. The port concession tender and real estate sale is expected by end-September 2014, while the Silopor concession, the transfer from the CTT health fund, and the sales of excess oil reserves are expected to be finalized by end-year.

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 ½ 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. The 2014 Fiscal Strategy Document, that we are about to submit to the EC by end-April, will provide detailed spending ceilings by line ministries and underlying adjustment measures consistent with our EU budgetary commitments. Specifically, the following measures will underpin our medium-term plans in the 2014 Fiscal strategy document, largely building on the Public Administration law which is expected to be approved by end-March:

- Supplements and Wage Scale Reforms. Building on the principles identified in the Public Administration law, we have recently conducted a comprehensive review of wage supplements, aimed at standardizing and rationalizing existing supplements by key categories. Draft proposals will be presented by the time of the twelfth review mission, with the draft law expected to be submitted to Parliament by end-June. In parallel, we are advancing our comprehensive review of public sector remunerations and careers towards a new single wage scale for public employees. We expect to finalize the reform in the second half of 2014, in line with the budgetary plans to be presented in the 2014 Fiscal Strategy document.

- Pension reform. New comprehensive measures as part of the ongoing pension reform shall be undertaken, aimed at improving the long-term sustainability of the pension system. The recently appointed Pension Reform Committee is tasked to develop the specific details of the reform. The reform shall include short-term measures further linking pension entitlements to demographic and economic criteria while also respecting progressivity principles, in line with the recent Constitutional Court ruling on the convergence of the public workers' pension regime (CGA) to the general system. The final design of these short-term measures shall be presented by the time of the twelfth review and a draft law will be submitted to Parliament in the first half of the year. Further measures ensuring the long-term sustainability of the pension systems shall be also specified by the time of the twelfth review. In addition, the Government shall ensure that the recently increased retirement age effectively applies to the pension requests made to CGA as of 2014.

• Additional areas that are being considered include, amongst others, a further reduction in the number of management positions and administrative units in central administration, the use of European funds for vocational and professional training, concessions in the transport sector, further reorganization of SOEs (including mergers and additional privatizations), as well as green taxes.

Measures deemed to be consistent with achieving the budget deficit target of 2.5 percent of GDP in 2015 will be specified as a prior action for completion of this review.

7. Reform of the State. 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. In recent months, we have conducted consultations with social partners and proposed the setting up of a Parliamentary committee to reach broad-based consensus on these reforms. Building on the first round of consultations with social partners, a new document will be approved by the Council of Ministers by end-March 2014 with draft proposals 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. Further progress with this process will be discussed at the time of the next review.

8. Debt Path. Preliminary data indicate that gross debt reached 128.8 percent of GDP in 2013, against an initial projection at the time of the 10th review of 129.4 percent of GDP, supported by the improved fiscal cash balance and upward revision in nominal GDP. Looking forward, under the programmed fiscal path, debt is expected to start gradually declining, with a projected debt ratio of 126¾ percent of GDP in 2014, supported by recent buyback operations, further use of cash deposits as well as the ongoing reallocation of the Social Security portfolio from foreign assets to government securities. Given the buildup of Central Government cash balances, net debt is projected below 120 percent of GDP by end-2014.

### Containing Fiscal Risks

9. Public Financial Management. We are advancing Public Financial Management reforms, including through new efforts to improve our accounting and reporting framework, but stricter compliance with the commitment control law (CCL) is needed to prevent any new accumulation of domestic arrears, particularly in the health sector.

• We remain committed to complete the transposition of the EU Fiscal Compact provisions 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 are working, in close consultation with IMF staff, on developing the key principles and elements that will be reflected at a later stage in an amended BFL to crystallize the reforms undertaken so far while underpinning an effective public financial management system. As the next step, we will consult in the coming months with key stakeholders to discuss the key elements of the legislation, notably streamlining the budget appropriation structure, strengthening accountability relations, and broadening the focus and analysis of fiscal risks. We will aim at developing the key aspects and structure of the new law by end-April and completing the underlying technical work, upon consultations with key stakeholders by end-September. As part of these efforts and key input into this process, we will undertake an IMF Fiscal Transparency Evaluation by the end of the program, which will be made publicly available.

- We remain committed to arrest any accumulation of new domestic arrears. As part of our strategy, we have identified specific public entities with structural financial imbalances, including twelve State Owned Enterprise (SOE) hospitals and the railroad company Comboios de Portugal (CP), and are finalizing by end-April the targeted programs to underpin their financial sustainability. Specifically, the programs targeted to SOE hospitals, envisage for 2014 the use of additional budgetary funds (up to €300 million) to close the operational imbalances and fully fund the investment needs of these hospitals. To this end, should any new arrears emerge, they will be fully offset by transfers from the general government. As regards CP, a new debt management strategy is currently being developed, which will aim at improving the company's funding model and halt any further accumulation of arrears, expected to be discussed at the time of the 12th review. Beyond these specific programs, the CCL will be enforced in full to all public entities in line with the continuous indicative target under the program. In this context, the dedicated unit within the Ministry of Finance, reporting directly to the State Secretary of the Budget in charge of the expenditure arrears for the public sector, was also established last February and is currently operational.

- We will take immediate steps to improve the public sector accounting and reporting framework, building on recent technical assistance recommendations by the IMF. In particular, we are committed to ensure adequate accounting for revenues, expenses, assets, and liabilities related to government bank accounts, debt, investments, tax revenue, and public private partnerships. To this purpose, we will have a central government accounting function in the Ministry of Finance by end-June, responsible for accounting for these and any other balance-sheet items that may not currently be accounted for in the government accounting system. It will also be responsible for preparing consolidated financial statements of general government and other public sector entities, including all SOEs and other controlled entities.

10. 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 include hiring approximately 1000 new tax auditors and developing successfully the e-invoicing reform. The Compliance Risk Management Unit, created last November, is fully operational since last February. This unit is focused on strengthening tax compliance by (i) phasing in of a modern compliance risk model; (ii) improving PIT compliance management, through the pilot projects on the High Net Wealth Individuals and Self-employed Professionals; and (iii) enhancing control of the monthly PIT withholding information. 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 its reorganization 50 percent of local tax offices will be closed by end-May 2014.

11. Anti-money laundering (AML). We are committed to strengthen our AML legal and regulatory framework to tackle more effectively money laundering (as we did with the publication of Notice nº 5/2013 of Bank of Portugal that regulates the conditions, mechanisms and procedures needed for effective compliance of the financial institutions subject to the supervision of Banco de Portugal with the anti-money laundering and terrorist financing obligations) and its predicate crimes, including tax crimes. To this end, we have set up a multidisciplinary working group that will carry out a national AML/CFT risk assessment. It will also propose any necessary amendment to bring our AML/CFT regime in line with the revised AML/CFT standard adopted by the Financial Action Task Force (FATF/GAFI). In this context, on the basis of recommendations made by IMF technical assistance, we have identified key areas of reforms to strengthen the exchange of information system between the AML authorities and other competent authorities, such as the Tax and Customs Authority, and we are committed to implementing these reforms by end-2014.

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 savings of more than €2.5 billion over the life cycle of these concessions. 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 also nearly finalized. Moreover, with a negotiation team appointed last February, 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 full network scope improvement and optimization. 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. State-Owned Enterprises. Despite the reinstatement of the 13th and 14th month salaries, cost-cutting efforts and voluntary separation programs ensured that the consolidated operational balance of transport SOEs remained in surplus in 2013. Nonetheless, legacy debt burdens continue to weigh on the financial results of most firms. We will retain formal cost-reduction objectives for these firms, while requiring other firms to continue improving operating balances. In addition, we launched a new comprehensive debt management strategy as part of the efforts to restore the financial sustainability of transport SOEs and stop the accumulation of arrears (see ¶9). A plan is expected to be discussed at the time of the 12th review. We have started the selection process to staff the dedicated Technical Unit that was created under the new framework law for SOEs, and are on track to make it operational by end-April 2014.

14. Privatization. The privatization program is ahead of target. Agreement was reached with an investor on the sale of the insurance arm of state-owned CGD in February, with the proceeds contributing towards CGD's CET1 capital. The sale of the airline, TAP, however, remains on hold. 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 and the approval of the rail investment plan, expected to take place by June 2014. We have prepared a strategic plan for the water, sanitation, and waste sectors (PENSAAR 2020 and PERSU 2020), with a view to improving their efficiency, including by introducing private capital and management in the public waste company. Binding offers for the sale of the waste management company, EGF, are expected by end-June 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. We have launched the consultation process for four concessions in February. The concessions are now expected to be launched by end-April 2014. The government will further consider expanding the privatization program to include additional assets for sale or concessions.

15. Regional and Local Governments. We remain committed to fiscal discipline in local and regional governments. Under the program for local governments' arrears settlement (PAEL), nine municipalities remain to be cleared by the Court of Auditors. The coordination council between the central and subnational governments, envisaged in the Regional Finance Law and Local Finance Law (LFL) approved by Parliament last year is expected to become operative by end-April 2014. The council is expected to enhance exchange of information in order to support budgetary planning. The LFL also introduced a Municipality Resolution Fund, for which rules and procedures are being proposed by a group of specialists. On this basis, we expect to submit to Parliament a draft law by end-April 2014. In terms of regional governments, we will continue to closely monitor Madeira's program with the State (PAEF).

### Safeguarding Financial Stability

16. Bank Supervision. Banco de Portugal (BdP) continues to scrutinize the resilience of the banking system amidst a challenging operating environment.

- Credit Impairments. In line with past credit impairment reviews, and also in anticipation of the ECB's Comprehensive Assessment, the BdP continues to monitor the adequacy of banks' impairment levels, including via targeted audits of provisioning levels for exposures that relate to a selected number of large non-financial groups—where necessary resulting in further reinforcements. Guidelines on measuring credit portfolio impairment and disclosure of asset quality and risk management practices have been published incorporating best practices identified during the impairment reviews that have been conducted since May 2011.

• Stress Testing. The BdP continues its quarterly stress tests, which have been strengthened via the enhanced top-down stress testing framework, and uses their results to improve the banks' resilience, also in the light of the forthcoming EU-wide stress test. As usual, and where necessary, the stress test will be used as the basis to require measures that result in a strengthening of banks' capital positions.

• Management of Distressed Loans. The BdP is reviewing action plans for enhancing operational capabilities in the area of distressed loan management (DLM), drawn up by the eight largest banks in response to the Special Assessment Program that reviewed DLM practices.

• Recovery and Resolution Plans. Banks have made significant progress in fine-tuning their recovery plans, based on recommendations and additional guidance from the BdP. In parallel, the BdP is continuing on-site visits to validate input received from the largest banks for resolution planning purposes. We remain committed to swiftly transposing the new EU Directive on bank recovery and resolution once it has been adopted.

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

18. BSSF. While we will continue to encourage banks to seek private solutions, we remain committed to providing further support to viable banks, with resources from the Bank Solvency Support Facility (BSSF), in the event new capital shortfalls were to arise. The BSSF resources—which currently amount to €6.4 billion, following the deposit of the remaining funds that were set aside for banking sector support as part of the program envelope—will solely be utilized to provide public support, if needed, to the banking system. Any public support will remain subject to strict conditionality, in line with 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.

19. Funding and Liquidity Conditions. Deposits have remained stable in an environment of gradually decreasing remuneration rates, while banks have been able to expand their access to financial markets funding. Non-standard measures by the ECB to restore the proper transmission of monetary policy continue to play a pivotal role in easing liquidity pressures and 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. Corporate Debt Restructuring. Considering its importance to the deleveraging of the economy and potential medium- to long-term growth outlook, we are reviewing our strategy to facilitate corporate debt restructuring. In particular, we will draft, in consultation with the BdP, a strategic plan, to be discussed with the EC, ECB, and IMF staff during the 12th review, aiming at addressing the corporate sector debt overhang—with a particular focus on economically viable SMEs—and supporting the necessary capital reallocation towards the productive sectors of the economy, notably in the tradable sectors, while promoting financial stability.

21. Initiatives to Facilitate Access to Finance. Notwithstanding recent improvements and banks continued efforts to facilitate an orderly deleveraging of the private sector, credit conditions and access to finance remain challenging, especially for SMEs. In light of that, we have made important progress with key government supported initiatives.

• National Guarantee System (NGS). We concluded the implementation of several enhancements to our existing government-guaranteed credit instruments, such as the implementation of a new pricing methodology for determining interest rate caps, supported by a new rating framework, and changes in the ownership and governance structure of the NGS. These improvements have led to lower interest rate caps than those applicable in 2013. Going forward, we will take stock of the impact of these measures on actual interest rates by May 15, 2014. We stand ready to pursue policy alternatives, if deemed necessary, in order to ensure that government guaranteed loans will be priced in a competitive and transparent manner in favor of end-users.

• Development Financial Institution (DFI). We continue to explore ways to promote an efficient use of EU structural funds and allocation of other government supported funding instruments. These initiatives will be streamlined and centralized through a DFI, already approved by the Council of Ministers. A task force has recently been constituted to design and operationalize the DFI, ensuring (i) that no additional burden on or risks to public finances will be incurred; (ii) that the DFI's sole purpose shall be to address market failures in the financing of private non-financial corporations, notably SMEs; and (iii) in doing so it shall not accept deposits or other repayable funds from the public, nor engage in direct lending, nor invest in Government debt or grant loans to the Government. The DFI's draft business model and by-laws will be submitted for in-depth consultations with EC, ECB and IMF staff prior of the 12th Review.

22. Central Credit Registry. We are on track to complete the agreed enhancements in our credit registry, including ongoing updates in the IT systems that will allow financial institutions to have access to companies' historical information as well as to the corporate balance sheet database, reducing information asymmetries. For this purpose, the Ministry of Finance is finalizing the needed changes to the Central Credit Registry legal framework, with support from BdP and in consultation with the Portuguese Data Protection Authority. We expect to be able to submit a final draft of the proposed legislation for approval by the Council of Ministers by end-April 2014, going subsequently to Parliament, and to complete the implementation of these changes before end-2014.

23. 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. Business plans of the two contracted service providers for the management of part of the credit portfolio of Parvalorem are expected to be finalized shortly, 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

24. 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. Most 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 wjudicial 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. This will form the basis for our medium-term reform strategy, to be adopted by the end of the program.

25. Competition/Regulation. A framework law for the functioning of regulators was enacted last year. 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 end-April 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's financing model. To avoid disruptions in the transitory period up to the entry into force of the corresponding provisions in the forthcoming bylaws, we have issued an executive order specifying the necessary transfers from the contributing sectoral regulators. We will also leave room to accommodate potential growing needs over the medium term, and ensure the competition authority is adequately and sustainably funded. The competition authority has a critical role to play in evaluating public policies. As a first step in this direction, a new unit was created to assess impediments to competition/market entry in selected sectors.

26. Energy. The Portuguese government has taken measures in excess of €3.4 billion in order to achieve an elimination of tariff debt by 2020. Having taken these steps, the focus should now be on limiting energy price increases. To this end, the government commits to present additional concrete measures to tackle remaining excess rents and to deliver cost reductions to be reflected in energy prices. These measures shall be agreed by end-April (structural benchmark). 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 are implementing measures in line with these reports to prevent the risk of overcompensation in the adjustment calculations (revisibilidade) of the CMEC scheme. In particular, an independent audit on the risk of overcompensation and the amount of past overcompensations will be launched soon and is expected to be finalized by the second half of the year. 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.

27. Transport. The reform agenda in the transport sector is geared toward reducing costs for exporters and making the economy more competitive.

- The bylaws of the transport sector regulator have been approved by the Council of Ministers. They were drafted so as to ensure its financial and operational independence.

- A stakeholder working group has prepared a long-term strategic transport infrastructure plan, which prioritizes infrastructure investment projects taking into account their impact on competitiveness and the budget constraint. Following public consultation, the infrastructure investment priorities will be included in the long-term strategic vision of the transport sector, to be adopted by the Council of Minister by end-April 2014 and discussed at the time of the 12th review.

- In the rail sector, we continue to prepare the privatization of the freight branch of the state-owned rail operator, by implementing measures to ensure operational balance by 2015, by assessing the investment plan on rail to fully enhance the economic value of the company, and by completing the company terminals' unbundling.

• In the ports sector, we have taken the initiative to fully eliminate the port user fee (TUP-Carga) as of January 2014. Following the revision of the Ports Work Law, we are monitoring its effective implementation. We are now seeking further transmission of lower labor costs to end-users of port services. We have published a 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 efficiency and price reduction. To this end, we have signed in March an executive order to appoint the legally required negotiation commissions and set out detailed guidelines on the scope and objectives of the negotiations. Formal negotiations will be launched on this basis (end-April structural benchmark). 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 12th review.

28. 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. Notwithstanding the recent decline, unemployment remains high, particularly for the youth and long-term unemployed. The labor market is also segmented, with a large proportion of new employment contracts extended on short-term basis—although flows have improved recently. In light of this we intend to further advance our reforms aimed at encouraging the creation of long-term jobs and a better job matching process. We are studying policy options in dialogue with the social partners with a view to specifying measures by the time of the 12th review. Several options are available to foster more effective wage bargaining and wage developments consistent with economic fundamentals namely: (i) foster collective agreements by adjusting the current criterion for the extension of collective agreements taking into account the representativeness of SMEs in the various sectors; (ii) after the analysis of the independent study on the desirability of shortening the survival (sobrevigência) of contracts that are expired but not renewed (art 501 of the Labour Code) the Government will present policy options, in dialogue with social partners about expiration and survival of collective agreements—in case the latter option is not implementable, we will study and present a proposal regarding mutually agreed and temporary suspensions of collective agreements; (iii) in the area of employment protection legislation, some reduction of severance pay for unfair dismissals would help reduce the gap opened up with the large reduction in severance for fair dismissal, striking a balance between limiting incentives to challenge fair dismissals in court and adequately penalizing unfair dismissals; (iv) finally, we intend to strengthen activation policies, with significant expected pay offs when vacancies pick up.

29. 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 submission of the remaining 5 (out of 68) necessary legislations—including to the Construction Law—to parliament by mid-April2014 for adoption by end-May. The related ordinance, ensuring appropriateness of fees linked to construction activities will be in enacted by the date of adoption of the Construction Law. Following the publication last year of the new legal framework aimed at improving the functioning of the regulated professions, 18 professional bodies' statutes are being amended. We expect all bylaws to be submitted to Parliament for final approval by end-April2014. These 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.

30. 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. We have already adopted legislation to ease licensing requirements for tourism and industrial sectors. The legislation regarding commercial activities has been submitted to Parliament. Once the Base Law of Soil and Territorial and Urbanism Planning will have been adopted by Parliament (twelfth review), the various related legal regimes will be reviewed. To prevent future growth

in excessive licenses and regulations, the government will adopt—by end-March—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 by end-March. 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.

### Table 1. Portugal: Quantitative Performance Criteria

(Billions of euros, unless otherwise specified)

| | Jun-13 | | Sep-13 | | Dec-13 | | Mar-14 |
|---|---|---|---|---|---|---|---|
| | Program | Actual | Program | Actual | Program | Actual | |
| 1. Floor on the consolidated General Government cash balance (cumulative) | -6.0 | -3.8 | -7.3 | -4.3 | -8.9 | -7.2 | -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 |
| 3. Ceiling on the overall stock of General Government debt | 187.3 | 184.1 | 188.9 | 184.7 | 191.3 | 187.5 | 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-December, domestic arrears for the purpose of the program declined by €0.2 billion since end-September (although the continuous indicative target was not met in October and November). The overall accumulation of domestic arrears since end-December 2012 was about €0.2 billion.

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

| Measure | | Timing | Status |
|---|---|---|---|
| Prior Actions | | | |
| 1 | Specify fiscal measures consistent with achieving the general government deficit target of 2.5 percent of GDP in 2015 (MEFP ¶6). | | Expected to be met by mid-April |
| Structural Benchmarks | | | |
| 2 | Present measures to tackle remaining excess rents in the energy sector and to deliver cost reduction to be reflected in energy prices (MEFP ¶26). | End-April, 2014 | |
| 3 | Launch formal negotiations with port concessionaries with a view to modifying existing concession contracts so as to foster efficiency and price reduction (MEFP ¶27). | End-April, 2014 | |

# ANNEX 5
# TECHNICAL MEMORANDUM OF UNDERSTANDING

March 28, 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.

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

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

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

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

Quantitative Performance Criteria, Indicative Ceilings, and Continuous Performance Criteria: Definitions and Reporting Standards

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

6. **Definition.** The consolidated General Government cash balance (CGGCB) is defined as the sum of the cash balances of the entities covered by the State Budget, the ISOE, the Regional and Local Governments, and the Social Security Funds, and other entities and EBFs, as defined in paragraph 4. Privatization receipts will be excluded from cash receipts. In 2012 and beyond, revenues from the reclassification of pension funds into the general government will not be accounted for as cash revenues

for the purpose of the calculation of the consolidated general government cash balance. In 2012-13, the cash proceeds from the sale of the ANA airport concession will be accounted for as cash expenditure-reducing transactions. The net acquisition of financial assets for policy purposes, including loans and equity participation will be recorded as cash expenditures, except for transactions related to the banking sector support and restructuring strategy under the Program. Called guarantees (excluding those related to the banking sector support and restructuring strategy), where entities of the General Government make cash payments on behalf of entities that are not part of the General Government, will be recorded as cash expenditures.

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

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

- 6.3. **Adjustor.** The 2013 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 ([12])**

| *Actions for the twelfth review (to be completed by end Q1-2014, by the twelfth review or before the end of the Programme)* | |
|---|---|
| **Financial sector** | **[2.20]** Submit the DFI's draft business model and by-laws for in-depth consultations with EC, ECB and IMF staff. It will be designed to ensure no additional burden on or risks to public finances. |
| **Fiscal structural** | **[3.1]** Publish a tax expenditure report as part of the 2014 budget.<br><br>**[3.3]** Finalise targeted programmes to underpin financial sustainability in selected public entities which face structural financial imbalances, such as twelve State-Owned Enterprise hospitals and the railroad company Comboios de Portugal.<br><br>**[3.5]** Publish a fiscal strategy document for the general government.<br><br>**[3.6]** Review the Budget Framework Law (BFL) to fully transpose the relevant EU legislation and develop the key aspects and structure of the new law.<br><br>**[3.12]** Following the comprehensive review of wage and supplemnts' scales in the general government, present in-depth studies for Transport SOEs plus REFER and Estradas de Portugal and also other SOEs.<br><br>**[3.16 i]** Announce and implement the final plan to reduce the number of municipal offices by at least 50 per cent.<br><br>**[3.16 ii]** Increase the resources devoted to auditing in the tax administration to at least 30 percent of the total staff.<br><br>**[3.18 ii]** Make fully operational the recently established Risk Management Unit.<br><br>**[3.21 i]** Present a report identifying potential overlaps of services and jurisdictions and other inefficiencies between the central and local levels of government, as well as new opportunities for decentralisation and outsourcing of services by the central government.<br><br>**[3.21 ii]** Present a report reorganising the network of decentralised services of ministries, aiming at increasing efficiency in the public sector and the quality of services for citizens and businesses.<br><br>**[3.24]** Provide a comprehensive review of wage scales in the public administration.<br><br>**[3.25]** Present draft legislation for a single supplement scale.<br><br>**[3.28]** Make effective a new general Public Administration Labour Law. |

([12]) Square brackets identify paragraph numbers in the MoU as signed on 23 April 2014.

| *Actions for the twelfth review (to be completed by end Q1-2014, by the twelfth review or before the end of the Programme)* | |
|---|---|
| **Health care system** | **[3.35]** Establish an observatory for prices and acquisitions.<br><br>**[3.36]** INFARMED shall continue to develop the national medicines formulary including four new therapeutic areas per quarter. Continue to work with professional associations and enforce the implementation of therapeutic prescription guidelines in outpatient settings.<br><br>**[3.39]** Implement the central accounting platform up to 20 hospital SOEs.<br><br>**[3.40]** 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.<br><br>**[3.41]** The 3-year strategic plans shall specify the reallocation of qualified and support staff within the NHS. |
| **Labour market** | **[4.3]** With a view to specifying measures, the Government will explore, in dialogue with social partners, some reduction in the level of compensation for unfair dismissals.<br><br>**[4.4 iii]** Present policy options, in dialogue with social partners, on the expiration and survival of collective agreements; if not implementable, study and present a proposal regarding the mutually agreed and temporary suspension of collective agreements.<br><br>**[4.4 iv]** Study ways to foster collective agreements, in dialogue with social partners, in order to specifying measures.<br><br>**[4.6 i]** Present in a report how the monitoring, assessment and reporting tool will be used to evaluate the impact of education policies and support the related decision making processes. |
| **Goods and services markets** | **[5.1]** Implement the plan to create a new gas and electricity logistics operator independent company.<br><br>**[5.2]** Present additional measures to tackle remaining excess rents and to deliver cost reductions to be reflected in energy prices. Implement measures to cope with the risks of overcompensation in the adjustment calculations of the CMEC scheme, pursue the actions to eliminate the distortion on the system services market and estimate their results in terms of cost reduction. Ensure that the impact of the energy sector levy will not be passed on to end-users.<br><br>**[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.<br><br>**[5.4]** Further revise the remuneration scheme for co-generation to improve efficiency of the support system. This revision will be undertaken in line with the |

| Actions for the twelfth review (to be completed by end Q1-2014, by the twelfth review or before the end of the Programme) | |
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| | framework of the transposition of the energy efficiency directive.<br><br>**[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 under the framework of the transposition of the Third Energy Package.<br><br>**[5.7 iv]** Reform the transport and infrastructures' regulatory framework in order to improve the effectiveness, efficiency and independence of the entities regulating the transport sector.<br><br>**[5.8]** Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability.<br><br>**[5.9 i]** Ensure that the rail regulator enjoys the independence required under the EU rail Directives. Strengthen the capacities of the railway regulator to fulfil its regulatory mandate effectively.<br><br>**[5.9 iii]** Ensure that the new Public Service Obligation (PSO) contracts concluded on rail passenger transport respect EU legislation including Regulation (EC) No 1370/2007. Develop administrative capacity for introduction of competitive tendering of PSOs.<br><br>**[5.9 iv]** Continue to prepare the privatisation of the freight branch of the state-owned rail operator.<br><br>**[5.9 v]** 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.<br><br>**[5.10 i]** Present a review of the port work law.<br><br>**[5.10 ii]** Ensure that the relevant regulator for ports has sufficient financial and administrative resources to carry out its function.<br><br>**[5.10 iii]** Launch the renegotiation with the relevant operators for ports.<br><br>**[5.11]** Complete the adoption of Construction Laws and the others outstanding sectorial amendments to fully implement the Services Directive and submit them to Parliament with the view of approval. The proportionality of fees linked to construction activities will be ensured by adoption of the Construction Law.<br><br>**[5.12]** Further improve the conditions for mobility of professionals in line with EU Directives.<br><br>**[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.<br><br>**[5.13 ii]** Adapt the content and information available at the PSC for the |

| ***Actions for the twelfth review (to be completed by end Q1-2014, by the twelfth review or before the end of the Programme)*** | |
|---|---|
| | outstanding regimes approved to ensure conformity with the Professional Qualifications Directive by and make available online forms and procedures. |
| **Housing market** | **[6.2]** Publish a comprehensive review of the functioning of the housing market. |
| **Framework conditions** | **[7.3]** Approve the corresponding amendments to the bylaws of the National Regulatory Authorities. Ensure the effective functioning of the Competition Authority financing model and leave room to accommodate growing needs in the medium term.<br><br>**[7.5]** Assess the impact of the optional VAT cash accounting regime.<br><br>**[7.7]** Carry out an inventory and an analysis of the costs of regulations that are likely to have a higher impact on economic activity.<br><br>**[7.8]** 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.<br><br>**[7.9 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, ensure the alignment with the new Industrial Licensing regime.<br><br>**[7.9 ii]** Adopt and make operational a Risk Sectorial Plan.<br><br>**[7.9 iii]** Review the legal regimes of the Territorial Management Instruments (RJIGT) and of the related regulations.<br><br>**[7.9 iv]** Adopt a legal provision for the regularisation of activities not in accordance with Territorial Management Instruments.<br><br>**[7.9 v]** Harmonise the Regional Plans – new generation will be included within the new legal regime of RJIGT<br><br>**[7.9 vi]** Review the Legal Regime for Urbanism and Building (RJUE), that should be aligned with the new Industrial Licensing regime.<br><br>**[7.10 i]** Implement a Legal Regime of Land Registration (*registo cadastral*).<br><br>**[7.10 ii]** Create a diploma on Land Registration and Land Registration Experts.<br><br>**[7.10 iii]** Review the cartography for plans regime and the diploma on Cartography.<br><br>**[7.10 iv]** Enforce the Council of Ministers Resolution 56/2012 to collect all land registration procedures. |

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