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The Economic Adjustement Programme for Portugal First review – Summer 2011

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The Economic Adjustment Programme for Portugal

First Review - summer 2011

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Outline of the report

EXECUTIVE SUMMARY

A joint EC/ECB/IMF mission met with the Portuguese authorities in Lisbon from 1 to 12 August 2011. The mission assessed compliance with the terms and conditions of the First Review under the Economic Adjustment Programme. The objectives of the programme are to restore competitiveness and to put Portugal's economy back on the path of sustainable growth, sound public finances and job creation. This report provides an assessment of compliance and summarises the findings of the mission.

It is the joint assessment of the three institutions that the programme is on track. The new government that took office on 21 June is fully committed to the programme agreed in May 2011 and has already shown its determination by reacting quickly to evidence of an emerging shortfall in public finances and by moving ahead with some important structural reforms.

The macroeconomic scenario of the programme remains valid. Economic growth and inflation for the year as a whole are expected to remain in line with the programme. Export growth has been strong; consumer confidence indicators are steady; and employment has remained broadly stable. While GDP is expected to contract in 2011 and 2012, a recovery is projected to begin taking hold in early 2013. Near-term risks to the scenario appear broadly balanced. GDP growth in the second quarter has been more favourable than expected, but the external environment is less favourable than previously assumed.

Recent data pointed to an opening gap between fiscal trends and the 2011 deficit targets. Expenditure overruns in the first half of the year, underperforming non-tax revenue and the reclassification of some operations led to a projected shortfall of about 1.1 percent of GDP. The net costs related to the sale of the troubled bank BPN will add another 0.2 percent of GDP to the headline deficit. The authorities have reacted promptly. Budget execution is being tightened; a one-off surcharge on the personal income tax has been introduced; increases in VAT on natural gas and electricity have been brought forward from next year to 1 October; sales of concessions will be stepped up. The ongoing process of a phased transfer of banks pension funds to the state social security system will exceptionally provide a buffer towards meeting the 5.9 percent of GDP deficit target in 2011. The authorities are committed to reducing the deficit to 3 percent of GDP by 2013 as programmed and are currently working on a 4-year fiscal strategy.

Progress is being made to strengthen public financial management. Availability of information has been stepped up (including on arrears) and reforms of the budgetary framework, including setting up an independent Fiscal Council and reinforcing expenditure control, have started. An IMF/EC technical assistance mission in the second half of July has provided detailed recommendations in this area.

In the financial sector, banks are working towards meeting the higher capital requirements established under the programme. Existing legislation is being amended to strengthen the implementation of the augmented solvency support facility. A balanced and orderly deleveraging of the banking sector remains critical, while safeguarding adequate credit for dynamic sectors to spur growth. Progress has also been made to strengthen the supervisory and regulatory capacity, including via technical assistance.

The success of the programme hinges above all on restoring competiveness and raising potential growth. The authorities acknowledge that opening the economy to competition and reducing government involvement in private sector activity are crucial. The Government has abolished the special rights of the state in private companies ahead of schedule and is pushing ahead with the *privatisation programme. A severe restructuring of State-owned enterprises is at the top of the government's agenda. Labour market reforms to align the protection and rights under fixed and open-ended contracts and to establish an employer-financed fund for paying out workers' severance entitlements are advancing. Progress is being made in preparation for a budget-neutral fiscal devaluation, and the authorities remain committed to take a major first step in this regard with the 2012 Budget.*

The government's programme is supported by loans from the European Union amounting to EUR 52 billion and a EUR 26 billion Extended Fund Facility with the IMF. Approval of the conclusion of this review allows the disbursement of EUR 11.5 billion (EUR 7.6 billion by the EU, and EUR 3.9 billion by the IMF). The disbursement is expected in September.

I. INTRODUCTION

1. The report assesses compliance with the conditions of the first review of the Portuguese economic adjustment programme. The assessment is based on the findings of a joint Commission/ECB/IMF mission to Lisbon from 1 to 12 August 2011. In accordance with the Council Implementing Decision 2011/344/EU on granting EU financial assistance to Portugal[1], the mission assessed compliance with the conditionality associated with the second disbursement and progress towards the key objectives of the programme of restoring competitiveness and putting Portugal's economy back on the path of sustainable growth, sound public finances and job creation[2,3].

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

3. The new government led by a PSD-CDS coalition is committed to the Programme. The programme was negotiated by the outgoing PS government in the run up to the 5 June elections, but supported by the current coalition parties. The PS, now the main opposition party, maintains a cooperative attitude. During the review mission, the Memorandum of Understanding (MoU) and the Memorandum of Economic and Financial Policies (MEFP) were updated to reflect economic and policy developments since the signature to the original MoU in May 2011. These modifications were made where necessary to make the various objectives more operational and reinforce the definition of measures and targets.

4. The first EU-IMF disbursement to Portugal, covering the period between June and September, totalled EUR 18.7 billion, equivalent to almost one-fourth of the entire programme. After the second disbursement of EUR 11.5 billion, almost 40 percent of the total Programme size will be covered. The frontloading of the payments is warranted by the Portuguese stringent cash position and upcoming financing needs. These needs were factored in already at the time of Programme's design.

5. The decisions taken by the Euro area summit on 21 July provide support to the Portuguese adjustment programme. Euro area leaders decided to lower interest rates to near the EFSF's funding rate, significantly extend maturities, and stand ready to provide financing until market access has normalised. The expected savings in interest payments on EU loans are significant, but pending finalisation of the technical work to implement the 21 July decisions their impact on financing conditions has not yet been factored in the projected external funding needs of Portugal.

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[1] OJ L 159/88 of 17.5.2011

[2] The cut-off date for the information included in this report is 18.08.2011.

[3] Please refer to the link below for the previous edition of the Memorandum of Understanding: http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/op79_en.htm

II. ECONOMIC DEVELOPMENTS AND OUTLOOK

MACROECONOMIC OUTLOOK

6. **The macroeconomic context is evolving broadly in line with existing programme projections.** Risks are roughly balanced with stronger than expected short-term developments offset by additional tax increases and a less favourable external environment than assumed a few months ago. In the first quarter of 2011, GDP contracted by 0.6 percent in volume terms compared with the previous quarter, slightly less than predicted in the macroeconomic scenario of the Programme. Domestic demand fell more than expected due to a strongly negative growth contribution of inventories and somewhat weaker private consumption expenditure. This was partly compensated by higher-than-anticipated private investment due to a surprise increase in housing construction. As a result, domestic demand subtracted 3½ percentage points from quarterly real GDP growth in Q1-2011. On the external side, exports of goods and services increased slightly while imports recorded a substantial fall compared to the previous quarter, resulting in an external growth contribution of 3 percentage points. According to the flash estimate released by Portugal's Statistical office (INE) on 16 August, real GDP was flat in the second quarter of 2011 over the first quarter. On an annual basis GDP fell 0.9 percent. As in the first quarter, a significant decrease in domestic demand was compensated by a big surplus in net trade. Overall, the data suggest a faster external adjustment than anticipated (net external borrowing has fallen below 8 percent of GDP from 10 percent less than one year ago) but also a less tax-favourable composition of GDP.

Table 1: Macroeconomic projection

	August 2011			May 2011			*Difference*		
	2010	2011	2012	2010	2011	2012	*2010*	*2011*	*2012*
	year-on-year volume change								
Gross domestic product	1.3	-2.2	-1.8	1.3	-2.2	-1.8	*0.0*	*0.0*	*0.0*
Private consumption	2.3	-4.4	-3.7	2.2	-4.4	-3.8	*0.1*	*0.0*	*0.1*
Public consumption	1.2	-4.1	-4.6	1.8	-6.1	-4.6	*-0.6*	*2.0*	*0.0*
Fixed investment	-4.9	-11.4	-9.0	-5.0	-9.9	-7.4	*0.1*	*-1.5*	*-1.6*
Exports of goods and services	8.7	6.6	6.5	8.7	6.2	5.9	*0.0*	*0.4*	*0.6*
Imports of goods and services	5.1	-4.9	-2.0	5.2	-5.3	-2.8	*-0.1*	*0.4*	*0.8*
	contributions to real GDP growth								
Domestic demand excl. inventories	0.8	-6.0	-5.0	0.8	-6.1	-4.8	*0.0*	*0.1*	*-0.2*
Change in inventories	-0.1	-0.1	0.1	-0.1	0.0	-0.1	*0.0*	*-0.1*	*0.2*
Net trade	0.6	3.9	3.1	0.6	4.0	3.1	*0.0*	*-0.1*	*0.0*
Employment (y-o-y change)	-1.5	-1.4	-1.0	-1.5	-1.5	-0.9	*0.0*	*0.1*	*-0.1*
Unemployment rate (level)	10.9	12.1	12.8	10.9	12.2	12.9	*0.0*	*-0.1*	*-0.1*
GDP deflator (y-o-y change)	1.1	1.3	1.4	1.0	1.1	1.2	*0.1*	*0.2*	*0.2*
HICP (y-o-y change)	1.4	3.4	2.1	1.5	3.4	2.0	*-0.1*	*0.0*	*0.1*

Source: Commission Services

7. **Stronger than expected GDP growth in the first half of the year does not change the near-term outlook.** Higher than expected levels of public consumptions in the first semester will be partly compensated by lower public investment and lower private consumption expenditure at the end of the year on account of higher income taxes and transport tariffs. The projection for fixed investment is also revised downwards on evidence that banks are spreading their deleveraging efforts more evenly between households and non-financial corporations. In addition, exports face headwinds in H2-2011 as increased sovereign stress in the US and in Europe weighs on global investor confidence and is

leading to accelerated fiscal consolidation efforts in some countries, with possible negative effects on foreign demand. Manufacturing activity in many parts of the world is slowing down. Moreover, recent data on developments in Q2-2011 are preliminary and incomplete. All in all, real GDP is therefore still forecast to decline by 2.2 percent this year, but there are upside risks. The projection for real GDP in the outer years has also been kept unchanged, with minor adjustments in the growth composition.

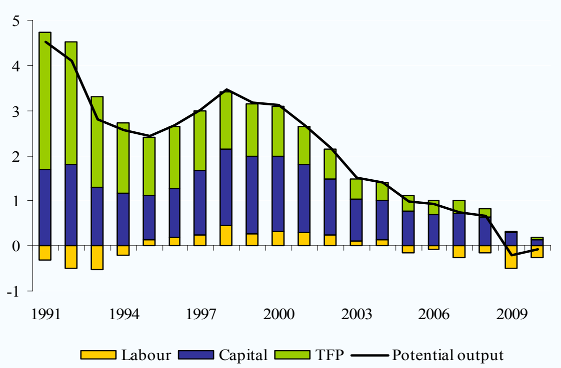
8. Inflation developments are driven by high energy prices and temporary VAT effects, while the labour market weakens. Headline HICP inflation is evolving as expected. In the first half of 2011, annual headline inflation was 3.7 percent, but has slowed to 3.0 percent in July, amidst weak domestic price pressures. At constant indirect taxes, annual HICP inflation has fallen to 2.2 percent in May, 0.3 percentage points lower than the euro area average. Employment was flat in the first quarter of this year, in line with Programme projections. The recent jump in the unemployment rate to 12.4 percent reflects a methodological change in the labour force survey. Compensation per employee has decelerated as projected in the Programme scenario.

Box 1: Boosting potential GDP growth

Portugal had established itself in the past as the low-wage region of Europe, specialising in low-skill manufacturing, especially textiles, which until the end 1990s alone accounted for one-third of total export value. This economic model is no longer viable also due to greater competition from new Member States and new emerging economies. Economic growth has been on a downward trend since 2000 with domestic consumption (public and private) on average contributing to and private investment and external trade dragging on economic growth. Large internal and external imbalances reflect low domestic savings (both public and private), low productivity growth and eroded competitiveness.

Capital, labour and total factor productivity (TFP) have all contributed to a steady decline in potential growth since 1998 (see Graph 1). The economic and financial crisis brought existing imbalances to the fore and further lowered the growth potential. In 2009, at the heights of the economic and financial crisis, strong increases in both unemployment and wages had an additional negative impact on labour supply. Going forward, a significant increase in investment activity to pre-crisis levels is uncertain given that the shift in investors' risk perception following the financial crisis is expected to persist. Hence, progress in the area of TFP and labour supply is all the more important in order to raise the economy's growth potential.

Graph 1: Portugal – contributions to potential output growth



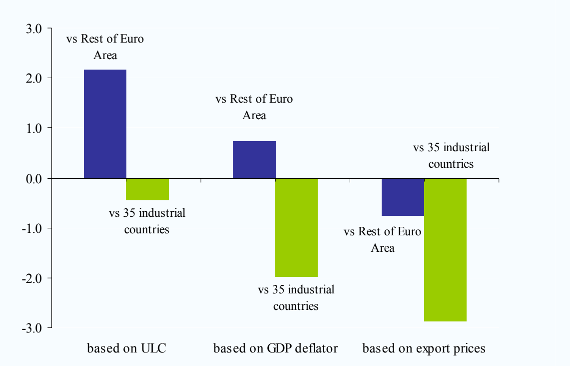
Source: Commission services

Portugal's Economic Adjustment Programme addresses these challenges in a comprehensive way. Labour market reforms will help to reduce the high level of structural unemployment and increase labour supply by encouraging more unemployed to enter the job market. Wide-ranging reforms of product and services markets and of framework conditions for business will foster the efficient allocation of capital to its most productive use and lead to higher productivity.

Box 2: Price competitiveness, export performance and current account adjustment

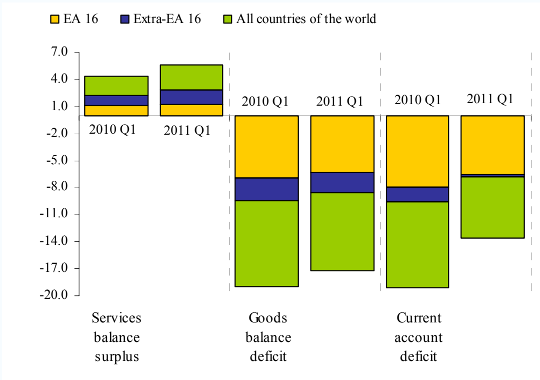
The intra-euro-area real effective exchange rates (REER) based on ULC and GDP deflator do not show clear signs of adjustment in price competitiveness so far. Portugal competitiveness vis-à-vis euro-area partners continued to worsen during the crisis. ULC-based REER suggest that close to no competitiveness adjustment took place through unit labour costs via the labour market. Conversely, the REER deflated by export prices shows some significant adjustment, reflecting either a squeeze in profit margins in the export sector or the lower price of the import content of exports (in Portugal, the import content of exports is on average 40%).

Graph 2: Real effective exchange rate adjustment in Portugal (change 2009-2011f, in %)



Source: Commission services

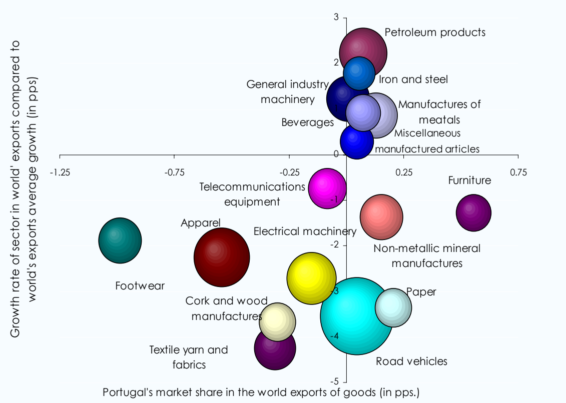
Graph 3: Current account balance (2010Q1 vs. 2011Q1 in percent of GDP)



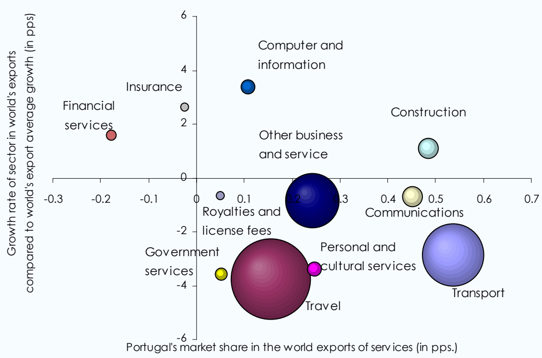
Source: Commission services

Graph 4 and 5 show that world Portugal's market shares have been increasing in most services sectors over the decade (although the share of fast-growing services is rather modest), while goods sectors have suffered from world market shares losses. This structural change is reflected in the recent narrowing of the current account balance. Graph 3 shows very modest adjustment of the current account balance with EA16 partners (including in the services sector), while the current account surplus in the services sector with extra-EA16 countries has increased significantly. The widening of the surplus in services has been three times larger than the narrowing of the goods balance deficit, trade in services being the main contributor to the current account adjustment, despite a lower share in the overall trade. In contrast, large negative income payments (4.6% of GDP in 2010, down from 5.1% in 2009) will continue to weigh on Portugal's current account and absorb a large share of disposable income.

Graph 4: Export performance in goods sector, 2000-2009 (1)



Graph 5: Export performance of services, 2000-2009 (1)



(1) Bubbles' size corresponds to the share in total exports in 2009. A 'performing sector' would be in the first quadrant.
Source: Commission services

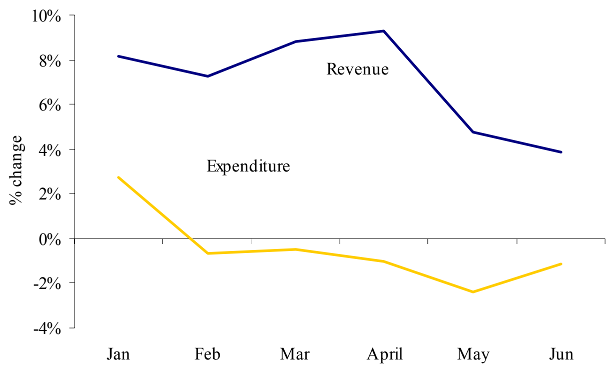
9. The strengthening of the external balance is expected to continue over the forecast period. On a year-on-year basis, exports were up by 8.5% in the first quarter, while imports had fallen by 0.8% on account of weak domestic demand. Encouragingly, export market shares have been rising. The key objective of the planned "fiscal devaluation" (see Section III) is to boost competitiveness and contribute to the external adjustment and GDP growth.

FISCAL POLICY DEVELOPMENTS

10. The Programme foresees a large fiscal consolidation effort in 2011, totalling above 5 percent of GDP. The target is to reduce the budget deficit from 9.1 percent of GDP last year to 5.9 percent of GDP in 2011. Planned consolidation measures on the expenditure side include an average cut of 5 percent in government wages, reductions in government payroll lists, cuts in social transfers such as unemployment benefits and family allowances, and a freeze of all other social outlays. Additional measures were targeted at reining in spending in particular in the health sector, state-owned enterprises (SOEs) or public investment. Consolidation efforts on the revenue side consisted mainly of an additional rise of 2 percentage points of the standard VAT rate as of 1 January 2011. In addition, revenue projections reflected the carry-over effect of tax hikes introduced in mid-2010. Increase in non-tax revenues, both by charging higher prices and fees for services and from asset sales, were also planned.

11. The first review mission found evidence of a shortfall with respect to the Programme target for the 2011 deficit. While execution cash data up to June 2011 have been in line with projections, accruals data on national accounts for the first quarter and additional information gathered during the mission point to a shortfall of about 1.1 percent of GDP in the absence of corrective measures. The gap is due to expenditure overruns (which could have led to an increase in payables and arrears), underperformance of non-tax revenue, unforeseen one-off deficit-increasing events (capital transfers). The costs related to the sale of troubled bank BPN (whose modalities have been known only recently) will add another 0.2 percent of GDP to the headline deficit in ESA-95[4]. The sources of the shortfall and the corrective measures are discussed in detail in section III.

Graph 6: Budgetary outturns for the period January-May 2011 (Cash data)



Source: Ministry of Finance and Commission services
Note: Includes data for the State, Autonomous Funds and Services and Social Security (up to June); Non-consolidated revenue and expenditure data.

12. Cash figures until June show a declining deficit. Revenue growth reflects the tax hikes referred to above. Spending has declined from previous year level. However, the decline is partly due to relatively low interest expenditure in the first half of 2011 (relative to total interest payments over the whole year). Preliminary and incomplete data for the month of July point to a deceleration of tax revenue and of the pace of deficit reduction, a trend that is expected to continue for the remainder of

[4] The budgetary costs of bank support measures are accounted in the budget deficit under ESA 95 but are not taken into account in the definition of the budget deficit to be considered for the fulfilment of Programme's targets.

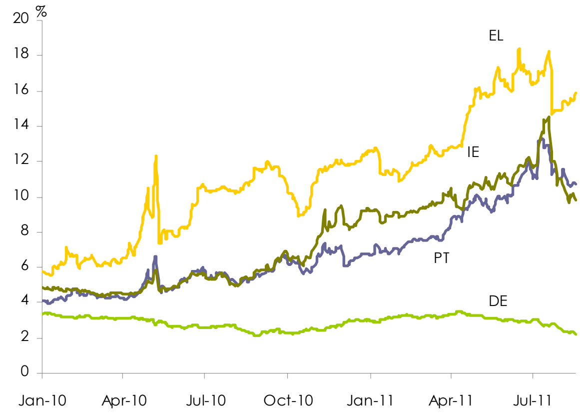
the year as weak economic activity takes its toll on public finances and the base effect of tax hikes in mid 2010 leads to lower revenue growth rates.

13. The budget deficit in Q1-2011 in national accounts terms was worse than the cash data would have suggested. In national accounts terms, a deficit of 7.7 percent of GDP was posted. The discrepancy with public accounts cash data is due to some standard factors, namely time adjustments in the recording of taxes and interest expenditure, the fact that public accounts cash data cover a smaller universe than national accounts data (notably, public enterprises are not considered in cash data). While based on past trends these effects could be expected to be particularly large in the first quarter, they still surprised on the deficit-increasing side. Even taking into account unexpected one-off events, such as the recording of the debt of a regional-government-owned enterprise worth almost 0.2 percent of annual GDP[5], these developments point also to an accumulation of spending arrears in the quarter. Whereas simple extrapolation of the first quarter national account deficit to the full year is not appropriate, such an outturn pointed to risks of missing the target for the year as a whole.

FINANCIAL MARKETS AND FINANCIAL SECTOR DEVELOPMENTS

14. Yields and spreads on Portuguese government bonds have risen sharply. Sentiment towards peripheral countries has deteriorated amidst a widening of the crisis to other euro area countries. Rating agencies have downgraded the credit status of the Portuguese sovereign to below investment grade (Moody's on 5 July) or are one notch above it with negative outlook (S&P and Fitch), reflecting inter alia the discussions on the assistance programme for Greece. The 10-year bond yield rose to above 13 percent in the beginning of July, compared to around 9 percent at the beginning of May 2011 when the financial assistance programme was launched. The 21 July euro area summit and the August ECB meeting led to a narrowing of Portuguese spreads and a flattening of the yield curve. Nevertheless, yields and spreads remain at elevated levels.

Graph 7: Ten-year bond yields in Portugal, Ireland, Greece and Germany

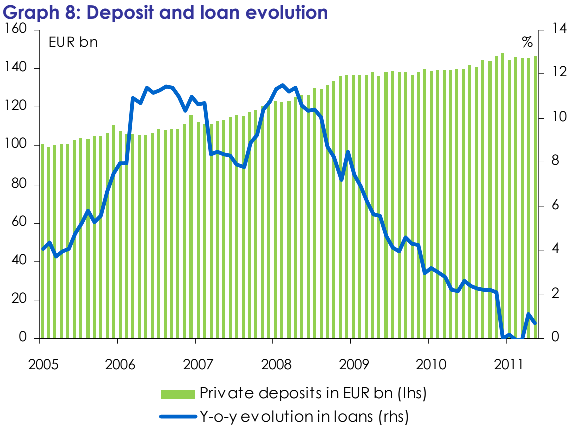


Source: Reuters

15. The liquidity situation of the banks remains tight, leading to increased competition for deposits. Portuguese banks have very limited access to the wholesale funding market and the sovereign downgrade implied higher valuation haircuts on their collateral. Borrowing from the Eurosystem declined somewhat to EUR 44 billion at the end of July compared to a peak of EUR 48 billion in April 2011. To alleviate possible liquidity constraints the scheme for issuing government guaranteed bank bonds was increased to EUR 35 billion in line with programme conditionality and after approval by the European Commission under state aid rules. The search for funding led also to increased competition for deposits prompting higher deposit rates and a reintegration on the balance sheet of savings products under management of mutual funds and life insurance companies. It resulted in an overall increase in deposits (graph 7).

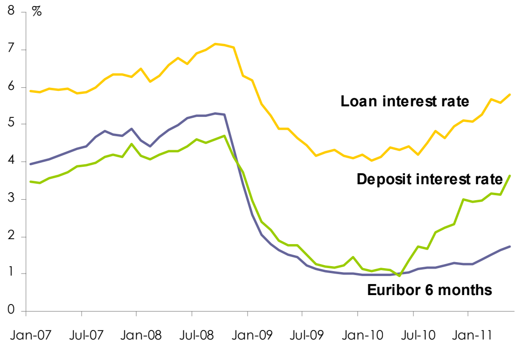
[5] This was triggered by a guarantee granted to a financially distressed company: according to ESA95 rules, the full amount of that company's guaranteed debt by the regional government had to be recorded in the general government deficit.

Graph 8: Deposit and loan evolution



Source: Banco de Portugal

Graph 9: Loan and deposit interest rates



Source: Banco de Portugal, Ecowin

16. Credit expansion is stalling and the intermediation margin is under pressure from both ends. With credit demand expected to decline as the economy shrinks and banks tightening credit standards in order to limit risk and reach their deleveraging targets, loan growth has come close to a halt since the second quarter of 2011. Weak demand curbs the potential for higher loan rates, which are traditionally linked to the Euribor rate (which is particularly low since October 2008). On the other hand as competition for deposits has intensified banks are offering increasingly higher deposit rates (graph 9).

Table 2 : Soundness indicators of the Portuguese banking system

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

Note: The Core Tier 1 ratio excludes the banks in resolution

Source: Banco de Portugal

17. Bank profitability is declining fast. In the first quarter of 2011 profitability has dropped by over 10 percent compared with one year earlier but remained positive with the return on equity at 6.4 percent (table 2). Weakened profitability is mainly driven by low margins and a deterioration in asset quality, but also partly by deleveraging, which forces banks to downsize the portfolio of assets and pay higher deposit rates. In particular income from financial operations suffered, while commissions could be maintained. Non-performing loans (NPL) stood at 3.5 percent in March for the whole banking system based on the national definition of NPL. In agreement with the international assistance programme, Portugal will adjust its regulation and intends to publish, along the national definition, also NPLs according to best international practices. Following the completion of the on-site inspections in November, the Financial Stability Report of the Banco de Portugal will include both NPL statistics (this could already take place in the November 2011 issue of the FSR). According to preliminary estimates, considering the entire impaired loan, rather than only the overdue amount, the NPL ratio would be pushed up only moderately, to levels which are still favourable in an international comparison. While the coverage ratio is further declining, provisioning for NPLs was also weighing on the profit and loss account, as well as administrative costs which in relative term continue to creep up as reflected in the rising cost to income ratio.

18. The resilience of the largest four Portuguese banks has been tested with mixed results. Although no Portuguese bank failed the 2011 EBA tests outright, two were reported being close to the stress test hurdle of 5 percent Core Tier 1 (table 3). In the adverse scenario, several shocks were introduced in 2011, including an aggravation of the sovereign crisis and country-specific bond yield increases as well as shocks to house prices and stock prices leading to a worsening of the economic situation. The stress tests have been carried out using a static balance sheet as of December 2010 and do not take into account future business strategies and management actions after April 2011. Thus, the deleveraging process through which the banks are going, is not taken into account, but recognised and timely reported mitigating factors are separately considered. Banco Comercial Português and Espírito Santo Financial Group had levels of core Tier 1 capital between 5 percent and 6 percent in 2012 in the adverse scenario. These two banks will devise, in agreement with Banco de Portugal, appropriate actions, such as increasing capital or putting in place asset disposals, to strengthen their balance sheets in the 3-month period since publication of the stress test

Table 3: The July 2011 EBA stress test results

Core Tier I in %, unless otherwise indicated	2010QIV			2012		
	CT I	RWA	CT I	Mitigating factors		
	EUR bn	EUR bn	%	No	Yes 2011	Yes 2012
Caixa Geral de Depósitos	6.5	77.0	8.5	6.2	6.2	6.5
Banco Commercial Português	3.5	59.6	5.9	3.6	5.4	6.2
Espirito Santo Financial Group	4.5	77.1	6.4	5.1	5.1	6.3
Banco Português de Investimento	2.1	26.0	8.2	6.7	6.7	7.0

Note: CT1: Core Tier 1 capital; RWA: Risk Weighted Assets; 2011 Mitigating factors up to April 2011; 2012 mitigating factors up to December 2012.

Source: European Banking Authority (EBA), Banco de Portugal

III. PROGRAMME IMPLEMENTATION

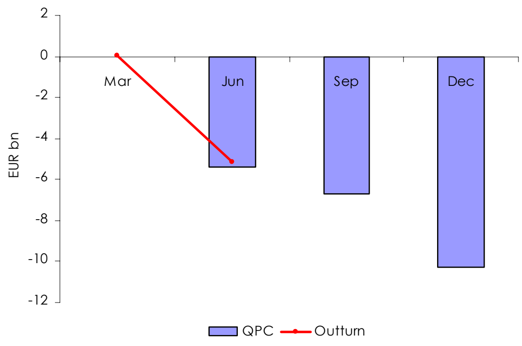
19. The joint EC/IMF/ECB mission concluded that implementation of the programme is on track. The new government has shown determination by reacting quickly to evidence of an emerging shortfall in public finances and by moving ahead with important structural reforms. In response to the adverse budgetary data, authorities have tightened budget execution and introduced new consolidation measures to ensure the achievement of the 5.9 percent of GDP deficit target in 2011. At the same time, the Public Financial Management framework was strengthened by the application of the Budgetary Framework Law and improvements in monitoring and reporting. The stabilisation of the banking system is proceeding as planned. Banks are taking steps towards meeting the enhanced capital requirements, and regulatory changes to strengthen the solvency support and the supervisory and regulatory framework are put in place. There has been visible progress in the area of structural reforms, particularly concerning the elimination of golden shares and the application of measures to open the product and labour markets. The authorities are fully cooperative with EC, IMF and the ECB staff, even though administrative resources are strained. An annex to this report provides a detailed list of the measures taken to meet the conditionality requirement for this first review.

Table 4: Summary of compliance with policy conditionality for the first review

Policy area	Status
Fiscal policy	The quarterly quantitative performance criteria on the general government cash balance and debt stock for the first half of 2011 were met. However, consolidation measures have not delivered the full expected impact and there have been substantial unexpected one-offs operations. The budget deficit for the year as a whole risked exceeding the programme target on a national account basis but corrective actions are being taken.
Fiscal devaluation	The technical work has advanced in view of taking a first step for a budget-neutral reduction in employers' SSC with the 2012 Budget, but full calibration of a proposal could not be finalised by the July deadline.
Financial sector	Banks have presented funding plans and capital plans on time. Preliminary results of the program of special on-site inspections to validate banks data on assets will be available by mid-October. A buyer has been selected for Banco Português de Negócios (BPN). The acquisition plan will have to be assessed by EU competition authorities. The central bank is refining the methodology for stress testing, and a new framework will be available after the completion of the on-site inspections.
Fiscal-structural	Public finance management. Definitions of arrears and contingent liabilities have been approved. A preliminary survey of arrears has been completed on schedule and the survey is being enhanced. Implementation of the amended 2011 Budgetary Framework Law is on track, including progress towards medium-term budgeting and the transition to accruals accounting, and the establishment of a Fiscal Council. An IMF/EC TA mission took place on 12-27 July as planned. SOEs. Plans to increase the average tariff for the public transport by 15 percent were implemented on 1 August. No overall assessment of tariff structure was provided. Plans to reduce central government SOEs operational costs specify quantitative cost savings goals but without providing specific means to assure achievement at this stage. Health care sector SOEs will need more time to achieve cost reduction targets (3 year horizon). Ceilings for borrowing requirements for central government SOEs for 2012 onwards have not been fully defined yet. PPPs. All planned new PPPs have been suspended. The assessment of most relevant PPPs is ongoing.
Structural reforms	Labour market. The draft the reform of severance payments for new hires has been presented to Parliament. Implementation is expected by end September. Energy. Progress is steady. Roadmaps have been set forth for the gradual phasing out of regulated tariffs in electricity and for the natural gas market. Implementation details will be defined in subsequent legislation. The transposition of the Third EU Energy Package is ongoing, but some amendments to legislation might still be needed to fully comply with the directive. Transposition of the provisions granting the necessary powers to the regulator is forthcoming. Telecommunications. All relevant articles of the directive to increase competition in telecommunications sector have been transposed in the draft law. Judicial system. Reforms are being advanced. The deadline for the development of measures to expedite the resolution of the backlogs has been extended in order to permit authorities to take account of all relevant studies and recommendations. "Golden shares". The authorities have taken clear action to eliminate existing "golden shares" and special rights by the State.
Data submission	Requirements under the Programme have been observed. Work is ongoing to improve further data submission.

20. Despite the good cash performance, the budget deficit for the year as a whole would exceed the programme target in the absence of policy changes. The quarterly quantitative performance criterion on the government cash balance for end June 2011 was met, thanks to relatively robust revenue growth and from nominal reductions in spending as described above. However, as described above, budgetary developments in spending were less favourable on a national account basis, and there were a number of sizeable deficit-increasing one-off operations. All in all, the mission concluded that without further action, the 2011 general government deficit target would haven been missed by about 1.1 percent of GDP. The costs related to the sale of BPN will add a further 0.2 percent of GDP to the ESA-95 headline budget deficit (Table 5). The quarterly quantitative performance criterion on the stock of government debt at end June 2011 was also met.

Graph 10 - Quarterly Performance Criterion (cash deficit)



Source: Commission services

21. Consolidation measures are not yielding the full expected results. The ambitious package of consolidation measures for 2011 has not been implemented to its full extent. In particular, spending levels are above plans in intermediate consumption and compensation of government employees. The latter reflects a lower-than-assumed reduction in government employment and an exceptionally large number of promotions in some ministries (home affairs, justice and defence) in the final part of 2010. Tax revenue is in line with programme's assumptions (and could even over-perform), but non-tax revenue is falling short of plans.

22. One-off operations complicate the achievement of the 2011 budget deficit target. Namely, the autonomous region of Madeira had to record in the regional government accounts the debt of one financially-troubled regional government enterprise and of an aborted Public Private Partnership agreement. These operations, for a total of EUR 500 million or 0.3 percent of GDP, are recorded as (one-off) expenditure-increasing operations in the general government accounts. The additional net costs related to the recently defined sale of troubled bank BPN are quantified at EUR 320 million (0.2 percent of GDP). Capital transfers towards SOE-hospitals amounted to 167 million (0.1 percent of GDP). All these operations will have a temporary impact in the government deficit only in 2011. At the same time, they highlight the risks related to SOEs and PPPs going forward.

23. The authorities have responded promptly to the risks to the 2011 target. Budget execution is being tightened. Already in late June, when the data for the first quarter pointed to a higher-than-expected deficit, a one-off surcharge in the context of the personal income tax was introduced. The surcharge is expected to yield 0.5 percent of GDP in 2011 and 0.1 percent of GDP in 2012. On 12 August the authorities announced that a planned increase in the VAT rate on electricity and natural gas from 6 to 23 percent would be brought forward from 2012 to 1 October 2011. The measure is expected to yield revenue of 0.1 percent of GDP in 2011 (and an additional 0.25 percent of GDP in 2012). The government will also endeavour to adopt other consolidation measures of a permanent nature and/or frontload other consolidation measures planned for 2012. The government is working towards accelerating the sale of a number of concessions (telecommunication and others) that are expected to yield additional proceeds worth 0.35 percent of GDP. Finally, the government will proceed with a planned phased transfer of banks pension funds to the state social security system, which will exceptionally be used towards meeting the 2011 deficit target. The authorities intend to carry out these transfers in an actuarially neutral way. The government is also committed not to use the acquired assets of these pension funds in a detrimental way to long-term sustainability, and it does not count on further transfers of pension funds to meet the targets for 2012 and beyond.

Table 5 - Projected 2011 budget shortfall and offsetting measures*

Sources of the shortfall	EUR bn	% of GDP
Expenditure overruns	1.1	0.6
Lower non tax revenues	0.7	0.4
Reclassification of SOE and PPP-related operations	0.5	0.3
Other SOEs / Capital injections	0.2	0.1
Total	**2.4**	**1.4**
Offsetting factors		
Tax revenue over performance	0.4	0.2
Lower investment	0.2	0.1
Total budget shortfall before measures	**1.9**	**1.1**
Offsetting measures		
Surcharge in the context of the PIT	0.8	0.5
VAT increase on electricity and natural gas	0.1	0.1
Sales of concessions	0.6	0.4
Possible other measures or anticipation of 2012 measures	unspecified	unspecified
Planned transfer of banks pension funds to the state	Up to 0.3	Up to 0.2
Total of measures	**1.9**	**1.1**
Memo: Net budgetary cost of the sale of BPN	0.3	0.2

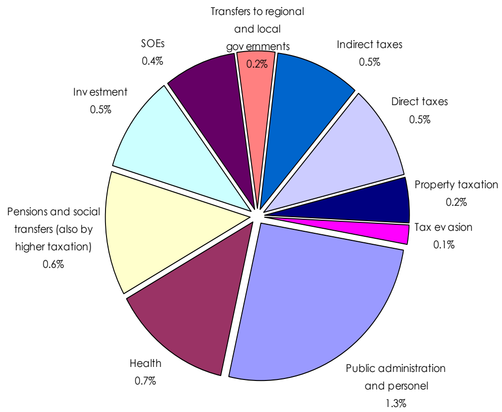
* The shortfall is measured against Programme's objectives and definitions. Sub-totals might not add up due to rounding.

24. The mission concluded that fiscal consolidation remains on track. The government is reacting effectively to slippages largely occurred in the first semester. While the response is partly made of one-off measures, there is a clear determination to base future consolidation on structural consolidation measures. The budgetary targets in the Programme for 2012 and 2013 are confirmed at 4.5 percent and 3 percent of GDP, respectively, as well as the consolidation measures detailed in the Programme. This path is in line with the Council Recommendations under the Excessive Deficit Procedure. A cumulative fiscal effort of over 5 percent of GDP over the next two years is needed to reach the targets. Overall, expenditure-reducing measures account for two thirds of the programmed consolidation effort over 2012-13.

25. The 2012 Budget law is expected to be fully consistent with the deficit target of 4.5 percent of GDP. It is particularly important that the primary spending slippages recorded in 2011 do not become permanent and that the carry-over of negative developments in 2011 is offset by permanent measures. The government agreed to hold further discussions with the EC, IMF and ECB prior to the presentation of the 2012 Budget to Parliament in mid October.

26. The authorities are committed to reducing the deficit to 3 percent of GDP by 2013 as programmed and are currently working on a 4-year fiscal strategy (2012-15). This medium term strategy is expected to convey further details on the fiscal consolidation plans, also beyond the programme horizon.

Graph 11: Consolidation measures in 2012 and 2013 per area (% of GDP)



Source: Commission services

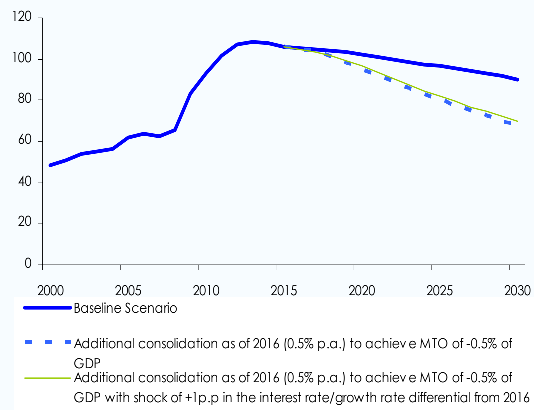
27. Debt projections are unchanged relative to the time of Programme's design. Government debt is projected to peak at 108 percent of GDP in 2013 and gradually decline thereafter (Box 3). The main parameters underlying the long-term sustainability analysis remain largely unchanged. The lower interest rates on the EFSF lending resulting from the decisions of the euro area Heads of State and Government of 21 July have not been integrated in the analysis at this stage, pending finalisation of the implementing provisions.

Box 3: Government debt and fiscal sustainability in Portugal

Under the Programme scenario, government debt is projected to peak at 108 percent of GDP in 2013 before starting a gradual decline. The baseline long-term calculations shown below incorporate the programme scenario up to 2015. Thereafter, it is assumed that: (i) the structural primary fiscal balance (i.e., the government balance adjusted for interest payments and for the effect of the cycle) remains unchanged at a surplus of 2.9 percent of GDP; (ii) nominal interest rates are 5 percent; (iii) nominal GDP growth stays close to 4 percent (2 percent growth in volume terms plus 2 percent inflation); (iv) ageing costs are taken into account according to the projections in the Commission's 2009 Sustainability Report; (v) the expected fiscal impacts of PPPs are factored into the analysis.

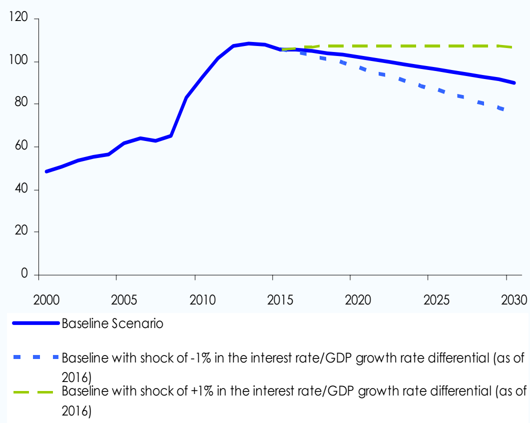
Graph 12 below (left panel) shows that full observance of the Programme plans can trigger a gradual decline of the debt ratio over the longer term. However, for a large number of years the debt ratio would remain higher than before the current crisis. The Graphs also show a sensitivity analysis. A one percentage point (pp) of lower GDP than in the baseline scenario, or higher average interest rate by 1 pp, would essentially jeopardise the reduction of the debt ratio. Conversely, higher GDP growth or continued fiscal consolidation beyond the Programme horizon can result in visibly lower debt-to-GDP ratios. The reduced interest rates decided by the euro area summit of 21 July will thus contribute to improve sustainability prospects, while the extension of maturities will alleviate re-financing needs. These decisions provide support to the authorities' efforts towards the Programme's objectives of restoring growth and sound public finances. Possible costs of bank recapitalisation are not included in the baseline scenario. Assuming bank recapitalisation costs of EUR 10 billion over the programme could result in a long-term debt level up to about 10 percent of GDP higher (depending on the assumptions on recovery rates).

Graph 12: Developments in the debt ratio – effect of further consolidation (% of GDP)



Source: Commission services

Graph 13: Developments in debt ratio – scenarios (% of GDP)



Source: Commission services

28. Preliminary data show a large stock of arrears. The authorities have been collecting data on arrears in view of the comprehensive survey as agreed under the Programme. The stock of arrears has been estimated at around EUR 4 billion (2.3 percent of GDP), for the combination of the general government sector (as defined in national accounts) and the SOEs that are not part of the general government (instead classified in the corporate sector). The health sector accounts for about half of the stock, mostly from incorporated hospitals classified outside the government sector. The rest has been recorded mainly in the local and regional government subsector. In the update of the Programme documents the government has committed to further enhance monitoring and reporting and to prepare a strategy for the settlement of arrears for the entities of general government, as well as SOE hospitals by end-September.

Box 4: Arrears – Preliminary survey results and possible fiscal policy implications

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

The existence of arrears may result from excessive spending and/or underfunding combined with difficulties of borrowing from the markets. The cash/accruals accounting implications are different depending on whether they originate in entities within or outside the government sector: When an entity included in the general government sector spends more than its budget, it may accumulate commercial debt. There is no impact on the government cash deficit but there is an impact on the accruals-based deficit if purchases are timely recorded (if not, the accrual deficit will be impacted at the moment of repayment of arrears). For entities outside the general government sector, such as the hospital SOEs accounting for almost 40% of arrears in Portugal, there is no immediate impact on either cash or accruals government deficit. Given their weak financial position, it seems unlikely that these hospitals will be able to find resources on their own to repay arrears. If and when the general government has to make a transfer to pay the arrears, this will increase the deficit both in cash and accruals terms.

The build-up of arrears originates in weaknesses in the expenditure control process, starting upstream at the level of control of commitments and authorization of expenditures. Strict commitment control for all types of expenditure and for all entities has been wanting so far. There are three main sets of provisions on arrears in the Programme: (i) Fiscal–structural measure (monitoring, reporting, expenditure control). These have been reinforced based on the recommendations of the July technical assistance mission on public finance management; (ii) An 'indicative target' on the non-accumulation of arrears by the general government sector; (iii) A commitment to prepare by end-September a strategy to settle arrears, also in SOEs. Measures taken in relation to SOEs should be consistent with EU competition and state aid rules.

The fiscal implications of clearing arrears differ according to the originating entity. If the arrears of entities outside the General Government sector (such as SOE hospitals) are settled with funds from the central budget, this would likely be reflected in the budget deficit in the absence of countervailing measures.

Fiscal devaluation

29. The authorities remain committed to a budget-neutral 'fiscal devaluation' as a key element of a strategy to boost competitiveness. A first major step in reducing employers' social security contributions is planned to be taken with the 2012 Budget. To maintain budget-neutrality, offsetting measures to finance the social security contribution SSC cut need to be defined at the same time, taking into account the need to protect vulnerable consumers and the risk of cyclical volatility in fiscal balances. Technical work on the design of the fiscal devaluation has advanced but a proposal has not been fully calibrated at this stage (Box 5 presents the result of model simulations with DG ECFIN's QUEST model)[6]. Across-the-board cuts in SSC appear more aligned with the key competitiveness objective than schemes targeted at specific companies or sectors (which would also raise competition policy concerns). Piecemeal changes to the tax system should be avoided. The reform will be finalised in consultation with the EC, IMF, and ECB in time for inclusion in the 2012 Budget.

[6] A recent study published by the Portuguese authorities discusses several options for a cut in employers' SSC without endorsing a particular proposal. These include an across-the-board reduction for all companies, a SSC cut only for companies that generate additional employment and a reduction for companies with significant export activities. The study makes no proposal as regards the possible size of the tax shift and the offsetting measures. See http://www.min-financas.pt/informacao-economica/informacao-economica-diversa/desvalorizacao-fiscal-relatorio

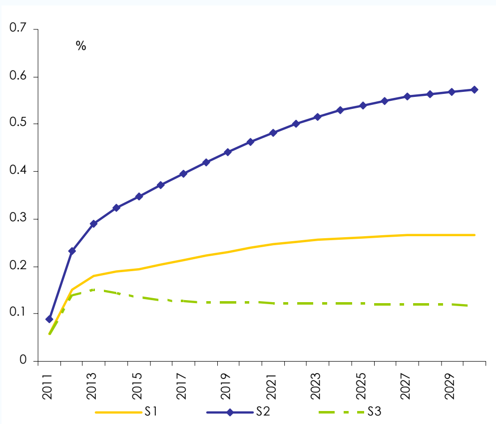
Box 5: The macroeconomic effects of a fiscal devaluation – Results from model simulations

This Box describes QUEST model simulations of a reform shifting the taxes away from labour towards consumption.[1] Such a reform is aimed at improving Portugal's external competitiveness through fiscal devaluation. The scenario modelled here assumes a reduction in employers' social security contributions by 1 percent of baseline GDP and is compensated by an increase in consumption taxes of equal size, so that the net budgetary impact of the proposal is zero. Any additional net revenues that might result from the induced higher growth are again recycled back into the economy by cuts in labour income taxes, reinforcing the impulse of the tax shift.

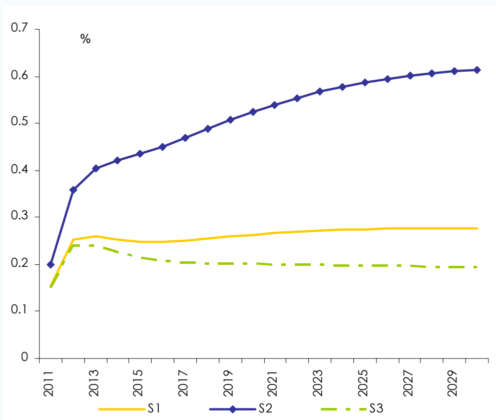
The economic mechanism can be described as follows: lower social security contributions reduce wage costs for firms and lead to lower producer prices. Exports increase because Portuguese goods become more cost competitive; at the same time import demand falls, because cheaper domestic products substitute for imports. The overall trade balance improves. This triggers higher growth, which gradually erodes the improvement in the trade balance, as domestic demand increases. What remain after ten years is a higher growth level and a permanent improvement in the net foreign asset position by 0.3 percent of GDP (see Graph 17). Employment is boosted by the reduction in wage costs and GDP is permanently raised (by 0.3 percent). The increase in consumptions taxes entails, however, an initial reduction in real disposable income and aggregate consumption, unless households are not compensated. The effect can be sizeable for the lowest income households, justifying compensatory transfers. In the medium run, however, consumption exceeds baseline levels by 0.4 percent, as wages gradually on account of higher labour demand.

The macroeconomic impact of this type of tax reform depends on the assumed wage response to changes in labour market conditions. A crucial parameter here is the labour supply elasticity, which the model sets at 0.2, based on empirical evidence. However, there is much uncertainty surrounding this estimate and the effect can be relatively stronger if for instance a labour supply elasticity of 0.5 is used. Real wage costs for firms would decline by more and long run employment and output effects would be larger. A second crucial parameter is the export price elasticity and the presence of adjustment costs in the reaction of export quantities to a change in the term-of-trade. The larger is the elasticity the bigger is the impact on the export volumes resulting from a change in relative prices. Another important assumption concerns the use of the improvement in the budget that results from higher tax revenues and lower unemployment expenditure. If this endogenously generated fiscal space is used to reduce government debt and not redistributed in the form of lower labour taxes, the gains in employment and GDP would be significantly smaller. On the other hand, the improvement in the current account balance would be more persistent, because of lower import demand. The government debt-to-GDP ratio would also decline more noticeably by 4 percentage points after twenty years, compared with 0.5 percentage points in the base case.

Graph 14: Real GDP

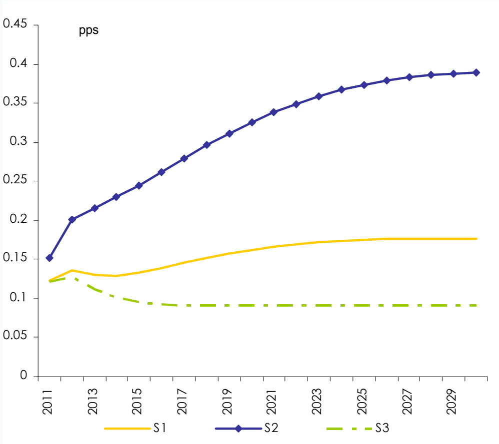


Graph 15: Real effective exchange rate

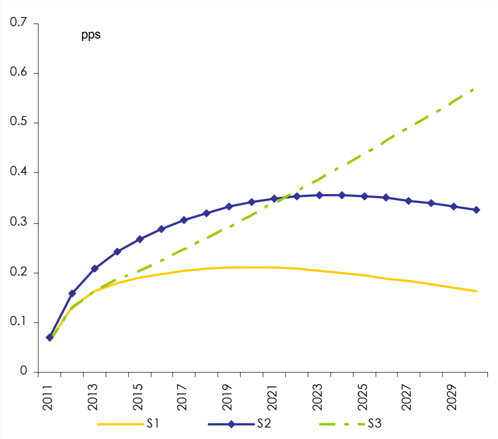


S1: Labour supply elasticity = 0.2, labour tax rule on (baseline scenario)
S2: Labour supply elasticity = 0.5, labour tax rule on
S3: Labour supply elasticity = 0.2, labour tax rule off (debt reduction scenario)

Graph 16: Employment rate



Graph 17: Net foreign asset position



S1: Labour supply elasticity = 0.2, labour tax rule on (baseline scenario)
S2: Labour supply elasticity = 0.5, labour tax rule on
S3: Labour supply elasticity = 0.2, labour tax rule off (debt reduction scenario)

[1] The model used in this exercise is a 3-country version of the QUEST model (Portugal, rest of euro area and rest of the world), see Jan In't Veld and Werner Röger: "QUEST model simulations of a budgetary neutral tax shift from social security contributions to consumer taxes in Portugal", DG ECFIN Note, 14 July 2011.

FISCAL STRUCTURAL REFORMS

Fiscal policy framework

30. The government has taken important steps to improve the quality of fiscal information and the management of fiscal risks. The government adopted an adequate definition of contingent liabilities. Going forward, progress is also reported for some items due for the second review. In particular, the government is applying tighter reporting standards across the general government sector, redefined to cover an enlarged group of entities[7]. Since July 2011, the Ministry of Finance monthly report on budgetary execution on a cash basis includes regional data with monthly frequency.

31. An IMF/EC technical assistance mission to Lisbon took place from 13 July to 27 July. The mission objective was to undertake a diagnostic of Portugal's public financial management system. The mission provided specific recommendations in the following areas: i) expenditure control; ii) accounting, reporting and audit; iii) implementation of the Budgetary Framework Law – particularly the adoption of a Medium-Term Budget Framework; iv) limiting fiscal risks from SOEs, PPPs and local governments. The recommendations from the IMF/EC technical assistance mission have led to some changes to the conditionality of the programme, aiming at making measures more specific and better tailored to the achievement of their objectives.

32. The Budgetary Framework Law, which requires careful planning and building up of new skills in the Ministry of Finance, will be implemented more gradually than initially foreseen. Taking into account the limited resources available, the TA mission concluded that these reforms should realistically be phased in over a number of years. In particular, expenditure ceilings beyond the budget year will be initially indicative, the coverage of the expenditure categories subject to ceilings will be revised and the transition to accruals accounting. The 2012 Budget is being prepared in accordance with the new Budgetary Framework Law. The statutes of the Fiscal Council are currently being discussed in Parliament and the institution will be operational by the end of the year. The slight delay with respect to the original deadline is justified by the need to nominate an independent board and staff the institution.

33. The revision of the regional and local finance laws will strengthen fiscal accountability. The laws should accommodate the changes foreseen in the Budgetary Framework Law. In addition, the

[7] ESA definition of general government.

conditionality has been strengthened so that: i) the Fiscal Council will review local and regional own revenue projections and multi-annual fiscal plans; ii) a contingency reserve is included under the overall current expenditure envelope as a buffer against negative revenue surprises or planning mistakes; iii) regional and local SOEs and other public bodies will be subject to tighter financial requirements and enhanced supervisory powers from the State; iv) the regime of transfers from the State to the regions and local authorities will be revised and v) tighter debt ceilings will be applied combined with a multi-tiered monitoring system as suggested by the July technical assistance mission.

34. Arrears are a threat to fiscal discipline and expenditure control. Further tightening of the requirements in the MoU and the MEFP is necessary. The government adopted a legal definition of what constitutes an expenditure arrear[8] and carried out a first survey across all general government entities, which revealed a sizeable stock of arrears, mostly in the health sector and local government. Against this background, the government will conduct another survey on arrears and prepare a comprehensive plan to reduce the stock and the building up of arrears by September. The design and scope of the survey should be modified to capture relevant data and the IT systems should be strengthened to prevent the creation of arrears. The IMF/EC technical assistance mission proposed a number of reforms including the immediate mandate of the Inspecção-Geral de Finanças (IGF) to carry out regular reviews of hospitals and municipalities – the main sources of arrears – to ensure that the controls are adequately implemented.

35. An IMF/EC technical assistance mission on revenue administration will take place in September. The mission team will provide guidance and support to fulfil the programme conditionality regarding, among others: i) the preparation of the strategic plan 2012-2014; ii) the assessment of the current state of tax information systems; iii) the design of the new merged revenue administration structure and iv) assess and discuss areas for further technical assistance in revenue administration to support the government's reform efforts.

PPPs, SOEs and privatisation

36. The state-owned companies (SOEs) and Public Private Partnerships (PPPs) at the central, local and regional level remain a crucial concern for the success of the Programme. The IMF/EC July technical mission analysed the financial position and performance of 85 major SOEs and 33 PPPs, which form a complex web of companies that are accounted partly within partly outside the government sector. SOEs continue to contribute negatively to public sector finances. Many SOEs are persistent loss makers. SOEs have accumulated large stocks of debt, which is often explicitly or implicitly guaranteed by the government. In addition, PPPs for road, health and railways require the government to make annual payments of about EUR 1 billion, rising to EUR 2 billion in 2016. SOEs and PPPs at the local and regional level are also posing threats to fiscal stability. Unforeseen losses of two separate SOEs and PPPs of the autonomous region of Madeira alone will contribute by around EUR 500 million (0.3 percent of GDP) to the general government deficit in 2011. A systematic review of the large number of local and regional SOEs will be undertaken under the Programme. The mission requested to further enhance the annual report prepared by the Ministry of Finance to take account of all fiscal risks, putting more focus also on those stemming from regional and local public enterprises. A comprehensive analysis of all liabilities (explicit and implicit) of all SOEs (at central, local and regional levels) is needed on a regular basis.

37. First steps to reduce the budgetary risks stemming from SOEs have been made, but large challenges remain. The review of the tariff structure at the central government level has begun. In August public transport tariffs were raised by 15 percent on average. Cost cutting plans were presented to reduce the operational costs of SOEs in 2011. The achievement of an average operational cost reduction by 15 percent appears to be on track for the transport sector, which constitutes about half of the SOEs and a larger share of SOEs debt. For commercial operations in this sector but excluding the more problematic rail companies (REFER and Comboios de Portugal), the government also aims at achieving balanced operational results by 2012. By contrast, the health sector (see below) poses more difficulties in reducing operating costs in a relatively short period of time. As a consequence, the overall cost-reduction goal for all state-owned SOEs turned out to be too ambitious. The target is now applied only to SOEs outside the health care sector, for which separate objectives have been fixed.

[8] Decreto-Lei No. 65- A/2011. See also Box 4.

38. Reductions in operating costs were partly counteracted by rising interest burdens, as SOEs find it increasingly difficult to access financial markets. As a consequence, the increase in SOE debt is set to breach the debt ceilings targeted in the Stability Programme of 2010, of 6 percent increase in 2011, as the sum of all central government SOEs so far suggest an increase above 8 percent. This points to the need for additional corrective measures and tighter central control of SOEs under the supervision of individual line ministries, the more so as the 2010 targets were already missed by a wide margin. The large financing needs of SOEs risks crowding out private sector credit in a context of deleveraging by banks. In addition, health care sector SOEs are increasingly building up arrears vis-à-vis their suppliers. Authorities have committed to set limits for the borrowing requirements of SOEs as of 2012. Reporting for plans for achieving the reduction targets have been moved to September such as to be better aligned with the budgetary calendar, to coincide with a budgetary review mission.

39. The IMF/EC technical assistance mission reviewed the projected fiscal costs associated with 33 PPPs, including those undertaken by Estradas de Portugal. Based on the recommendations of the technical mission, the government should present the terms of reference for a deeper study on PPPs to be contracted to an international auditing firm and due in March 2012. The report should include long-term cash flow forecasts and associated present values. It should present forecasts of gross cost and revenues, not just net cost. In addition, the government should analyse the risk related to traffic, force majeure, and other factors that could lead to spending or revenue surprises. Given data availability, it is recommended that the report covers 33 PPPs instead of the 20 foreseen by the programme conditionality.

40. The Government is pushing ahead with its privatisation programme. Public sector shares in EDP, REN, GALP and, if market conditions permit, TAP, are planned to be sold by the end of the 2011. The divestments will be done under the new framework law for privatisation. Águas de Portugal and RTP have been included for privatisation by end-2012, in addition to enterprises identified for sale under the broader strategy of comprehensive SOE restructuring. The privatisation plan through 2013 covers also Aeroportos de Portugal, the freight branch of CP, Correios de Portugal and Caixa Seguros, as well as a number of smaller firms. The plan targets front-loaded proceeds of about €5 billion through the end of the program. By end-2011, a strategic privatisation plan for Parpublica will be prepared, given that its sources of income will be affected by privatisation. The plan will reconsider the role of Parpublica as a public company, including eliminating the obligation to remit the proceeds of the sale of assets to the Treasury in return for new assets, and considering the possibility of winding down the company or consolidating it with the general government. In the interim, the government will ensure that Parpublica has sufficient income-generating assets to manage its debt and financing needs.

Healthcare

41. In the healthcare sector, progress has been observed in a number of areas and legislative changes are put in motion. Legislation has been passed to reduce the categories exempted from moderating fees (taxas moderadoras), introduce automatic indexation to inflation, increase the number of services covered by fees, and raise the overall fees. Another regulation, issued in May, introduced stricter internal control procedures and a monthly electronic monitoring system regarding patient transportation. The authorities are also preparing legislation to revise profit margins, to update the reference price system and to reduce entry barriers to generic medicines. The adoption of this legislation is crucial to achieve the savings needed in the sector.

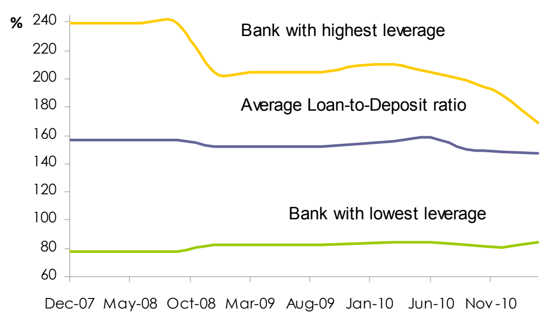
42. The process of hospital reorganisation and concentration is underway but significant cost savings will become only visible in 2012. The reduction in hospitals costs appears in line with the health part of the Memorandum. Authorities are currently making an inventory of staff needs. E-prescription is being extended to cover all medicines and diagnostic tests. A comprehensive system to monitor and assess prescription behaviour is being developed. The authorities have also planned some measures to reduce expenditure on overtime (e.g. organisation of time and professions in emergency wards). The revision of fees paid to private providers is ongoing.

43. The health care sector needs to accommodate a further substantial reduction of government spending in health in 2012. The authorities will have to consider additional measures to increase savings in 2012 and potentially in 2013. In addition, following the definition of arrears and the collection of data authorities have identified substantial payment delays (arrears) in the health sector (about EUR 2 billion). The Programme also requires defining by end-September 2011 a strategy and binding timetable to clear all arrears in the health sector. In general, more emphasis is to be put on enhancing monitoring and tighten control procedures to prevent the re-emergence of arrears and ensure that savings materialise. Coordination between the Ministry of Health and the Ministry of Finance for the application of the same monitoring and control criteria to all types of hospitals is to improve.

FINANCIAL SECTOR

44. The implementation of the deleveraging process in the banking sector remains a key component of the programme. As foreseen in the Programme conditionality, all eight banks submitted in end-June 2011 to Banco de Portugal funding plans detailing their respective deleveraging paths for the period 2011-2015. The indicative loan-to-deposit ratio of 120 percent, now included in the programme conditionality, is being met and in most cases overshot at latest by 2014 by all banks. Starting positions are different, however, and the strains on banks vary accordingly (graph 18). The strategy to deleverage is similar across the sector. Priority is given to increasing the deposit base whereas lending is being decreased in a controlled way mostly by not renewing maturing mortgages, decreasing the exposure to SOEs and public debt as well the disposal of non-core business activities. Furthermore, the sale of non-strategic assets abroad and project finance form part of the effort to reduced the balance sheets. The deleveraging process bears risks for the private economy in so far that the higher exposure to the public sector which was recently observed may shift the burden of adjustment towards the more productive parts of the economy. Pushing ahead with ambitious restructuring of the SOEs gains thus additional urgency in order to reduce their dependence on the domestic banks.

Graph 18: The loan to deposit ratio



Source: Banco de Portugal

45. Banks are working towards meeting the required Core Tier 1 ratios. Banks were requested to raise their Core Tier 1 (CT1) capital ratios to 9 percent by end-2011 and to 10 percent by end-2012 at the latest. The implementation of these guidelines has already started within all financial groups supervised by the Banco de Portugal. The CT1 ratio for Portuguese banks stood at 8.4 percent at the end of March 2011. The estimated capital shortfall to reach the 9 percent threshold in 2011 amounted to EUR 3.4 billion. Banks are taking measures aiming on the one hand at raising capital levels and on the other hand at reducing the risk-weighted assets on their balance sheets. In the second quarter of 2011 Banco Comercial Português raised EUR 1.2 billion in capital, bringing its CT1 ratio close to the required level. Although all banks have included in their funding plans submitted in June 2011 measures to raise capital directly through their shareholders or via the market, the EUR 12 billion bank solvency facility is available for the duration of the programme as backstop. EUR 1 billion is already paid into the facility and deposited on a dedicated account at the Banco de Portugal.

46. The balance sheet of state-owned Caixa Geral de Depósitos (CGD) is being streamlined. An independent evaluation of the market value of its insurance arm will be performed before the second review with the perspective of a later sale in order to strengthen the capital of the bank. The operation is prepared by transferring the insurance business to a separate state-owned entity. The capital of CGD will be reinforced at the moment of the transfer. Both the market valuation and transfer process will be examined under EU rules. This plan for raising capital may need to be adjusted if the expected value is not realised.

47. A buyer for the nationalised Banco Português de Negócios (BPN) has been found. However, the deal involves several adjustments to the balance sheet of the bank which have to be cleared under EU competition and state aid rules. Among these is a major capital injection financed by the state and additional transfers of assets to the previously created special purpose vehicles dealing with impaired loans. The government reimbursement for CGD's funding of BPN, foreseen in the Adjustment Programme, is pending the finalisation of the sale process.

48. The first meeting of the Steering Committee for the Special on-site Inspections Programme took place end-July 2011 in Lisbon. The Steering Committee is composed of experts from foreign central banks and supervisory bodies, representatives of the EC, ECB and IMF and the management of the Banco de Portugal. The Steering Committee refined the scope of the programme and established three work streams. First, external auditors will perform a valuation according to International Financial Reporting Standards of eight major banks' domestic credit portfolio. Second, the risk-weighted assets and corresponding capital requirements will be assessed by the Banco de Portugal. Third, an external consultancy firm, with the participation of Banco de Portugal, will examine the stress test parameters and methodologies that these banks use. The assets scrutinised include those that will be sold by banks in the context of their deleveraging process and loans to Public Private Partnerships and SOEs. The Banco de Portugal is committed to conclude the validation of data on assets that banks provide as inputs to the solvency assessment by end-November with a preliminary report to be made available by end-September. The work on stress tests methodologies is expected to be completed by early 2012. The Banco de Portugal will send bi-weekly updated reports to the Steering Committee as well as provide the Programme's final deliverables.

49. The Banco de Portugal's Solvency and Deleveraging Assessment Framework (SDAF) has been evaluated at the end of June by a joint EC/ECB/IMF technical assistance team. The analysis focused on the methodological aspects of the framework, data issues and calibration, and reporting of the results. The overall mission assessment was that the SDAF is appropriate to assess the solvency of the Portuguese financial institutions, but some components need to be made more robust. In particular the technical team recommended enhancing the following components of the framework: (i) explicit inclusion of sovereign, concentration, and funding risks, (ii) the introduction of risk weighted assets adjustments, following a shock, (iii) the introduction of refinements in current estimates of the probability of default and the loss given default and (iv) a more rigorous modelling of bank income. The technical team also recommended the refinement of the reporting template for the final results for the use of the ECB, EC and IMF.

50. Works are well advanced on the preventive and corrective actions regarding resolution in the banking sector. Banco de Portugal presented the draft amendments to strengthen early intervention and introduced a resolution regime to its law on credit institutions. The final amendments will follow latest EU developments with respect to bank resolution regimes. The draft law has been sent for comments to the Portuguese Banking Association. The IMF, EC and ECB have formed a working group that will deliver its consolidated feedback to the Banco de Portugal by end-August 2011. This will leave an appropriate time span to pass the amendments before the end-November deadline for this structural benchmark in the Programme.

51. With non-performing loans in the banking system rising, the level of indebtedness of the private sector requires close monitoring. The Banco de Portugal has taken the lead in producing jointly with the statistical office, industry federations, government associations in charge of implementing State guarantees and the banking sector a report that will assess on a quarterly basis the state of indebtedness of the corporate and household sectors. A draft version of this report was presented in mid-July to all involved parties and to the representatives of the EC, IMF and ECB. The authorities are committed to provide a detailed and forward looking document that would meet the Programme requirements by end-November.

STRUCTURAL REFORMS

Labour market

52. The government submitted legislation to Parliament to reform the severance payments for new hires. The draft law submitted to Parliament is in line with the labour market reform commitments in the Memorandum. The reform aligns the severance payments of open-ended contracts with those of fixed-term contracts, reduces the severance payments and foresees a fund to partly finance dismissals. The reduction in severance payments is expected to enter into force by September. The fund to finance dismissals will be implemented as soon as the legislation regulating the fund is ready. A draft law regulating the functioning of the fund, as well as a description of technical details concerning its operation and a planned time frame for its implementation are expected by end September 2011.

Golden shares

53. The authorities have taken clear action to eliminate existing "golden shares" and special rights by the State. A recently published Decree Law 90/2011, of July 25, has eliminated "golden shares" and special rights by the state in EDP, PT Telecom, and GALP). The corresponding proposals for modification of these undertakings' bylaws have been approved in the respective general assemblies, with the exception of the bylaws of EDP whose general assembly still needs to take place on 25 August 2011. Moreover, the authorities have amended the Framework Law of Privatisations by Decree 3/XII of the Parliament of 5 August 2011, eliminating the possibility to create such state rights in future privatizations. Article 13(2) of the said framework law - which allowed for State measures to set caps on the acquisition or voting rights of shares in private companies – has also been modified eliminating the possibility of voting caps while referring to the eventual use of acquisition caps only in the context of privatisation transactions to be determined in the implementation law of each privatisation.

54. Going beyond the requirement in the original MoU to eliminate special rights of the State, the authorities have also committed to ensure that obstacles to free movement of capital will not be created by their action. To this end, the use of article 13 (2) will be proportionate and privatization implementing laws will not set or allow holding or acquisition caps beyond the privatization transaction. To acknowledge this commitment the updated Memorandum includes a measure to this effect. Through this new measure the authorities also commit that the Portuguese State or any other public body, will not conclude, in a shareholder capacity, agreements which hinder the free movement of capital or which influence the management or control of companies. Finally, concerning the existing shareholder agreement of Caixa Geral de Depositos (CGD) in Galp, the Portuguese State will ensure that CGD alienates its participation in Galp until the end of 2011.

Energy

55. Progress in energy sector reforms is steady. The Council of Ministers' Resolution of 27 July 2011 sets forth a roadmap to gradually phase-out regulated tariffs in electricity. The roadmap ensures full liberalization of tariffs for the remaining regulated segment of the market of the so-called low voltage consumers (below 41.4 kVA of installed power): i) the upper segment (10.35 kVA to 41.4 kVA) by end-2014 at the latest; and ii) the lower segment (below 10.35 kVA) by end-2015. Moreover, a roadmap for the gas market is also set up in the Resolution, going beyond the requirements in the Memorandum. The implementation details of the roadmap will be spelled out in a forthcoming Decree Law.

56. Despite clear efforts, the reform process is not yet complete. The transposition of the "Third EU Energy Package" is on-going. Two decree laws have been adopted, and further legislation will be presented to the Parliament in Q4 2011in order to fully transpose and implement the energy package by Q1-2012, in particular concerning the provisions granting the necessary powers to the regulator. In addition, some provisions in the recently transposed elements need to be amended or complemented by secondary legislation. A preliminary assessment points to the need to clarify and make consistent throughout the text of the Decree Laws the link between "vulnerable consumers" and the existing social tariff and to make the arbitration powers of the regulator compatible with the directive. The definition of the Universal Service Obligation (USO) should not be too broad and the USO should be separated from the last resort supplier obligation.

57. The increase in the VAT tax rate in electricity and natural gas has been anticipated by the government relative to the requirements in the MoU. Moreover, as foreseen in the agreed measures on energy, the excises for electricity are also expected to be changed to comply with the minima required by the EU legislation by end-2011.

58. The government has acknowledged the need to tackle concerns related to the sustainability of the national electricity system, notably the substantial accumulated tariff deficit. Since 2006 the Portuguese energy system has accumulated a tariff deficit, currently of over EUR 1.7 billion. This has resulted partly from misalignments between regulated tariffs (based on 1 year-ahead estimates of fuel costs) and actual market prices and more importantly from high and growing costs associated with "policy costs" for production of energy under the special regime (co-generation and renewables) and the additional costs associated with the production of electricity under the ordinary regime. The current situation raises concerns on the sustainability of the system. The objectives of the measures in the energy area have been redrafted in the updated Memorandum to more clearly acknowledge the need to address these concerns.

Telecommunications and postal services

59. Reforms to increasingly open up telecom markets to competition are on-going. The implementation of the EU electronic regulatory framework will facilitate the establishment of telecoms operators and cross-border communication services, and strengthen the role of an independent sectoral regulator to supervise the functioning of the market and guarantee competition and a level playing field. Authorities have shared a pre-draft law transposing the "Better Regulation directives" as well as the "Citizens' Rights Directives" (except E-Privacy directive) ahead of the mission. The choice of a transposition law covering more than the "Better Regulation directives" (which was the strict requirement in the Memorandum) is welcome and, as it implies the need for adoption by the Parliament (as those laws contain provisions which have an impact on municipalities), implementation is expected to take place by the third quarter instead of the second quarter as it was initially foreseen. At first glance the draft law seems to contain all articles of the "Better Regulation directives". A detailed content analysis of the transposing legislation will follow once it is adopted and notified, leading to an assessment of implementation to be discussed in the next review mission.

60. The forthcoming auction of spectrum must respond to the objective of facilitating market entry and increasing competition as set in the Memorandum. The auction will be determinant for the future market structure of the telecoms sector for the next couple of decades. The corresponding measure in the updated Memorandum has been redrafted in order to set conditions meant to achieve this objective and ensure a level playing field. To further facilitate this, a new deadline has been agreed and moved from Q3 to Q4-2011. The updated Memorandum of the first review also includes a measure to ensure an adequate monitoring and enforcement mechanism guaranteeing the effective implementation of the obligations to negotiate fair and reasonable access to national roaming and mobile virtual network operator (MVNO) agreements. Furthermore, as the value of the fees on the use of frequencies can act as a barrier for potential new entrants, it is welcomed that the authorities are committed to comply with a new measure to allow for a review of this fees by Q4-2011.

61. The measure requiring elimination of VAT exemptions within the universal service provision in postal services has been suppressed. This was necessary in order to ensure compliance with the EU VAT Directive.

Services sectors

62. Implementation of the Services Directive has been progressing. General principles and rules to simplify the free access and the exercise of service activities in the Portuguese territory have been adopted and since then, authorities have adopted several competition-enhancing sector-specific laws. Remaining necessary amendments to some sector specific legislation are foreseen, in particular for construction and real estate services. Legislation that needs approval from Parliament will be submitted in December, delaying the deadlines in the Memorandum by one quarter. A recent Decree law has abolished about 170 regulated professions and set up a new commission which will analyse all remaining regulated professions and requirements. In order to continue the simplification reform effort, authorities are further developing the Point of Single Contact (PSC) – a tool to simplify licensing procedures - for which strategy and quality standards have been revise it upwards. This is welcome but makes some deadlines difficult to meet; therefore, deadlines have been moved by one or two quarters. A new measure will make the PSC available in three languages (PT, ES and EN) with a significant amount of general information covering all relevant aspects of the Services Directive by October 2011.

Housing market

63. The government has confirmed its commitment to undertake a comprehensive housing market reform aiming to enhance labour mobility and improve access to housing. A task force involving several ministries and led by the Ministry of Agriculture, Sea, Environment and Regional

Planning was set up to draft the proposal for Q3-2011 measures. A draft proposal of the task force is expected to be ready in September. The measures are expected to include amending regulation to: i) liberalise the rental market for both housing and non-housing leases, in particular by limiting the perpetuity of lease agreements and phasing out rent controls; ii) simplify administrative procedures for renovation; and iii) improve housing valuation for taxation purposes (combined with changes in the local government finances law in order to fully use the additional proceeds for deficit reduction).

Judicial system

64. Reforms are being advanced to unblock the inefficient judicial system. To achieve the goal to resolve the backlog of cases in the courts within two years, the Portuguese Government completed in time, i.e. in June 2011, an audit based on which targeted measures will be developed by end-September, 2011. First reforms are taking place on several axes:

- Improving management efficiency of the court system: Authorities remain committed to establish thirty-nine court units with added management support for each unit by end-2012, which will be entirely financed through expenditure savings and gains of efficiency and are part of the rationalization effort. Development of a roadmap for this reform identifying key quarterly milestones is under way and will be completed by end-September 2011. The development of a new personnel management plan to support judicial specialization and mobility of court officials is also underway. Preparations for new Courts on Competition Matters and Intellectual Property Rights to become operational by end-March 2012 and for assessing the need for separate Chambers within the Commercial Courts with specialized judges for insolvency cases by end-2011 are in the process of realization.

- Faster processing of civil cases: The new experimental civil procedure regime has been applied to seven courts but given the current financial and staff constraints and the perspective of a wider reform of the Code of Civil Procedure, it will not be extended to an additional four courts.

- Sustainable and transparent budget for the judiciary: A proposal for standardizing court fees and introducing special court fees for certain cases and procedures is under completion and still needs to be implemented by end-September 2011. The development of an annual plan for 2012 on the allocation of resources based on court by court performance data (to be published by end-January 2012) is in preparation. The same applies to a workload/staffing assessment for the six pilot courts under the Judicial Reform Map and the specialized courts scheduled for end-March 2012. Quarterly reports on recovery rates, duration and costs of corporate insolvency and tax cases for the third quarter of 2011 are being prepared, to be published by end-October 2011.

- Strengthening alternative dispute resolution (ADR) to facilitate out-of-court settlement: the draft Law on Arbitration which should be adopted by end-September 2011 has been completed and measures to give priority to the ADR enforcement cases in the courts by end-2011 are in the process of realization, as well as measures to make arbitration fully operational by end-February 2012, to facilitate resolution of backlog cases and out-of-court settlement (structural benchmark). Concerning the commitment to increase the capacity of the Justices for Peace to handle small claim cases (deadline end-March 2012), the Portuguese Government has already completed a proposal.

65. A new measure has been added which aims at improving the legal and institutional framework to address the backlog in the debt enforcement process, notably in view of the pivotal role of enforcement agents. In line with international practice, it strengthens financing structure and authority of the oversight body, granting it full access to the enforcement case files. A decree law to this end will be adopted by end-December 2011.

66. Reflecting the current financial and staff constraints and priority given to a wider reform of the Code of Civil Procedure, the new experimental civil procedure regime will not be extended. Therefore, the former measures pertaining to this item have been eliminated, as the experiences which were gained from seven courts will flow into the review of the Code of Civil Procedure. In addition, the proposal needs to be prepared after due consultation of all stakeholders. Smaller adjustments have been made to deadlines.

Competition and sectoral regulators

67. First actions to improve the speed and effectiveness of competition rules' enforcement have been taken with the creation of a specialised court for Competition, Regulation and Supervision in compliance ahead of the deadline with the requirements in the Memorandum. This court is to be made fully operational by Q1-2012 as part of the judicial system reforms. To accompany the liberalization and market-opening reforms, the role of sectoral regulators will be strengthened. An independent report on the governance and resources of the National Regulator Authorities (NRA) is due by Q1-2012, to be followed by proposals in the following quarter which will be implemented by Q3 and Q4-2012. A new measure sets October 2011 for the launch of the report's call for tender.

Public procurement

68. Modifications to the Portuguese Public Procurement Code are currently under review. The requested ex-ante auditing checks on public procurement by the Court of auditors will be extended to cover more generally Public-Private Partnerships. As this new responsibility of the Court of Auditors will require amendments in its bylaws and require Parliament adoption, the deadline has been set now for Q4-2011. Moreover, the present Public Procurement Code makes mandatory a 1 percent investment in R&D projects on all public contracts above EUR 25 million. Recognizing that, in the interest of getting good value for public money, R&D projects accompanying public contracts should respond to a need and not an imposition, this provision has been eliminated.

IV. PROGRAMME FINANCING

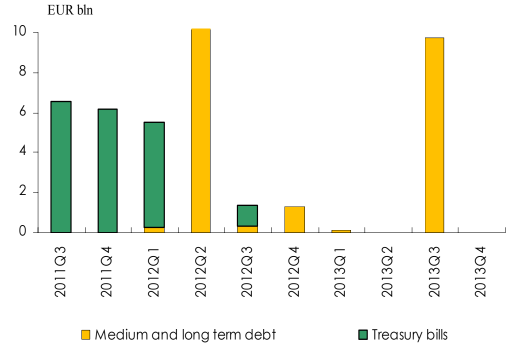
69. The first EU-IMF disbursement to Portugal, covering the period between June and September, totalled EUR 18.7 billion[9]. The disbursement was paid in five tranches during May and June 2011, with the IMF disbursing EUR 6.4 billion on 25 May and 1 June, the EFSM disbursing a total of EUR 6.5 billion on 31 May and 1 June, and the EFSF completing the first disbursement through payments on 22 June and 29 June totalling EUR 5.8 billion.

70. The government's cash position remains tight[10]. Tense market conditions in euro area debt markets and Moody's downgrade of Portugal's sovereign credit rating on 5 July to below investment grade have complicated access to short-term markets. Nevertheless, total issuance of Treasury bills in 2011 is expected to be in line with the Programme. Households' redemption of saving certificates, partly driven by the higher interest rates offered on bank deposits have also weighed on the government cash balance, as well as larger-then-expected financing to state-owned enterprises (SOEs) in the last months. The latest authorities' projections for SOEs financing needs in the remainder of 2011 are in line with Programme's assumptions.

71. Subject to the successful completion of the review, the second disbursement, covering the financing needs for Q4-2011, will amount to EUR 11.5 billion[11], of which EUR 7.6 billion from the EU. The latter will bring the amount disbursed to Portugal by the end of 2011 to 38 percent of the total programme envelope. On the basis of current projections, the Government cash position is expected to strengthen by year end, also thanks to the fact that the bank solvency support fund will be kept at EUR 1.0 billion for the time being (also not to impose an unnecessary cost on Portugal) and that large payments related to the sale of BPN could be deferred to next year.

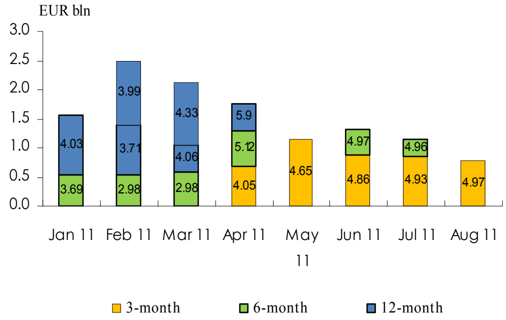
[9] The size of the first disbursement was EUR 0.3 billion higher than originally planned in the programme due to a higher payment by the IMF in euro currency as a result of changes in the euro/SDR exchange rate.
[10] Commission services' estimates of the government's cash balance in 2011 are based on data received from the authorities during the review mission.
[11] The size of the second disbursement is expected to be EUR 0.1 billion higher than originally planned in the programme due to a higher payment by the IMF in euro currency as a result of changes in the euro/SDR exchange rate

Graph 19: Maturing debt



Source: Bloomberg, IGCP

Graph 20: Short-Term auctions (amount and yield at issue)



Source: IGCP

72. The Programme's policies are key to reducing financing needs and/or increase financing sources. The authorities are committed to fiscal consolidation. They intend to pursue efforts to obtain financing for SOEs from external sources, particularly from foreign banks, and to proceed at a rapid pace with the restructuring of SOEs. This would reduce their borrowing requirements and help improve SOEs access to foreign funding sources. In addition, it is a necessary condition for the orderly de-leveraging of the domestic banking sector over the programme period and it would avoid that it bears an excessive exposure on the public sector. The authorities are also exploring possible market-based solutions to encourage households to retain their non-tradable debt.

V. CONCLUSIONS

73. Portugal is adhering closely to the conditionality outlined in the Memorandum of Understanding and other Programme documents. The authorities have reacted promptly to emerging risks to the achievement of the 2011 budget deficit target. Progress is being made to strengthen public financial management. In the financial sector, banks' solvency and liquidity positions are being strengthened while ensuring an orderly deleveraging. Structural reforms are being advanced. Overall, the actions taken so far by the new government testify the commitment to the programme's goals and objectives. A continued broad support by all important stakeholders in Portugal is a crucial element to the success of the adjustment programme.

74. The challenges ahead are large. The process of reviewing the full risk to government finances from the expansion of the effective perimeter of the government occurred over the years will provide a basis for a scaling down of government activities and better fiscal planning. At the same time, it might also bring new challenges for policy makers. One example is evidence of large stock of arrears, in particular in the health care sector and local administration. Resistance to an in-depth restructuring of State-owned enterprises and the budgetary framework of local and regional governments must be overcome. The process of opening up the economy via decisive structural reforms in labour, product and services markets has started but it will require perseverance. Opportunities for moving faster in some areas should be exploited.

75. The Commission services support the completion of the review. This would release the second instalment of the EU financial assistance to Portugal. The disbursement is expected to take place in the course of the third quarter of 2011.

ANNEXES

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

Actions for the first review (to be completed by end-July 2011)	Status
Financial sector	
[2.2] Request banks to devise by end-June 2011 medium-term funding plans to achieve a stable market-based funding position.	**Observed.** The funding plans are under examination.
[2.3] Request banks to present plans by end-June 2011 on how they intend to reach the new capital requirements through market solutions.	**Observed.** The capital plans are under examination.
[2.7] Design by end-June 2011 a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment. (**SB**, **MEFP ¶31**)	**Observed**. The Steering Committee, composed of representatives from the IMF, EC and ECB as well as from three euro area supervisory authorities, met on 27 and 28 July. On-site inspections will start in September and preliminary results will be available by mid-October, while the exercise should be closed in November.
[2.10] Launch a process to sell Banco Português de Negócios (BPN) on an accelerated schedule and without a minimum price. The target is to find a buyer and submit the new plan to the EC for approval under competition rules by end-July.	**Ongoing**. The conditions of the sale are under examination. Banco International de Credito (BIC) has been selected as the buyer. The acquisition plan has not been transmitted to the EC yet.
Fiscal-structural	
[1.3] Finalise a proposal for a budget neutral recalibration of the tax system with a view to reduce labour costs. **(SB, MEFP ¶39)**	**Ongoing.** The technical work has advanced in view of taking a first step for a budget-neutral reduction in employers' SSC with the 2012 Budget, but full calibration of a proposal could not be finalised by the July deadline.
[3.10] Approve definition of contingent liabilities.	**Observed.** Definition to be published in the report on fiscal risks.
[3.23] Review the tariff structure of central government SOEs to reduce the degree of subsidisation.	**Partially observed**: A further increase in public transport charges might take place in January. No assessment has been provided. Government presented and implemented on 1 August plans to increases in the average tariff charged for public transport by 15 percent. The assessment for the health cares sector is delayed.

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

Actions for the first review (to be completed by end-July 2011)	Status
[3.24] Complete concrete plans to reduce central government SOEs operational costs by at least 15% on average.	**Ongoing**: The target is achieved for transport companies, but the underachievement by health care sector suggests an underachievement of the overall aim. Full implementation needs to be assured. Reductions of operating costs in the health care sector are lagging behind. Government reported on plans differentiated by 92 individual SOEs owned by the central government. SOEs that submitted insufficient cost-savings plans are asked to resubmit plans to the MoF.
[3.25] Apply tighter debt ceilings to central government SOEs from 2012 onwards.	**Partially observed**: Debt ceilings are not effectively met. Authorities presented current plans for debt developments of SOEs by line ministry. On current plans SOE debt will rise by 8.2% in 2011, well in excess of the ceiling of a 6% growth. One reason supplied for this failure are higher interest rates, but overshooting also has a structural component. Already in 2010, with 10.8% debt growth substantially missed the target of 7% for that year. No plans for going below the already planned debt increase of 5% for 2012 have been provided.
Labour market	
[4.4 i] Send legislation to Parliament to implement a reform in the severance payments for new hires in line with the March 2001 Tripartite Agreement. **(SB, MEFP ¶38)**	**Observed.** Draft law submitted to Parliament, authorities indicated early September for its enter into force. A draft law regulating the functioning of the fund, as well as a description of technical details concerning its operation and a planned time frame for its implementation are expected by end September 2011.The authorities mentioned the possibility of moving straight away to a fund based on individual accounts and portability, as envisaged in the MoU for 2012. The state of implementation of the fund will be reviewed by the time of the next review mission.
[4.7 i] Commit over the programme period that any increase in the minimum wage will take place only if justified by economic and labour markets developments.	**Observed.** There has been no increase in the minimum wage.
Goods and services markets	
[5.1] Present a roadmap for the elimination of regulated tariffs in electricity.	**Largely observed.** Resolution of Council of Ministers R.18/2011 of 26.07.2011. The exact implementation of the roadmap which will be defined by the government in subsequent legislation which will set the implementation detail responding to the MoU.
[5.2] Transpose Third EU Energy Package.	**Partially observed.** Decree laws 77/2011 and 78/2011 of 20.06.2011. A set of provisions have been transposed. Transposition of the provisions granting the necessary powers to the regulator – forthcoming. Existing transposition legislation requires amendments to fully comply with the directive
[5.16] Draft law ensuring the implementation of the new Directive on "Better Regulation" to increase competition in telecommunications sector.	**Ongoing.** Draft Law approved at Council of Ministers on 21.07.2011, presented to the Parliament on 22.07.2011, approval expected on 23.08.11. Transposition law drafted, adoption forthcoming. Preliminary assessment of the predraft indicates *prima facie* it will transpose of all relevant articles. A final assessment of transposition following approval of the law. Implementation of the directive has been set for Q3 in updated MoU.

Actions for the first review (to be completed by end-July 2011)	Status
Judicial system	
[7.1 and 7.2] Intensify the implementation of the Judicial Reform Map. Audit of the backlog cases, including debt enforcement, insolvency, tax and labour cases and additional measures to expedite the resolution of the backlog.	**Observed [7.1].** An Audit and Analysis of the Backlog of Cases has been completed by end of June 2011. **Ongoing [7.2].** The deadline has been extended to end of September 2011 to permit PT to take account of all relevant studies and recommendations. Technical meetings have been conducted to discuss the status of measures mentioned under MoU **[7.2]** and clarify issues in the Task Force Report. The timeline for implementing recommendations/ measures should be identified in the report. IMF/EU to receive draft report by end- August The wording in the MoU has been rendered a bit stronger: "develop targeted measures to expedite the resolution of the backlog" instead of "assessing the need of additional measures".
Competition, public procurement, and business environment	
[7.19] Eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state. **(SB, MEFP ¶40)**	**Observed**. DL 90/2011 published on 25-07-2011. Decree 3/XII of the Parliament amending Framework law of privatization (Law 11/90) pending presidential signature. Bylaws of two of the three companies concerned (PT Telecom and Galp) modified as necessary, amendment of EDP bylaw foreseen 25.08.2011. DL 90/2011 eliminated "golden shares" and special rights by the state in EDP, PT Telecom, and GALP. Corresponding proposals for modification of these undertakings' bylaws approved. Amendment of Framework Law precludes the creation of such state rights in future privatizations. Going beyond MoU, amending Law eliminates voting caps and restrains the creation of acquisition caps to the privatization transaction. A new MoU measure goes even further by committing the Portuguese State or any public bodies not to conclude, agreements which hinder the free movement of capital or which influence the management or control of companies.

Annex 2. Commission services' macroeconomic projections, 2011-2015

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

Annual % change	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-1.1	2.3	-4.4	-3.7	-0.5	0.7	0.6
2. Government consumption expenditure	3.6	1.2	-4.1	-4.6	-3.0	-0.2	-0.2
3. Gross fixed capital formation	-11.3	-4.9	-11.4	-9.0	2.2	4.0	2.3
4. Final domestic demand	**-2.3**	**0.7**	**-5.6**	**-4.8**	**-0.5**	**1.1**	**0.8**
5. Change in inventories	--	--	--	--	--	--	--
6. Domestic demand	**-3.0**	**0.6**	**-5.6**	**-4.6**	**-0.5**	**1.2**	**0.7**
7. Exports of goods and services	-11.6	8.7	6.6	6.5	6.5	6.6	6.6
7a. - of which goods	-13.4	9.7	6.5	6.5	6.5	6.5	6.5
7b. - of which services	-6.5	6.3	6.7	6.6	6.6	6.9	6.9
8. Final demand	**-4.9**	**2.3**	**-2.9**	**-1.8**	**1.4**	**2.7**	**2.5**
9. Imports of goods and services	-10.6	5.1	-4.9	-2.0	2.2	3.4	3.3
9a. - of which goods	-11.3	5.4	-5.0	-2.1	2.1	3.3	3.2
9b. - of which services	-6.3	3.6	-4.0	-1.7	2.5	3.8	3.6
10. Gross domestic product at market prices	**-2.5**	**1.3**	**-2.2**	**-1.8**	**1.2**	**2.5**	**2.2**
Contribution to change in GDP							
11. Final domestic demand	-2.5	0.8	-6.1	-4.8	-0.3	1.4	1.0
12. Change in inventories + net acq. of valuables	-0.7	-0.1	-0.1	0.1	0.1	0.1	0.0
13. External balance of goods and services	0.8	0.6	4.0	3.1	1.6	1.1	1.2

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

Annual % change	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-3.5	4.0	-1.1	-1.6	1.0	2.2	2.1
2. Government consumption expenditure	6.5	0.6	-6.3	-4.0	-2.5	0.3	0.9
3. Gross fixed capital formation	-13.2	-2.3	-8.3	-7.8	3.8	5.6	3.9
4. Final domestic demand	**-3.7**	**2.1**	**-3.4**	**-3.1**	**0.8**	**2.4**	**2.2**
5. Change in inventories	--	--	--	--	--	--	--
6. Domestic demand	**-4.3**	**2.1**	**-3.4**	**-3.0**	**0.9**	**2.5**	**2.2**
7. Exports of goods and services	-15.5	13.4	12.2	8.3	8.0	8.2	8.3
8. Final demand	**-6.8**	**4.5**	**0.1**	**-0.1**	**2.8**	**4.1**	**4.0**
9. Imports of goods and services	-18.2	10.1	2.0	-0.5	3.6	4.8	4.7
10. Gross national income at market prices	-2.5	3.1	-1.0	-0.4	2.3	3.6	3.5
11. Gross value added at basic prices	-0.2	1.7	-1.4	0.0	2.9	4.4	4.3
12. Gross domestic product at market prices	**-2.0**	**2.4**	**-0.7**	**0.0**	**2.5**	**3.9**	**3.7**

Table 3: Implicit price deflators

% change in implicit price deflator	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-2.5	1.6	3.5	2.2	1.5	1.5	1.5
2. Government consumption expenditure	2.7	-0.6	-2.3	0.6	0.5	0.5	1.1
3. Gross fixed capital formation	-2.1	2.7	3.5	1.4	1.5	1.5	1.5
4. Domestic demand	**-1.3**	**1.5**	**2.3**	**1.8**	**1.3**	**1.3**	**1.4**
5. Exports of goods and services	-4.5	4.3	5.3	1.7	1.4	1.5	1.6
6. Final demand	**-2.0**	**2.1**	**3.1**	**1.7**	**1.3**	**1.4**	**1.5**
7. Imports of goods and services	-8.5	4.8	7.2	1.5	1.4	1.4	1.4
8. Gross domestic product at market prices	**0.5**	**1.1**	**1.54**	**1.84**	**1.33**	**1.37**	**1.51**
HICP	**-1.0**	**1.5**	**3.4**	**2.0**	**1.4**	**1.5**	**1.5**

Table 4: Labour market and cost

Annual % change	2009	2010	2011	2012	2013	2014	2015
1. Labour productivity (GVA per employee)	0.3	2.9	-1.5	-0.7	1.2	1.9	1.5
2. Compensation of employees per head	3.4	1.5	0.1	-0.1	0.7	1.3	1.0
3. Unit labour costs	3.2	0.3	0.7	0.4	-0.4	-0.2	0.0
4. Total population	0.1	0.0	0.0	0.0	0.0	0.0	0.0
5. Population of working age (15-64 years)	-0.1	-0.2	-0.2	-0.1	0.0	0.1	0.1
6. Total employment	-2.6	-1.5	-1.4	-1.1	0.3	1.1	1.1
7. Calculated unemployment rate - Eurostat definition (%)	9.5	10.9	12.1	12.9	12.6	11.7	10.9

Table 5: External balance

levels	2009	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	33.7	38.9	43.8	47.5	51.3	55.4	60.0
2. Imports of goods (fob)	50.7	56.2	57.4	57.1	59.1	62.0	64.8
3. Trade balance (goods, fob/fob) (1-2)	**-17.0**	**-17.2**	**-13.6**	**-9.6**	**-7.9**	**-6.5**	**-4.9**
3a. p.m. (3) as % of GDP	*-10.1*	*-10.0*	*-8.0*	*-5.6*	*-4.5*	*-3.6*	*-2.6*
4. Exports of services	13.4	14.5	16.2	17.5	18.9	20.5	22.3
5. Imports of services	9.1	9.6	9.7	9.6	10.0	10.5	11.0
6. Services balance (4-5)	**4.3**	**4.9**	**6.5**	**7.9**	**8.9**	**10.0**	**11.3**
6a. p.m. 6 as % of GDP	*2.6*	*2.8*	*3.8*	*4.6*	*5.1*	*5.5*	*5.9*
7. External balance of goods & services (3+6)	**-12.6**	**-12.4**	**-7.1**	**-1.8**	**1.1**	**3.5**	**6.4**
7a. p.m. 7 as % of GDP	*-7.5*	*-7.2*	*-4.2*	*-1.0*	*0.6*	*1.9*	*3.4*
8. Balance of primary incomes and current	-5.5	-4.5	-5.3	-6.1	-6.8	-7.5	-8.2
8a. - of which, balance of primary income	*-6.8*	*-5.9*	*-6.4*	*-7.1*	*-7.7*	*-8.4*	*-9.2*
8b. - of which, net current Transfers	*1.3*	*1.3*	*1.1*	*1.0*	*1.0*	*1.0*	*1.0*
8c. p.m. 8 as % of GDP	*-3.3*	*-2.6*	*-3.1*	*-3.6*	*-3.8*	*-4.1*	*-4.3*
9. Current external balance (7+8)	**-18.1**	**-16.9**	**-12.4**	**-7.9**	**-5.7**	**-4.0**	**-1.8**
9a. p.m. 9 as % of GDP	-10.8	-9.8	-7.2	-4.6	-3.2	-2.2	-0.9
10. Net capital transactions	1.8	2.4	2.6	2.6	2.7	2.8	2.9
11. Net lending (+)/ net borrowing (-) (9+10)	**-16.4**	**-14.5**	**-9.8**	**-5.3**	**-3.0**	**-1.2**	**1.1**
11a. p.m. 11 as % of GDP	*-9.7*	*-8.4*	*-5.7*	*-3.1*	*-1.7*	*-0.7*	*0.6*

Table 6: Fiscal accounts

	2009	2010	2011	2012	2013	2014	2015
		% of GDP					
Indirect taxes	12.6	13.4	14.0	14.4	14.4	14.4	14.4
Direct taxes	9.0	8.9	9.6	9.4	9.5	9.5	9.5
Social contributions	12.5	12.2	12.5	12.4	12.2	12.1	12.0
Sales and other current revenue	4.6	4.5	4.6	4.6	4.6	4.7	4.7
Total current revenue	**38.8**	**38.9**	**40.7**	**40.8**	**40.7**	**40.7**	**40.7**
Capital transfers received	0.9	2.6	1.7	1.3	1.3	1.3	1.3
Total revenue	**39.7**	**41.5**	**42.4**	**42.0**	**42.0**	**42.0**	**41.9**
Compensation of employees	12.6	12.2	11.6	11.2	10.8	10.3	10.0
Intermediate consumption	4.9	5.1	4.6	4.2	4.0	4.0	4.0
Social transfers in kind via market producers	4.9	4.9	4.7	4.4	4.1	3.9	3.9
Social transfers other than in kind	17.0	17.0	17.3	17.4	17.2	17.2	17.1
Interest paid	2.9	3.0	4.2	4.7	5.0	5.1	5.0
Subsidies	0.8	0.7	0.7	0.5	0.5	0.5	0.5
Other current expenditure	2.6	2.5	2.2	1.9	1.7	1.7	1.7
Total current expenditure	**45.8**	**45.4**	**45.2**	**44.4**	**43.3**	**42.7**	**42.2**
Gross fixed capital formation	2.9	3.3	2.4	1.7	1.4	1.3	1.3
Other capital expenditure	1.1	2.0	0.6	0.4	0.3	0.4	0.3
Total expenditure	**49.8**	**50.7**	**48.2**	**46.5**	**44.9**	**44.3**	**43.8**
General Government balance (EDP)	**-10.1**	**-9.1**	**-5.9**	**-4.5**	**-3.0**	**-2.3**	**-1.9**
		% change					
Indirect taxes	-12.0	8.2	4.5	2.4	3.0	3.5	4.2
Direct taxes	-8.5	0.5	7.9	-2.3	3.4	4.1	3.7
Social contributions	2.9	-0.4	1.7	-0.4	0.8	3.4	2.8
Sales and other current revenue	-4.2	0.4	0.4	0.9	2.7	6.0	3.3
Total current revenue	**-5.8**	**2.7**	**3.9**	**0.3**	**2.4**	**3.9**	**3.6**
Capital transfers received	26.1	186.3	-35.8	-25.2	2.4	3.8	3.6
Total revenue	**-5.3**	**7.0**	**1.4**	**-0.8**	**2.4**	**3.9**	**3.6**
Compensation of employees	3.0	-0.9	-5.7	-3.4	-1.6	-0.6	0.5
Intermediate consumption	9.0	6.4	-11.3	-7.7	-3.1	3.2	4.5
Social transfers in kind via market producers	15.2	1.4	-4.7	-6.0	-4.7	0.0	2.9
Social transfers other than in kind	10.3	2.2	1.3	0.4	1.8	3.4	3.4
Interest paid	-7.7	6.9	36.0	14.2	8.2	5.6	2.6
Subsidies	14.9	-3.6	-8.5	-26.3	-8.9	14.9	2.6
Other current expenditure	15.4	-1.8	-11.5	-12.3	-8.3	3.1	3.7
Total current expenditure	**7.5**	**1.7**	**-2.6**	**-1.6**	**-0.1**	**2.8**	**2.4**
Gross fixed capital formation	0.9	13.9	-26.4	-29.9	-18.6	-1.9	2.7
Other capital expenditure	698.1	75.5	-69.4	-31.0	-16.7	14.2	-4.0
Total expenditure	**9.3**	**4.1**	**-5.5**	**-3.6**	**-0.9**	**2.4**	**2.6**
Nominal GDP, EUR bn	168.6	172.7	171.6	171.6	176.0	182.8	189.6

Table 7: Government debt developments

	2009	2010	2011	2012	2013	2014	2015
EDP deficit (% of GDP)	**-10.1**	**-9.1**	**-5.9**	**-4.5**	**-3.0**	**-2.3**	**-1.9**
EDP gross debt (% of GDP)	83.0	92.9	101.1	106.2	107.3	106.4	104.4
			levels, EUR bn				
EDP deficit	**-17.0**	**-15.8**	**-10.0**	**-7.6**	**-5.2**	**-4.2**	**-3.6**
Gross debt	139.9	160.5	173.5	182.3	188.8	194.4	198.0
Change in gross debt	16.8	20.5	13.0	8.8	6.5	5.6	3.6
Nominal GDP	168.6	172.7	171.6	171.6	176.0	182.8	189.6
Real GDP	167.7	169.9	166.2	163.3	165.2	169.3	173.0
Real GDP growth (% change)	**-2.5**	**1.3**	**-2.2**	**-1.8**	**1.2**	**2.5**	**2.2**
Change in gross debt (% of GDP)	10.0	11.9	7.6	5.1	3.7	3.1	1.9
Stock-flow adjustments (% of GDP)	-0.1	2.7	1.7	0.7	0.7	0.7	0.0
			% of GDP				
Gross debt ratio	**83.0**	**92.9**	**101.1**	**106.2**	**107.3**	**106.4**	**104.4**
Change in gross debt ratio	11.4	9.9	8.2	5.1	1.1	-0.9	-1.9
			Contribution to change in gross debt				
Primary balance	7.2	6.1	1.7	-0.3	-2.0	-2.8	-3.1
"Snow-ball" effect	4.3	1.0	4.7	4.7	2.3	1.0	1.1
of which							
Interest expenditure	*2.9*	*3.0*	*4.2*	*4.7*	*5.0*	*5.1*	*5.0*
Real growth effect	*1.8*	*-1.1*	*2.0*	*1.8*	*-1.2*	*-2.7*	*-2.3*
Inflation effect	*-0.4*	*-0.9*	*-1.4*	*-1.9*	*-1.4*	*-1.5*	*-1.6*
Stock-flow adjustments	**-0.1**	**2.7**	**1.7**	**0.7**	**0.7**	**0.7**	**0.0**
Implicit interest rate	*4.0*	*3.7*	*4.4*	*4.7*	*4.8*	*4.9*	*4.9*

Annex 3. List of consolidation measures

2011	% of GDP
Expenditure measures in the 2011 Budget Law + March 2011	3.6
Revenue measures in the 2011 Budget Law + March 2011	2.1
Slippages (excluding one-off operations)	-0.8
One-time surcharge on personal income tax	0.5
Higher VAT on energy goods	0.1
Sales of concessions	0.4
Total annual impact	**5.8**
2012	
Expenditure	
Reduction of health expenditure	0.3
Savings in State-owned enterprises	0.3
Reduction of investment	0.3
Public administration savings	0.3
Pensions cut	0.3
Wage bill restraint	0.3
Education spending	0.1
Lower transfers to local and regional authorities	0.1
Reduction of costs in other public bodies and entities	0.1
Lower financing to government sector health insurance	0.1
	2.1
Revenue	
Revision of VAT rates	0.2
Higher excises	0.1
Property taxation	0.1
Reduction of tax expenditures - corporations	0.1
Reduction of tax expenditures - households	0.1
Taxation of pensions and social transfers	0.1
One-time surcharge on personal income tax	0.1
Fight of tax evasion	0.1
	1.0
Total annual impact	**3.1**
2013	
Expenditure	
Public administration operating savings	0.3
Reduction of health expenditure	0.2
Reduction of investment	0.2
Reduction of social transfers	0.2
Wage bill restraint	0.2
Education spending	0.1
Lower transfers to local and regional authorities	0.1
Savings in State-owned enterprises and other public bodies	0.1
Lower financing to government sector health insurance	0.1
	1.4
Revenue	
Higher excises	0.1
Property taxation	0.1
Reduction of tax expenditures - corporations	0.1
Reduction of tax expenditures - households	0.1
Taxation of pensions and social transfers	0.1
	0.5
Total annual impact	**1.9**

Annex 4. Indicative financing needs and sources

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

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

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

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

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

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

[5] Includes maturing medium and long-term debt owed by state-owned enterprises classified within the general government sector.

[6] Includes change in cash position and bank restructuring costs.

Source : Portuguese authorities and Commission services' estimates.

Planned quarterly disbursements (EUR billion)

Review	TOTAL	Approval	1	2	3	4	5	6	7	8	9	10	11
Approximate disbursement period		Jun 2011	Sept 2011	Dec 2011	Mar 2012	June 2012	Sept 2012	Dec 2012	Mar 2013	June 2013	Sept 2013	Dec 2013	Mar 2014
Period covered by disbursement		Jun-Sept 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014
Loan disbursements[1]	**78.0**	**18.7**	**11.5**	**8.0**	**14.6**	**3.9**	**4.1**	**2.4**	**1.9**	**2.6**	**2.9**	**2.6**	**2.5**
of which IMF (one third)[2]	26.4	6.4	3.9	2.7	4.9	1.3	1.4	0.8	0.6	0.9	1.0	0.9	0.8
of which EU (two thirds)	52.0	12.3	7.6	5.3	9.7	2.6	2.8	1.6	1.3	1.8	1.9	1.8	1.7

1 Data are subject to revision.

2 IMF disbursements are defined in SDR. Due to exchange rate fluctuation, the sum of the IMF first two disbursements was €0.4bn higher than calculated at the Programme exchange rate.

Annex 5: Programme documents

Letter of Intent

Lisbon, 1st September, 2011

Mr Jean-Claude Juncker
President
Eurogroup

Mr. Jan Vincent Rostowski
Minister of Finance
Poland

Mr Olli Rehn
Commissioner
European Commission

Mr Jean-Claude Trichet
President
European Central Bank

Dear Sir

1. The Council granted financial assistance to Portugal (Council Implementing Decision 2011/344/EU of 17 May 2011) in support of our comprehensive adjustment and reform programme as laid down in the Memorandum of Economic and Financial Policies (MEFP) and in the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU). The new government, which took office on 21 June 2011, is fully committed to the policies and objectives of the programme. In the attached update we describe progress and additional policy steps towards meeting the objectives of our economic programme.

2. Our policy implementation is mostly on track. All the quarterly quantitative performance criteria at end-June were met, along with the continuous criterion on external arrears. An inventory of domestic arrears is being completed (structural benchmark) and this will provide the quantitative basis for monitoring such arrears going forward. While tax revenue performance has been better than envisaged in the programme, expenditure overruns occurred in the first semester, which will require additional fiscal measures in the remainder of the year. The overruns also reinforce the need for stronger control and a clearly defined strategy for addressing fiscal risks from State-Owned Enterprises (SOEs). Our measures to address these challenges in the remainder of the year are laid out in the attached MEFP and MoU.

3. Structural benchmarks to strengthen competition, restore competitiveness, and foster growth have been met except the final calibration of the reduction of social security contributions (SSC) towards a fiscal devaluation. We have abolished all special rights of the

State in private companies. We will withdraw from the shareholder agreement in GALP, by committing to sell the remaining shares in GALP held by the state-owned CGD. We have also submitted to Parliament legislation that brings about a substantial reduction in dismissal costs for new contracts. However, we have not yet finalised the calibration of the major reduction of social security contributions (SSC) towards a fiscal devaluation (end-July benchmark) and further discussion with the EC, ECB, and the IMF is needed ahead of the finalisation of the 2012 budget. We are also making progress on the other structural reforms foreseen in the programme, including of the energy, telecommunication and services sector and of the judicial system. We remain committed to an ambitious and frontloaded structural reform agenda to support the rebalancing of the economy. These are only the first steps in the implementation of our comprehensive and ambitious plans for structural reforms.

4. The Bank of Portugal (BdP), in close cooperation with the ECB, stands ready to ensure sufficient liquidity in the banking system, while banks continue their orderly deleveraging process and strengthen capital buffers. In line with the programme, we have augmented the existing package of support measures, by approving the issuance of government guaranteed bank bonds in an amount of up to €35 billion. The BdP has directed all banking groups subject to supervision in Portugal to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent at the latest by end-2012. We have found a buyer for BPN, and are taking important steps in strengthening capital in the core banking arm of CGD using the group's internal resources. We are strongly committed to our financial sector reform program and are prepared to forcefully tackle the challenges that lie ahead.

5. On the basis of the policies defined in this letter, we request completion of the first review of the Economic Adjustment Programme. We are confident that the policies described in the 17 May MEFP and MoU and in the attached updates are sufficient to achieve the objectives under the programme. We stand ready to take additional measures that may be needed to meet the objectives of the economic programme and will maintain a close policy dialogue with the IMF, the European Commission, and the ECB. We will consult in advance of any necessary revisions to the policies contained in this letter.

6. This letter is copied to Ms. Lagarde

Sincerely yours,

/s/	/s/
Vítor Gaspar Minister of State and Finance	Carlos da Silva Costa Governor of the Banco de Portugal

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

Portugal—Memorandum Of Economic And Financial Policies

September 1, 2011

A Macroeconomic Outlook

1. **GDP growth and inflation for the year as a whole are expected to remain in line with the program framework.** Following two consecutive quarters of declines in growth, activity was flat in the second quarter. Exports have been relatively strong; consumer confidence indicators are steady, albeit at historical lows; credit developments have so far been consistent with a gradual deleveraging process; and employment has remained broadly stable. However, GDP is still expected to contract at an accelerated pace in 2011H2. In addition there are downside risks arising from the less favorable external environment than assumed even a few months ago. The path of inflation during 2011 is largely influenced by tax measures (VAT and tariff adjustments) in the context of the adjustment program.

B Reducing Public Debt and Deficit

2. **We remain fully committed to our fiscal targets,** of deficit-to-GDP ratios of 5.9 percent in 2011, 4.5 percent in 2012, and 3 percent in 2013. Achieving fiscal consolidation while protecting vulnerable groups remains a priority.

3. **Fiscal performance has so far been broadly in line with the program, but pressures have emerged.** While the end-June quantitative performance criterion on the general government cash balance was met, a number of developments during the first semester are threatening the achievement of the end-year fiscal target. These include support to several SOEs and Public-Private Partnerships (PPPs), and slippages in expenditure controls, mainly on employment costs and intermediate consumption. The projected shortfall for the year as a whole is expected to be about 1.1 percent of GDP.

4. **We commit to implement new measures to address this shortfall.**

- A one-time surcharge in the context of personal income tax has been introduced. We expect this new tax to generate 0.5 percent of GDP in 2011, with an adjustment yielding 0.1 percent of GDP in 2012.

- A number of measures initially scheduled for 2012 will be brought forward. Increases in the VAT rates for gas and electricity to the standard rate will be implemented starting on October 1, generating additional revenues of 0.1 percent of GDP in 2011.

- Additional sales of concessions (including an augmented spectrum auction) will raise 0.4 percent of GDP in 2011.

- The ongoing process of a phased transfer of banks' pension funds to the state social security system will exceptionally be used toward meeting the 2011 deficit target (see also the MoU).

5. **The 2012 budget, currently under preparation, will be fully consistent with the deficit target of 4.5 percent of GDP.** On current projections, the shortfalls in 2011 are projected to create a gap of about 0.6 percent of GDP in 2012. The budget will include measures to cover this gap, in addition to measures of about 3 percent of GDP specified in our May 2011 MEFP. In view of the already high tax burden, we are determined to focus this additional effort needed on expenditure cuts. The draft budget will be discussed with staff of the EC, ECB, and IMF before it is approved by the council of ministers.

C Streamlining the Public Sector

Public Financial Management (PFM)

6. **We are committed to strengthening our PFM system.** We will implement all the measures defined in the May 2011 MEFP and the MoU. Our reform will be guided by an action plan determined in consultation with a recent IMF/EU technical assistance mission. We are working on a medium-term fiscal strategy document for the general government (structural benchmark), which will outline how some of the key reforms introduced by the amended 2011 budget framework law, in particular medium-term budgeting and the transition to accruals accounting, will be implemented over time. In order to support an improved assessment of fiscal risks starting with the 2012 budget, a definition of contingent liabilities was approved in July. Finally, the statutes of the independent fiscal council are expected to be approved in Parliament by September, and we are committed to making this council fully operational by end-December 2011.

7. **We will strengthen expenditure control and prepare a strategy to clear the stock of arrears over time.** Our preliminary survey, which was completed ahead of the schedule, has revealed a sizable stock of arrears as of end-June (about €3.8 billion), most of which are concentrated in the health sector and local governments. Our near-term priorities in this regard are to:

- Enhance, by end-September 2011, our survey of arrears, which will cover all entities within the general government and all transactions (e.g., employment costs, utilities, interest costs, transfers to local and regional governments, goods and services, capital expenditure, and transfers of withheld taxes and social contributions to respective responsible collection agencies and institutions);

- Prepare a strategy for the settlement of arrears for the entities of general government, as well as SOE hospitals, by end-September;

- Issue an instruction to general government units requiring that from January 1, 2012, (i) commitments must be controlled against available funds recorded in the accounting system and evidenced by authorized commitment documents ("*cabimento*") bearing valid commitment numbers; (ii) all other commitments would be considered illegal and not eligible for payment; and (iii) any public official incurring such illegal commitment or expenditure will be subject to specified penalties in accordance with the budget framework law. (Prior Action)

- Issue an instruction to general government units to ensure that systems and procedures will comply, by end-December 2011, with the revised budget execution rule, as set out in the above instruction. (Prior Action)

- Carry out, through the Ministry of Finance, regular reviews of the commitment control systems of hospitals and local governments.

8. **The financial accountability and management functions of regions and municipalities will be strengthened.** In particular, given the sizeable risks to public finances, we will urge the two regional governments to adopt PFM reforms similar to those envisaged for the central government. Under the current commitments to revise the regional and local public finance laws , by end-December 2011 we will, in consultation with regional and local governments, endeavor to put a framework in place to: (i) require that their revenue projections be reviewed by the fiscal council; (ii) introduce a contingency reserve under their overall expenditure envelope as a buffer against genuine surprises; (iii) review the revenue-sharing mechanism between the State and the regions; (iv) strengthen the supervisory power of the State over the regions; and (v) apply tighter debt ceilings combined with the adoption of a multi-tiered monitoring system, as suggested by the July 2011 TA mission.

Revenue Administration

9. **We remain committed to the reforms set in the May 2011 MEFP.** An IMF/EC TA mission in early September will review our revenue administration reform agenda and provide inputs for fulfillment of our upcoming commitments, in particular: (i) the preparation of the strategic plan for 2012-14; (ii) the assessment of the current state of tax information systems; and (iii) the design of the new merged revenue administration structure. We are already improving the resolution process for tax appeals, and the number of outstanding cases above €1 million at the tax court has already fallen by 200. The new tax arbitration law has been implemented as planned.

Public Administration and its Perimeter

10. **The public administration is being streamlined.** A second phase of the restructuring program was launched for the central government. We are preparing a new set of organic laws aiming at reducing by at least 15 percent management positions and administrative units. The draft legislation will be submitted to the Council of Ministers by end-October. As a key step to fulfill our commitments, we will submit to public discussion a White Book of administrative reform by end-September 2011. Starting with the 2012 budget, we will reduce the number of State Autonomous Funds. We will also aim to classify as general revenues, on a case by case basis, all own revenues of these funds that arise directly or indirectly from the use of the sovereign powers of the government (e.g. court fees, fines, fees for licenses or permits, and audit fees charged by the Court of Auditors).

SOEs

11. **We are committed to fundamentally overhauling the SOE sector.** We recognize that SOEs should not continue to act as off-budget arms of the state, but must focus on efficient provision of essential public services. Our strategy for firms with commercial operations rests on a combination of operational restructuring to restore financial balance and eliminate deficits and closure or divestiture of firms providing nonessential services or producing goods. Regarding noncommercial firms, in particular in the health sector, we will implement measures to improve efficiency and effectiveness, and generate saving, as detailed in the MoU.

12. **We will restore operational balance to most SOEs by the end of 2012.** We have implemented cost reduction measures across the SOE sector, aiming at a 15-percent average reduction and raised tariffs on public transportation. Results have been mixed, in particular due to the underperformance of the health sector, which will need a longer period to adjust. We will take further new measures to ensure that all but the most problematic cases have a zero operational deficit by the end of 2012, preparing an SOE strategy document by end-September with numerical targets on cost reductions, including measures to realign wages or reduce employment, and further tariff increases as needed. A review of SOE operations and finances will be an input to the budget. We will impose progressively stricter limits on the SOEs' borrowing requirement from 2012 onwards. For the firms with the most entrenched financial and operational difficulties restructuring may take longer, and require a recomposition of their liabilities from debt to equity. Our strategy document will address these issues fully.

13. **Financial support for SOEs may be needed during the transition to long-term viability.** Some SOEs face significant difficulties rolling over amortizing debts. These debts are principally owed to the domestic and European banks, including the EIB, and our restructuring strategy will be a key tool in helping SOEs' roll over amortizing debt. While we have been largely successful in this policy, in some cases the central government has had to step in to provide resources and allowing SOEs to meet their commitments on time. Any such support will be provided within the agreed deficit target for the general government. The SOEs will urgently develop medium term restructuring plans with a view to reduce their indebtedness and restructure to ensure improved conditions for markets financing.

Privatization

14. **We are pushing ahead with privatization.** We will fully divest public sector shares in EDP, REN, and GALP (and if market conditions permit, TAP), by the end of the 2011. We will do this under the new framework law for privatization (see MEFP ¶ [27]) and in accordance with EU competition and state aid rules. We have also decided to include Aguas de Portugal and RTP in privatization by end-2012, in addition to enterprises identified for sale under the broader strategy of comprehensive SOE restructuring.

15. **We will develop a strategic plan for Parpublica, whose sources of income would be affected by privatization.** The plan, which will be prepared before end-2011, will reconsider the role of Parpublica as a public company, including eliminating the obligation to

remit the proceeds of the sale of assets to the Treasury in return for new assets, and considering the possibility of winding down the company or consolidating it with the general government. In the interim we will ensure that Parpublica will have sufficient income-generating assets to manage its debt and financing needs.

D Protecting the Financial System amidst Deleveraging

16. **Bank liquidity remains under pressure.** We continue to encourage banks to strengthen their collateral buffers, and we have finalized the approval of the issuance of government guaranteed bank bonds in the amount of up to €35 billion.

17. **A balanced and orderly deleveraging of the banking sector remains critical to eliminating funding imbalances on a permanent basis.** The process has started with banks having delivered a first version of their medium-term plans to achieve a stable market-based funding position. The funding plans target a reduction in the loan-to-deposit ratio to about 120 percent and a reduction of the reliance on Eurosystem funding during the duration of the program, while ensuring adequate support to the more productive sectors of the domestic economy, including SMEs. The BdP and the ECB will ask banks to revise their funding plans by end-September. These funding plans will be reviewed quarterly, starting with the second review of the program, with a view to ensuring, in particular, consistency with the macroeconomic framework—including the medium-term plans for the public sector that are under development (MEFP ¶ 12). The BdP will take appropriate action in case of deviations from the banks' funding plans. To facilitate quarterly reviews, we will develop high frequency indicators for credit to the main sectors of the economy.

18. **To bolster the resilience of the banking sector, banks have been asked to further strengthen their capital buffers, while we have augmented the bank solvency support facility.** Banks have presented plans to the BdP by which they intend to reach a core tier 1 capital ratio of at least 9 percent by end 2011 and 10 percent by end 2012 through internal means and market solutions. Banks will revise their capital plans on a quarterly basis. In the event that they cannot reach the targets on time through market based solutions, ensuring higher capital standards may temporarily require public provision of equity for the private banks. In this regard we have increased the bank solvency support facility to €12 billion, as planned under the program. The banks benefitting from equity injections will be subjected to specific management rules and restrictions, and to a restructuring process in line with EU competition and state aid requirements.

19. **We have started to streamline the state-owned CGD group to increase the capital base of its banking arm as needed.** We plan to transfer the insurance arm of the group to a state entity, as a first step toward its eventual sale. Prior to the transfer, a new independent evaluation of its market value will be performed, to be completed by the time of the second review. On the basis of that evaluation, CGD's capital increase plan will be adjusted to ensure that all the necessary resources come from within the group, as it does not have recourse to the bank solvency support facility.

20. **The BdP has intensified its monitoring of the banking sector.** It stepped up the application of its Solvency and Deleveraging Assessment Framework (SDAF) for the system as a whole and for each of the eight largest banking groups. A joint team of experts from the EC, the ECB and the IMF completed an evaluation of the enhanced assessment framework in June 2011 and a timetable has been agreed upon for the implementation of most of the recommendations by the second and third reviews. The BdP will monitor the banks' potential capital needs on a quarterly basis, with a forward looking approach under stress conditions The BdP has also launched a Special on-site Inspections Program (SIP) to validate the data on assets that banks provide as inputs to the SDAF. This process is overseen by a steering committee chaired by the BdP that comprises representatives from the EC, ECB and the IMF as well as from three euro area supervisory authorities, with participation from external consultants. The process should be completed by early 2012. In addition, disclosure of nonperforming loans is being improved by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments.

21. **We have chosen a buyer for Banco Português de Negocios (BPN).** In order to conclude the deal, we understand that there are a number of issues to be cleared under EU competition and state aid rules. We will fully cooperate in these matters with the relevant authorities.

22. **Legislative amendments to strengthen the framework for early intervention, resolution, and deposit insurance will be adopted by end-November 2011 (structural benchmark).** Amendments (prepared in consultation with the ECB, and EC and IMF staff) will grant the authorities adequate resolution tools (including recapitalization in accordance with the relevant EU framework and transfer of assets and liabilities) to orderly resolve banks under official control. To adequately fund such resolution, amendments will also (i) strengthen the availability of funding for the resolution by clarifying that the Deposit Guarantee funds' (FGD and FGCAM) may contribute, if necessary, by funding the transfer of guaranteed deposits to another bank, up to the amount that would have to be paid out in liquidation (while removing their ability to recapitalize banks), and (ii) introduce a priority insolvency ranking for guaranteed deposits. We will further examine the establishment of a resolution fund and the interaction between such a fund and the deposit guarantee funds in line with developing EU legislation in this area.

23. **The legal framework for corporate and household debt restructurings is being strengthened.** A review of the insolvency law is underway and the corporate insolvency law will be amended by end-December 2011 (structural benchmark) to better support early rescue of viable firms. The Ministry of Justice is taking the lead in preparing voluntary corporate out of court restructuring guidelines which will be issued by end-September 2011. Proposals to authorize the tax administration to use a wider range of restructuring tools are being prepared. Finally, we are developing an action plan to raise public awareness of the restructuring tools available for early rescue and re-organization of viable firms.

24. **We are intensifying the monitoring of the corporate and household sectors.** Following up on recommendations from a recent IMF-EC-ECB technical assistance mission, the quarterly monitoring of the corporate and household sectors is being enhanced and we

have started to prepare action plans to deal with the large debt overhang of these sectors, based on the assessment of existing support programs and market-based funding alternatives.

E Enhancing Competitiveness through Structural Reforms

Labour Markets

25. **The government remains committed to fostering job creation and wage flexibility through a well-functioning labor market.** We strive for a timely and effective implementation of the measures described in the May 2011 MEFP:

- We have submitted to Parliament legislation to reform severance payments for new hires, aligning the payments of open-ended contracts with those of fixed-term contracts, reducing dismissal costs to 20 days per year of service, eliminating the three month minimum payment, and capping payments at 12 months of pay. The law is expected to enter into force by September 2011.

- Following consultation with social partners, we will prepare a draft law regulating the functioning of the employer-financed dismissal fund by end-September 2011.

- In line with our commitment to a sweeping employment protection reform over the next few quarters, we are giving careful consideration to ways of (i) extending the severance pay adjustment to include current employees without reducing accrued-to-date entitlements, and (ii) benchmarking to the EU average.

Fiscal Devaluation

26. **A major fiscal devaluation remains a key element in our strategy to boost price competitiveness.** To this end, we will incorporate, in the context of the 2012 budget, a fiscally neutral cut in the employers' rate of social contributions (SSC). The offsetting measures will be integrated in the context of the ongoing fiscal consolidation, to avoid piecemeal changes to the tax system. These offsetting measures will take into account the need to protect vulnerable consumers, and will allow for a buffer to address cyclical volatility in the fiscal balance. The reform will be finalized after consultation with the IMF, EC, and ECB in September, ahead of the finalization of the 2012 budget.

Competition Framework

27. **To encourage competition, the State will strongly reduce its direct involvement in private sector activities.** We have effectively abolished involvement through controlling shares or special rights of the State, while ensuring consumer protection and a level-playing field.

- Legislation adopted by Parliament in end-July eliminated "golden shares" of the government in publicly quoted companies. Going beyond our commitment in the MoU, we have amended the Framework Law of Privatization by repealing all provisions which allow for special rights of the State or other public bodies in the corporate management or control of private companies.

- To encourage entry of strategic investors, we have also amended the articles of the Privatization Law which gave the State power to set caps on the acquisition or voting rights in privatized companies. We have eliminated voting caps, and commit not to set acquisition caps beyond the initial privatization transaction. In EDP, where such provisions already exist, we have proposed increasing voting caps for any individual shareholder from 5 percent to 20 percent.

- The State or any public entity will not conclude shareholder agreements whose intention or effect is to hinder the free movement of capital. We commit to sell the remaining shares held by CGD in GALP, thereby withdrawing from the last remaining such agreement.

- We are preparing a new draft Competition Law, clearly separating rules on competition enforcement procedures and penal procedures and harmonized with the EU competition legal framework, which we expect to present for public consultation by end-September, and approve by end-December 2011. A new specialized Court on Competition, Regulation, and Supervision was established at end-June, to start functioning by end-March 2012.

- To strengthen the independence of regulators, we are preparing the terms of reference for an independent report by internationally recognized specialists on the main National Regulatory Authorities (NRAs), on the basis of which we will consider further changes to the regulatory framework. We will launch a call for a tender by end-October 2011, which would produce a report by end-March 2012.

28. **We are taking bold steps to address excessive profits in non-contested markets and reduce the scope for rent-seeking behavior.**

Telecommunications

- The spectrum auction rules will ensure that potential new entrants are not placed at a competitive disadvantage, by carrying out an assessment of possible distortions and anti-competitive behavior, and creating a level playing field in terms of access to national roaming and taking other measures, as detailed in the updated MoU.

Energy markets

- We will continue to press forward with measures described in the MoU to foster competition and to rationalize the additional costs associated with the production of electricity under the ordinary and special regimes.

- Beyond exploring measures to put downward pressure on policy costs, we remain committed to a rigorous analysis of the costs and consequences for energy prices of all future investments in renewables. Through these and other measures we will ensure the sustainability of the national electricity system, and avoid further unfavorable developments in the deficit in the energy sector.

- As to the Third EU Energy package, we commit to take the required steps to implement the provisions of the package, in particular concerning the powers of the regulator, by end-March 2012, as detailed in the MoU.

Services and regulated professions

- We will continue with reforms that facilitate the establishment and cross-border provision of services, allowing for a more integrated and competitive market. Following the recently approved legislation for the construction and real estate sectors, we will analyze the need for further amendments to the sectoral legislation to ensure that all unjustified restrictions are lifted.

Judicial Reforms

29. **We recognize the urgent need to make the judicial system more effective.** To achieve our goal of resolving the backlog of cases within 2 years, we have developed targeted measures based on the June 2011 audit. Given the pivotal role of enforcement agents in the debt enforcement process, as a new measure, we will strengthen the legal and institutional framework in line with international practice with a particular focus on the financing structure and authority of the oversight body, including adopting a decree law by end-2011 to ensure the body's full access to the enforcement case files.

30. **We are advancing with reforms to improve efficiency of the court system.** We will, by end-2011, conduct an assessment of court management with a view to speeding up court proceedings and improving cost efficiency. The new Courts on Competition Matters and Intellectual Property Rights will now become operational by end-March 2012. We have accelerated a comprehensive review of the Code of Civil Procedure and are now preparing a proposal in a consultative manner by end-2011 (structural benchmark) to analyze the experience with the new experimental regime, and building on such experience, to address the key areas for refinement. We are also strengthening alternative dispute resolution framework to facilitate out of court settlement. Finally, we have decided not to continue with planned extensions of experimental civil procedure regime to more courts, given the fiscal costs (May MEFP, Para 46).

31. **We are committed to putting in place a more sustainable and transparent budget for the judiciary.** In particular, we will publish, by end-January 2012, an annual plan for 2012 on the allocation of resources based on court by court performance data. Quarterly reports on recovery rates, duration and costs of corporate insolvency and tax cases for the third quarter of 2011 are being prepared and will now be published by end-October 2011.

F Safeguard Assessment

32. **In line with the recommendations of an IMF safeguard mission, the BdP's governance structure will be reinforced.** We are committed to managing the resources provided by the international community in a transparent and prudent manner. To strengthen the Board's role in supervising the activities of its executive members, we will seek amendment of the BdP's organic law in order to codify independent oversight in line with

new corporate governance models. The BdP will adopt internal regulations extending the supervisory responsibilities of the Audit Board to other tasks such as oversight of internal control functions, financial reporting and audit.

33. **We will also conduct a review of Fund related transactions with the debt management agency (IGCP).** We have asked the Court of Auditors to conduct a special review of the IGCP's internal controls over foreign exchange transactions related to program disbursements. In addition, the IGCP has, at the request of the IMF, updated its investment policy which now requires that all in transactions related to Fund disbursements be undertaken with investment grade counterparties.

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

	Performance Criteria (unless indicated otherwise)				Indicative Targets			
	Jun-11							
	Program	Actual	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
1. Floor on the consolidated General Government cash balance (cumulative) 1/	-5.4	-5.1	-6.7	-10.3	-1.7	-3.9	-5.9	-7.6
2. Ceiling on accumulation of new domestic arrears by the General Government (continuous indicative target) 2/	…	…	0	0	0	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	167.9	175.9	175.9	189.4	189.4	189.4	189.4
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government. 3/	0	0	0	0	0	0	0	0

1/ Corresponds to an overall deficit of the General Government of €10,042 million on ESA 95 basis. Cumulative from January 1, 2011 for 2011, and cumulative from January 1, 2012 for 2012.
2/ Applies on a continuous basis. The indicative target will start applying with the end-September arrears data, to be compared to the end-August arrears data.
3/ Applies on a continuous basis from June 15 onwards.

Table 2. Portugal: Structural Conditionality

	Measure	Timing	Status
Prior Actions			
1	Issue an instruction to general government units requiring that from January 1, 2012, (i) commitments must be controlled against available funds recorded in the accounting system and evidenced by authorized commitment documents ("cabimento") bearing valid commitment numbers; (ii) all other commitments would be considered illegal and not eligible for payment; and (iii) any public official incurring such illegal commitment or expenditure will be subject to specified penalties in accordance with the budget framework law.		
2	Issue an instruction to general government units to ensure that systems and procedures will comply, by end-December 2011, with the revised budget execution rule, as set out in the above instruction.		
Structural Benchmarks			
A. Strengthen financial stability and enhance banking sector monitoring:			
3	Design a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment.	End-Jun. 2011	Met
4	Seek evaluation of the enhanced solvency and deleveraging assessment framework by a joint team of experts from the EC, the ECB and the IMF.	End-Sep. 2011	Met
5	Improve disclosure on non-performing loans by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments.	End-Sep. 2011	Met
6	Amend relevant legislation in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework, introduce a regime for restructuring of banks as a going concern under official control and strengthen deposit insurance framework	End-Nov. 2011	
7	Amend the Insolvency Law to better facilitate effective rescue of viable firms	End-Dec. 2011	
B. Enhance competitiveness:			
8	Eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state.	End-Jul. 2011	Met
9	Submit to Parliament a law, already agreed with social partners, to align and reduce severance payments on all new contracts (fixed term and open-ended).	End-Jul. 2011	Met
10	Finalize calibration of fiscal reform to reduce unit labor costs via deficit-neutral reduction in labor taxes.	End-Jul. 2011	Not met 1/
11	Submit to Parliament legislation revising the Competition Law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonized with the European Union competition legal framework.	End-Dec. 2011	
12	Review the efficiency of support schemes for co-generation and renewables and propose possible options for reducing the implicit subsidy.	End-Dec. 2011	
13	Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011	
14	Take all necessary legal, administrative, and other steps to make arbitration fully operational.	End-Feb. 2012	
C. Strengthen public financial management and reduce fiscal risks:			
15	Publish a fiscal strategy document for the general government which will specify 4-year medium-term economic and fiscal forecasts, supporting analysis and underlying assumptions, and 4-year costings of new policy decisions.	End-Aug. 2011	
16	Conduct and publish the results of a survey of arrears of general government entities and SOEs for all categories of expenditure as at end-June 2011.	End-Aug. 2011	
17	Based on assessment from EU/IMF technical assistance on the budgetary implications of main PPP programs, recruit a top tier international accounting firm to complete a more detailed study of PPPs and identify areas for deeper analysis by an international consulting firm.	End-Dec. 2011	
18	Prepare a report on SOEs based on forecast financial statements assessing their financial prospects, potential government exposure, and scope for orderly privatization.	End-Feb. 2012	

1/ A study highlighting key design issues and a number of options for achieving a reduction in labor taxes has been published. Further discussion with the EC, ECB, and IMF is needed ahead of the finalization of the 2012 budget.

Portugal—Technical Memorandum Of Understanding (TMU)

September 1, 2011

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

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

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

General Government

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

- 4.1. The Central Government. This includes:
  - 4.1.1. The entities covered under the State Budget, which covers the budgets of the Central Administration, including the agencies and services that are not administratively and financially autonomous, agencies and services that are administratively and financially autonomous (*Serviços e Fundos Autónomos* – SFA).
  - 4.1.2. Other entities, including Incorporated State-owned enterprises (ISOE), or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government

Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government.

- 4.2. Regional and Local Governments, that include:

  - 4.2.1. Regional Governments of Madeira and Azores and Local Governments (*Administrações Regionais and Locais*);

  - 4.2.2. Regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government.

- 4.3. Social Security Funds comprising all funds that are established in the general social security system.

- This definition of General Government also includes any new funds, or other special budgetary and extra budgetary programs or entities that may be created during the Program period to carry out operations of a fiscal nature and which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE in the correspondent subsector. The MoF will inform the EC, ECB, and IMF of the creation of any such new funds, programs, entities or operations at the time of its creation or statistical re-classification or, in the case of Regional and Local Governments, at the time the Government acknowledges its creation.

- The General Government, as measured for purposes of Program monitoring in 2011, shall not include entities nor operations that are re-classified into General Government during the remainder of 2011[1]. In 2012, it shall not include entities or operations (including pension funds) that are re-classified into General Government during 2012, but shall include those reclassified in 2011[2].

5. **Supporting Material**

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

- 5.2. Data on the cash balances of the other parts of General Government as defined in paragraph 4[3] will be provided to the EC, the ECB and the IMF by the MoF within seven weeks after the end of the month. Data will include detailed information on revenue and expenditure items. Data will also include detailed information on PPP-

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

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

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

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.

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, revenues from the reclassification of pension funds into the general government will not be accounted for as cash revenues for the purpose of the calculation of the consolidated general government cash balance. The net acquisition of financial assets for policy purposes, including loans and equity participation will be recorded as cash expenditures, except for transactions related to the banking sector support and restructuring strategy under the Program. Called guarantees (excluding those related to the banking sector support and restructuring strategy), where entities of the General Government make cash payments on behalf of entities that are not part of the General Government, will be recorded as cash expenditures.

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

6.2. The cash balance of the Regional and Local Governments, Social Security Funds, ISOE and other entities or EBFs. The cash balance of each of these parts of the General Government will be measured from above the line, based on revenues minus expenditures as it will be provided by the DGO of the MoF in the monthly General

Government budget execution report (see Para 5), and in line with the corresponding line items established in their respective budgets. All entities including ISOE that prepare accrual-based financial statements will submit monthly cash flow statement in accordance with form and content specified by the MoF. The reporting by Local Government will be phased as set out in paragraph 8 below.

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

Other provisions

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

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

9. **Supporting material**.

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

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

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

10. **Definitions.** Commitment, liabilities, payables/creditors, and arrears can arise in respect of all types of expenditure. These include employment costs, utilities, transfer payments, interest, goods and services and capital expenditure. Commitments are explicit or implicit agreements to make payment(s) to another party in exchange for that party supplying goods and services or fulfilling other conditions. Commitments can be for specific goods and services and arise when a formal action is taken by a government agency, e.g., issuance of a purchase order or signing a contract. Commitment can also be of a continuing nature that require a series of payments over an indeterminate period of time and may or may not involve a contract, e.g. salaries, utilities, and entitlement payments. Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources (usually cash) embodying economic benefits or service potential. In relation to commitment, the liability arises when a third party satisfies the terms of the contract or similar arrangement. Payables/creditors are a subset of liabilities. For the purposes of the program payables/creditors exclude provisions and accrued liabilities. Arrears are a subset of payables/creditors. For the purposes of the Program domestic arrears are defined as payables/creditors that have remained unpaid for 90 days or more beyond any specified due date (regardless of any contractual grace period). In case no due date is specified, arrears are defined as payables/creditors that have remained unpaid for 90 days or more after the date of the invoice or contract. Data on arrears will be provided within seven weeks after the end of each month. The continuous indicative target of non-accumulation of new domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the end of the previous month. Furthermore, in line with quantitative targets to be established at the time of the first review, the existing stock of arrears will be settled or otherwise reduced. This also includes arrears that are being accumulated by the SOEs not includes in the General Government under ESA95 and ESA95 Manual on Government Deficit and Debt rules classification.

11. **Supporting material.** Starting in September 2011, the MoF will provide consistent data on monthly expenditure arrears of the General Government, as defined above. Data will be provided within seven weeks after the end of each month and will include total arrears classified by the different constituent sectors of the General Government sub-sector as defined in paragraph 4. The indicative target will start applying with the end-September arrears data, to be compared to the end-August arrears data—based on the same perimeter with respect to the entities covered.

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

12. **Definition.** The overall stock of General Government debt will refer to the definition established by Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of

the Protocol on the Excessive Deficit Procedure annexed to the Treaty establishing the European Community. For the purposes of the Program, the stock of General Government debt will exclude: (i) debt contracted for bank restructuring, when carried out under the Program's banking sector support and restructuring strategy; (ii) IGCP deposits; and (iii) (from end-September 2011) the 'prepaid margin' on all EFSF loans.

13. **Adjusters.** For 2011, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock at end-December 2010 general government debt of EUR160.47 billion. From 2012 onwards, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) reclassification of entities or operations that affects the stock at end-December of the previous year.

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

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

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

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

E Bank Solvency Support Facility

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

F Overall Monitoring and Reporting Requirements

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

19. Concerning the Central Administration, and Regional and Local Administrations owned companies not classified by INE within the General Government, the MoF will

provide by end-September 2011 data on the 2010 financial statements reported under the Simplified Business Information framework, to be reported by end-June 2011.

Portugal

MEMORANDUM OF UNDERSTANDING ON SPECIFIC ECONOMIC POLICY CONDITIONALITY

First Update – 1 September 2011

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism (EFSM), and in particular Article 3(5) thereof, this Memorandum of Understanding details the general economic policy conditions as embedded in Council Implementing Decision 2011/344/EU of 17 May 2011[1] on granting Union financial assistance to Portugal. [2,3]

The first disbursement of financial assistance from the EFSM took place following the entry into force of the Memorandum of Understanding on specific economic policy conditionality (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 MEFP and in this MoU, as well as Council Recommendations in the context of the Excessive Deficit Procedure.

The first quarterly review was carried out in August 2011. It assessed compliance with the conditions to be met by end-July and the need and scope for additional policy steps. This update of the MoU reflects the findings of the first 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.

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

1. Fiscal policy

Objectives

Reduce the Government deficit to below EUR 10,068 million (equivalent to 5.9% of GDP based on current projections) in 2011, EUR 7,645 million (4.5% of GDP) in 2012 and EUR

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1 As amended by the Council on 2 September 2011.

2 This final version of the MoU includes some limited changes made during the internal Commission approval process relative to the version agreed between the staff level mission team and the Portuguese authorities on 11 August. The MoU was signed by the authorities and the Commissions on 6 and 7 September 2011, respectively..

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

5,224 million (3.0% of GDP) in 2013 by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups; bring the government debt-to-GDP ratio on a downward path as of 2013; maintain fiscal consolidation over the medium term up to a balanced budgetary position, notably by containing expenditure growth; support competitiveness by means of a budget-neutral adjustment of the tax structure.

Fiscal policy in 2011

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

1.2. Within the year, progress will be assessed against the (cumulative) quarterly ceilings for the consolidated General Government cash balance in the Memorandum of Economic and Financial Policies (MEFP), as defined in the Technical Memorandum of Understanding (TMU), without prejudice to full-year ESA-95 deficit targets. **[Q3 and Q4-2011]**

1.3. Over the remainder of the year, the government will rigorously implement the Budget Law for 2011 and the additional consolidation measures the government has announced since then.

1.4. With the information available as of early August, the Government has identified a projected shortfall for the year 2011 as a whole of about 1.3 percent of GDP, due in particular to (i) government support to several SOEs and Public-Private Partnerships (PPPs), and (ii) slippages in expenditure controls, mainly on employment costs and intermediate consumption. The recapitalisation costs related to the sale of Banco Português de Negócios (BPN) will add another 0.2 percent of GDP to the headline deficit. Excluding these recapitalisation costs, the shortfall is about 1.1 percent of GDP. To address this shortfall, the Government will take new measures as follows:

- i. A one-time surcharge in the context of the personal income tax in 2011 has already been approved. This new tax is projected to generate 0.5 percent of GDP in 2011, with an adjustment yielding 0.1 percent of GDP in 2012.
- ii. The increases in the VAT rates for natural gas and electricity to the standard rate which were foreseen for 2012 will be brought forward to 1 October 2011, generating additional revenues of 0.1 percent of GDP in 2011. These measures are still subject to Government approval. The Government will also endeavour to adopt other consolidation measures of a permanent nature and/or frontload other measures planned for next year.
- iii. Additional sales of concessions (including an augmented spectrum auction) will raise 0.4 percent of GDP in 2011.
- iv. The ongoing process of a phased transfer of banks' pension funds to the State social security system will exceptionally be used towards meeting the 2011 deficit target. The Government is committed not to use the acquired assets of these pension funds in a way which would undermine long-term sustainability.

Fiscal policy in 2012 and fiscal devaluation

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

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

1.7. The measures listed below, worth about 3 percent of GDP, will be carried out with the 2012 Budget Law **[Q4-2011]**, unless otherwise specified. Further measures, mostly on the expenditure side, will be taken to fill the gap arising from the shortfalls in 2011, and which could be about 0.6 percent of GDP. The Government will prepare an updated assessment of the budgetary situation and prospects in view of the discussion of the 2012 Budget with the European Commission, the IMF and the ECB before its approval by the Council of Ministers.

1.8. A major fiscal devaluation remains a key element in the Government's strategy to boost competitiveness. To this end, the 2012 budget will include a major fiscally neutral cut in the employers' rate of social contributions (SSC). The offsetting measures will be integrated in the context of the ongoing fiscal consolidation, to avoid piecemeal changes to the tax system, and will take into account the need to protect vulnerable consumers, and will allow for a buffer to address cyclical volatility in the fiscal balance. The reform will be finalised after consultation with the IMF, EC, and ECB in September, ahead of the finalisation of the 2012 budget **[October 2011]**.

Expenditure

1.9. Improve the working of the central administration by eliminating redundancies, increasing efficiency, reducing and eliminating services that do not represent a cost-effective use of public money. This should yield annual savings worth at least EUR 500 million. Detailed plans will be presented by the Portuguese authorities and will be assessed **by Q1-2012**; the budgetary impacts will spread to 2014**.** To this end, the government will:

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

ii. create a single tax office and promoting services' sharing between different parts of the general government;

iii. reorganise local governments and the provision of central administration services at local level;

iv. regularly assess the value for money of the various public services that are part of the government sector as defined for national accounts purposes;

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

vi. reduce transfers from the State to public bodies and other entities;

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

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

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

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

i. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 1% per year in the staff of central administration and 2% in local and regional administration. **[Q3-2011]**

ii. Freeze wages in the government sector in nominal terms in 2012 and 2013 and constrain promotions.

iii. Reduce the overall budgetary cost of health benefits schemes for government employees schemes (ADSE, ADM and SAD) lowering the employer's contribution and adjusting the scope of health benefits, with savings of EUR 100 million in 2012.

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

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

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

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

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

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

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

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

ii. tightening compensation schemes and fringe benefits;

iii. rationalisation of investment plans for the medium term;

iv. increase their revenues from market activities.

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

Revenue

1.20. Introduction of a standstill rule to all tax expenditure, blocking the creation of new items of tax expenditure and the enlargement of existing items. The rule will apply to all kinds of tax expenditure, of a temporary or permanent nature, at the central, regional or local level.

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

i. abolishing all reduced corporate income tax rates;

ii. limiting the deductions of losses in previous years according to taxable matter and reducing the carry-forward period to three years;

iii. reducing tax allowances and revoking subjective tax exemptions;

iv. curbing tax benefits, namely those subject to the sunset clause of the Tax Benefit Code, and strengthening company car taxation rules;

v. proposing amendments to the regional finance law to limit the reduction of corporate income tax in autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

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

i. capping the maximum deductible tax allowances according to tax bracket with lower caps applied to higher incomes and a zero cap for the highest income brackets;

ii. applying separate caps on individual categories by (a) introducing a cap on health expenses; (b) eliminating the deductibility of mortgage principal and phasing out the deductibility of rents and of mortgage interest payments for owner-occupied housing; eliminate interest income deductibility for new mortgages (c) reducing the items eligible for tax deductions and revising the taxation of income in kind;

iii. proposing amendments to the regional finance law to limit the reduction of personal income tax in autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

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

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

1.25. Raise VAT revenues, including through an increase in the efficiency of the VAT structure, to achieve a yield of at least EUR 410 million by**:**

i. reducing VAT exemptions;

ii. moving categories of goods and services from the reduced and intermediate VAT tax rates to higher ones;

iii. proposing amendments to the regional finance law to limit the reduction of VAT in the autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

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

i. raising car sales tax and cutting car tax exemptions;

ii. raising taxes on tobacco products;

iii. indexing excise taxes to core inflation;

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

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

Fiscal policy in 2013

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

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

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

Expenditure

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

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

ii. education and school network rationalization: EUR 175 million;

iii. wage bill: annual decreases of 1% per year in headcounts of central administration and 2% in local and regional administrations;

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

v. health sector: EUR 375 million;

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

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

viii. capital expenditure: EUR 350 million;

ix. maintain the suspension of pension indexation rules except for the lowest pensions in 2013.

1.32. In addition, the government will extend the use of means testing and better target social support achieving a reduction in social benefits expenditure of at least EUR 350 million**.**

Revenue

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

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

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

iii. taxation of all types of cash social transfers and convergence of personal income tax deductions for pensions and labour income: EUR 150 million;

iv. excise taxes: EUR 150 million.

1.34. Update the notional property value of real estate assets for tax purposes to raise revenue by at least EUR 150 million in 2013. Transfers from the central to local governments will be reviewed to ensure that the additional revenues are fully used for fiscal consolidation**.**

Fiscal policy in 2014

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

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

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

2. *Financial sector regulation and supervision*

Objectives

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

Maintaining liquidity in the banking sector

2.1. Encourage banks to strengthen their collateral buffers and monitor the issuance of the government guaranteed bank bonds, which has been authorised up to EUR 35 billion in line with the EU State aid rules.

Deleveraging in the banking sector

2.2. Monitor the implementation of the medium-term plans in order to achieve a stable market-based funding position. Funding plans target a reduction in the loan-to-deposit ratio to about 120 percent and a reduction of the reliance on Eurosystem funding during the duration of the program, while ensuring adequate support to the more productive sectors of the domestic economy, including SMEs. The BdP and the ECB will ask banks to revise their funding plans by **end-September**. These funding plans will be reviewed ahead of the second review of the program with a view to ensure, in particular, consistency with the macroeconomic framework— including the medium-term plans for the public sector that are under development. The BdP will take appropriate action in case of deviations from the plans. Such reviews will be conducted quarterly in the future.

Capital buffers

2.3. BdP will follow closely the plans the banks presented to reach a core Tier 1 capital ratio of 9 percent by **end-2011** and 10 percent at the latest by **end-2012**. Banks will revise their capital plans on a quarterly basis. If needed, using its Pillar 2 powers, the BdP will also require some banks, based on their specific risk profile, to reach these higher capital levels on an accelerated schedule, taking into account the indications of the solvency assessment framework described below.

2.4. In the event that banks cannot reach the capital requirement thresholds on time, might temporarily require public provision of equity for the private banks through the established EUR 12 billion bank solvency support facility. The banks benefitting from equity injections will be subjected to specific management rules and restrictions, and to a restructuring process in line with EU competition and state aid requirements, that will provide the incentive to give priority to market-based solutions.

Caixa Geral de Depósitos (CGD)

2.5. The state-owned CGD group will be streamlined to increase the capital base of its core banking arm as needed.The insurance arm of the group will be transferred to a state entity, as a first step toward its eventual sale. Prior to the transfer, a new independent evaluation of its market value will be performed to be completed by the time of the **second review**. On the basis of that evaluation, CGD's capital increase plan will be adjusted to ensure that all the necessary resources come from within the group, as it does not have recourse to the bank solvency support facility.

Monitoring of bank solvency

2.6. The BdP will implement by the **second and third reviews** most recommendations on its Solvency and Deleveraging Assessment Framework (SDAF) formulated by a joint IMF, EC and ECB technical assistance mission in June 2011.

2.7. The BdP will complete the Special on-site Inspections Program (SIP) to validate the data on assets that banks provide as inputs to the SDAF. This process is overseen by a steering committee chaired by the BdP that comprises representatives from the EC, ECB and the IMF as well as from three euro area supervisory authorities with the participation of external consultants. The process and should be completed by **early 2012**.

2.8. The BdP will monitor quarterly banks' potential capital needs with a forward looking approach under stress conditions **[Ongoing].**

Banking regulation and supervision

2.9. BdP will ensure that the disclosure of non-performing loans is improved by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments[4].**[Q3-2011]**

Banco Português de Negócios

2.10. The authorities complete the process of selling Banco Português de Negócios (BPN) after clearance from EU competition and state aid authorities.

2.11. Once the deal is concluded, the CGD's state guaranteed claims on BPN and all related special purpose vehicles will be taken over by the state according to a timetable to be defined at that time.

Bank resolution framework

2.12. The authorities are amending legislation concerning credit institutions in consultation with the EC, the ECB and the IMF before **end-November 2011** to, inter alia, impose early

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

reporting obligations based on clear triggers and penalties. BdP will be authorised to take remedial measures to promote implementation of a recovery plan. Credit institutions with systemic risks will be required to prepare contingency resolution plans subject to regular review[5].

2.13. The amendments will introduce a regime for the resolution of distressed credit institutions as a going concern under official control to promote financial stability and protect depositors[6]. The regime will set out clear triggers for its initiation, and restructuring tools for the resolution authorities shall include recapitalization without shareholder pre-emptive rights in accordance with the relevant EU framework, transfer of assets and liabilities to other credit institutions and a bridge bank.

The deposit guarantee funds and resolution fund

2.14. The authorities amend the legislation on the Deposit Guarantee Fund (FGD) and on the Guarantee Fund for Mutual Agricultural Credit Institutions (FGCAM) and establish a resolution fund with a view to strengthen depositor protection and adequately fund resolution of distressed credit institutions, in consultation with EC, the ECB and the IMF, **by end-November 2011**[7]**.** FGD and FGCAM's functions will be re-examined to strengthen protection of guaranteed depositors. These funds should retain the ability to contribute to funding, if necessary, the resolution of distressed credit institutions and in particular the transfer of guaranteed deposits to another credit institution, while removing their ability to recapitalise banks. Such financial assistance shall be capped at the amount of guaranteed deposits that would have to be paid out in liquidation. This should be permissible only if it does not prejudice their ability to perform their primary function.

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

Corporate and household debt restructuring framework

2.16. To better facilitate effective rescue of viable firms, the Insolvency Law will be amended by **end-December 2011** with technical assistance from the IMF, to, inter alia, introduce fast track court approval procedures for restructuring plans[8].

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

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

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

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

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

Monitoring of corporate and household indebtedness

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

3. Fiscal-structural measures

Objectives

Improve the efficiency of the public administration by eliminating redundancies, simplifying procedures and reorganising services; regulate the creation and functioning of all public entities (e.g. enterprises, foundations, associations); streamline the budgetary process through the newly approved legal framework, including by adapting accordingly the local and regional financial legal frameworks; strengthen risk management, accountability, reporting and monitoring of all parts of the general government. Government action will build on the recommendations provided by the IMF/EU technical assistance mission that took place in July 2011.

Public Financial Management framework

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

Reporting

3.1. Apply the recently approved standard definition of arrears and commitments at all levels of government (central, local and regional). **[Ongoing].**

3.2. Conduct and publish a comprehensive survey of arrears by **end-August 2011** covering all categories of expenditure payables as at the end of June 2011[9]. All general government entities and SOEs classified outside the general government will be covered by this survey. The survey will be further enhanced by **September 2011** to include all transactions (including employment costs, utilities, interest costs, transfers to local and regional governments, goods and services, capital expenditure, and transfers of withheld taxes and social contributions to respective responsible collection agencies and institutions). Prepare a strategy for the settlement of arrears for the entities of general government, as well as SOE hospitals, **by end-September 2011.**

3.3. Enhance the existing monthly reporting on budgetary execution on a cash basis for the general government, including on a consolidated basis. The monthly reporting perimeter currently includes the State, Other public bodies and entities, Social Security, regional and local governments and it will be progressively expanded to include all SOEs and PPPs reclassified within the general government, regional and local governments. **[Q3-2011]**

3.4. Following the inventory on tax expenditures of June, the existing annual report on tax expenditures will be improved by **end-October**, starting with the 2012 budget, in line with

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

international best practices. The report will cover central, regional and local administrations. Technical assistance may be provided if necessary.

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

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

ii. public quarterly balance targets for the general government as defined in national accounts.

3.6. Implement any changes to the budget execution rules and procedures necessary to align with the standard definition of arrears and commitments. Meanwhile, existing commitment control procedures will be enforced and where necessary strengthened for all types of expenditure across the general government including the regional and local administration. In particular:

i. an instruction will be issued by **mid-September 2011** to general government units requiring that from January 1, 2012[10]:

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

ii. an instruction will be issued by **mid-September 2011** to general government units to ensure that systems and procedures will comply, by end-December 2011, with the revised budget execution rule, as set out in the above instruction[11];

iii. the Inspecção-Geral de Finanças (IGF) will ensure that the commitment control is operating effectively by **Q4-2011.**

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

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

3.9. Publish information on: number of general government staff on a quarterly basis (no later than 30 days after the end of the quarter); stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. The regional and local administration will transmit the necessary information. Information on employment in SOEs (central, local and regional) and other public entities and/or bodies will also be compiled. **[Q1-2012]**

[10] Prior action for the second disbursement in the Memorandum of Economic and Financial Policies.
[11] Prior action for the second disbursement in the Memorandum of Economic and Financial Policies.

Monitoring

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

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

Budgetary framework

3.12. Publish a fiscal strategy document for the general government by **end-August 2011** and annually thereafter in April for the Stability Programme. The document will specify 4-year medium-term economic and fiscal forecasts and 4-year costs of new policy decisions. Budgets will include a reconciliation of revisions to the 4 year fiscal forecasts attributable to policy decisions and parameter revisions e.g. policy decisions, changes in the macroeconomic environment[12].

3.13. Following the recommendations of the July technical assistance mission, ensure full implementation of the Budgetary Framework Law adopting the necessary legal changes:**[Q3-2011]**

i. The general government perimeter will cover the State, Other public bodies and entities, Social Security, SOEs and PPPs reclassified within the general government and local and regional administrations.

ii. Define in detail the proposed characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry over rules, commitment controls; and appropriate contingency reserves and related access rules. **[Q3-2011]**

3.14. The budgetary frameworks at local and regional levels will be considerably strengthened, in line with recommendations by the IMF/EC technical assistance mission:

i. A proposal to revise the local and regional finance laws will be submitted to Parliament, in consultation with regional and local governments, in order to fully adapt the local and regional financing framework to the principles and rules in the recently revised Budgetary Framework Law, namely in what concerns (i) the inclusion of all relevant public entities in the perimeter of local and regional government; (ii) the multi-annual framework with expenditure, budget balance and indebtedness rules, and programme budgeting; and (iii) the interaction with the function of the Fiscal Council. The revision will also foresee that: (i) the Fiscal Council reviews local and regional governments own revenue projections and multi-annual fiscal plans and (ii) a contingency reserve is included under the overall current expenditure envelope as a buffer against negative revenue surprises or erroneous expenditure planning. **[Q4-2011]**

ii. The revision of the regional and local finance laws will also strengthen fiscal accountability, in particular by: i) tighter financial requirements for regional and local SOEs and other regional and local public bodies; ii) a revision of the

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

regime of transfers between the State and the regions and the local authorities; iii) strengthening the supervisory power from the State on budgetary execution and iv) apply tighter debt ceilings combined with the adoption of a multi-tiered monitoring system as suggested by the July technical assistance mission. This reform should follow international best practices. **[Q4-2011]**

3.15. The forecast underpinning the preparation of the budget and of the fiscal strategy document will be published, including supporting analysis and underlying assumptions. **[Q3, Q4-2011]**

3.16. Adopt the Statutes of the Fiscal Council. **[Q3-2011]** The Fiscal Council will be operational by **[Q4-2011].**

Public Private Partnerships

The Government will:

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

3.18. Following the recommendations of the July technical assistance mission, perform an initial assessment of at least the 20 most significant PPP contracts, including the major *Estradas de Portugal* PPPs, covering a wide range of sectors. **[end-August 2011]**

3.19. The Government will recruit a top tier international accounting firm to undertake a more detailed study of PPPs in consultation with INE and the Ministry of Finance[13]. The review will identify and, where practicable, quantify major contingent liabilities and any related amounts that may be payable by the Government. It will assess the probability of any payments by Government in relation to the contingent liabilities and quantify such amounts. The study, to be completed by **end-March 2012,** will assess the feasibility to renegotiate any PPP or concession contract to reduce the Government financial obligations. All PPPs and concession contracts, including those undertaken by regional authorities, will be available for these reviews. **[Q4-2011]**

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

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

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

State-owned enterprises[14]

3.22. A report on concrete plans to reduce the overall operating costs of central government 10 State-owned enterprises (SOEs) posing the largest potential fiscal risks to the State by at least 15% over the 2009 levels and on a planned review of the tariff structure was presented in May. Measures taken in relation to SOEs will respect EU competition and State aid rules.

3.23. Implement ongoing plans to reduce operational costs of central government SOEs outside the health care sector by at least 15% on average compared with 2009 by the end of 2011. **[Q4 2011].** For local and regional government SOEs equivalent company-specific cuts of 15 % of operational costs will be presented by **end-September 2011.**

3.24. All but the most problematic SOEs will reach an operational balance by **end-2012.** To this end the government will prepare a comprehensive SOEs strategy document by **end-September 2011** reviewing the tariff structure and service provision of central, local and regional government SOEs, with numerical targets on cost reductions, including measures to realign wages or reduce employment, and further tariff increases as needed. The review of SOEs operations and finances will be an input to the 2012 budget.

3.25. The government will prepare a plan to tighten borrowing requirements for central, regional and local SOEs from 2012 onwards **by September 2011.**

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

3.27. Prepare a report reviewing the operations and finances of SOEs at central, regional and local government levels. The report will assess these companies' business financial prospects, the potential exposure of the government and scope for orderly privatisation. The government will adopt the necessary legal changes to fulfil this requirement. Technical assistance will be provided[15]. **[Q1-2012]**

3.28. No additional SOEs at central, regional and local government level will be created until this review is completed. **[Ongoing]**

3.29. The Government will submit to Parliament a draft law to regulate the creation and the functioning of SOEs at the central and local levels. The law will enhance the monitoring powers of the central administration over all SOEs. In addition, the timing and content of financial and operational reporting will be defined. The decisions adopted at central level to improve the efficiency of the enterprises while reducing their financial burden will be implemented at all SOEs, taking into account their specificities. The government will promote the initiatives needed so that the same objective is achieved by the regions. **[Q4-2011]**

3.30. MoF will prepare a complement to the annual SOEs report published in July on local SOEs by **end-October 2011**. A separate report on regional SOEs will be prepared by each region by **end-October 2011**. As of next year, the annual SOEs report prepared by the MoF **in July** will include all SOEs (at central, local and regional levels) and a comprehensive fiscal risk analysis of all liabilities (explicit and implicit). **[July-2012]**

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

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

Privatisation

3.31. The Government is pushing ahead with its privatisation programme. Public sector shares in EDP, REN, GALP and, if market conditions permit, TAP, will be sold **by the end of the 2011**. The divestments will be done under the new framework law for privatisation). Aguas de Portugal and RTP have been included for privatization **by end-2012**, in addition to enterprises identified for sale under the broader strategy of comprehensive SOE restructuring. The privatisation plan through 2013, covers also Aeroportos de Portugal, the freight branch of CP, Correios de Portugal and Caixa Seguros, as well as a number of smaller firms. The plan targets front-loaded proceeds of about €5 billion through the end of the program.

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

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

Revenue administration

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

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

i. Establishing special chambers within the tax tribunals, specialised to handle large cases and assisted by a specialised technical staff pool; **[Q1-2012]**

ii. Reducing the number of municipal offices by at least 20% per year in 2012 and 2013; **[Q4-2012 and Q4-2013]**

iii. Increase in the resources devoted to auditing in the tax administration to at least 30% of the total staff, mostly through reallocations of staff within the tax administration and other parts of the public administration. The threshold should be attained by **Q4-2012**.

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

i. Reviewing the assessment of audit performance based on both qualitative and quantitative indicators; **[Q3-2011]**

ii. Applying interest charges on the outstanding debt over the whole appeal period using an interest rate above market levels. Impose a special statutory interest on non-compliance with a tax court decision; **[Q4-2011]**

iii. Implement the new tax arbitration law by **Q3-2011;**

iv. Establishing an integrated IT system between the revenue administration and the tax courts; **[Q4-2011]**

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

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

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

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

Public administration

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

Central, regional and local administration

3.40. Reduce management positions and administrative units by at least 15% in the central administration. **[Q4-2011]** The draft legislation will be submitted to the Council of Ministers by **end-October 2011**.

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

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

3.43. In conjunction with the review of SOEs (see above), prepare a detailed cost/benefit analysis of all public and quasi-public entities, including foundations, associations and other bodies, across all levels of government. **[Q4-2011]** Based on the results of this analysis, the administration (central, regional or local) responsible for the public entity will decide to close or to maintain it in respect of the law (see below). **[Q1-2012**]

3.44. Regulate by law the creation and the functioning of foundations, associations, and similar bodies by the central and local administration. This law, which will also facilitate the closure of existing entities when warranted, will be prepared in coordination with a similar framework to be defined for SOEs. The law will define the monitoring and reporting mechanisms and evaluation performance. Starting with the 2012 Budget, the number of SFAs will be reduced. The law will also aim at classifying as general government revenues, on a case-by-case basis, all own revenues of these funds that arise directly or indirectly from the use of the sovereign powers of the government (e.g. court fees, fines, fees for licenses or permits, and audit fees charged by the Court of Auditors). In addition, the Government will promote the initiatives needed so that the same objective is achieved by the regions. **[Q4-2011]**

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

3.46. Carry out a study to identify potential duplication of activities and other inefficiencies between the central administration, local administration and locally-based central administration services. **[Q4-2011]** Based on this analysis, reform the existing framework to eliminate the identified inefficiencies. **[Q2-2012]**

Shared services

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

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

ii. Rationalise the use of IT resources within the central administration by implementing shared services and reducing the number of IT entities in individual Ministries or other public entities. **[Q4-2012]**

3.48. Reduce the number of local branches of line ministries (e.g. tax, social security, justice). The services should be merged in citizens' shops covering a greater geographical area and developing further the e-administration over the duration of the programme. **[Q4-2013]**

Human resources

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

3.50. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 1% per year in the staff of central administration and 2% in local and regional administrations. The Government will submit to Parliament a draft law to implement this measure at local administration level and will promote the initiatives needed so that each region will present its plan to achieve the same target. **[Q3-2011]**

Health care system

Objectives

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

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

Financing

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

i. a substantial revision of existing exemption categories, including stricter means-testing in cooperation with Minister of Social Security; **[by September-2011]**

ii. increase of moderating fees in certain services while ensuring that primary care moderating fees are lower than those for outpatient specialist care visits and lower than emergency visits; **[by September-2011]**

iii. legislate automatic indexation to inflation of NHS moderating fees. **[Q4-2011]**

3.52. Cut substantially (by two thirds overall) tax allowances for healthcare, including private insurance by **end-October**.

3.53. In the light of the urgency and size of the savings needed in the health sector to address large arrears and budget limitations plans to achieve a self sustainable model for health-benefits schemes for civil servants will be accelerated. The current plan foresee that the overall budgetary cost of existing schemes – ADSE, ADM (Armed Forces) and SAD (Police Services) - will be reduced by 30% in 2012 and by further 20% in 2013 at all levels of general government. The system would become self-financed by 2016. The budgetary costs of these schemes will be reduced by lowering the employer's contribution and adjusting the scope of health benefits. **[Q4-2011]**

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

Pricing and reimbursement of pharmaceuticals

3.55. Set the maximum price of the first generic introduced in the market to 50% of the branded product with same active substance. **[Q3-2011]** Reduce automatically prices of drugs when their patent expires. **[Q4-2011]**

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

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

Prescription and monitoring of prescription

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

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

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

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

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

Pharmacies sector

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

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

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

Centralised purchasing and procurement

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

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

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

3.69. Implement the centralised purchasing of medical goods through the recently created Central Purchasing Authority (SPMS), using the uniform coding system for medical supplies and pharmaceuticals. **[Q1-2012]**

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

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

Primary care services

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

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

ii. set-up a mechanism to guarantee the presence of family doctors in needed areas to induce a more even distribution of family doctors across the country. **[Q4-2011]**

Hospital services

3.73. Set out a strategy and a binding timetable to clear all arrears in the health sector. The strategy will include the introduction of standardised and tight control procedures for all health sector entities to prevent the re-emergence of arrears. In addition, a mechanism is put in place to ensure strong coordination between the Ministry of Health and the Ministry of Finance for the application of the same monitoring and control criteria to all types of hospitals. **[Q3-2011]**

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

3.75. Provide detailed description of measures aimed at achieving a reduction of at least EUR 200 million in the operational costs of hospitals in 2012 (EUR 100 million in 2012 in addition to savings of over EUR 100 million already in 2011). This is to be achieved through the reduction in the number of management staff, concentration and rationalisation in state hospitals and health centres and annual ceilings to PPP contracts. **[Q3-2011]**

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

3.77. Improve selection criteria and adopt measures to ensure a more transparent selection of the chairs and members of hospital boards. Members will be required by law to be persons of recognised standing in health, management and health administration. **[Q4-2011]**

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

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

3.80. Continue with the reorganisation and rationalisation of the hospital network through specialisation and concentration of hospital and emergency services and joint management (building on the Decree-Law 30/2011) joint operation of hospitals. These improvements will deliver additional cuts in operating costs by at least 5 per cent in 2013. A detailed action plan is published by 30 November 2012 and its implementation is finalised by the first quarter

2013. Overall, from 2011 to 2013, hospital operational costs must be reduced by at least 15% compared to 2010 level. **[Q2-2012]**

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

3.82. Annually update the inventory of all practising doctors by specialty, age, region, health centre and hospital, public and private sector so as to be able to identify practising, professional and licensed physicians and current and future staff needs by the above categories by **October 2011**. The inventory will subsequently be extended to other categories of staff. It will also include figures for the autonomous regions of Madeira and Azores. **[Q1-2012]**

3.83. Prepare regular annual reports presenting plans for the allocation of human resources in the period up to 2014. The Report specifies plans to reallocate qualified and support staff within the NHS. **[Q3-2011]**

3.84. Introduce rules to increase mobility of healthcare staff (including doctors) within and across health regions. Adopt for all staff (including doctors) flexible time arrangements, with a view of reducing by at least 20% spending on overtime compensation in 2012 and another 20% in 2013. Implement a strict control of working hours and activities of staff in the hospital. **[Q1-2012]**

Regional health authorities

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

Cross services

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

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

4. *Labour market and education*

Labour market

Objectives

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

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

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

Unemployment benefits

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

i. reducing the maximum duration of unemployment insurance benefits to no more than 18 months. The reform will not concern those currently unemployed and will not reduce accrued-to-date rights of employees;

ii. capping unemployment benefits at 2.5 times the social support index (IAS) and introducing a declining profile of benefits over the unemployment spell after six months of unemployment (a reduction of at least 10% in the benefit amount). The reform will concern those becoming unemployed after the reform;

iii. reducing the necessary contributory period to access unemployment insurance from 15 to 12 months;

iv. presenting a proposal for extending eligibility to unemployment insurance to clearly-defined categories of self-employed workers providing their services to a single firm on a regular basis. The proposal will take into account the risks of possible abuses and will contain an assessment of the fiscal impact of extending benefits under several scenarios concerning eligibility criteria (namely the involuntary character of unemployment) and requirements for increased social security contributions for firms making use of these arrangements.

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

Employment protection legislation

4.3. The Government will carry out reforms in the employment protection system aimed at tackling labour market segmentation, fostering job creation, and easing adjustment in the labour market:

4.4. Severance payments.

i. The Government submitted end-July 2011 legislation to Parliament to implement a reform in the severance payments for new hires in line with the March 2011 Tripartite Agreement[16]. The reform aligns severance payments of open-ended contracts with those of fixed-term contracts. The reform re-designs the system for severance payment entitlements as follows:

- total severance payments for new open-ended contracts are reduced from 30 to 10 days per year of tenure (with 10 additional days to be paid by an employers' financed fund) with a cap of 12 months and elimination of the 3 months of pay irrespective of tenure;
- total severance payments for fixed-term contracts are reduced from 36 to 10 days per year of tenure for contracts shorter than 6 months and from 24

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

to 10 days for longer contracts (with 10 additional days to be paid by an employers' financed fund);

- implementation of the fund agreed in the March Tripartite Agreement to partly finance the cost of dismissals for new hires will be done through a law regulating the functioning of the fund, as well as a description of technical details concerning its operation and a planned time frame for its implementation **by end-September 2011.**

ii. By **Q4-2011**, the Government will present a proposal to align severance payment entitlements for current employees in line with the reform for new hires, (taking into account the revised link between entitlement and seniority and the cap to total entitlements) without reducing accrued-to-date entitlements. This plan will lead to draft legislation to be submitted to Parliament by [**Q1-2012**].

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

- aligning the level of severance payments to that prevailing on average in the EU;
- allowing the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers by means of the creation of notional individual accounts.

On the basis of this proposal, draft legislation will be submitted to Parliament no later than **Q3-2012**.

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

i. Individual dismissals linked to unsuitability of the worker should become possible even without the introduction of new technologies or other changes to the workplace (art. 373-380, 385 Labour Code). Inter alia, a new reason can be added regarding situations where the worker has agreed with the employer specific delivery objectives and does not fulfil them, for reasons deriving exclusively from the workers' responsibility;

ii. Individual dismissals linked to the extinction of work positions should not necessarily follow a pre-defined seniority order if more than one worker is assigned to identical functions (art. 368 Labour Code). The predefined seniority order is not necessary provided that the employer establishes a relevant and non- discriminatory alternative criteria (in line with what already happens in the case of collective dismissals);

iii. Individual dismissals for the above reasons should not be subject to the obligation to attempt a transfer for a possible suitable position (art. 368, 375 Labour Code). As a rule, whenever there are work positions available that match the qualifications of the worker, dismissals should be avoided.

Working time arrangements

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

i. The Government will prepare an assessment regarding the use made of increased flexibility elements by the social partners associated with the 2009 Labour Code revision and prepare an action plan to promote the use of flexible working time arrangements, including on modalities for permitting the adoption of "bank of hours" working arrangement by mutual agreement of employers and employees negotiated at plant level**. [Q4-2011]**

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

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

Wage setting and competitiveness

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

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

ii. define clear criteria to be followed for the extension of collective agreements and commit to them. The representativeness of the negotiating organisations and the implications of the extension for the competitive position of non-affiliated firms will have to be among these criteria. The representativeness of negotiating organisations will be assessed on the basis of both quantitative and qualitative indicators. To that purpose, the Government will charge the national statistical authority to do a survey to collect data on the representativeness of social partners on both sides of industry. Draft legislation defining criteria for extension and modalities for their implementation will be prepared by **Q2-2012;**

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

- how the tripartite concertation on wages can be reinvigorated with the view to define norms for overall wage developments that take into account the evolution of the competitive position of the economy and a system for monitoring compliance with such norms**;**

- the desirability of shortening the survival (sobrevigência) of contracts that are expired but not renewed (art 501 of the Labour Code).

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

i. implement the commitments in the Tripartite Agreement of March 2011 concerning the "organised decentralisation", notably concerning: (i) the possibility for works councils to negotiate functional and geographical mobility conditions and working time arrangements; (ii) the creation of a Labour Relations Centre supporting social dialogue with improved information and providing technical assistance to parties involved in negotiations; (iii) the lowering of the firm size threshold above which works councils can conclude firm-level agreements to 250 employees. Action for the implementation of these measures will have to be taken **by Q4-2011;**

ii. promote the inclusion in sectoral collective agreements of conditions under which works councils can conclude firm-level agreements without the delegation of unions. An action plan will have to be produced **by Q4-2011**.

iii. **By Q1-2012,** present a proposal to reduce the firm size threshold for works councils to conclude agreements below 250 employees, with a view to adoption **by Q2-2012**.

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

Active labour market policies

4.9. The Government will ensure good practices and an efficient amount of resources to activation policies to strengthen job search effort by the unemployed and to other Active Labour Market Policies (ALMPs) to improve the employability of the young and disadvantaged categories and ease labour market mismatches. The Government will present by **Q4-2011**:

i. a report on the effectiveness of current activation policies and other ALMPs in tackling long-term unemployment, improving the employability of the young and disadvantaged categories, and easing labour market mismatch;

ii. an action plan for possible improvements and further action on activation policies and other ALMPs, including the role of Public Employment Services.

Education and training

4.10. The Government will continue action to tackle low education attainment and early school leaving and to improve the quality of secondary education and vocational education and training, with a view to increase efficiency in the education sector, raise the quality of human capital and facilitate labour market matching. To this purpose, the Government will:

i. Set up an analysis, monitoring, assessment and reporting system in order to accurately evaluate the results and impacts of education and training policies, notably plans already implemented (notably concerning cost saving measures, vocational education and training and policies to improve school results and contain early school leaving). **[Q4-2011]**

ii. Present an action plan to improve the quality of secondary education services including via: (i) the generalization of trust agreements between the

Government and public schools, establishing wide autonomy, a simple formula-based funding framework comprising performance evolution criteria, and accountability; (ii) a simple result-oriented financing framework for professional and private schools in association agreements based on fixed per-class funding plus incentives linked to performance criteria; (iv) a reinforced supervisory role of the General Inspectorate**. [Q1-2012]**

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

5. *Goods and services markets*

Energy markets

Objectives

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

Liberalisation of electricity and gas markets

5.1. Regulated electricity tariffs will be phased out **by January 1, 2013**. The government and the regulator will launch information campaigns to raise awareness of consumers **[Q3-2011].** Following the approval in the resolution of Council of Ministers of 27 July 2011 of a roadmap setting the main principles for the liberalisation of electricity markets, the government will implement it through legislation by **[Q4-2011].** The provisions will:

i. specify the timeline and criteria to liberalise the remaining regulated segments, such as pre-determined conditions relating to the degree of effective competition in the relevant market; and shorten the maximum length of the transitory period for the segment 10,35 kVA to 41,4 kVA, from 3 years, as set out in the resolution of the Council of Ministers, to 30 months.

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

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

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

5.4. Regulated gas tariffs are to be phased out by **January 1, 2013**. The government will implement, through legislation, the roadmap proposed in the resolution of Council of Ministers of 27 July 2011 by **[Q4-2011].**

5.5. Review in a report the reasons for lack of entry in the gas market, despite the availability of spare capacity, and the reasons for the lack of diversification of gas sources. The report will also propose possible measures to address the identified problems. **[Q4-2011]**

Additional costs associated with electricity production under the ordinary regime

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

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

5.7. Review the efficiency of support schemes for co-generation and propose possible options for adjusting downward the feed-in tariff used in co-generation (reduce the implicit subsidy)[17]. **[Q4-2011]**

5.8. Review in a report the efficiency of support schemes for renewables, covering their rationale, their levels, and other relevant design elements[18]. **[Q4-2011]**

5.9. For existing contracts in renewables, assess in a report the possibility of agreeing a renegotiation of the contracts in view of a lower feed-in tariff[19]. **[Q4-2011]**

5.10. For new contracts in renewables, revise downward the feed-in tariffs and ensure that the tariffs do not over-compensate producers for their costs and they continue to provide an incentive to reduce costs further, through digressive tariffs. For more mature technologies develop alternative mechanisms (such as feed-in premiums). Reports on action taken will be provided annually in **Q3-2011, Q3-2012** and **Q3-2013**.

5.11. Decisions on future investments in renewables, in particular in less mature technologies, will be based on a rigorous analysis in terms of its costs and consequences for energy prices. International benchmarks will be used for the analysis and an independent evaluation will be carried out. Reports on action taken will be provided annually in **Q3-2011, Q3-2012** and **Q3-2013**.

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

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

Energy policy instruments and taxation

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

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

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

Telecommunications and postal services

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

Telecommunications:

The Government will:

5.16. Ensure more effective competition in the sector by implementing the new Directive on EU electronic communications regulatory framework ("Better Regulation Directive"), which will (among others) enhance independence of the National Regulator Authority. **[Q3-2011]**

5.17. Facilitate market-entry by lowering mobile termination rates **[Q3-2011]** and by launching the auction for the assignment of further radio frequencies (i.e. auction of spectrum) for broadband wireless access **[Q4-2011]**. In designing the spectrum auction rules, it will be ensured that they adhere to the legal principles of the EU framework and that potential new entrants are not placed at a competitive disadvantage. In particular, the auction tender will:

i. announce the commitment to an ex-post assessment, to be carried out by the regulator, of possible competitive distortions, covering the electronic communications mobile markets for which the spectrum is to be used as well as the commitment to, where justified and proportionate, the implementation of remedies to redress any resulting situation considered anti-competitive.

ii. include appropriate caps for strategic spectrum bands (under 1 GHz) which, while respecting the technological neutrality principle, facilitates an effective entry into the market avoiding that potential new entrants will face competitive disadvantages in terms of service quality and network costs.

iii. as a contribution to the enhancement of market competition, conditions for potential new operators to have access to national roaming will strike an effective balance between safeguarding the interests of current operators and those of potential new entrants. The regulator will adopt the necessary measures in order to enable potential new entrants to benefit from a level playing field as to the provision of high quality mobile broadband services. This will be achieved namely by ensuring operators' obligation to negotiate fair and reasonable national roaming access, unless otherwise justified and proportionate.

iv. Auction pricing rules such as reserve prices and potential new entrant price discounts will take full account of the objective of facilitating market entry by creating a level playing field.

5.18. The Government will ensure the existence of an adequate monitoring and enforcement mechanism to guarantee the effective implementation of the obligations to negotiate fair and reasonable access to national roaming and mobile virtual network operator (MVNO) agreements, ensuring timely access and reasonable prices. Such mechanism will be announced in the auction tender **[Q4-2011]**.

5.19. The Government will review the current value of the fees on the use of frequencies to ensure that they are objectively justified, transparent, non-discriminatory and proportionate in relation to their intended purpose. Such review will be announced in the auction tender **[Q4-2011].**

5.20. Ensure that the provision on universal service designation and the incumbent's concession contract are non-discriminatory: re-negotiate the concession contract with the undertaking currently providing the universal service and launch a new tender for designation of universal service providers. **[Q4-2011]**

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

Postal services

The Government will:

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

Transport

Objectives

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

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

Strategic Plan for Transport:

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

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

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

iii. Measures to facilitate entry for low-cost airline companies, making use of the existing infrastructure;

iv. A set of priorities for investment with an estimate of the financial needs and the foreseen sources of financing as well as of energy savings.

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

Railways sector

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

i. Strengthen the rail regulator independence and competences including by strengthening its administrative capacity in terms of decision and execution powers and staffing;

ii. Ensure full independence of the state-owned railway operator CP from the State;

iii. Balance the infrastructure manager's revenues and expenditures on the basis of a multi-annual contract with the infrastructure manager of a duration of at least three years and concrete commitments on State finance and performance;

iv. Carry-out a rationalisation of the network and effective incentives for the infrastructure manager to reduce its costs, whereby the regulatory body will be given a monitoring role;

v. Revise the existing Public Service Obligations (PSOs) on rail passenger transport, including the legal basis and administrative capacity for stepwise introduction of competitive tendering for PSOs;

vi. Revise the infrastructure charging scheme to introduce a performance scheme, permitting operators to introduce yield management of tickets, in particular to raise ticket prices;

vii. Privatise the freight branch of the state-owned rail operator and some suburban lines.

Ports **[Q4-2011]**

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

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

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

5.28. Revise the legal framework governing port work to make it more flexible, including narrowing the definition of what constitutes port work, bringing the legal framework closer to the provisions of the Labour Code.

Other services sector

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

Sector-specific legislation of Services

5.29. Adopt the remaining necessary amendments to the sector specific legislation to fully implement the Services Directive, easing the requirements related to establishment and reducing the number of requirements to which cross-border providers are subject. Amendments will be presented to the Parliament **[Q4-2011]** and adopted by **[Q1-2012].**

5.30. In case unjustified restrictions remain following the notification to the Commission of the recently adopted sector-specific amendments in the areas of construction and real estate, review and modify them accordingly. This includes making less burdensome the requirements applying to cross-border providers, both for construction and real estate activities, and reviewing obstacles to the establishment of service providers such as restrictions on subcontracting (for construction) and on excessive liquidity obligations and physical establishment (for real estate). **[Q4-2011]**

Professional qualifications

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

Regulated professions

5.32. Eliminate restrictions to the use of commercial communication (advertising) in regulated professions, as required by the Services Directive. Necessary amendments will be presented to the Parliament **[Q4-2011]** and adopted by **[Q1-2012].**

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

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

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

Administrative burden

5.36. Continue the simplification reform effort by:

i. presenting a roadmap to monitor progress in building up the Points of Single Contact (PSC) by **Q3-2011;**

ii. making available the PSC in three languages with general information covering all relevant aspects of the Services Directive and of the Professional Qualifications Directive as well as at least five procedures on-line **by October 2011**;

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

iv. making fully operational the "Zero authorisation" project that abolishes authorisations/licensing and substitute them with a declaration to the PSC for the wholesale and retail sector and restaurants and bars **[Q2-2012]**. The platform will be available to all levels of administration, including all municipalities **[Q3-2012]**;

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

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

6. *Housing market*

Objectives

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

Rental market

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

Administrative procedures for renovation

6.2. The Government will prepare draft legislation to simplify administrative procedures for renovation **[Q3-2011],** and adopt legislation by **[Q4-2011].** In particular, the specific measures will: i) simplify administrative procedures for renovation works, safety requirements, authorisation to use and formalities for innovations that benefit and enhance the building's quality and value (such as energy savings measures). The majority of apartment owners will be defined as representing the majority of the total value of the building; ii) simplify rules for the temporary relocation of tenants of building subject to rehabilitation works with due regard of tenants needs and respect of their living conditions; iii) grant landlords the possibility to ask for termination of the lease contract for major renovation works (affecting the structure and stability of the building) with a maximum 6 months of prior notice; iv) standardise the rules determining the level of conservation status of property and the conditions for the demolition of buildings in ruin.

Property taxation

6.3. The Government will review the framework for the valuation of the housing stock and land for tax purposes and present measures to (i) ensure that by end 2012 the taxable value of all property is close to the market value and (ii) property valuation is updated regularly (every year for commercial real estate and once every three years for residential real estate as foreseen in the law). These measures could include enabling municipal officers, in addition to tax officers, to evaluate the taxable value of property and the use of statistical methods to monitor and update valuations. **[Q3-2011]**

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

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

7. *Framework conditions*

Judicial system

Objectives

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

The Government will:

Court backlog

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

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

7.2. Based on the audit of backlog cases which has been completed in June 2011, develop targeted measures to expedite the resolution of the backlog **[Q3-2011]**

7.3. Given the pivotal role of enforcement agents in the debt enforcement process, strengthen the legal and institutional framework in line with international practice with a particular focus on the financing structure and authority of the oversight body, including adopting a decree law by **end-December 2011** to ensure the oversight body's full access to the enforcement case files.

Management of courts

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

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

7.5. Conduct an assessment of court management with a view to speeding up court proceedings and improving cost efficiency. **[Q4-2011]**

7.6. Define a new personnel management plan to support judicial specialisation and mobility of court officials. **[Q4-2011]**

Alternative dispute resolution for out-of-court settlement

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

7.7. The Government will adopt a Law on Arbitration by **end-September 2011** and measures to give priority to the ADR enforcement cases in the courts by end-2011. The Government is committed to take all necessary legal, administrative, and other steps to make arbitration fully operational by **end-February 2012** to facilitate resolution of backlog cases and out of court settlement[20].

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

Civil cases in the courts

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

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

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

7.11. To review the Code of Civil Procedure and to prepare a proposal in a consultative manner **by end-2011** to analise the experience with the new experimental regime that has

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

been applied to seven courts, and building on such experience, to address the key areas for refinement, including (i) consolidating legislation for all enforcement cases before the court, (ii) giving judges the power to expedite cases, (iii) reducing administrative burdens on judges, and (iv) enforcing statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases[21].

7.12. Following the steps taken to implement the Tax Arbitration Law (to enable an effective out of court resolution of tax claims), adopt further specific measures for an orderly and efficient resolution of outstanding tax cases (also covered under revenue administration). In particular, assess the scope for measures to expedite the resolution of tax cases such as: i) creating a special procedure for high value cases; ii) establishing criteria for prioritizing; iii) extending statutory interests for the entire the court proceeding; iv) imposing a special statutory interest payment on late compliance with a tax court decision. **[Q4-2011]**

Budget and allocation of resources

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

7.13. Standardise court fees and introduce special court fees for certain categories of cases and procedures with the aim of boosting revenue and disincentivising spurious civil litigation. **[Q3-2011]**

7.14. Publish an annual workplan for 2012 on the allocation of resources based on court by court performance data, which will be published on the internet by **end-January 2012**.

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

7.16. Prepare and publish quarterly reports on recovery rates, duration and costs of corporate insolvency and tax cases, with the report for third quarter of 2011 to be published by **end-October 2011.**

Competition, public procurement and business environment

Objectives

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

Competition and sectoral regulators

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

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

7.18. Going beyond elimination of special rights of the State, the authorities also commit to ensure that obstacles to free movement of capital will not be created by their action. The authorities acknowledge that the discretion granted under the amended article 13(2) of the Framework Law of Privatisations (Law 11/90 amended by Decree 3/XII of the Parliament of 5 August 2011), if used, shall be restricted solely to the concrete 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. **[Q3-2011]**

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

i. Following the already adopted legislation establishing specialised court for Competition, Regulation and Supervision, make it operational in the context of the reforms of the judicial system (see measure 7.10) **[Q1-2012]**.

ii. Propose a revision of the competition law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonized with the European Union competition legal framework, in particular[22]: **[Q4-2011]**

   - simplify the law, separating clearly the rules on competition enforcement procedures from the rules on penal procedures with a view to ensure effective enforcement of competition law;
   - rationalize the conditions that determine the opening of investigations, allowing the competition authority to make an assessment of the relevance of the claims;
   - establish the necessary procedures for a greater alignment between Portuguese law on merger control and the EU Merger Regulation, namely with regard to the criteria to make compulsory the ex ante notification of a concentration operation.;
   - ensure more clarity and legal certainty in the application of Procedural Administrative law in merger control.
   - evaluate the appeal process and adjust it where necessary to increase fairness and efficiency in terms of due process and timeliness of proceedings.

iii. Ensure that the Portuguese Competition Authority has sufficient and stable financial means to guarantee its effective and sustained operation. **[Q4-2011]**

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

i. provide an independent report (by internationally recognised specialists) on the responsibilities, resources and characteristics determining the level of independence of the main NRAs. The report will benchmark nomination practices, responsibilities, independence and resources of each NRA with respect to best international practice. It will also cover scope of operation of sectoral regulators, their powers of intervention, as well as the mechanisms of coordination with the Competition Authority. **[Q1-2012]** The call for tender for

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

the report will be launched by **end-October 2011** and the report will be completed by **March 2012**;

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

Public procurement

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

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

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

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

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

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

7.26. Ensure ex-ante auditing/checks on public procurement by the appropriate national bodies (most notably the Portuguese Court of Auditors) as a tool to prevent and counteract the practice of illegal award of additional works/services and increase transparency. Amendments to the Court of Auditors' bylaws to be adopted by Parliament by **[Q4-2011].**

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

7.28. Repeal Art. 42 (7) (8) (9) of the Public Procurement Code which sets out a requirement for investment in R&D projects on all public contracts worth more than EUR 25 million **[Q4-2011].**

Business environment

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

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

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

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

Annex 1. Provision of data

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

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

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

To be provided by the Ministry of Health	
17. Data on health expenditure as follows: a. hospital expenditure for the different hospitals and by sub-category of hospital expenditure (e.g., pharmaceuticals, medical supplies, other supplies, services contracted to private providers such as diagnostic tests and treatments, staff) b. outpatient pharmaceutical expenditure c. remuneration costs for staff, by type of staff and specifying remuneration costs related with overtime work	Quarterly, 30 days after the end of each quarter.
To be provided by the Banco de Portugal	
18. Detailed monthly data on the financing of the General Government	Monthly, 7 weeks after the end of each month
19. Data on General Government debt as per the relevant EU regulations on statistics national accounts, showing also the main factors other than the Government deficit that contributed to the variation of the General Government debt level (Stock-flow adjustment)	Quarterly, 90 days after the end of the quarter Monthly estimates for the stock of General Government debt, 7 weeks after the end of the month
20. Government debt (Portuguese and foreign) held by banks	Monthly, 40 days after the end of each month
21. 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.	Monthly, 40 days after the end of the month
22. Assets and liabilities of Banco de Portugal	Monthly, 10 days after the end of each month
23. Assets and liabilities of the Portuguese banking system – aggregate monetary balance sheet of credit institutions	Monthly, 40 days after the end of each month
24. Report on banking sector liquidity situation, including collateral	Weekly on Friday, reporting on the previous Friday
25. Report on financial stability indicators for the banking sector as whole and for individual systemic important banks	Quarterly, 60 days after the end of each quarter
26. Report on results from the regular quarterly solvency and deleveraging assessment	Quarterly, 60 days after the end of each quarter depending on data availability.
27. Detailed report on the dedicated account, on which the funding for Bank Support Facility is held with indication of changes in the amounts	Weekly on Monday, reporting on the previous Friday
28. Detailed breakdown of lending to the economy by category of borrower: government, SOEs inside and outside the government, large enterprises, SMEs, households	Monthly, 40 days after the end of each month

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

Actions for the second review (to be completed by end Q3-2011)	
Financial sector	**[2.2]** BdP and ECB will ask banks to revise their funding plans by end-September. **[2.5]** Transfer of CGD insurance arm to a state entity as fist step towards its eventual sale, with a new independent evaluation of its market value performed to be completed by the time of the second review. **[2.6]** Implementation by BdP of most recommendations on its solvency and deleveraging Assessment Framework (SDAF). **(SB, MEFP ¶31)** **[2.8]** Monitor quarterly banks' potential capital needs. **[2.9]** Improve disclosure on non-performing loans by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments. **(SB, MEFP ¶32)** **[2.17]** Issue general principles on voluntary out of court restructuring in line with international best practices. **[2.21]** Report on corporate and household sectors indebtedness, their funding pressures and debt refinancing activity (to be repeated quarterly).
Fiscal-structural	**[1.20]** Introduction of a standstill rule to all tax expenditure, blocking the creation of new items of tax expenditure and the enlargement of existing items. **[3.2]** Conduct and publish a comprehensive survey of arrears by end-August 2011 covering all categories of expenditure payables as at the end of June 2011. Prepare a strategy for the settlement of arrears for the entities of general government. **(SB, MEFP ¶11)** **[3.3]** Enhance monthly reporting on budget execution on cash basis for the general government, including on a consolidated basis. **[3.4]** Improve the annual report on tax expenditures. **[3.5]** Establish intra-annual fiscal targets. **[3.6]** Issue an instruction for commitments control to general government units against available funds recorded in the accounting system and setting up procedures to ensure compliance. Non-compliance will be subject to specified penalties in accordance with the budget framework law. **(PA, MEFP ¶1,2)** **[3.7]** Report the consolidated monthly arrears for the general government. **[3.11]** Publish report on fiscal risks (annual). **[3.12]** Publish a medium-term fiscal strategy document for the general government by end-August. **(SB, MEFP ¶9)** **[3.13]** Fully implement the Budgetary Framework Law. **[3.15]** Publish forecasts underpinning the budget.

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

	[3.16] Adopt the Statutes of the Fiscal Council. **[3.18]** Perform with the technical assistance from EC and the IMF, an initial assessment of at least the 20 most significant PPP and concession contracts, including the major *Estradas de Portugal* PPPs, by end-August 2011. **[3.23]** Present operating cost reduction plans for local and regional government SOEs. **[3.24]** Prepare a comprehensive SOEs strategy document. **[3.25]** Prepare plan to tighten borrowing requirements for local and regional SOEs from 2012 onwards. **[3.30]** Prepare reports on local and regional SOEs by end-October. **[3.34]** Study to assess costs and benefits of merging the social security administration with tax, customs and DGITA. **[3.36]** Make a new assessment of audit performance in the revenue administration. **[[3.36]** Implement new tax arbitration law. **[3.38]** Report on the state of IT in the revenue administration. **[3.39]** Prepare a strategic plan 2012-2014 for the revenue administration, including concrete actions to combat tax fraud and evasion, to strengthen audit and enforce collection based on risk management techniques. **[3.40]** Submit draft legislation to reduce management positions and administrative units in central administration by end-October. **[3.50]** Draft law and other initiatives to ensure annual decreases of at least 1% per year in the number of central administration employees in 2012-14 and of at least 2% at regional and local levels.
Health care system	**[3.51]** Draft legislative acts to substantially revise existing exemption categories from NHS moderating fees and increase moderating fees in certain services. **[3.52]** Reduce tax allowances for healthcare by two thirds by end-October. **[3.55]** Revise the pricing of the first generic. **[3.58]** Make compulsory the electronic prescription for medicines and diagnostic. **[3.59]** Establish the monitoring system of prescription and assessment by individual doctor with future regular feedback. **[3.60]** Measures to induce physicians to prescribe generic medicines and less costly available branded product (regulation or guidelines to doctors). **[3.66]** Legislative and administrative framework for a centralised procurement system for the purchase of medical goods in the NHS. **[3.72]** Increase in the number of USF units contracting with regional authorities. **[3.71]** Present timetable to clear arrears in the health system. Ensure coordination between Ministry of Health and Ministry of Finance. **[3.75]** Present detailed description of measures aimed to achieve a reduction of EUR 200 millions in the operational costs of hospitals in 2012. **[3.76]** Publish clinical guidelines and setting up of an auditing system of their implementation.

	[3.82] Update annually the inventory of all practising doctors by speciality, age, region, health centre and hospital, public and private sector. **[3.83]** Prepare annual report, , on the allocation of human resources in the period up to 2014. **[3.87]** Reduce costs for patient transportation by one third.
Goods and services markets	**[5.3]** Take measures to improve functioning of Iberian gas market through regulatory convergence. **[5.10]** Report annually on action taken to improve the compensation schemes of new contracts in renewables (if any). **[5.11]** Report annually on the cost and benefits of new investments in renewables, including the consequences for energy prices. **[5.13]** Review consistency and possible overlapping of energy policy instruments. **[5.16]** Implement "Better Regulation Directive." **[5.17]** Decrease mobile termination rates. **[5.21]** Introduce standardized contracts, make explicit the right to free cancellation, and facilitate price comparison, in order to increase consumers' mobility in fixed communications. **[5.22]** Transpose the Third Postal Directive to liberalize Postal Services. **[5.23]** Strategic Plan for Transport to rationalize, better integrate and increase competition in the sector. **[5.24]** Transpose EU Railway Package law and privatise the freight branch of CP and suburban lines. **[5.31]** Law to improve recognition of professional qualifications: adopted (for professions not regulated by Parliament); presented to Parliament for the other professions. **[5.33 and 5. 34]** Make adjustments to the legislative framework in order to reduce the number of regulated professions and eliminate unjustified reserves of activity: adopted for professions not regulated by Parliament; presented to Parliament for the other professions. **[5.34]** Adopt measures to liberalise access and exercise of regulated professions. **[5.36]** Present a roadmap to monitor progress of Points of Single Contact (PSC), and make PSC available in three languages by October 2011.
Housing market	**[6.1]** Present measures amending the New Urban Lease Act Law. **[6.2]** Prepare legislation to simplify administrative procedures for renovation. **[6.3]** Review the framework for the valuation of housing.
Judicial system	**[7.2]** Develop targeted measures to resolve court backlog. **[7.4]** Finalise roadmap for the implementation of the Judicial Reform. **[7.7]** Adopt new law on Arbitration. **[7.14]** Implement the Tax Arbitration Law. **[7.13]** Introduce standardised court fee and special court fees for certain categories of cases to disincentivise spurious litigation.

Competition, public procurement, and business environment	**[7.18]** Restrict use of holding or acquisition caps beyond the privatisation transaction. **[7.20]** Launch the call for tender for the report. **[7.22]** Eliminate exemptions permitting direct award of public contracts below the Public Procurement Directives thresholds wherever this does not entail amending the Public Procurement Code.

Actions for the third review (to be completed by end Q4-2011)	
Financial sector	**[2.12]** Amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework and introduce a regime for restructuring of banks as a going concern under official control, by end-November. **(SB, MEFP ¶34)** **[2.14]** Amend the legislation on the Deposit Guarantee Fund and the Guarantee Fund for Mutual Agricultural Credit Institutions to cap the amount of financial assistance to a distressed bank. **(SB, MEFP ¶35)** **[2.15]** Amend legislation to provide that guaranteed depositors and/or funds will be granted a higher priority ranking over unsecured creditors in the insolvent state of the credit institution, by end-November. **[2.16]** Amend the Insolvency Law to better facilitate effective rescue of viable firms and support rehabilitation of financially responsible individuals, by end-December. **(SB, MEFP ¶36)**
Fiscal-structural	**[3.6]** Assure effective operation of commitment control. **[3.8]** Publish quarterly accounts for SOEs 45 days after end of quarter. **[3.14]** Draft law proposal to Parliament to reform local and regional finance laws. **[3.19]** Complete a preliminary review of budgetary implications of main PPP programs and recruit a top tier international accounting firm to complete a more detailed study of PPPs. **(SB, MEFP ¶14)** **[3.23]** Implement ongoing plans to reduce operational costs of central government SOEs outside the health sector by at least 15% on average over 2009 levels. **[3.26]** Prepare a plan to strengthen the governance of SOEs (at central, local and regional level). **[3.29]** Draft law to regulate the creation and functioning of SOEs. **[3.31]** Frontload privatisation plans. **[3.32]** Prepare plan to privatise Parpublica. **[3.34]** Complete the design, in consultation with the EC and IMF staff, of the new structure that merges tax, customs and DGITA. **[3.35]** Prepare comprehensive reform plans to reform the revenue administration (including special chambers, reduction of number municipal tax offices, increase in auditing staff). **[3.36]** Apply interest charges on outstanding debt over the court appeal period. **[3.36]** Integrate the IT systems between the revenue administration and tax tribunals. **[3.37]** Submit law to Parliament to strengthen the auditing and enforcement powers of the central tax administration. **[3.40]** Reduce management positions and administrative units by at least 15% in central government. **[3.41]** Implement a second phase of the administration reform programme (PREMAC).

Actions for the third review (to be completed by end Q4-2011)	
	[3.42] Submit law to Parliament to reduce management positions and administrative units in local administration; promote equivalent initiatives in regions. **[3.43]** Carry out a cost/benefit analysis of public entities (foundations, institutes, etc). **[3.44]** Draft law on creation and functioning of public entities (foundations, institutes, etc) in central and local administration. **[3.44]** Take initiative to regulate the creation and functioning of public entities in regional administration. **[3.46]** Identify inefficiencies and duplications between the central, local and locally based central administration. **[3.49]** Prepare plan of mobility of human resources within the administration.
Health care system	**[3.51]** Legislation on automatic indexation to inflation of NHS co-payments. **[3.53]** Reduce the public expenditure on public health-benefits schemes by 30% in 2012, by 20% in 2013. Ensure further similar reductions in subsequent years with a view to have the health-benefits schemes self-financed by 2016. **[3.54]** Prepare the medium-term health care budgetary framework. **[3.55]** Reduce the prices of drugs once their patent expires. **[3.57]** Revise the existing pricing system for medicines based on external prices. **[3.59]** Carry out the first quarterly feedback on prescription to each physician. **[3.61]** Establish rules for the prescription of drugs and complementary diagnostic exams (prescription guidelines). **[3.62]** Reduce the administrative/legal hurdles in generic medicines market. **[3.63]** Effectively implement the existing legislation regulating pharmacies. **[3.64]** Change the calculation of profit margins for wholesale companies and pharmacies to ensure that at least EUR 50 million in savings in public expense comes from reduction in profits of pharmaceutical sector. **[3.67]** Finalise the uniform coding system and the common registry for medical supplies. **[3.68]** Reduce by 10 percent in the overall spending (including fees) of the NHS with private providers delivering services to NHS – increase competition among private providers. **[3.72]** Establish the mechanism to guarantee the presence of family doctors in needed areas. **[3.77]** Improve selection criteria and adopt measures to ensure a more transparent selection of the chairs and members of hospital boards.
Labour market and education	**[4.1]** Adopt an action plan to reform the unemployment benefits system, in line with specific commitments in MoU and MEFP. **[4.4]** Prepare legislative proposal to revise severance payment entitlements for current employees in line with the reform for new hires. **[4.5]** Prepare legislative proposal to revise the cases for fair individual dismissals. **[4.6]** Prepare plan to promote the use of flexible working time arrangements.

Actions for the third review (to be completed by end Q4-2011)	
	[4.8] Implement commitments in the Tripartite Agreement on "organised decentralisation". Adopt an action plan to allow works councils to conclude firm-level agreements. Draft legislation on firm-level agreements concluded by works councils to be submitted to Parliament. **[4.9]** Report on current activation policies and other active labour market policies (ALMP). **[4.9]** Adopt an action plan to improve further activation policies and other ALMPs. **[4.10]** Prepare a monitoring, assessment and reporting system to evaluate education and training policies.
Goods and services markets	**[5.5]** Report on lack of entry in gas market (reasons and measures). **[5.6]** Revise downwards payment to electricity producers under guarantee compensation mechanism and long-term power-purchase agreements. **[5.7]** Report on the efficiency of support schemes for co-generation. **(SB, MEFP ¶41)** **[5.8]** Report on the efficiency of support schemes for renewable. **(SB, MEFP ¶41)** **[5.9]** Review the options for adjusting downwards the feed-in tariff used in co-generation (reduce the implicit subsidy) and renewables. **(SB, MEFP ¶41)** **[5.12]** Streamline administrative procedures and increase transparency of charges for renewable energy producers. **[5.14]** Take measures to modify energy policy instruments to ensure consistency and eliminate possible overlapping of energy policy instruments. **[5.15]** Increase VAT tax rate in electricity and gas and in excise duties in electricity. **[5.17]** Auction new radio frequencies (i.e. auction of spectrum). Ensure that spectrum auction rules are in line with the legal principles of the EU framework. **[5.18]** Ensure adequate enforcement of the obligations to negotiate fair and reasonable access to network. **[5.19]** Review of use of frequencies fees to address possible barrier for potential new entrants. **[5.20]** Renegotiate existing contract with current provider and launch a new (non-discriminatory) tender for the designation of providers of universal services in telecommunications. **[5.25 and 5.26]** Prepare the Port Strategy and a proposal for legal framework to implement the Port Strategy for integration of ports into overall logistic and transport system and for improvement of governance. **[5.27]** Report on (objectives, instruments and efficiency gains) on-going and planned initiatives in the port sector. **[5.28]** Revise the legal framework governing port work (more flexible) in place. **[5.29]** Present to the Parliament the amendments to sector-specific legislation under the Services Directive in order to further liberalise the sector. **[5.30]** Eliminate unjustified restrictions to free establishment and to cross-border provision for construction and real estate, when transposing sector-specific regulation in accordance with the Services Directive. **[5.35]** Report of remaining requirements in regulated professions and elimination of unjustified ones.

Actions for the third review (to be completed by end Q4-2011)	
Housing market	**[6.1]** Draft legislation amending the New Urban Lease Act Law 6/2006 to be submitted to Parliament. **[6.2]** Adopt legislation to simplify administrative procedures for renovation. **[6.4]** Modify property taxation with a view to i) level incentives for renting versus acquiring housing and ii) shift the tax burden towards the recurrent real estate tax.
Judicial system	**[7.3]** Strengthen legal and institutional framework in line with international practice with a particular focus on the financing structure and authority of the oversight body. Adopt a decree law to ensure the oversight body's full access to the enforcement case files. **[7.5]** Assess court management to speeding up court proceedings and improving cost efficiency. **[7.6]** Present courts personnel management plan. **[7.7]** Take measures to give priority to alternative dispute resolution enforcement. **[7.10]** Assess the need for separate Chambers within the Commercial Courts with specialised judges for insolvency cases. **[7.11]** Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement. **(SB, MEFP ¶46)** **[7.12]** Prepare measures to expedite the resolution of tax cases.
Competition, public procurement, and business environment	**[7.17]** Avoid shareholder agreements by public bodies; alienate CGD participation in Galp. **[7.19]** Revise the Competition Law to make it more autonomous from administrative and penal procedural laws and more in line with the EU legal framework. **(SB, MEFP ¶41)** **[7.19]** Take measures to ensure the Competition Authority has the necessary and stable resources to guarantee its effective operation. **[7.21]** Eliminate exemptions permitting direct award of public contracts above the Public Procurement Directives thresholds. **[7.22 and 7.23]** Amend the Public Procurement Code provisions on errors and omissions and additional works/services, and to eliminate the remaining exemptions permitting direct award of public contracts below the Public Procurement Directives thresholds. **[7.24]** Implement measures regarding irregular direct awards for additional works/services. **[7.25]** Adopt measures making financially responsible contracting authorities for non-compliance with public procurement rules. **[7.26]** Establish rules ensuring ex-ante auditing/checks on public procurements by appropriate body. **[7.27]** Upgrade the national Public Procurement Portal (Base) based on Resolution 17/2010 of the National Parliament. **[7.28]** Modify Art 42 of the Public Procurement Code concerning R&D projects for large public contracts. **[7.29]** Adopt the "Simplex Exports" programme. **[7.30]** Implement the strategy to facilitate access to finance and export markets for companies, in particular SMEs.

Actions for the fourth review (to be completed by end Q1-2012)	
Fiscal-structural	**[1.9]** Present detailed plans on improving the working of central administration, increasing efficiency, reducing and eliminating services that do not represent a good use of public money. **[3.9]** Publish additional information on general government staff on a quarterly basis.

Actions for the fourth review (to be completed by end Q1-2012)	
	[3.19] Finalisation by end-March of detailed study on PPPs and concessions by the top tier international accounting firm. **[3.20]** New legal and institutional framework for analysing PPPs. **[3.27]** Report on operations and finances of SOEs (at central, regional and local levels), by end-February 2012. **(SB, MEFP ¶16)** **[3.34]** Merge the revenue collection units of social security administration, if cost-benefit assessment is favourable. **[3.35]** Establish specialised large tax cases courts and technical staff group.
Health care system	**[3.65]** Introduce a contribution in the form of an average rebate, in case the change in the calculation of profit margin will not produce the expected savings. **[3.69]** Implement the centralised purchasing of medical goods through the recently created Central Purchasing Authority. **[3.70]** Introduce a regular revision of the fees paid to private providers. **[3.71]** Comply with European competition rules of the provision of services in the private healthcare sector. **[3.78]** Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators and regular reports. **[3.79]** Achieve full interoperability of IT systems in hospital. **[3.82]** Extend the inventory [by speciality, age, region, health centre and hospital] to other categories of staff, including those of Madeira and Azores. **[3.84]** Adopt rules to increase mobility of healthcare staff including doctors within and across regions. **[3.84]** Adopt for all staff flexible time arrangements, to reduce by at least 10% spending on overtime compensation in 2012 and another 10% in 2013. **[3.84]** Implement a stricter control of working hours and activities of staff of hospital.
Labour market and education	**[4.2]** Draft legislation on unemployment benefits system to be adopted by the government. **[4.4]** Draft legislation on severance payment entitlements for current employees to be submitted to Parliament. **[4.4]** Prepare legislative proposal to: i) align the level of severance payments to the EU average; and ii) allow the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers. **[4.5]** Draft legislation on the cases for fair individual dismissals to be submitted to Parliament. **[4.6]** Draft legislation on the use of flexible working time arrangements and revision of the minimum additional pay for overtime. **[4.8]** Draft proposal to reduce the firm size threshold for works councils to conclude agreements below 250 employees. **[4.10]** Adopt an action plan to improve the quality of secondary education. **[4.10]** Adopt an action plan on attractiveness and labour market relevance of vocational education and training and enhancing career guidance mechanisms.
Goods and services markets	**[5.21]** Present market analysis in fixed communications and adopt measures to reduce entry barriers. **[5.29]** Adopt amendments to sector-specific legislation under the Services Directive. **[5.31]** Law to improve recognition of professional qualifications framework approved by Parliament.

Actions for the fourth review (to be completed by end Q1-2012)	
	[5.33] Law to reduce the number of regulated professions and eliminate unjustified reserves of activity approved by Parliament. **[5.34]** Law to liberalise access and exercise of regulated professions approved by the Parliament. **[5.36]** Extend on-line procedures in PSC to all sectors under the Services Directive. Adapt PSC to incorporate new legislation in order to reduce administrative burdens for firms.
Judicial system	**[7.7]** Make arbitration for debt enforcement cases fully operational, by end-February 2012. **(SB, MEFP ¶48)** **[7.8]** Increase capacity of Justices for the Peace regimes to handled small claims. **[7.9]** Make the specialised courts on Competition and IPR fully operational. **[7.14]** Annual work plan on the allocation of resources based on court by court performance data by end-January. **[7.15]** Assess workload/staffing for the six pilot courts under the Judicial Reform Map.
Competition, public procurement, and business environment	**[7.20]** Present an independent report on the independence and resources of the national regulator authorities.

Actions for the fifth review (to be completed by end Q2-2012)	
Fiscal-structural	**[1.11]** Prepare the plan ensuring that the aggregate public sector wage bill as a share of GDP decreases in 2012 and 2013. **[3.21]** Annual PPP and concessions report. **[3.32]** Prepare an asset inventory, including real estate, owned by municipalities and regional government, examining scope for privatisation. **[3.41]** Municipalities to present plans to reduce management positions and administrative units by at least 15% by the end of 2012. **[3.42]** Close the public entities with an unfavourable cost/benefit analysis. **[3.45]** Eliminate inefficiencies and duplicities in the central, local and locally-based central administration. **[3.46]** Implement fully the strategy of shared services in central administration in the areas financial and human resources.
Health care system	**[3.77]** Reorganise and rationalise the hospital network continued through specialisation and concentration of hospital and emergency services and joint management. **[3.78]** Move some outpatient services to primary care units (USF). **[3.82]** Finalise the system of patient electronic medical records.
Labour market and education	**[4.7]** Prepare draft legislative proposal containing criteria and modalities for the extension of collective agreements. **[4.7]** Prepare an independent review on how the tripartite concertation on wages can be reinvigorated and on the desirability of shortening the survival of contracts that are expired but not renewed. **[4.8]** Adopt the proposal to reduce the firm size threshold for works councils to conclude agreements below 250 employees.
Goods and services markets	**[5.36]** Implement the "Zero authorisation" project abolishing licenses on wholesale, retail and bars and restaurants.
Competition, public procurement, and business environment	**[7.20]** Present a proposal to reinforce the independence of regulators where necessary.

Actions for the sixth review (to be completed by end Q3-2012)	
Fiscal-structural	**[3.11]** Publish the annual report on fiscal risks. **[3.25]** Apply tighter debt ceilings for SOEs from 2012 onwards. **[3.30]** Include all SOEs in the MoF report as well as a comprehensive fiscal risk analysis. **[3.45]** Develop by July 2012 a consolidation plan to reduce significantly the number of local authorities, to come into effect by the beginning of the next local election cycle.
Labour market	**[4.4]** Draft legislation submitted to Parliament to: i) align the level of severance payments to the EU average; and ii) allow the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers
Goods and services markets	**[5.10]** Annual report on new contracts in renewables (see Q3-2011). **[5.11]** Annual report on new investments in renewables (see Q3-2011). **[5.36]** Extend the "Zero authorisation project" abolishing licenses on wholesale and retail and restaurants and bars to all levels of administration.
Competition, public procurement, and business environment	**[7.20]** Implement the proposal on reinforcing the independence and resources of the main NRA.

Actions for the seventh review (to be completed by end Q4-2012)	
Fiscal-structural	**[3.31]** Privatise Aguas de Portugal and RTP by end-2012. **[3.34]** Complete the implementation of the new structure that merges tax, customs and DGITA. **[3.35]** Reduce number of municipal tax offices by 20%. **[3.35]** Increase to 30% the number of auditors in the tax administration. **[3.36]** Clear cases above EUR 1 million with the support of the tax court judges. **[3.47]** Implement shared services in IT. **[3.50]** Reduce the number of central administration employees by at least 1% per year, with larger reductions at regional and local level of 2%.
Health care system	**[3.78]** Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators – first regular report. **[3.80]** Publish detailed action plan to deliver additional cuts in the hospitals network operating costs of at least 5% in 2013.
Goods and services markets	**[5.4]** Eliminate regulated tariffs in electricity and gas (Jan 1).
Housing market	**[6.3]** Bring value of all property stock close to market value.
Judicial system	**[7.4]** Create 39 court units, entirely financed through expenditure savings and gains of efficiency (implementation of the Judicial Reform Map).
Competition, public procurement, and business environment	**[7.20]** Implement the proposal on reinforcing the independence and resources of the other NRAs.

Actions for the eighth review (to be completed by end Q1-2013)	
	[7.31] Implement the New Late Payments Directive. **[7.32]** Include all municipalities and all levels of public administration within the scope of the Simplex Programme.

Actions for the ninth review (to be completed by end Q2-2013)	
Fiscal structural	**[1.11]** Complete the plan that ensures that the aggregate public sector wage bill as a share of GDP decreases in 2012 and 2013.
Goods and services markets	**[5.36]** Extend the Points of Single Contact reducing administrative burdens for firms to all sectors.
Housing market	**[6.5]** Review of the impact of all housing market reforms.
Judicial system	**[7.1]** Eliminate the court backlog.

Actions for the tenth review (to be completed by end Q3-2013)	
Fiscal structural	**[3.11]** Publish the annual report on fiscal risks.
Goods and services markets	**[5.10]** Annual report on new contracts in renewables (see Q3-2011) **[5.11]** Annual report on new investments in renewables (see Q3-2011). **[5.36]** Extend the "Zero authorisation project" abolishing licenses to other sectors of the economy.

Actions for the eleventh review (to be completed by end Q4-2013)	
Fiscal-structural	**[3.35]** Reduce number of municipal tax offices by 20%. **[3.48]** Reduce the number of local branches of line ministries. **[3.50]** Reduce the number of central administration employees by at least 1% per year, with larger reductions at regional and local level of 2%.
Health care system	**[3.53]** Further reduce public expenditure on public health-benefit schemes of 20% in 2013.