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The Economic Adjustment Programme for Portugal  
Fifth review – Summer 2012



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European Commission  
Directorate-General for Economic and Financial Affairs  
Publications  
B-1049 Brussels  
Belgium  
E-mail: <mailto:Ecfm-Info@ec.europa.eu>

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European Commission

Directorate-General for Economic and Financial Affairs

# **The Economic Adjustment Programme for Portugal**

## **Fifth review – Summer 2012**

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

Contributors:

Lourdes Acedo-Montoya, Ana Agúndez García, Narcissa Balta, Giuseppe Carone, Ángel Catalina Rubianes, Catarina Dantas Machado, António Dias da Silva, Oana Garjoi, Isabel Grilo, Pedro Guedes de Campos, Martin Hallet, Mariusz Hubski, Heinz Jansen, Isabelle Justo, Filip Keereman, Stefan Kuhnert, Josefina Monteagudo, Christoph Sajonz (Directorate General Justice), Michal Strojwas, Alessandro Turrini, Milda Valentinaite, Peter Weiss, Michal Wiktorowicz (Directorate General Justice), Markus Wintersteller, Ana Xavier and the financial crisis task force of the Directorate General for Competition.

The report was prepared in liaison with the ECB.

Comments on the report would be gratefully received and should be sent, by mail or e-mail to:

Peter Weiss  
European Commission  
Unit ECFIN.F2  
BU-1 01/176  
B-1040 Brussels  
e-mail: [peter.weiss@ec.europa.eu](mailto:peter.weiss@ec.europa.eu)

or

Heinz Jansen  
European Commission  
Unit ECFIN.F2  
BU-1 01/163  
B-1040 Brussels  
e-mail: [heinz.jansen@ec.europa.eu](mailto:heinz.jansen@ec.europa.eu)

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## EXECUTIVE SUMMARY

***A joint EC/ECB/IMF mission met with the Portuguese authorities in Lisbon between 28 August and 11 September to assess compliance with the terms and conditions set out in the Fifth Review of the Portuguese Economic Adjustment Programme. The objectives of the Programme are to restore sound public finances, improve competitiveness and put Portugal's economy back on the path of sustainable growth and job creation. This report provides an assessment of compliance and summarises the findings of the mission.***

***The rebalancing of the economy is taking place at a faster-than-expected pace. The second quarter brought a substantial quarter-on-quarter contraction of economic activity by 1.2 percent following a flat first quarter. For the year as a whole, the projected pace of the economic recession remains unchanged at -3 percent. The current account deficit is declining more rapidly than anticipated, falling to around 3 percent of GDP in 2012 from nearly 10 percent just two years ago. This adjustment is taking place on the back of well-performing exports and a rapid fall in imports linked to a shrinking domestic demand. Looking forward, economic activity will be affected by a diminishing stimulus from external demand and the impact of further budgetary consolidation needs. As a consequence, GDP growth has been downward revised by about 1 percentage point in both 2013 and 2014 to around -1 and +1 percent.***

***In spite of a rigorous budget implementation on the expenditure side, data until July point to a budgetary gap of 1¾ percent of GDP in 2012 compared with budget plans. While the faster-than-projected adjustment from domestic demand to exports is welcome, it impacts on budgetary execution in two ways. First, employment-intensive domestic sectors, such as construction, are affected most negatively and the resulting higher unemployment weighs on social security budgets. Second, the tax-intensity of production and consumption is falling, leading to noticeable revenue shortfalls. The growth composition effect on revenues is compounded by intra-category shifts away from higher-taxed items such as consumer durables towards lower-taxed items of daily consumption. Also, the weakness in direct taxation is amplified by negative bracket creep as falling incomes are taxed at lower rates and tax revenues on profits shrink. By contrast, expenditure has overall developed according to plans, with higher expenditure on unemployment benefits balanced by savings in other areas, particularly compensations of employees. Budgetary execution is also benefitting from lower-than-expected interest payments and the reprogramming of EU Structural Funds. Although some one-off factors could reduce the fiscal gap to about ¾ percent of GDP in 2012, a large carry-over into 2013 and 2014 of about 1½ percent of GDP would remain, making the Programme's fiscal targets over 2012-2014 unattainable.***

***In view of the large revenue shortfalls and the more subdued growth outlook, the mission proposed to adjust the deficit targets to 5.0 percent of GDP in 2012, 4.5 percent in 2013 and 2.5 percent of GDP in 2014. As the fiscal gap is assessed to be essentially outside the control of the government a revision of the targets to accommodate part of the shortfall seems appropriate. Even under the revised targets significant consolidation efforts of 3 percent and 1¾ percent of GDP will be necessary in 2013 and 2014. In order to maintain the credibility of the Programme some degree of frontloading of the adjustment is warranted. The structural effort of the revised fiscal path remains impressive and amounts to 9½ percent of GDP from 2011-2014.***

***A range of structural spending and revenue measures underpin the revised fiscal targets. Measures worth ¼ percent of GDP will be taken still in 2012. These include, inter alia, spending freezes and a frontloading of some of the measures planned for next year. For 2013, consolidation measures amounting to 3 percent of GDP will be incorporated in the budget to achieve the target of 4.5 percent of GDP. These include a further decrease in the wage bill mainly through a reduction in number of public employees, a reduction in intermediate consumption, a cut in social transfers, a further rationalisation in the health sector, reduced spending on capital formation, as well as revenue increases achieved via base broadening of several taxes and increasing the average tax rate of personal and investment income taxes, changes in property taxation and a rise in consumption taxes. Beyond 2013, a comprehensive expenditure review has been initiated with the aim of identifying spending cuts of EUR 4 billion over a two-year period which should be instrumental to reaching a budget deficit of 2½ percent of GDP in 2014.***

***Following a Constitutional Court judgment ruling the suspension of holiday and Christmas bonuses for public sector workers and pensioners as unconstitutional as from 2013, the government plans to reinstate one extra payment and raise personal income taxes to compensate for the higher expenditure. In addition to the measures necessary to close the fiscal gap in 2013, the government has to address a Constitutional Court ruling***

*annulling on equity grounds the suspension of the holiday and Christmas bonuses for public sector employees and pensioners from 2013 on. In response, the government plans to reinstate one extra payment (1.1 payments for pensioners), whilst raising personal income taxes through a revision of the tax structure combined with a general solidarity surcharge. To provide a buffer against possible revenue shortfalls, the government will prepare in the framework of 2013 budget proposal a set of contingency measures, predominantly on the expenditure side, which could be used in case of need.*

***Instruments to control government expenses are being put in place.*** *The new commitment control system is being implemented but full compliance needs to be ensured so as to avoid a further build-up of new arrears. Budgetary fragmentation will be reduced and costly inefficiencies are being tackled in a number of areas, inter alia, containing losses of public sector enterprises, renegotiating public-private partnerships and pushing for further savings in the health care sector.*

***Orderly deleveraging of the economy remains a key objective.*** *All banks foresee to meet the indicative loan to deposit target of 120% by 2014. The recent recapitalisation of the four largest banking groups has injected more than EUR 7 billion into the system, thereby improving liquidity and solvency ratios. Given the difficult operating environment, three of the banking groups had to resort mostly to assistance from either the Portuguese government directly or the Bank Solvency Support Facility (BSSF) created under the Programme. Banks are expected to meet the Core Tier 1 Programme target of 10 percent by end-2012. Funding costs have levelled off thanks to extra-ordinary support from the Eurosystem. Difficult access to credit for small and medium-sized enterprises is an issue that is being addressed by dedicated government action aimed at finding alternative sources of finance. The legal framework for crisis management measures has been improved, in particular regarding recovery plans, bridge banks and the establishment of a resolution fund. Also, a framework for out-of-court restructuring of household and corporate debt has been set up.*

***Raising competitiveness, employment and the growth potential of the economy remains of crucial importance for the success of the Programme.*** *Good progress has been made in implementing the structural reform agenda in a number of areas such as services, regulated professions and judiciary reform. Further sustained efforts are required in several other areas to achieve the envisaged results. In order to further advance the labour market reform additional measures are required, notably a limitation of the extension of collective agreements to non-signatory enterprises, a further reduction of severance payments and the creation of a fund to partly finance severance payments. Cost reductions in the electricity sector are advancing, but in other network industries a number of bottlenecks are still to be tackled. Reforms aimed at making Portuguese ports cheaper and more flexible are underway and a revision of the port work law has been presented. In view of uncertainties whether these changes will be sufficient to trigger a significant improvement in the competitive position of Portuguese ports, their impact will be reassessed next year. Ease of doing business is benefitting from a reduction in the regulatory and administrative burden and the government plans a far-reaching overhaul of licensing requirements and permits with a view to accelerating and giving higher political priority to a number of on-going initiatives that have experienced delays in the implementation stage. Delays in the implementation of some important initiatives (e.g. Zero Authorisation, Point of Single Contact) are being addressed by the Portuguese government.*

***Overall, programme implementation remains solid, but important risks and challenges are lying ahead.*** *The revised fiscal adjustment path coupled with the additional measures planned for 2013-2014 should keep the programme on track. But risks and challenges derive from several areas. Concerning the macro-economic outlook, the continued tensions in the euro area and particularly neighbouring Spain have the potential to spill over to Portugal through the trade, financial markets or confidence channel. Fiscal adjustment has moved more strongly towards the revenue side in the short run. As this entails risks of revenue shortfalls the government needs to prepare contingency measures, notably on the expenditure side. In a forward-looking perspective, the composition of consolidation measures should be rebalanced towards the expenditure side which is more conducive to medium-term growth. Finally, as testified by the recent fissures in the political and social texture effective consensus-building is paramount for a successful implementation of the Programme.*

***The Programme's financing envelope remains sufficient.*** *The financing needs derived from the target revision amount to EUR 3.9 billion and can be covered by the Portuguese State within the Programme envelope. The review mission confirmed the assumption that Portugal will be able to regain market access by mid-2013. The Programme is supported by loans of EUR 52 billion from the European Union and EUR 26 billion from the IMF's Extended Fund Facility. Approval of the conclusions of this review will allow the disbursement of EUR 4.3 billion (EUR 2.8 billion by the EU and EUR 1.5 billion by the IMF) in October 2012, bringing the total amount disbursed to Portugal to EUR 61.4 billion.*

## I. INTRODUCTION

**1. The report assesses compliance with the conditions of the Fourth Review of the Portuguese Economic Adjustment Programme.** The assessment is based on the findings of a joint European Commission (EC)/European Central Bank (ECB)/International Monetary Fund (IMF) staff mission to Lisbon from 28 August to 11 September.<sup>1</sup> In accordance with the Council Implementing Decision amending Implementing Decision 2011/344/EU on granting EU financial assistance to Portugal<sup>2</sup>, the mission assessed compliance with the conditionality associated with the fifth disbursement and progress towards the key objectives of the Programme of sound public finances, restoring competitiveness and putting Portugal's economy back on the path of sustainable growth and job creation. It also revised the specific policy conditionality while keeping unchanged its main objectives.

**2. The Economic Adjustment Programme was agreed by the Ecofin Council on 17 May 2011 and by the IMF Executive Board on 20 May.** The Programme, which covers the period 2011-2014, entails an external financing by the European Union, the euro-area Member States and the IMF of some EUR 78 billion<sup>3</sup>, for possible fiscal financing needs and support to the banking system. One third will be financed by the European Union under the European Financial Stabilisation Mechanism (EFSM), another third by the European Financial Stability Facility (EFSF), and the remaining third by the IMF under an Extended Fund Facility.

**3. A successful completion of the Fifth Review will pave the way for the release of the next loan instalment of around EUR 4.3 billion, of which EUR 2.8 billion from the EU.** This instalment will bring EU and IMF financing to EUR 61.4 billion, representing almost 80 percent of total available financial assistance.

## II. ECONOMIC DEVELOPMENTS AND OUTLOOK

### MACROECONOMIC OUTLOOK

**4. Real GDP growth in 2012 remains in line with projections, but the composition is tilted more strongly towards exports.** In the second quarter of 2012, real GDP contracted by 1.2 percent over the previous quarter, as anticipated in the last Programme review. The contraction of domestic demand, in particular gross fixed investment, was stronger than expected while exports surprised on the upside, further accelerating the shift in GDP composition from domestic demand towards exports. In the first half of 2012, real GDP fell by 2.8 percent year-on-year, with domestic demand subtracting 7.1 percentage points from growth and net trade adding 4.3 percentage points. While most economic activity indicators have stabilised since the beginning of the year - at very low levels though - construction activity remains on a downward path. Exports are facing headwinds from the deteriorating external environment, but gains in export market shares due to improved competitiveness are partly compensating for this. Overall, real GDP is expected to fall by 3.0 percent in 2012, unchanged from the previous review. The short term outlook for the labour market remains broadly unchanged as well, with unemployment estimated to average 15½ percent of the labour force in 2012. Unit labour costs are expected to decrease by about 3¾ percent in 2012, mostly due to a 3 percent fall in compensation per employee. However, this decrease is by and large the result of the cut of two monthly salaries in the public sector, while per capita wages in the private sector are expected to decrease by only ½ percent in 2012. HICP inflation, which has been on a downward trajectory since October 2011, bounced back in August to 3.2 percent from 2.8 percent in July as a result of higher energy prices. Domestic price pressures are nevertheless subdued as capacity utilisation remains low and domestic demand anaemic. HICP inflation adjusted for the effect of changes in indirect taxes and administered prices stayed at 0.7 percent in July, well below the euro area average.

**5. The growth outlook has been revised downward by about one percentage point for both 2013 and 2014 to around -1 percent and +1 percent.** Domestic demand will be marked by the effects of additional budgetary measures in order to compensate for the carry-over of the fiscal slippage in 2012. In addition, to accommodate the Constitutional Court ruling on the public sector salary cut the authorities envisage a broad reform of the personal income tax structure that increases progressivity. Private consumption will suffer from the

<sup>1</sup> The cut-off date for the macro-economic and fiscal projections of this report is 18 September 2012.

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

<sup>3</sup> The IMF share of the Programme was set in Special Drawing Rights. Due to the lower Euro Exchange rate, since May 2011, the projected payout by the IMF in Euro has become higher, so the current projected Programme total is EUR79 billion.

fall in disposable income, despite some consumption smoothing from decreasing household savings, and is now forecast to fall by 2 percent in 2013 (down from -½ percent in the last review). Lower public consumption on the back of additional fiscal consolidation will also contribute to the sharp contraction in domestic demand, which in turn will negatively impact on private investment. However, the downward revision of fixed investment in 2013 by 3½ percentage points is mainly due to the negative carry-over of the marked drop of investment in the second quarter of 2012, even though the assumption of positive investment growth as of mid-2013 has been maintained. Negative carry-over effects will also impact on annual growth of other domestic demand components. Export growth is expected to slow down as a result of slackening external demand despite some further gains in market shares. Continued weak domestic demand is projected to weigh on employment in 2013 and the unemployment rate is expected to peak at above 16 percent. Stronger employment gains are only expected in 2014, when the economy is set to gain traction on the back of accelerated export activity. As a result of ample slack in the economy, price pressures should remain weak even when the economy will be on a recovery path in 2014.

**Table 1: Projections of main macroeconomic aggregates**

	Sep 2012 (5th review)			Jun 2012 (4th review)			Difference		
	2012	2013	2014	2012	2013	2014	2012	2013	2014
	year-on-year volume change								
Gross domestic product	-3.0	-1.0	1.2	-3.0	0.2	2.1	0.0	-1.2	-0.9
Private consumption	-5.9	-2.2	0.2	-6.0	-0.5	1.2	0.2	-1.7	-1.0
Public consumption	-3.5	-3.2	-1.5	-3.4	-2.7	-0.8	-0.1	-0.5	-0.7
Fixed investment	-14.1	-4.2	2.7	-12.2	-0.5	4.6	-1.9	-3.7	-1.9
Exports of goods and services	4.3	3.5	5.5	3.5	3.5	5.0	0.8	0.0	0.5
Imports of goods and services	-6.5	-1.0	3.3	-6.2	0.9	3.3	-0.3	-1.9	0.0
	contributions to real GDP growth								
Domestic demand excl. inventories	-7.1	-2.7	0.2	-6.8	-0.9	1.4	-0.3	-1.8	-1.2
Change in inventories	0.1	0.0	0.0	0.1	0.1	0.0	0.0	-0.1	0.0
Net trade	4.1	1.8	1.0	3.7	1.0	0.7	0.4	0.8	0.3
Employment (y-o-y change)	-3.9	-1.6	0.3	-4.2	-0.7	0.4	0.3	-0.9	-0.1
Unemployment rate (level)	15.5	16.4	15.9	15.4	15.8	15.3	0.1	0.6	0.6
HICP (y-o-y change)	2.8	0.7	1.1	2.7	1.1	1.0	0.1	-0.4	0.1
Current external balance (% of GDP)	-3.2	-1.9	-1.3	-3.6	-2.5	-1.6	0.4	0.6	0.3

Source: European Commission

**6. Risks to the macroeconomic outlook are tilted to the downside.** Continued tensions in the euro area and particularly neighbouring Spain have the potential to spill over to Portugal through the trade, financial markets or confidence channel. There is also a risk that in view of the large fiscal adjustment in 2013 macro-fiscal feed-back loops will be more adverse than projected as the composition of the consolidation has moved strongly towards the revenue side.

## FISCAL DEVELOPMENTS

**7. Budgetary execution in the first seven months of the year revealed deviations relative to the 2012 budget of about 1¾ percent of GDP.** This is the net effect of lower tax revenues, higher deficits in social security budgets and deficit-increasing one-off operations amounting to around 2¼ percent of GDP, partly compensated by savings on compensation of employees and net interest payments of ½ percent of GDP (see Table 2). The execution rates on tax revenues and social security contributions deviated significantly from the projections in the 2012 budget (see Table 3). The outcome for direct taxes was below target by about 0.4 percent of GDP, which is explained by low revenue collection in both corporate and personal income tax. The outcome for indirect taxes recorded a negative deviation of about 1 percent of GDP relative to target, mainly due to lower VAT revenue collection but also due to a sharp fall in other indirect taxes such as the motor vehicle tax and taxes on oil and tobacco. The stronger than expected fall in social security contributions added another 0.4 percent of GDP to the revenue shortfall, while the increase in expenditure on unemployment benefits added another 0.2 percent of GDP to the social security budget deficit. By contrast, expenditure has overall developed according to plans, with higher expenditure on unemployment benefits balanced by savings in other areas, particularly compensations of employees. Budgetary execution is also benefitting from lower-than-expected interest payments and the reprogramming of EU Structural Funds as well as some one-off factors. In sum, these factors are expected to reduce the fiscal gap to about ¾ percent of GDP in 2012.

**Table 2: Budget deviations, 2012**

<b>Budget negative deviations (in % of GDP)</b>	
Tax revenues	-1.5
Social security budget	-0.6
CGA budget (public employees social security scheme)	-0.1
Other non-recurrent factors	-0.2
<b>Total</b>	<b>-2.4</b>
<b>Budget execution savings (in % of GDP)</b>	
Savings in compensation of employees	0.3
Net interest payments savings	0.2
<b>Total</b>	<b>0.5</b>
<b>Overall deviation from the deficit target of 4.5% of GDP</b>	<b>-1.8</b>
<i>Other off-setting factors (in % of GDP):</i>	
ANA airport concession (initially part of the privatisation plan)	0.7
QREN (co-financing and re-programming of EU funds)	0.3
Net interest savings on banks recapitalisation funds (CoCos)	0.1
<b>Overall budget deficit deviation before measures (in % of GDP)</b>	<b>-0.8</b>
Additional measures in 2012	0.2
Additional expected savings in compensation of employees	0.1
<b>Overall budget deficit deviation after measures (in % of GDP)</b>	<b>-0.5</b>

Source: Commission services

**Table 3: Execution rates of the budget, January-July cumulated (in %)**

State budgetary execution rates (%)	2011 Budget	2012 Budget	Jan - July	Jan - July
	objective	objective	2011	2012
	mn Euro	mn Euro	%	%
<b>Tax revenues</b>	34,386.4	<b>35,135.5</b>	<b>53.6</b>	<b>50.6</b>
Direct taxes	14,613.2	14,449.0	50.5	50.3
Indirect taxes	19,773.2	20,686.5	55.8	50.8
<b>Non-tax revenues</b>	5,477.8	<b>6,910.8</b>	<b>43.0</b>	<b>78.0</b>
Current non-tax revenues	4,234.6	3,570.2	49.5	60.6
Capital revenues	1,243.2	3,340.6	21.0	96.4
<b>Effective revenues</b>	39,864.2	<b>42,046.3</b>	<b>52.1</b>	<b>55.1</b>
<b>Current expenditure</b>	46,683.8	<b>45,643.7</b>	<b>54.4</b>	<b>56.2</b>
Employees	10,432.1	8,813.3	56.2	55.9
<b>Primary current expenditure</b>	40,310.2	<b>38,313.9</b>	<b>54.7</b>	<b>56.6</b>
Capital expenditure	3,482.0	2,678.0	55.5	56.6
<b>Primary expenditure</b>	43,792.2	<b>40,991.8</b>	<b>54.8</b>	<b>56.6</b>
<b>Effective expenditure</b>	50,165.8	<b>48,321.6</b>	<b>54.5</b>	<b>56.2</b>
<b>Overall balance</b>	-10,301.6	<b>-6,275.3</b>		
<b>Primary balance</b>	-3,928.0	<b>1,054.5</b>		
Social security execution rates (%)	2011 Budget	2012 Budget	Jan - April	Jan - April
	objective	objective	2011	2012
	mn Euro	mn Euro	%	%
<b>Current revenue</b>	24,003.6	<b>24,114.1</b>	<b>56.7</b>	<b>57.5</b>
Social security contributions	14,096.8	13,592.0	56.1	55.6
<b>Current expenditure</b>	23,618.5	<b>24,045.7</b>	<b>56.3</b>	<b>57.1</b>
Unemployment benefits expenditure	2,122.4	2,184.8	56.9	67.8
<b>Overall balance</b>	<b>374.2</b>	<b>62.9</b>		

Source: Ministry of Finance (DGO).

Note: Comparable universe (excluding reclassified SOEs)

**8. Pressure from the macroeconomic environment and growth composition effects can explain about 1½ percent of the deviation (see Table 4).** The faster-than-expected rebalancing of GDP away from domestic demand towards net exports and the more intense labour shedding has adversely affected tax bases and social security budgets and, to a limited extent, the ex-post yield of tax measures adopted in 2012. Moreover, the fall in per capita income has led to an inverse bracket creep reflecting a shift towards lower tax income brackets and tilted consumption in favour of less tax-yielding goods. Composition effects seem to be dominant for both tax revenues and social security contributions, as evidenced by the falling average tax rates since the 2012 supplementary budget in March. After accounting for the above-mentioned factors, a smaller part of the revenue gap is due to one-offs (notably in terms of VAT reimbursement) and some residual factors, which will be monitored for the presence of weakening tax compliance.

**Table 4: Tax revenue and social security deviations as compared to 2012 supplementary budget**

Revision in nominal growth rates (in pps.)	2012		
Private consumption	-1.2		
Domestic demand (excluding public consumption)	-1.7		
Nominal wages	-2.6		
Nominal GDP	-0.6		
Unemployment rate	1.1		

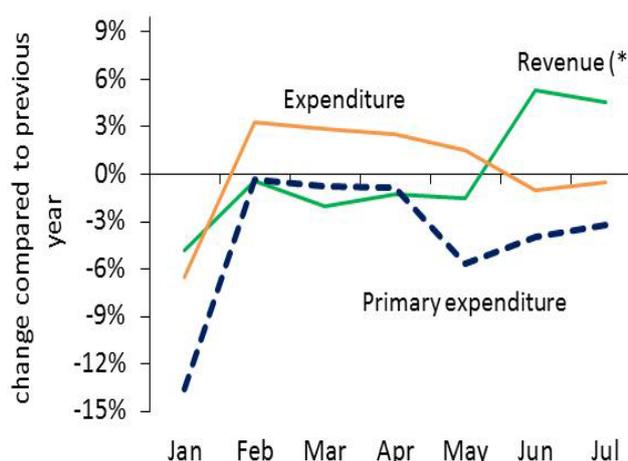
Budget deviations (in % of GDP)	Macro and composition effects	One-offs and unexplained residual	Total
Indirect taxes	-0.7	-0.3	-1.0
Direct taxes	-0.5	0.05	-0.4
Social security contributions	-0.3	-0.1	-0.4
Unemployment benefits	-0.1	-0.1	-0.2
<b>Total</b>	<b>-1.5</b>	<b>-0.6</b>	<b>-2.1</b>

Source: Commission services.

Note: The revision in the nominal growth rates is considered relative to the 2012 supplementary budget. The change in bases is driven by both the release of end-2011 data since the March budget adoption and the update in the 2012 outlook of the Fifth Review.

**9. Expenditure has developed according to plans.** Primary expenditure fell by 3.2 percent in the first seven months of the year as compared with the same period of last year. Higher-than-budgeted savings were achieved, in particular, for compensations of employees. However, overall expenditure decreased by a more limited ½ percent, as an increase in interest payments during the first semester and an exceptional capital transfer in relation to the debt amortization of the national radio and television broadcaster, the state-owned Rádio e Televisão de Portugal (RTP) partly offset the savings on primary expenditure. Compared with the same period of last year, between January and July 2012 revenues of Central Government and Social Security decreased by 1 percent, when corrected for the second tranche of the banks' pension fund transfer increasing capital revenues, while expenditure decreased by ½ percent, widening the state budget deficit (see Graph 1).

**Graph 1: Budgetary outturn for January-July 2012 (Cash data)**

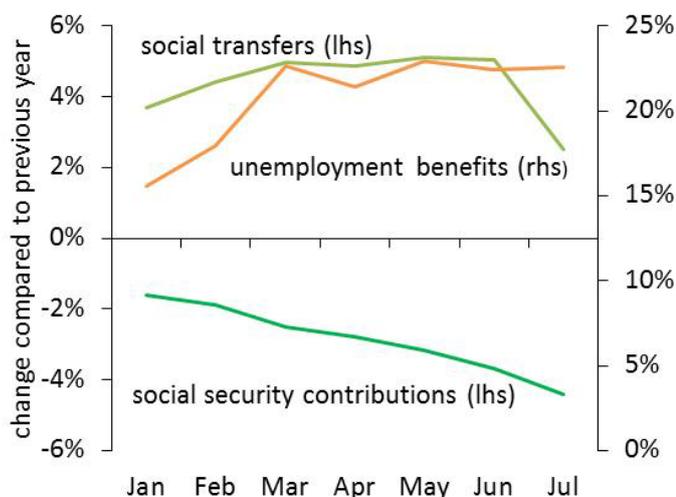


Source: Ministry of Finance and Commission services

Note: Includes non-consolidated data for the State, Autonomous Funds and Services and Social Security; Primary expenditure includes data for the State subsector only. (\*) Not corrected for the second tranche of the banks' pension fund transfer.

**10. The faster-than-expected increase in unemployment has significantly deteriorated the budgetary execution of social security.** Social transfers increased by some 4% in the first seven months of 2012 when compared with the same period of 2011 (Graph 2). While the path of social transfers related to pensions was in line with the implicit target of the supplementary budget, the sharp deterioration in labour market conditions led to higher than projected expenditure on unemployment benefits as illustrated also by a much higher execution rate when compared to the previous year (see also Table 3). However, the main driver of the underperformance of the social security budget were social security contributions which saw a strong decline over the first seven months of the year as a consequence of falling employment and wages.

**Graph 2: Budgetary outturn for Social security in January-July 2012 (Cash data)**



Source: Ministry of Finance and Commission services  
 Note: Includes non-consolidated data for Social security

**11. The stock of arrears in central and local governments and the health sector classified inside the general government seems to have stabilised.**<sup>4</sup> At the end of June, the combined stock of arrears for the general government sector and SOEs classified outside the general government has been estimated at about EUR 5 billion or about 3 per cent of GDP. Local and regional governments account for 60 per cent of the stock (see Table 5). Progress in reducing the stock of arrears at regional level is dependent on the update of the arrears settlement strategy for the region of Madeira, where the further accumulation of arrears has not yet been brought to a halt. The decline in local arrears is most probably driven by poorer reporting over the past months. A decisive decline will likely only happen when the payments under the Support Programme for Local Authorities start by the end of this year. The stock of arrears in the health sector will be reduced over the next months as the EUR 1.5 billion for the payment of stock of arrears will be exhausted. Performance during the next few months will have to be closely monitored, in particular with regard to the evolution of new arrears in some subsectors, with a view to gauging whether the indicative targets of non-accumulation for some subsectors of general government could be made binding.

<sup>4</sup> 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.

**Table 5: Stock of arrears in 2012 (in EUR million)**

Subsector of the General Government	2012 (1)					(2)	(3)=(2)-(1)	% total
	Jan	Feb	Mar	Apr	May	Jun	Δ Jun-Jan	
<b>Central Government excluding NHS</b>	151	165	153	140	135	155	3	3%
<b>NHS classified in General Government</b>	219	194	152	185	202	216	-3	3%
<b>Reclassified entities</b>	51	50	45	46	61	48	-3	1%
<b>Local Government</b>	1,661	1,685	1,706	1,724	1,623	1,584	-78	33%
<b>Regional Government</b>	1,185	1,215	1,287	1,320	1,261	1,319	134	25%
<b>Total</b>	3,268	3,309	3,343	3,415	3,281	3,321	54	66%
<b>Total Consolidated</b>	3,153	3,192	3,223	3,376	3,174	3,218	65	63%
<b>Other entities outside General Government</b>								
<b>Enterprises excluding NHS</b>	11	18	19	26	32	34	23	0%
<b>NHS incorporated hospitals</b>	1,695	1,697	1,856	1,948	1,996	1,877	182	36%
<b>p.m.: health sector inside + outside GG</b>	1,914	1,891	2,007	2,132	2,197	2,093	179	39%
<b>Arrears settlement in the health sector</b>						175	175	
<b>TOTAL</b>	4,859	4,907	5,098	5,350	5,201	5,305	446	
<b>TOTAL, adjusted for arrears' settlements</b>	4,859	4,907	5,098	5,350	5,201	5,130	271	
<b>p.m.: percent of GDP</b>	2.9	3.0	3.1	3.2	3.1	3.1		

Source: Ministry of Finance and Commission services

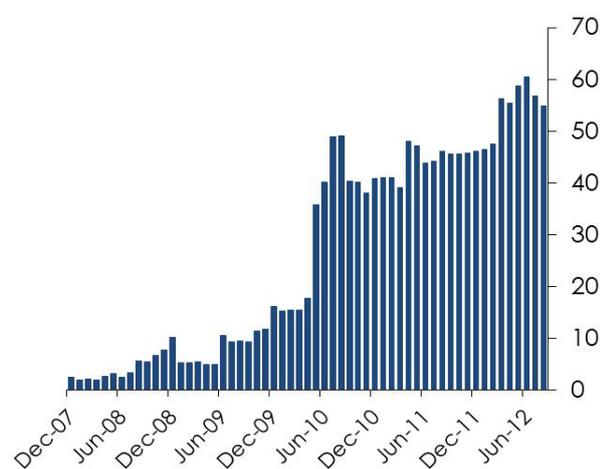
Note: Consolidated data concerns data net of intra-government sector arrears

## FINANCIAL MARKETS AND FINANCIAL SECTOR DEVELOPMENTS

**12. As confidence towards the sovereign returns, financial markets in Portugal are improving, but remain fragile.** The decline in Portuguese yields, which started early 2012, has continued until August, even though the government bond market appears illiquid with bid/ask spreads above 100 basis points and few transactions can move yields significantly. Nevertheless, yields for the ten-year bond dropped to single digits and the 2-year yields have fallen below 5 percent by mid-September, their lowest levels since programme start and around one quarter of their February peak. Several non-financial companies succeeded in issuing bonds yielding around 6 percent to the general public.

**13. ECB lending to Portuguese banks decreased somewhat in recent months.** This has partly benefited from the capital injections which took place by end of the first half of 2012 (Graph 3). More than three quarters of the outstanding ECB funding stems from the two long term operations providing liquidity for 36 months, enhancing the stability of banks' funding.

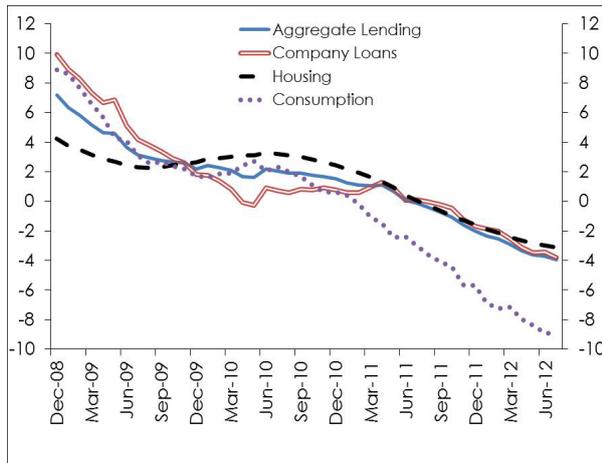
**Graph 3: ECB lending (EUR bn)**



Source: Bank of Portugal

**14. Deleveraging takes place in all loan sectors.** Overall outstanding bank loans decreased by 4.5 percent in July 2012 (Graph 4) compared to one year earlier. Newly granted consumer credits amount to only half of the monthly average of pre-crisis years. The outstanding amount of consumer loans has decreased by 9.0 percent annually. The monthly amount of newly granted mortgages amounts to only 1/8 of the past ten years' average, which is explained by the high interest mark-ups for mortgages and by the overall deteriorating outlook for the housing market. Given the mortgage loan segment's typical long maturities, housing loans stocks decreased by 2.1 percent annually. Monthly new loans to companies are still 3/4 of the past decade's average, but given their fast roll-over, stocks declined by 3.8 percent in the year to July. As the construction is under severe stress, loans to companies involved in the real-estate sector declined by 6.5 percent annually in the second quarter 2012 (Graph 5). Loans to manufacturing and distribution fell by an annualised 7.5 percent on average during the second quarter, reflecting the difficult domestic economic environment, but loans to the trading sector increased by 7.7 percent per annum in June 2012, supporting a strong export performance.

**Graph 4: Trends in different loan segments (yoy % growth)**



Source: Bank of Portugal

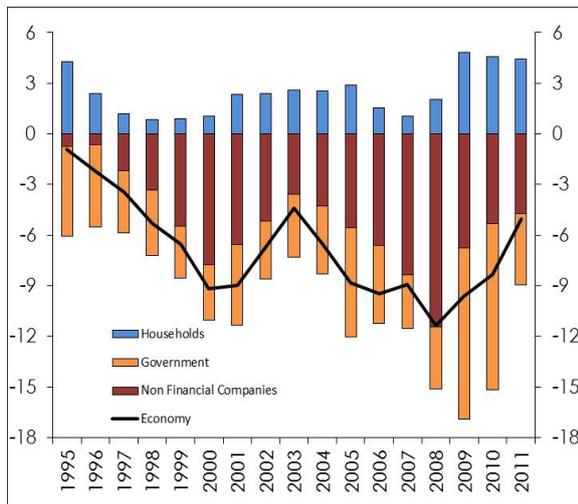
**Graph 5: Loan growth per industry branch (yoy % growth)**



Source: Bank of Portugal

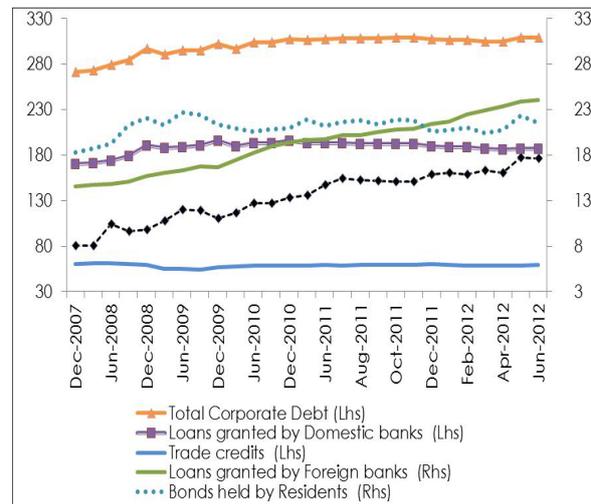
**15. The deleveraging in the banking sector goes hand in hand with a rebalancing of the economy and leads the corporate sector to explore alternative financing sources.** The over-indebted private sector is adjusting, with firms reducing their borrowing needs while households are increasing their savings. The rebalancing goes along with a fast narrowing of Portugal's trade deficit, thanks to a strong export performance and the government's action to reduce its borrowing requirement. These developments are mirrored in a more balanced net lending position of the private sector (Graph 6). The necessary deleveraging by domestic banks diminished also lending to almost all productive sectors. However, this is to some extent counterbalanced by increased borrowing from foreign credit institutions and financing directly provided by the market. In particular, foreigners hold more Portuguese corporate bonds, which can be interpreted as a sign of confidence (Graph 7).

**Graph 6: The private sector reaches a balance net lending position (% of GDP)**



Source: National Statistics Institute

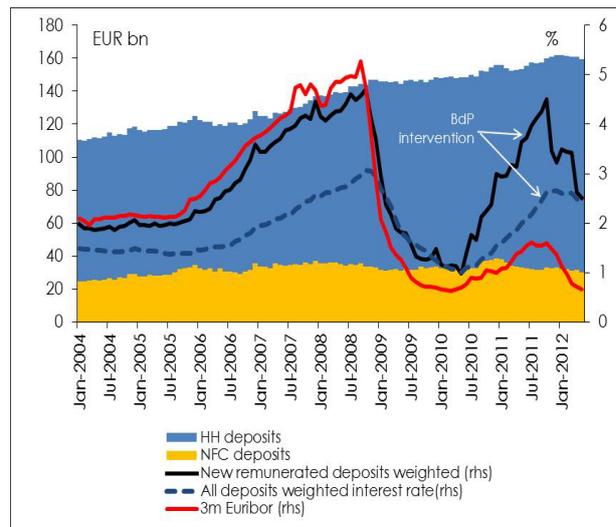
**Graph 7: Corporate lending by source (EUR bn)**



Source: Bank of Portugal

**16. Aggregate deposits remained stable in the second quarter, after an increase by 4.6 percent annually since programme start in May 2011.** The deterioration of the economic climate led to a rise in precautionary savings. Furthermore, banks persuaded customers to reinvest expiring life insurance and mutual fund products into term deposits yielding comparatively high interest rates. The remuneration of deposits impacts directly on the net intermediation margin. To protect the latter, banks increased the cost of loans. In November 2011, the Banco de Portugal (BdP) effectively achieved a change in trend through obliging banks to withhold extra capital if savings were remunerated 300 basis points above the equivalent Euribor rate. In February 2012, the measure was harshened to 225 basis points for shorter maturities (Graph 8). Notwithstanding the lower remuneration on offer, monthly deposits remained flat at the aggregate level. Compared with May 2011, companies' term and sight deposits fell by

**Graph 8: Deposits and their remuneration**



Source: Bank of Portugal, Reuters

9.1 percent. This reflects that the corporate sector runs down deposits as a substitute for corporate loans, which are difficult to obtain and highly expensive. By contrast, household deposits increased by 8.8 percent over the same time-span, reflecting higher savings and a continued trust in the Portuguese banking system.

**17. The trend of tighter credit conditions seems to have petered out in the second quarter of 2012.** Only one bank reported more restrictive credit supply conditions in the second quarter of 2012, which contrasts with earlier quarters where credit tightening was almost universal. For companies, a move towards shorter loan maturities, more restrictive loan covenants and tighter collateral requirements was observed. Demand for company loans declined marginally in the second quarter but some banks forecast a slight rise between July and September. Lower funding needs for fixed investment were counter-balanced by higher working capital and inventory financing. Concerning loans to households for house purchases, requirements regarding the loan-to-value ratio became stricter. The deteriorating outlook for the housing market led to lower demand and tighter conditions for mortgage loans. For consumer credit, a moderate tightening dovetailed with reduced demand. Lower spending on durable consumer goods was the most important factor contributing to the reduction in the demand for consumer loans. According to Portuguese banks the tensions in the European sovereign debt market were among the most important factors explaining banks' deteriorating funding conditions resulting in tighter credit standards applied on loans to the nonfinancial private sector.

**18. In the first half of 2012, profitability was hit by impairments on bad debt.** The country's sharp economic contraction is taking its toll on banks' results (Table 6). The continuous rise of non-performing credit – currently at over 9 percent, double the 2010 levels – and the associated bad debt impairment charges (rising by almost a third from a year ago) are by far the most detrimental profitability developments of the past six months. Banks also struggle to maintain their core revenue (-6 percent on an annual basis) as their net interest income<sup>5</sup> is squeezed by the generous rates offered on deposits on the one hand and the steep fall in the short term yields, and banks' limited ability to reset credit rates on the other hand. Domestic core performance remains poor across the board. Nonetheless it is compensated, to a certain extent, by the better than expected portfolio investment results and the banks' international presence, which remains a key growth driver for some Portuguese credit institutions. On the downside, banks with exposure to Greek debt had to book additional provisions and effective losses, which depressed their net profits.

<sup>5</sup> The difference between interest paid on deposits and those charged on loans

**Table 6: Soundness indicators of the Portuguese banking system**

	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2
Return on equity (1)	6.0	7.2	7.6	7.1	6.7	6.2	4.3	2.4	-3.8	2.2	-1.1
Gross income on assets	2.8	2.5	2.6	2.6	2.7	2.4	2.5	2.5	2.5	2.5	2.7
Cost to income ratio	56.8	57.7	57.1	57.2	57.6	59.1	58.3	59.0	61.4	55.8	53.6
Non-performing loans	4.8	5.4	5.5	5.8	5.2	5.5	6.2	6.9	7.5	8.2	9.0
Coverage ratio	59.0	63.2	62.9	60.8	61.5	60.7	57.7	55.3	56.7	53.0	51.9
Capital adequacy ratio (2)	11.6	11.3	10.9	11.0	11.1	11.4	11.0	10.1	10.7	10.7	12.3
Core tier 1 ratio (3)	7.9	7.8	7.8	8.0	8.1	8.4	8.7	8.5	9.6	9.6	11.3
Loan-to-deposit ratio	161.5	163.4	166.6	158.4	157.8	156.7	149.7	146.2	140.2	137.5	137.1

Note: (1) Income before minority interests /Average shareholders' equity before minority interest

(2) Excluding the banks in resolution

(3) The Core Tier 1 ratio according to Programme definition and excluding the banks in resolution

Source: Banco de Portugal

### III. PROGRAMME IMPLEMENTATION

**19. The implementation of the Programme is broadly on track.** Authorities are implementing significant fiscal consolidation efforts. Acknowledging that the failure to meet the 2012 deficit target of 4.5 percent of GDP and negative carry-overs into 2013 are mostly owed to macro-economic factors outside the control of the government, the mission proposed an adjusted deficit path of 5.0 percent of GDP in 2012, 4.5 percent of GDP in 2013, and 2.5 percent of GDP in 2014, to strike a balance between the need for moving public finances to a sustainable path and the risk to the macro-economy. The government is committed to implementing strict consolidation measures and to rebalancing the consolidation towards the expenditure side. Improvements in public financial management are aimed at tighter spending controls, risk assessment and the application of corrective action in case of deviations. Significant advances are also being made in the tax administration, in addressing fraud and tax evasion and the reinforcement of the tax appeals system. An ambitious reorganisation of the public sector is moving ahead swiftly while shadow budgeting through PPPs, SOEs and other public bodies is increasingly monitored and reduced. Over the past few months also major steps have been undertaken towards raising the efficiency of local and regional governments, including a redrawing of administrative borders. The settlement of arrears has begun, but controls to limit the build-up of new arrears need to be tightened.

**20. The adjustment of the banking system is proceeding, with orderly deleveraging of the economy remaining the key objective.** Banks are expected to meet the Core Tier 1 Programme target of 10 percent by end-2012. The recent recapitalisation of the four largest banks has injected more than EUR 7 billion into the system, with two banks drawing on Bank Solvency Support Facility, the backstop created under the Programme. Financing conditions of the Portuguese economy remain tight. The exceptional liquidity support provided by the Eurosystem is playing a pivotal role in easing liquidity pressures and mitigating potential constraints to bank lending. Measures are under preparation to facilitate credit to productive firms, in particular SMEs, while continuing to ensure that these steps do not burden or pose risks to public finances. Progress is being made towards strengthening the early intervention and resolution framework, while the legal framework for corporate debt restructuring has been further improved.

**21. Portugal is overall advancing with reforms to raise competitiveness, employment and the growth potential but further progress is necessary in a number of areas.** The revised Labour Code entered into force in August this year and will be followed by some further important reforms of labour market institutions that remain to be implemented to create a better functioning labour market. The judiciary reforms in the areas of civil procedure and court organisation, which will speed up civil and commercial litigation and unclog the court system, are progressing well. On network industries, certain progress has been made since the beginning of the Programme but a number of bottlenecks are still to be tackled. On services, progress is steady but major efforts are still necessary to reduce administrative burden and set a more-friendly business environment. Access to finance for Small and Medium Enterprises remains a major constraint for the Portuguese economy and it is at the source of the problems of some exporting companies.

**Table 7: Summary of compliance with policy conditionality for the Fifth Review**

	Status
<b>Fiscal policy</b>	The quarterly quantitative performance criteria on the general government cash balance and debt for Q2-2012 were met. Budgetary execution for the first seven months of the year revealed a deviation in tax revenues and social security contributions of about 2 percent of GDP in 2012, as higher unemployment and the growth composition has become more unfavourable for fiscal consolidation than projected. Given the size of the gap assessed to be outside government control, the targets have been revised with a view to accommodating the negative windfall from the deterioration in the macroeconomic environment. The mission proposed to adjust the deficit targets to 5.0 percent of GDP in 2012, 4.5 percent in 2013 and 2½ percent of GDP in 2014.
<b>Financial sector</b>	In an effort to improve the functioning of the Portuguese money market, the Bank of Portugal set up a domestic trading platform. As part of its normal supervisory tasks, a follow-up of the on-site inspection programme has been launched focusing on the loan portfolio which is sensitive to the business cycle. The recovery of the assets of BPN which have been transferred to the SPV is disappointing and its management will be outsourced through a competitive bidding process. The regulation concerning bank resolution including recovery plans, bridge banks and a resolution fund are being finalised. The framework for out-of-court restructuring of household and corporate debt has been established.
<b>Fiscal-structural</b>	<p><u>Public finance management:</u> The authorities remain committed to reform the Budget Framework Law by the end of the year to include the new EU fiscal governance rules. The Public Finance Management strategy document outlining the reform priorities over the next three years will be finalized shortly. A focus will be on further reducing budgetary fragmentation, notably by streamlining the services and autonomous funds (SFAs) sector.</p> <p><u>Arrears:</u> Overall performance is below expectations. All conditions for applying the commitment controls law are now in place, but implementation is only being gradually completed. The observed decline in arrears is driven by the settlement programme for the stock health sector worth EUR 1.5 billion. Reporting should be strengthened to better appraise the evolution of the stock and the flows of arrears.</p> <p><u>Revenue administration:</u> The implementation of several reforms to modernise and increase efficiency of the revenue administration continues, notably the exchange of information between the collection units of the Tax Authority and the social security. A plan that reinforces VAT invoicing mechanisms, aimed at improving control and fighting non-compliance, has been approved and will come into force as from 1 January 2013.</p> <p><u>Regional and local government reform:</u> Progress towards reforming the regional and local financing laws is broadly satisfactory. The law on the administrative reorganisation of local entities entered into force, allowing for the reduction in the number of parishes by 23 percent before 2013 elections. The laws on the governance of local SOEs and the reduction in the number of management positions and administrative units will help contain fiscal risks and improve public finance management at local level. The second evaluation of the adjustment programme of Madeira reveals a significant degree of non-compliance.</p> <p><u>Public sector reform:</u> The final report on the implementation of PREMACE to reduce the number of management positions and administrative units is expected in September. The cost/benefit analysis on foundations will lead to the extinction and the reduction of State transfers to a considerable number of institutions yielding savings of about EUR 40 million in 2013. The proposal to reform the public employment regime to enhance mobility and flexibility has been submitted to Parliament. The study on wage scales in the general government has been awarded to an international consulting group and the methodology has already been developed.</p> <p><u>SOEs and PPPs:</u> Progress in SOEs' operational restructuring was made in the first half of the year towards reaching the objective of operational balance of SOEs, on aggregate, by the end of the year. The draft law to strengthen SOEs governance and enhance the monitoring powers of the Ministry of Finance over all SOEs (including</p>

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local SOEs) has been submitted to Parliament. The government is further assessing options for managing the heavy debt load of SOEs, including Parpública. The new legal and institutional framework for PPPs is in force and the PPP technical unit in the Ministry of Finance is expected to be fully operational by the end of the year. The renegotiation of road sub-concessions was completed. Following the study on 36 PPPs, a detailed strategic plan for further PPPs' renegotiation is expected to be developed in full compliance with applicable EU law including Public Procurement law before the sixth review.

Privatisation: The sale of CGD's health insurance is foreseen to be completed in 2012. The sale of ANA and TAP is expected to be signed before the end of 2012 and fully concluded at the beginning of 2013. The privatisation programme will be expanded to include additional companies and assets for sale or concession in 2013.

Health: Policy implementation is broadly in line with Programme deadlines and produces significant savings. These result in particular from the revision of the co-payment system, new rules on prescriptions and centralised purchasing of pharmaceuticals, services outsourced to private providers, and hospital restructuring.

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

Labour market and training: Extension of collective agreements will need to meet a set of criteria before an extension to non-signatory parts could be considered. Only collective agreements concluded by employers' associations employing at least 50 per cent of the workers in the sector will be considered for extension. Severance payments will be reduced to 8-12 days per year of work, which will make them more aligned with other EU countries. A fund will be created to partly finance them. The report carried out on Active Labour Market Policies (ALMPs) reveals that employment measures were more effective than training measures. Among the training measures, short term training revealed the most effective. The authorities are using these results to improve the mix of ALMPs. In addition, the Portuguese authorities are starting the implementation of the Action Plans on secondary school and vocational training.

Energy: The plans for the reduction of electricity costs and the tariff debt elimination are ongoing at a satisfactory pace. The revision of different schemes will entail saving of at least EUR 1275 million up to 2020. They will be complemented by the allocation of revenues from CO<sub>2</sub> licences, which are expected to yield about EUR 1930 million to the electricity system up to 2020. The efficient functioning of the electricity and gas markets after their full liberalisation in January 2013 is at risk because the revised by-laws of the functioning of the energy regulator (ERSE) do not ensure its full independence and autonomy.

Telecommunications and postal: Delays related to the designation and concessions of the universal service providers are overshadowing progress achieved in these markets. The Law 35/2012 of 23 August approved the Compensation Fund designed to reimburse the universal service provider(s) net costs. A concession agreement with postal operator CTT is expected to be adopted swiftly.

Transport: The government has announced a comprehensive strategy to significantly reduce costs in Portuguese ports by around 25-30 per cent over the next years. Its firm and complete implementation will be critical to tackle the existing bottlenecks and trigger significant short-run gains in the competitive position of Portuguese ports. In the railway sector, the transfer of CP Carga terminals to an independent entity (unbundling) is a matter of urgency.

Services, qualifications and professions: The full transposition of the Services Directive and the deregulation of professions are advancing at a steady pace. An additional number of legislation of specific sectors concerned by the Services Directive has been adopted since the previous review bringing the total number of legal regimes adopted by the Council of Ministers to 45. In addition, the amendment to Law 9/2009 was published in Law 41/2012 of 28<sup>th</sup> of August. Finally, the government has submitted to Parliament a new horizontal framework law aimed at lowering the degree of regulation of highly regulated professions governed by professional bodies such as lawyers, accountants or architects. Work on developing the Point of Single Contact as envisaged by the Services Directive and making operational the Zero Licensing Project has been slowed down.

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<b>Reform of framework conditions</b>	<p><u>Housing market</u>: The law for amending the urban rental legislation was published in the Official Gazette and will enter into force on 12 November.</p> <p><u>Judicial system</u>: Reforms are still advancing according to the agreed schedule: backlog clearance is making progress, nearly 100 000 enforcement cases being closed so far; a roadmap to adjust court districts was prepared and the relevant legislative proposal is expected by end-November; the legislative proposal for the new Code of Civil Procedure is expected to be submitted to the Parliament by end-November.</p> <p><u>Business environment</u>: The government is committed to take additional measures to facilitate access to finance of Small and Medium Enterprises (SME). In addition, a number of specific measures to reduce licensing requirements has been introduced in the Memorandum of Understanding.</p> <p><u>Obstacles to free movement of capital / special rights</u>: The sale of the 1 percent share of CGD in Galp has been further postponed, thus maintaining a situation of special rights by the State.</p>
<b>Data submission</b>	Requirements under the Programme have been observed. Work is ongoing to improve further data submission.

## FISCAL POLICY

### *Budgetary execution in 2012 and the fiscal targets*

**22. The quarterly quantitative performance criteria on the government cash balance and on the stock of government debt for end June 2012 were met.** The achievement of the June ceiling on the cash balance was possible due to nominal spending reductions, despite the deviation in tax revenues and social security contributions as described above. However, the indicative target of non-accumulation of arrears by the general government sector was not met (see also Table 7 above).

**23. In spite of tight spending controls and favourable one-off factors, the deficit targets of 4½ percent of GDP in 2012 and 3 percent of GDP in 2013 are no longer achievable.** Expenditure has developed according to plans, with higher-than-budgeted savings on compensations of employees. Moreover, lower net interest payments, the reprogramming of EU structural funds and, possibly, one-off revenues from an airport concession will help to partly offset the revenue shortfalls. Despite these savings, a fiscal gap to the 4½ headline target of about ½ percent of GDP will remain in 2012. This gap may increase by another ¾ percent of GDP if the planned sale of an airport concession is not classified as a deficit-reducing transaction by the statistical authorities. As some of the deficit-reducing factors in 2012 are one-off, the 2012 gap translates into a carry-over of about 1.5 percent of GDP in 2013 caused by the shrinkage in tax revenue bases and labour market developments. Given the size of the gap assessed to be outside government control, the mission proposed to revise the fiscal targets with a view to accommodating the negative windfall from the deterioration in the macroeconomic environment.

**24. In view of the large revenue shortfalls and the more subdued growth outlook, the mission proposed to adjust the deficit targets to 5.0 percent of GDP in 2012, 4.5 percent in 2013 and 2½ percent of GDP in 2014.** The new targets have been carefully calibrated to allow the partial working of automatic stabilisers and facilitate the ongoing internal adjustment of growth towards net exports alongside a sustained implementation of the budgetary and structural reform programmes. The revised targets still require significant consolidation efforts in 2013 and 2014 of 3 percent and 1¼ percent of GDP, respectively. They ensure that over the medium-term the debt-to-GDP ratio will be on a steady downward path.

**25. With the budget deficit for 2012 currently projected at 5.3 percent of GDP, the authorities are taking measures to bring down the deficit to 5 percent of GDP.** These include the freezing of some budget appropriations, raising stamp duties on high value properties, higher tax rates on investment income and a frontloading of some of the 2013 budgetary measures and other measures generating savings in intermediate consumption and revenues from sales. Additional savings in compensation of employees amounting to 0.1 percent of GDP are also expected as an offsetting factor. These measures are expected to reduce the deficit by about 0.3 percent of GDP. There are, however, negative risks to the 5 percent deficit target, particularly if the sale of the airport concession is not classified as a deficit-reducing measure by the statistical authorities. The transaction is estimated by the government at about 0.7 percent of GDP and a classification 'below the line' would thus increase the 2012 deficit by this amount.

**26. Permanent consolidation measures of about 3 percent of GDP were identified to reach the revised deficit target in 2013 (see Table 7).** On the expenditure side, savings amount to 1.6 percent of GDP and include a further decrease in the wage bill mainly through reduction in number of public employees, a reduction in intermediate consumption, a cut in social transfers, a further rationalisation in the health sector and reduced spending on capital formation. On the revenue side, the measures total some 1.3 percent of GDP and include, inter alia, broadening the tax bases of personal and corporate income taxes by eliminating some tax expenditures, increasing the investment income tax rate, changes in property taxation and a rise in excises duties.

**Table 8: Discretionary measures, 2013**

2013	Fifth review
	% of GDP
<b>Revenue Measures</b>	<b>1.3</b>
Consumption tax	0.1
Property taxes	0.4
Direct taxes	0.8
Social contributions	0.1
PIT structure reform (reinstatement of one public wage and pension)	0.8
<b>Total revenue measures</b>	<b>2.1</b>
<b>Expenditure Measures</b>	<b>1.6</b>
Compensation per employee	0.4
Intermediate consumption	0.1
Social transfers and subsidies, incl. health sector	1.0
Investment	0.1
PIT structure reform (reinstatement of one public wage and pension)	-0.8
<b>Totalexpenditure measures</b>	<b>0.8</b>
<b>Total measures</b>	<b>2.9</b>

\*no-policy change relative to previous year

#### Box 1: PUBLIC PRIVATE SECTOR WAGE GAPS

Correcting for the substantial fiscal imbalance in Portugal imposes a high burden on the Portuguese society. The primordial principle of such a large adjustment should be economic efficiency—fiscal policy should be growth-enhancing and facilitate moving economic activity from domestic demand to exports. On the other hand, the package of measures must pay respect to equity considerations.

On 5 July 2012, the Portuguese Constitutional Court ruled that the suspension of holiday and Christmas bonuses (13<sup>th</sup> and 14<sup>th</sup> monthly salary) for public sector workers and pensioners, a measure that was adopted with the Budget Law 2012, was unconstitutional. The ruling was based on the opinion that this measure puts too much burden on public sector employees and pensioners while sparing other societal groups and was therefore unbalanced from an equity perspective.

Clearly, the measure imposes a large burden on public sector workers and pensioners. However, it must be viewed in the context of the overall package of measures in the framework of the adjustment programme. Taking a broader view shows that the programme attempts to maintain a social balance as a variety of measures affect a much larger part of the population. These measures include, *inter alia*, cuts in social benefits, an increase in consumption and excise taxes, a solidarity surcharge on high incomes, an increase in the tax rate of dividends and capital gains, an increase in the taxation of luxury goods or the planned high-value property tax. Focussing exclusively on one measure provides a misleading picture of the actual burden on the various group of the population.

Moreover, when judging how public sector workers and pensioners are burdened compared to their private sector peers one should also consider their initial position before the introduction of the measure. A recent study\* comparing wages in the public and private sector in the pre-crisis period in euro area Member States provides interesting insights in this respect. The results of the study are summarised in Table I. The numbers represent the wage premium of the public sector over the private sector in percent of the average wage in the private sector. It shows that in terms of monthly wages, in Portugal public sector workers received a 47 percent higher pay (column 'Raw' –'Monthly') than the private sector. This premium is substantially larger than in other euro area countries. Moreover, since working hours in the Portuguese public sector are lower than in the private sector the premium increases markedly, to 77%, when hourly wages are compared (column 'Raw' – 'Hourly').

One of the reasons for the public sector premium is that the average qualification level of public sector workers is higher than that of private sector workers. For this reason, a comparison between the sectors needs to correct for such differences

in educational attainment but also other individual and job-specific characteristics such as work experience, job status, etc. The columns labelled 'Corrected' show public sector wage premiums adjusted for such differences. While this correction reduces the public sector wage premium, it remains substantial at more than 20% in the case of hourly wages. Short working hours in the public sector are again one of the reasons for the large wage gap. The education sector and the high-income group stand out as enjoying particularly large premiums. Furthermore, the public sector enjoys the benefit of a usually much better protection from dismissal than the private sector, which is a significant benefit during the current downturn.

**Table I: Public sector wage premium 2004-2007 (in % of the average wage in the private sector)**

	Raw		Corrected*							
	Monthly	Hourly	Monthly	Hourly						
	All	All	All	All	Sector			Income level		
					PA	Educ.	Health	Low	Medium	High
AT	12	24	10	10	5	25	7	13	5	21
BE	-1	12	4	5	7	6	2	5	5	5
DE	16	19	15	11	11	9	-6	22	12	8
ES	28	44	17	25	24	34	17	12	18	34
FR	-1	15	3	5	6	5	5	4	6	6
GR	24	49	16	21	19	35	15	16	19	26
IE	25	42	16	19	19	32	9	5	13	30
IT	17	38	13	19	16	26	16	16	20	22
PT	<b>47</b>	<b>77</b>	<b>11</b>	<b>21</b>	<b>24</b>	<b>28</b>	<b>11</b>	<b>16</b>	<b>9</b>	<b>41</b>
SI	26	28	10	11	13	15	6	2	18	3

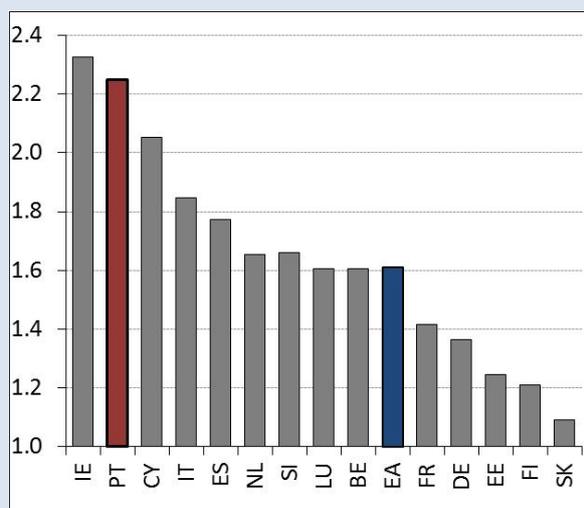
Corrected: Correcting for individual and job characteristics such as education, age etc.

PA: Public administration; Educ: Education sector

Source: Giordano, R. et al, ECB Working Paper No 1406 / December 2011

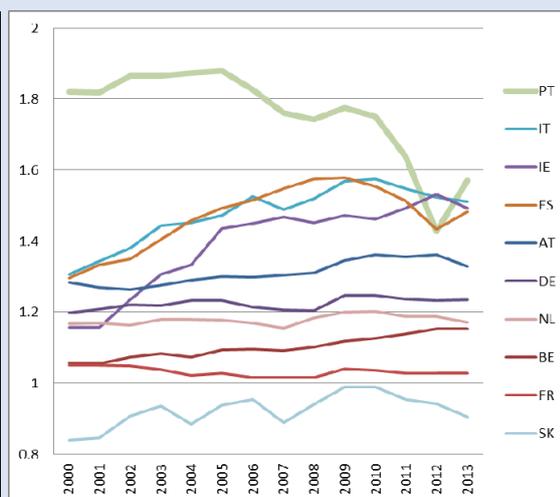
While programme implementation has acted to change the balance between public and private sector workers, a significant wage advantage in the public sector persists. In 2011, the ratio of compensation per government employee to GNP per capita remains the second highest in the euro area (Graph I). These figures already incorporate a substantial reduction of public sector compensations as a result of the budget consolidation. Using the ratio of public to private sector compensation per employee as another measure shows that the relative overpayment of the public sector in Portugal has come down but remains at the high end in a euro area comparison even after the cuts in the holiday and Christmas bonuses in 2012 (Graph II). As requested by the programme, the government is preparing a review of the wage scales in the general government by the end of the year, to identify unwarranted differences in remuneration between the public and the private sector for similar types of qualifications. A comprehensive study for SOEs will follow in 2013. The results of these studies should translate into policies aimed at increasing transparency and efficiency of remuneration of the public sector.

**Graph I: Compensation per government employee relative to GNP per capita in 2011**



Source: OECD and Commission services

**Graph II: Ratio of public to private compensation per employee**



Source: Commission services estimates and projections for 2013

\*R Giordano, D. Depalo, M. Coutinho Pereira, B. Eugène, E. Papapetrou, J. Perez, L. Reiss, and M. Roter: The Public Sector Pay Gap in a Selection of Euro Area Countries, ECB Working Paper No 1406, December 2011

**27. Further measures will be adopted to offset the Constitutional Court's ruling to annul the suspension of the holiday and Christmas bonuses of public sector workers and pensioners from 2013 on.** In response to this judgment the government plans to reinstate one extra payment in 2013. The additional expenditure of an estimated  $\frac{3}{4}$  percent of GDP will be financed by a revision of the personal income tax structure resulting in a reduction of the number of brackets combined with a general surcharge of 4 percent of taxable income and a 2.5 percent solidarity tax the highest tax bracket. This measure is expected to yield total revenue of  $1\frac{1}{4}$  percent of GDP. In addition to the  $\frac{3}{4}$  percent of GDP from the reinstatement of one extra payment of public sector wages and pensions the measures should also compensate for revenue losses due to the abolition of previously planned increases in social security contributions and personal income taxes of about  $\frac{1}{2}$  percent of GDP. The measure should be calibrated respecting the yields expected through other measures aimed at broadening the PIT base described above. However, the fact that the overall balance of the fiscal consolidation in 2013 is now significantly tilted towards the revenue side would caution against taking the estimated yield at face value. First, the adverse impact of the fiscal retrenchment on growth could turn out stronger than currently estimated. Second, as witnessed also in 2012 tax bases could shrink more rapidly as a result of endogenous shift in the distribution of income classes. To provide a buffer against negative surprises the government should prepare in the framework of 2013 budget proposal a set of contingency measures, predominantly on the expenditure side, which could be used in case of need. In addition, the government will explore ways to increase the weight of expenditure reducing measures in the 2013 budget to ensure a medium term growth friendly fiscal adjustment.

**28. The deficit reduction in 2012 and 2013 is hampered by an adverse macroeconomic environment.** The impact of the consolidation package put forward with the 2013 budget will to some extent be offset by unfavourable developments in economic activity in 2013. Moreover, the dissipation of the net effect of the one-off transactions in 2012 amounting to about 1 percent of GDP (among the one-off measures deficit-decreasing are the BPN pension fund transfer, the extraordinary 3.5 per cent temporary surcharge on the 2011 taxable income, the revenue from the spectrum auction and the sale of the airport concession). Furthermore, these developments are expected to be reinforced by an important increase in interest expenditure (see Table 9).

**Table 9: Arithmetic of the government deficit: from the deficit in one year to the next**

	(+) means balance-improving impact; (-) means balance-reducing impact	% of GDP
<b>2010 balance (observed)</b>		<b>-9.8</b>
Primary balance drift in 2011		1.6
Change in interest expenditure		-1.0
Dissipation of one-offs and non-recurrent effects from previous year		0.7
New consolidation measures		4.3
<b>2011 balance (estimate)</b>		<b>-4.2</b>
Primary balance drift in 2012		-2.6
Change in interest expenditure		-0.7
Dissipation of one-offs and non-recurrent effects from previous year		-3.2
New consolidation measures		5.7
<b>2012 balance (target)</b>		<b>-5.0</b>
Primary balance drift in 2013		-1.3
Change in interest expenditure		-0.1
Dissipation of one-offs and non-recurrent effects from previous year		-1.0
New consolidation measures		2.9
<b>2013 balance (target)</b>		<b>-4.5</b>

Balance in year  $t$  equals balance in year  $t-1$  plus nominal primary balance drift in year  $t$ , plus the impact of the change in interest expenditure in year  $t$ , plus the impact of the dissipation of the one-offs and non-recurrent measures from year  $t$ , plus the impact of new consolidation measures in year  $t$ .

The Primary Balance Drift includes the change in the balance level that would take place without discretionary measures. It includes the impact of economic activity on the balance and the structural increase in expenditure in real terms, e.g., the increase in pension expenditure.

#### *Structural fiscal adjustment 2011-14*

**29. A comprehensive expenditure review to identify the measures to reach a budget deficit well below the target of 3 percent of GDP by 2014 has been put into place.** The authorities are committed to reaching a nominal budget deficit target of 2.5 percent of GDP in 2014 and meeting the medium-term objective of lowering the general government structural deficit below  $\frac{1}{2}$  percent of GDP by 2015. To achieve this objective, further

consolidation measures of about 1¼ percent of GDP will be necessary in 2014. Savings will be generated mainly through expenditure cuts (about EUR 4 billion over two years) which are to be presented in a first draft by the sixth review in November and fully specified by mid-February 2013 in time for the seventh review to be detailed in the 2013 Stability Programme.

**30. Over 2011-2014, the improvement in the cyclically-adjusted primary balance, net of one-off measures, is estimated to amount to 9½ percent of GDP (see Table 10).** The fiscal structural adjustment remains the same under the revised nominal targets, although it will be achieved one year later than initially envisaged in the programme. The consolidation effort in 2013 will constitute the basis for the achievement of a deficit below 3 percent by 2014. In addition, measures of some 2½ percent of GDP will be taken over 2014-15, including through a further broadening of tax bases and a reduction of primary expenditure by further cost rationalisation in the public administration, the SOEs, and the health sector, while limiting cuts in capital spending.

**31. Debt is projected to peak at about 123½ percent of GDP in 2013-2014 and to gradually decline thereafter.** The sustainability assessment of Portuguese debt remains essentially unchanged. As under the original programme assumption, Portugal would achieve a primary surplus from 2013 on, while the cyclical component of the primary balance is expecting to narrow from a level of about 2 percentage points of GDP in 2012 and 2013 to close to zero by 2016. A primary structural surplus of 3 percent from 2016 on appears feasible. Under unchanged assumptions on primary surplus, interest and GDP growth the debt-to-GDP ratio would be on a firm downward trajectory from 2015 onwards. These projections take into account additional sources of debt reduction such as the enhanced privatisation plan presented by the authorities to off-set the impact of the deficit increase, but do not include other instruments contemplated by the government. (Box 2)

**Table 10: Fiscal targets and structural adjustment, 2011-14**

<b>Fiscal indicators</b>				
	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>Programme deficit targets</b>	<b>-5.9%</b>	<b>-4.5%</b>	<b>-3.0%</b>	<b>-1.8%</b>
Planned structural primary balance	-1.5%	2.0%	3.9%	4.1%
Fiscal adjustment (pps)	3.1	2.9	1.7	1.7
<b>Budget deficit, revised targets</b>	<b>-4.3%</b>	<b>-5.0%</b>	<b>-4.5%</b>	<b>-2.5%</b>
<b>Budget deficit, net of one-offs</b>	<b>-7.5%</b>	<b>-6.0%</b>	<b>-4.5%</b>	<b>-2.5%</b>
Primary balance	-0.4%	-0.5%	0.2%	2.5%
Structural balance	-6.3%	-4.1%	-2.5%	-1.2%
Structural primary balance	-2.5%	0.5%	2.2%	3.9%
<b>Planned fiscal adjustment (pps)</b>	<b>3.9</b>	<b>4.5</b>	<b>1.9</b>	<b>0.2</b>
Consolidation measures (MoU)	4.3%	5.7%	2.9%	1.8%

*Note: The planned fiscal adjustment in 2012 reflects the 2012 Budget.*

*The initial Programme design was frontloaded in 2011, the planned adjustment for 2012 being only of about 3 pps.*

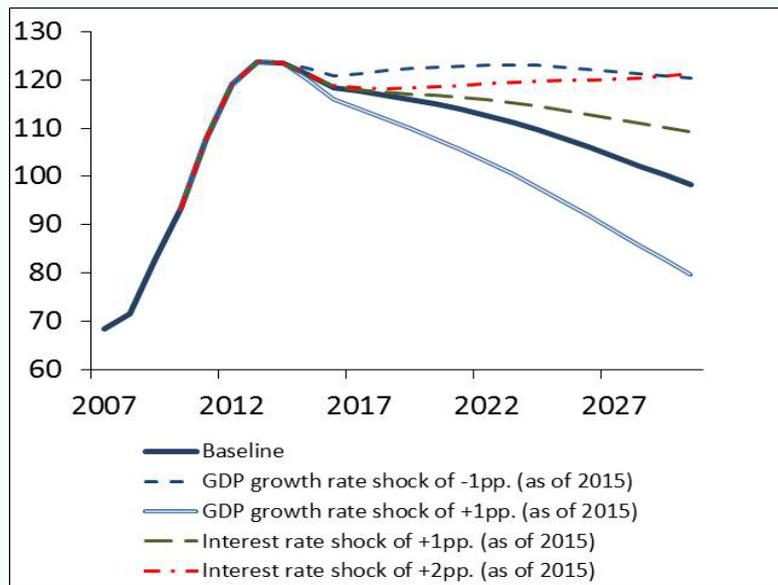
## Box 2: GOVERNMENT DEBT AND FISCAL SUSTAINABILITY IN PORTUGAL

Under the Programme scenario, government debt is projected to peak slightly below 124 per cent of GDP in 2013-14 before starting a gradual decline. The baseline long-term calculations shown below incorporate the Programme scenario up to 2016. The precise calculations for these figures are shown in Table 7 in the annex. The turning point is the result of achieving a primary surplus of over 3 per cent of GDP, combined with a modest GDP growth. After 2016, it is assumed that: (i) the structural primary fiscal balance remains unchanged at a surplus of 3 per cent of GDP; (ii) nominal interest rates are 5 per cent; (iii) nominal GDP growth stays close to 3 per cent (about 2 per cent growth in volume terms plus below 2 per cent inflation); (iv) ageing costs are taken into account according to the projections in the Commission's 2012 Ageing Report; and (v) the expected fiscal impact of PPPs costs and bank recapitalisation costs of EUR 12 billion over the Programme period is factored into the analysis.

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

Graph I illustrates the sensitivity to macro-economic assumptions by considering a shock to real GDP growth and hikes in interest rates as from 2014 and 2015. A lower GDP growth rate or a higher interest rate on maturing and new debt by one percentage point would significantly slow down the pace of debt reduction. The declining debt ratio profile would be jeopardised in the medium-term by either a one percentage point negative shock to the GDP growth rate or a nominal interest rate of about 7 percent as of 2015. Conversely, upside risks to growth in the medium-term given the significant structural reform measures already undertaken may result in visibly lower debt-to-GDP ratios and a higher pace of debt reduction.

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

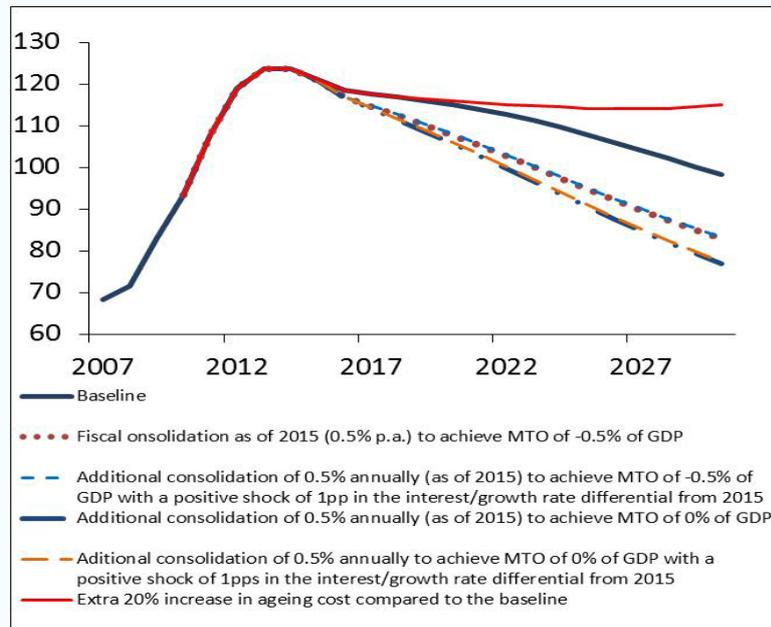


Source: Commission services

Additional fiscal consolidation beyond 2015 and the Programme horizon would clearly accelerate the debt reduction path (Graph II). Additional fiscal consolidation of 0.5 pp. in 2015 would achieve the Medium Term Objective (MTO) of a structural deficit of 0.5 percent by 2015 and would significantly accelerate the fall in the debt-to-GDP ratio, bringing it below 100 percent by 2024. A more ambitious MTO of a balanced structural deficit by 2016 would bring the debt-to-GDP ratio below 100 percent by 2022. On the other hand, if ageing costs are allowed to rise significantly (simulated as a 20 per cent increase), the fall in the ratio would be severely curtailed, stabilising at a high level in the absence of compensating fiscal consolidation.

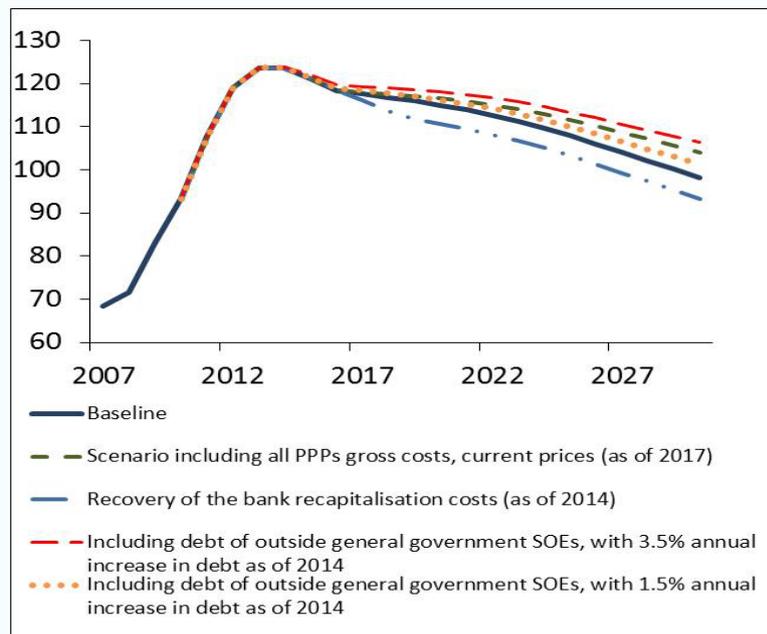
Graph III illustrates the impact of changes in the government perimeter. The inclusion of all gross costs of PPPs and the debt of all state-owned enterprises (SOE) classified outside general government would move the government debt curves noticeably up, especially if further increases in SOE debt are not reined in. On the other hand, privatisation and an effective strategy to reduce SOE debt would contain the budgetary risks from SOE activities. By the same token, a quick repayment of the bank recapitalisation funds to the government by 2020 would quicken the adjustment towards lower debt-to-GDP ratios. The baseline projections already include expectations of a partial recovery of the bank recapitalisation costs in 2014-16.

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



Source: Commission services

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



Source: Commission services

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

## FISCAL STRUCTURAL REFORMS

### *Fiscal policy framework*

**32. The authorities remain committed to incorporating the new EU fiscal governance rules into the Budget Framework Law by the end of the year.** A dedicated EC technical assistance mission took place in mid-September to discuss options for implementing the EU fiscal governance framework in Portugal and to share European best practices. It builds on an earlier IMF/EC technical assistance mission to provide guidance for the preparation of the strategy document, to strengthen the medium-term budgetary framework in view of the Budget Framework Law review and to assess the degree of implementation of the commitment control law. The Public Finance Management strategy document outlining the reform priorities over the next three years was finalised and will be assessed in the sixth review. An important focus will be on further reducing budgetary fragmentation, notably by streamlining the autonomous funds (SFA) sector.

### *Reduction of arrears*

**33. Progress to reduce arrears remains below expectations despite important efforts to implement the commitment control law.** The main reason is that the detailed rules of the commitment control law were only enacted recently and hospitals and local authorities have only now adopted the necessary IT systems. The decline of arrears in the health sector is largely explained by the settlement programme worth EUR 1.5 billion. New data may also reflect a further decline in the future due to efforts towards lengthening the grace periods in purchasing contracts. Payments of arrears under the Support Programme for Local Authorities (PAEL) – with a total envelope of EUR 1 billion – will only start in November. Better data collection - differentiating between stock and flows - and ensuring a wide coverage will help to assess progress towards controlling the accumulation of arrears.

### *Revenue administration*

**34. Reforms to modernise and increase efficiency of the revenue administration continue.** They include unifying the tax and customs administrations and the information technology service; reducing the number of local tax collection offices by 20 percent (and other 20 percent by 2013) to improve efficiency in the organisation, since Portugal is one of the EU countries with highest number of local tax branches per inhabitant; increasing enforcement capacities by raising the percentage of the auditors to 30 percent of the total revenue administration workforce ; and establishing an organisational unit to manage the tax affairs of the large taxpayer segment (Large Taxpayers Office). Also the temporary task force of judges is established to clear pending tax cases worth more than EUR 1 million by end-2012.

**35. Further measures to fight non-compliance will enter into force in 2013.** As a result of the joint work between the Tax and Customs Authority and the Social Security Administration, a unified monthly return covering withholding information is expected to be adopted as well as a unified form on independent workers' annual revenue, thereby improving control and simplifying compliance. Furthermore, on 1 January 2013 a major reform of the VAT invoicing system will come into force. The reform relies on four pillars: (i) mandatory invoicing for all sectors and transactions; (ii) a centralized VAT monitoring database to better keep track of transactions; (iii) a system to electronically monitor goods in circulation; and (iv) a tax incentive for final consumers to ask for invoices in hard-to-tax sectors. These measures represent a change in tax auditing paradigm and should significantly enhance the capacity of the tax administration to access information and strengthen control, thereby contributing to fight fraud and evasion. Investigations to fight non-compliance in direct taxation are currently being particularly targeted towards taxpayers that present large falls in tax collection (e.g. self-employed, corporations), but efforts should be reinforced.

**36. The authorities presented a new plan to reorganize the State's representation in the tax courts.** While preliminary data indicate that the State's efficacy in the tax courts (substantive decisions) is already increasing, the new plan provides for a centralized and increasingly interconnected management of the States representation activities. This is expected to build-up the States track record in terms of balances of cases won/lost, namely as it concerns high-valuable cases.

**37. The revaluation of urban property is progressing while overcoming obstacles.** The number of trained evaluators has been increasing, but delays have built up mainly due to difficulties in accessing the buildings blueprints. The revision of the cadastral value of the housing stock risks running behind schedule, but will not

affect the adjustment of the 2013 property taxes (Imposto Municipal sobre Imóveis), as means would be put in place to ensure that these will be based on the updated values.

#### *Regional and local governments*

**38. Fiscal consolidation and public financial management are being strengthened at local level.** Preparations to reform the local and regional budget laws are progressing despite minor delays, and the end-year target remains within reach. Two dedicated IMF/EC technical assistance missions have already taken place and the scope of the reform goes beyond the Programme requirements. The work of the working group to propose common revenue forecasting guidelines for subnational governments ahead of the 2013 budget has started. Data requirements to support the revenue projections will be identified, balancing the need to preserve tax secrecy and the elaboration of sound revenue forecasts. The law allowing for the reduction in the number of parishes by approximately one quarter is currently being implemented and the process will be finished before the end of 2012. A law improving the governance of local SOEs and a law reducing the number of managers and administrative units will soon enter into force. Given the high degree of political autonomy granted to local governments by the Portuguese Constitution, this process is politically and legally challenging.

**39. The region of Madeira is showing a significant degree of non-compliance with the conditions of the assistance programme with the government.** Although fiscal performance during the second quarter was largely driven by adverse regional economic conditions that led to lower tax-revenues, expenditure reduction is severely lacking. In particular, the 2 percent reduction in public employment is not proceeding at good pace and investment projects still need to be cut. The regional authorities have not yet formulated an adequate strategy for the settlement of arrears which would be fully in line with the national one. The government decided to suspend the payments until effective action was taken by the region.

#### *Streamlining the public sector*

**40. At central level, significant progress in streamlining the public administration is being made.** The reduction of managers and administrative units according to PREMAC [was] concluded in September as requested in the Programme. The evaluation of foundations was completed in early August. The responsible line ministries will decide whether to extinguish individual foundations or cut their public support by less than 30 percent, more than thirty percent or completely. This measure is expected to yield savings of about EUR 40 million in 2013. The government is committed to redouble efforts to reduce the size of the parallel State in line with the requirements of the Programme. Analysis to identify areas of overlap of activities and responsibilities between the decentralised services of the State and local government is ongoing. In addition, the authorities are preparing a Law of Competences to establish the legal framework of the decentralisation process. An international auditing firm is studying the differences in remuneration between the public and private sector for similar qualifications by the end of the year – those of SOEs will follow in 2013. The detailed bulletin on public employment statistics (SIEP) is becoming an essential tool to assess progress in restructuring public employment and attaining the 2 percent staff reduction target for 2012. The scope of the bulletin will be enlarged to cover SOEs.

#### *SOEs, PPPs and privatisations*

**41. The public enterprise sector is seeing a significant transformation.** As restructuring of state-owned enterprises (SOEs) is proceeding at good pace, the objective to reach operational balance by the end of 2012 remains within reach. It should be extended to achieving profits whenever possible over the medium term. In addition, the authorities will assess options for managing the heavy debt load and rising interest costs of SOEs, including the Parública state holding. The authorities expect the privatisation of the national air carrier (TAP) and the airport operator Aeroportos de Portugal (ANA) to be signed by the end of this year. CGD's health insurance is planned to be sold in 2012. The privatisation programme will be expanded to include additional companies and assets for sale or concession in 2013. Throughout the process, the authorities remain committed to consult the European Commission to ensure respect of competition and state aid rules.

**42. The legal and institutional framework for Public Private Partnerships (PPPs) has been reinforced with a view to containing fiscal risks.** The new legal and institutional framework for PPPs is in force and the PPP Technical Unit in the Ministry of Finance is expected to be fully operational by the end of the year.<sup>6</sup> Regions will be encouraged to design a framework with similar requirements. New PPPs will only be launched

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<sup>6</sup> Decreto-Lei N° 111/2012, of 23 May, Diário da República, 1ª série – N° 100

after the new regime is fully effective in order to end malpractices and legal uncertainties in PPP arrangements which have led to a substantial financial burden for the taxpayer.

**43. The authorities will develop a detailed strategic plan for the renegotiation of PPPs.** For road sub-concessions, the renegotiation process is already complete. Savings deriving from scope reduction on investment, operation and maintenance costs over the project lifespans are expected to reach EUR 1 billion (in net present value terms), starting from 2014. Based on the comprehensive study for 36 PPP contracts prepared by an international auditing firm in end-June, a detailed strategic plan for renegotiations will be developed in time for the sixth review, aiming to obtain substantial fiscal gains, while minimising the debt burden, and ensuring a sustainable reduction in government liabilities. The legal implications of the renegotiations will be carefully assessed including the respect of public procurement legislation.

#### *Healthcare sector*

**44. Policy implementation is continuing broadly in line with MoU's deadlines and is starting to produce important savings.** Savings result in particular from the revision of the co-payment system, new rules on prescriptions and centralised purchasing of pharmaceuticals, services outsourced to private providers, and hospital restructuring.

**45. Regarding pharmaceuticals, a wide set of measures has been implemented.** This includes compulsory e-prescription and INN prescription, changes in pharmacies mark-ups, changes in the international reference price system and in the pricing of generics, removal of administrative and legal hurdles to entry of generics, prescription guidelines and regular monitoring of prescription behaviour and feedback to physicians. These measures are leading to important savings in outpatient public spending (-7.7 percent year-on-year in the first half of 2012). They are also contributing to a reduction in the private pharmaceutical spending (-8.8 percent for the same period). As these measures have been implemented only recently, one can expect the savings to be even higher next year. Savings on pharmaceuticals in hospitals have been slower to materialise (-1.2 percent year-on-year in the first half of 2012), though recent centralised tenders may potentially lead to important savings. Together with the agreement made with the pharmaceutical industry (which includes a "clawback" of up to EUR 300 million for 2012), these measures are likely to ensure the attainment of the MoU target for 2012, which is a reduction in expenditure to 1.25 percent of GDP.

**46. Regarding primary care, authorities are taking steps to ensure that all the population is served by family doctors and that health services are used in a more rational manner.** More family care units (USFs) opened (29) and will open (27) in 2012 and the patient registries for family doctors are being updated. The set-up of the electronic medical record now has to be rolled out through NHS facilities. These steps are important for a rational use of services and an improved quality, including by avoiding duplication or unnecessary use of services (diagnostics, emergency care). The revision of the co-payment system also contributed to reducing the use of emergency care while increasing the use of primary care. Revenues from co-payments doubled: about EUR 80 million in the first half of 2012 (EUR 37 million in the first half of 2011).

**47. Regarding the hospital sector important savings have been realised.** Operational costs of hospitals were reduced by 10 percent in 2011 (EUR 290 million) and by an additional 8.7 percent in the first half of 2012 (EUR 228 million). These savings are in line with MoU targets (15 percent reduction over 2011-2013). Authorities confirmed their commitment to implementing a hospital reform which includes hospital reorganisation and changes to hospital financing and hospital performance measurement. They will present the plan for the restructuring of the hospital network in November. Meanwhile, some measures have already been implemented as several hospitals have been merged into existing hospital groups, resulting in the concentration of medical departments and laboratories, along with a reduction of beds and overtime.

**48. Regarding the reform aiming at making public healthcare sub-systems (ADSE, SAD, ADM) self-financed by 2016, little has been done so far.** There has been a small reduction in spending and effort has been put in negotiating prices with providers. However, the agreed cut in the transfers from the public budget has not taken place.

## FINANCIAL SECTOR

**49. Banks have reinforced their capital levels to comply with stricter regulatory requirements.** Capital needs were predominantly driven by the regulatory capital buffers required by the European Banking Association (EBA) to address market concerns over sovereign risks. Four Portuguese banking groups (CGD, BCP Millennium, Banco BPI and ESFG) were subject to the EU wide capital exercise led by EBA and the resulting additional core tier 1 (CT1) capital buffers requirements in order to comply with the 9 percent CT1 EBA threshold by end June 2012. The capital augmentation for these four banking groups was a sizeable EUR 8.2 billion. In addition, the top eight Portuguese banking groups were required to accommodate the one-off prudential impact of the Special Inspections Programme (SIP) and the partial transfer of banks' pension funds to the Portuguese Social Security System. Given the difficult operating environment, only one major bank was able to accommodate for all of its additional capital needs through private means, whilst the three other had to resort either to the Portuguese government directly or tapped the EUR 12 billion strong Bank Solvency Support Facility (BSSF) created under the financial assistance programme which catered for roughly half the capital increase.

**50. A crisis management toolkit has replaced the credit institutions' reorganisation regime previously in force.** Under the new intervention regime the central bank will be able to intervene in a credit institution or investment firm in financial distress. The intervention range may take several forms and stages going from the simple corrective intervention to the most intrusive step, i.e. the appointment of an interim administration and/or adoption of resolution measures. Generally, the aim of the measures set out under the new framework is the recovery of the distressed institution; however, where the recovery becomes unrealistic, the central bank will prepare for an orderly winding-up of the institution through the total or partial sale of the assets to another authorised credit institution and/or through the setting up of one or more bridge banks that would ensure the continuity of entities deemed to be systemically important. The resolution process will be accompanied by funding from a dedicated bank resolution fund, which will be financed by an initial contribution and from bank levy proceeds (some EUR 150-200 million per year) from 2013 onward, supplemented by annual contributions by participant institutions. The framework also foresees that each bank in the system will prepare its own recovery plan, which becomes a requirement for the top eight banks from January 2013 onward and for the remaining banks from November 2013 onward.

**51. The sale of Banco Português de Negócios (BPN) to a foreign bank was completed in March.** Before the sale bad assets were transferred to three special purpose vehicles (SPV): Doubtful loans into Parvalorem, financial assets into Parups and former intra-group entities into Parparticipadas. Parvalorem holds loans with a nominal value of EUR 3.6 billion, 80 percent of them non-performing. Recoveries in 2012 add up to EUR 35.7 million until July, i.e. 1 percent of the nominal amount outstanding and 12 percent worse compared to the same period in 2011. The combined book value of BPN intra-group subsidiaries in Parparticipadas reads EUR 44 million. These entities will be partly sold and partly liquidated. Parups financial assets amount to EUR 933 million after provisions. In 2010 and during the sale negotiations the buyer obtained the right to also transfer non-performing assets to these SPVs until December 2012.

**52. The SPVs are run by former BPN staff, which has failed to realise any significant recoveries from these assets.** Beyond the adverse market circumstances, the incentive structure for the staff is sub-optimal as successful recoveries would imply dissolving the SPVs. To remedy the situation, the government will run a Europe-wide call for tender for managing these assets. Given the relatively large amount, the government is open to several solutions ranging from a single contract covering all the assets to splitting the management into a number of lots. In order to allow for extensive due diligence the government intends to launch the process in October and finish by March 2013. Caixa Geral de Depósitos (CGD) state-guaranteed claims will be gradually settled in cash and any net recoveries from the SPV will add to CGD's reimbursements.

## STRUCTURAL REFORMS

### *Labour market*

**53. Following the entry into force of the revised Labour Code, the authorities are finalising proposals for a further reduction in severance payments and for setting criteria for extensions of collective agreements to non-signatory parts.** Severance payments, now at 20 days per year of work, will be reduced to 8-12 days per year of work, which will make them more aligned with the practices in other EU countries. A fund will be created to partly finance severance payments. Extension of collective agreements will need to meet a set of criteria before an extension to non-signatory parts could be considered. Only collective agreements concluded by

employers' associations employing at least 50 percent of the workers in the sector will be considered for extension. Additional criteria will be considered to take into account the effect of extension on competitiveness of non-signatory firms.

**54. The authorities are taking action to improve the effectiveness of active labour market policies (ALMP) and tackle high unemployment.** A report has been prepared to assess the effectiveness of ALMPs. It concluded that ALMPs implemented in Portugal have had a positive effect on employability and that employment measures were more effective than training measures. Among the training measures, short term training revealed the most effective. The authorities are using these results to improve the mix of ALMPs. In this regards, substantial progress has been made in implementing the measures under the Council of Ministers Resolution to improve the Public Employment Services (PES) and other ALMPs.

- Activation of unemployed has been stepped up, targeting especially unemployed older than 45 years.
- The measure *Estímulo 2012* – a wage subsidy scheme target to unemployed registered in PES for more than 6 months and finances up to 50 per cent of wage up to a maximum amount of 420 euros per month – is being implemented.
- *Impulso Jovem* - an initiative to target youth unemployment - started in August 2012.
- Certain categories of unemployed will be able to accumulate paid work with unemployment benefits in case they accept job offers paying less than the unemployment benefits under certain circumstances. The measure was enacted in August 2012
- The programme *Vida Ativa* aims at developing high-employability training modules targeted to unemployed. Newly-registered unemployed will be attending a training course in no more than 45 days after enrolment in PES.
- Dual training system for youth under 25 years old with a diploma equivalent to lower secondary education.

#### *Education*

**55. The Portuguese authorities are starting the implementation of the Action Plans on secondary school and vocational training.** A number of trust agreements have been signed with selected primary and secondary schools, which gives the schools management autonomy. A simple formula-based funding framework comprising performance evaluation criteria and accountability for public schools and those under autonomy agreement is however still awaited. On vocational and educational training, the government presented the recent programme of internships co-financed by the Structural funds. It is expected than about 90 000 young people benefit from it. In addition, the government is working on the creation of Professional Schools of Reference. The aim is to conclude agreements with at least two key corporations' partners in every economic area identified. However, the details provided suggest that a lot still needs to be done. By contrast, the monitoring and reporting system to evaluate results of education policies seems to be well advanced. A simple formula to calculate the cost per student and a set of cost-saving indicators should be presented soon. The first complete results from this monitoring tool are expected to be obtained at the next school year. The results from a review of a sample of schools carried out by the General Inspectorate do not seem to reflect the actual situation and are not fully in line with the indicators of the Portuguese educational system compared to other EU and OECD countries.

#### *Housing market*

**56. The reform of the law on housing rental market was published in the Official Gazette and will enter into force on 12 November 2012.** Four implementing legal texts will be revised by the government before its entry into force to adapt them to the new provisions of the law, including the revision of the Decree Law 158/2006 which sets the methodology to calculate the Weighted Gross Annual Income of the household (Rendimento Anual Bruto Corrigido do agregado familiar). The Single Window for the rental market (Balcão do Arrendamento) will also be operational by that date. New laws on renovation works are already in force. The revision of the cadastral value of the housing stock risks running behind schedule, but will not affect the adjustment of the 2013 property taxes (Imposto Municipal sobre Imóveis), as means would be put in place to ensure that these will be based on the updated values. Progress on the gradual rebalancing of property taxation from the transfer tax (IMT) towards the recurrent real estate tax (IMI) as envisaged by the MoU is expected in the budget 2014.

### *Judicial system*

**57. Reforms of the judicial system continue to advance according to the agreed schedule.** Progress has been achieved on the new Code of Civil Procedure and the geographical reorganisation of the court districts, also thanks to the expert meetings on these two subjects, which allowed improving some aspects of the proposals. An additional expert meeting in September addresses the structures of fees and market-based incentives for the enforcement agents.

- A task force to expedite the backlog resolution and quarterly monitoring is put in place, and regulations adopted to ensure the oversight body's full access to the enforcement cases. Almost 500 000 cases have been investigated which resulted in nearly 100 000 enforcement cases being closed so far. The Portuguese Ministry of Justice will reinforce the efforts of meeting the target to eliminate the backlog bearing into consideration the commitment established in the Memorandum of Understanding.
- Following the road map of judicial reform, the judicial districts will now be aligned with the administrative districts. The court, as a unit, will consist of the court sitting in the capital of each district, local instances courts, and extensions without judges, if needed. However, as these will be considered as one unit, the management will be streamlined and a better allocation of human resources ensured.
- The control and supervision of the enforcement agents by CPEE is made tighter which resulted in several disciplinary proceedings this year. In addition, a fully independent organisation will soon be established by the new legislative proposal to replace the CPEE. With one supervisory and control structure in place, and the right incentives, the legal framework of the enforcement agents will vastly improve.
- Code of Civil Procedure: The government is currently finalising the proposal in order to implement an even more ambitious reform, with extensive consultation with stakeholders and experts, including through expert meetings held at the end of July with the IMF and EC technical assistance. The Ministry of Justice plans to finalise the legislative proposal for the new Code of Civil Procedure by end-November when it will be submitted to the Parliament.

### *Business environment*

**58. Authorities presented preliminary proposals to diversify financing to the corporate sector.** Portuguese companies, and particularly SMEs, are highly dependent on traditional bank debt and therefore particularly affected by the tighter credit conditions resulting from banks' deleveraging strategies. To mitigate credit constraints various options are being considered, such as corporate debt investment vehicles, granting senior status to private creditors of viable but illiquid companies, the use of EIB facilities, and information sharing mechanisms. Measures to stimulate a more equity-oriented culture are also being explored. For all instruments, the key challenge is the promotion of private sector initiative while minimising fiscal risks. Furthermore, an analysis was presented on current use and effectiveness of government-sponsored export credit insurance schemes. Existing state-guaranteed financing lines (mostly *PME Crescimento*) of EUR 2.5 billion are part of the governments' effort to facilitate access to finance to SMEs. However, these credit lines make up only 3.7 % of the total debt stock of private companies and are expected to be fully used by the beginning of 2013. A concrete action plan to facilitate finance and equity instruments notably for SMEs and export-oriented companies will be presented by the sixth review.

### *Energy*

**59. In the energy sector, the plans for the reduction of electricity costs are ongoing.** Expected savings up to 2020 from the revision of the power guarantee mechanism are of the order of EUR 440 million, which reduces the total cost of this mechanism by 65 percent. On cogeneration the expected savings are higher than announced (EUR 500 million up to 2020) and a further revision of this mechanism to bring it closer to Market principles is envisaged for Q1-2013 along with changes foreseen in the forthcoming energy efficiency directive. Measures to decrease the rents associated with CMECs (stranded costs from previous power purchasing agreement) include the change of the annuity discount rate from 7.55 percent to 5 percent which will be done in a manner ensuring legal certainty and will yield saving of EUR 165 million EUR up to 2020. Negotiations concerning the Sines and Pego power plants are ongoing but their timing and final outcome remain undefined and represent an element of uncertainty in the overall electricity cost reduction. Negotiations concerning wind power capacity not granted under tender procedures are well advanced and expected to yield savings of at least EUR 100 million up to 2020. In any case, the tariff debt elimination will be mostly reached via allocation of revenues from CO<sub>2</sub>

licences (bringing financing of EUR 1930 million to the electricity system up to 2020) and less via cost reduction measures (about EUR 1275 million up to 2020).

**60. A crucial step in the efficient functioning of the electricity and gas markets after their full liberalisation in January 2013 is still missing.** The revised by-laws of the functioning of the energy regulator (ERSE), adopted by the Council of Ministers in August, will be further amended according to the version previously agreed with the EC/IMF/ECB in July in order to ensure the regulator's independence and its capacity to guarantee an efficient and competitive functioning of the energy sector in Portugal.

#### *Telecommunications and postal sector*

**61. The progress made last year on the telecommunications market is becoming overshadowed by significant delays designing a universal service provider.** Significant delays have accumulated in allowing market players to enter the universal service segment through an efficient, transparent and non-discriminatory public tender in compliance with the EU law requirements. The tender for the designation of the universal service provider(s) foreseen for December 2011 has not been launched and if the tender is launched in September, the universal service provider(s) would be designated in Q1-2013. As in past review, the MoU measure has not been implemented and the European Court Ruling of 7 October 2010 has not been ensured. The Compensation Fund designed to reimburse the universal service provider(s) net costs has been set by Law 35/2012 of 23<sup>rd</sup> of August. Similarly, in the postal sector there is a delay in setting up a new concession scheme for the provision of universal service.

#### *Transport*

**62. The government has devised a comprehensive strategy to significantly reduce costs in Portuguese ports by around 25-30 per cent over the next years.** This strategy builds on the reform of the port work law, the revision of concession contracts with port operators to make them more cost-efficient, and a reduction in the port taxes and tariffs. It remains to be seen if the draft of the port work law approved by the Council of Ministers on 20 September, and then submitted to the Parliament will sufficiently tackle the existing bottlenecks and trigger significant improvement in the competitive position of Portuguese ports. For this reason, the MoU foresees a review of the outcome within a year. Specific plans about the revision of the concessions and the tariffs will be presented at the next review. The government is also working to improve the port governance by creating a more centralised entity composed of the Ministry for Transport and the port authorities, which will devise a more coherent port development policy.

**63. In the railway sector, bold steps forward are still to be made.** The transfer of CP Carga terminals to an independent entity (unbundling) has been postponed, with negative consequence for functioning of competition in the cargo sector. The implementation of the performance scheme on infrastructure charges is also delayed. A clear strategy of priorities on the rail sector development over the medium-term is still awaited. The negotiations for the construction of the freight rail connection between Lisbon and Madrid are ongoing with the Spanish authorities and with the European Commission. The total cost of completing the missing link between Évora and Elvas (on the border with Spain) until 2018 is estimated at EUR 740 million, from which more than EUR 650 million are expected to be financed by the EU Funds.

#### *Other services sectors*

**64. Significant progress has been made in improving the legal framework for the recognition of professional qualifications, deregulating professions and in the full the implementation of legislative changes required by the Services Directive.** Amendments bringing the law transposing the Professional Qualifications Directive have been adopted end of July and published end of August<sup>7</sup> and will enter into force on 1st of October. Information for professionals about their rights will be added to the Point of Single Contact, including advice on the various legally admissible means for a professional to attest professional experience acquired in Portugal when there is no Portuguese competent authority. The government has submitted to Parliament a new horizontal framework law aimed at improving the regulatory framework of highly regulated professions governed by professional bodies such as lawyers, accountants or architects. This new legal framework, once adopted by the Parliament, should ease rules governing access and exercise of professional services and ensure that profession-specific regulations do not contain unjustified requirements that could limit competition. In addition, access to certain professions not governed by professional bodies shall be eased, in

<sup>7</sup> Lei 41/2012, of 28 August, Diário da República, 1.ª série — N.º 166 —

some cases through the deregulation of the profession. A law proposal deregulating three professions has been submitted to Parliament for such purpose.

**65. An additional number of sector-specific legislative amendments required by the Services Directive have been adopted since the previous review.** It brings the number of legal regimes already endorsed by the Council of Ministers to about two thirds. Legislative amendments for the remaining sectors should be adopted by January 2013. The legal regime on real estate activities was endorsed by the Council of Ministers on 26<sup>th</sup> of July and then submitted to Parliament. The text introduces major simplifications in the rules governing access and exercise to the profession both for established and for cross-border service providers. An agreement has also been reached with the EC/ECB/IMF on a draft governing the construction activities in Portugal for private and public works. . This draft, which represents a major simplification of the existing legal framework, should be submitted to Parliament in the coming weeks. Some concerns remain however about the amount of the authorisation fees to be set in a specific Executive Order. .

**66. Work on administrative burden reduction (in particular, on the Point of Single Contact envisaged by the Services Directive and on the making operational the Zero Licensing Project) has been slowed down.** There has not been much progress on the work of the Point of Single Contact ("Balcão do Empreendedor") since the last review. Major changes in mid-June of the board of the authority responsible for administrative simplification (AMA) in charge of the PSC seem to explain this lack of progress. Deadlines were already extended in past reviews. A new action plan and clear roadmap to be updated on a monthly basis has been requested. It will include an update of the work undertaken on the PSC on the regimes falling within the scope of the Services and the Professional Qualification Directives as well as the implementation of "Zero Authorisation" project to facilitate establishment of small retail. The government shows commitment but prioritization of the completion of ongoing measures on services that are currently suffering delay becomes essential in view of the ambitious programme extending the scope of license reduction to other areas of the economy.

#### *Competition and sectoral regulators*

**67. A Framework Law setting the main principles of the functioning of the main National Regulator Authorities (NRA) and the competition authority is under preparation.** This framework law will build on the recommendation made in the independent report on governance aspects of regulators which was itself foreseen as a measure in the Memorandum of Understanding. This legal framework is an important milestone in empowering the identified NRA (regulators of insurances, securities market, energy, communications, aviation, transport, health and water and waste services as well as the competition authority) with strong independence and autonomy, which are a major prerequisites for efficient functioning of important sectors and for the effective enforcement of competition rules in the overall economy. The Portuguese authorities have presented a draft which is a first step forward but is still lacking some elements of effective independence and financial, administrative and management autonomy. The present draft is being revised in order to make it fully compliant with the EU law on regulator's independence and autonomy. It is important that this Framework Law is fully in line with the Competition Law adopted recently and serves as an additional element in fostering the effectiveness of the competition authority in enforcing of competition rules. Further discussions will take place in subsequent reviews before submission to the Parliament, which is expected not later than March 2013.

**68. The sale of the 1 percent share of CGD in Galp has been further postponed.** This means that a situation of special rights by the State is maintained. As a consequence, the corresponding MoU measure has not been respected and the European Court Ruling of 10 November 2011 has not been complied with.

#### *Licensing*

**69. The revised Memorandum of Understanding incorporates a number of new measures to achieve a business-friendly licensing environment.** A detailed calendar is set with specific milestones for the revision of important legal regimes such as environment and territorial planning, industrial, commercial and tourism licensing. The comprehensive programme aims at tackling excessive licensing procedures and other administrative burdens to the economy. Their explicit and implicit costs present a major obstacle to economic growth in Portugal and disproportionately affect smaller enterprises. While this encompassing approach to less-burdensome licensing is welcome, significant delays in the implementation of the Zero Authorisation initiative and in the set-up of the Point of Single Contact risk a significant slow-down in the reduction of administrative burden and in fully complying with the Services Directive.

## IV. PROGRAMME FINANCING

**70. Successful completion of the Fifth Review will allow disbursing EUR 4.3 billion of international assistance.** The planned EU instalment amounts to EUR 2.8 billion and that of IMF EUR 1.5 billion, bringing the total amount of the disbursed funds to EUR 61.4 billion. The average interest rate on EU assistance to Portugal is below 3 percent.

**71. The revision of the fiscal targets increases the financing needs of the Portuguese sovereign.** The new fiscal targets that take into consideration the worsened macroeconomic outlook lead to a fiscal deficit of EUR 8.3 billion in 2012, EUR 7.5 billion in 2013 and EUR 4.2 billion in 2014. As a result of this adjustment of the targets, the sovereign faces an additional financing need of EUR 3.9 billion in 2012-2014 compared with original Programme plans.

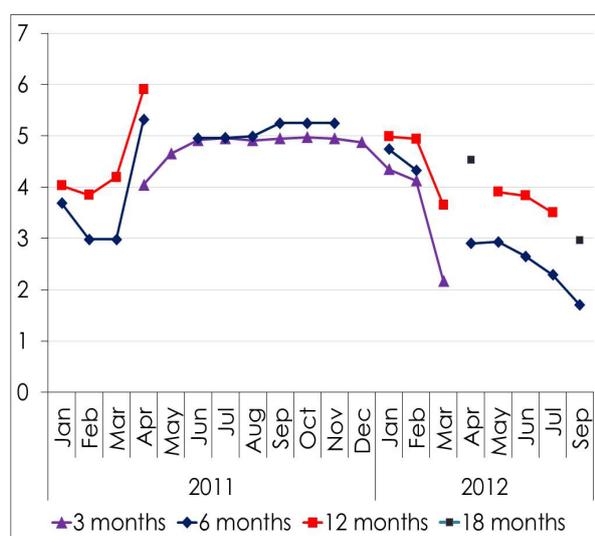
**72. The current official financing envelope remains sufficient.** The current programme financing continues to expect that Portugal will regain market access to medium- or long-term financing by mid-2013. If market re-entry is successful, Portugal will be able to accommodate the higher fiscal deficits by issuing additional debt. The Treasury has already managed to fund its fiscal needs for the first eight months of 2012. The financing needs for the remainder of 2012 and the first half of 2013 are limited and can be covered from cash reserves and by short-term financing.

**Table 11. Disbursements to Portugal after 5th review (bn EUR)**

Review	Date	EU	IMF	Total
Programme	Q2-2011	12.4	6.1	18.5
1 <sup>st</sup> Review	Q3-2011	7.6	4.0	11.6
2 <sup>nd</sup> Review	Q4-2011	5.3	2.8	8.1
3 <sup>rd</sup> Review	Q1-2012	9.7	5.2	14.9
4 <sup>th</sup> Review	Q2-2012	2.6	1.4	4.0
5 <sup>th</sup> Review	Q3-2012	2.8	1.5	4.3
<b>Total disbursed</b>		<b>40.4</b>	<b>21.0</b>	<b>61.4</b>
Total undisbursed		11.6	6.4	18.0

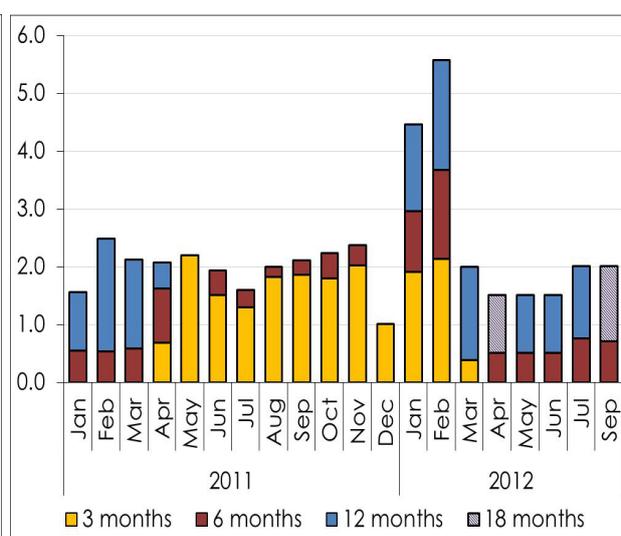
*Note: Total disbursements do not add up to EUR 78 bn due to changes in EUR-SDR rate.*

**Graph 9: Portugal – short-term auctions (weighted average yield)**      **Graph 10: Amounts (EUR bn)**



Source: Bloomberg

Note: rounded months to maturity.

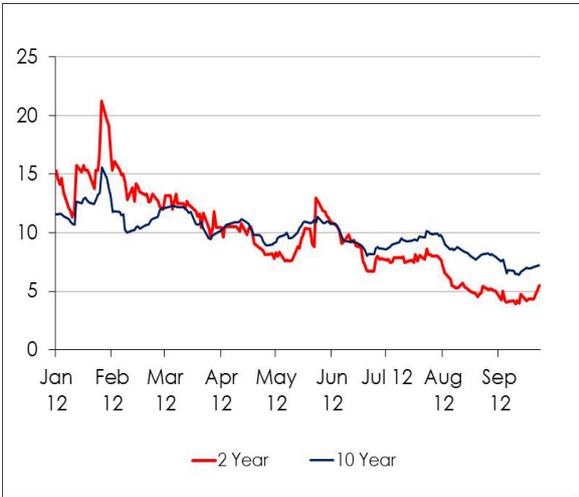


Source: Bloomberg

**73. The issuance of short-term debt continues successfully.** The Treasury witnesses strong demand for its short-term securities. The market is dominated by domestic buyers but foreign investors lately regained interest and started to participate in primary auctions. The Treasury sells securities across a wide range of maturities, from 3 to 18-months. The 18-month T-bill auction, last time conducted in September follows a similar one conducted in April. This strategy allows extending gradually the maturity of the new debt and lays the ground for future bond issuances.

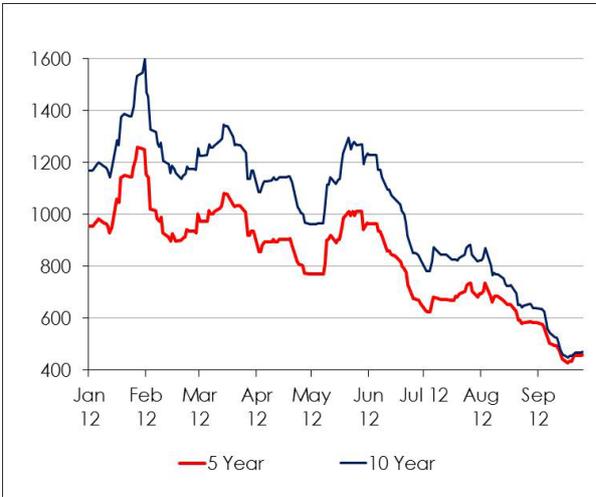
**74. The prospects of the market re-entry have improved as investors are taking a more positive view of Portugal.** Since the beginning of the year the 2-year yields on Portuguese bonds were on a steeply declining trajectory. This suggests that investors are gaining trust in Portugal's ability to service debt. A similar trend is evident in the level of credit default swaps, a measure reflecting investor expectation on sovereign default. Good progress in programme implementation was a possible driver behind investor confidence in the Portuguese government bonds, while lately the ECB's announcement of Outright Monetary Transactions (OMT) supported market sentiment more broadly in the euro area.

**Graph 11: Government bond yields (%)**



Source: Reuters

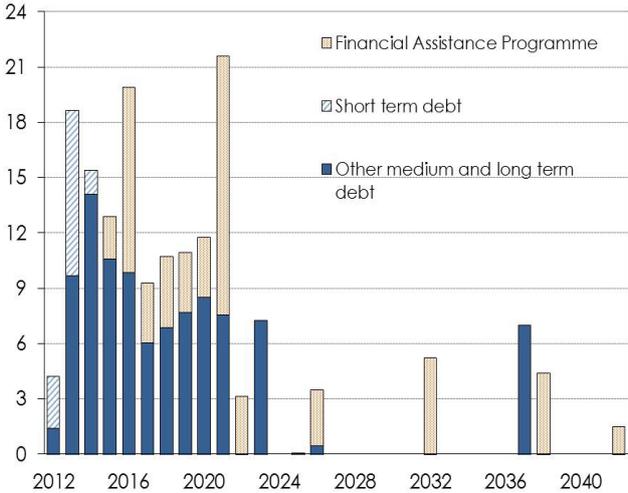
**Graph 12: Credit default swaps (basis points difference)**



Source: Reuters

**75. The Portuguese Treasury has recently taken several steps to increase the available financing.** In early September, the Treasury has raised the interest rate on Saving Certificates (an instrument with undefined, though typically long maturity for retail customers) in order to stop the previous outflow of cash from the Treasury coffers to private banks. The Treasury is also considering issuing medium-term debt to domestic or foreign investors and is actively seeking foreign participating in T-bill auctions. The Treasury is confident about strong demand for short-term papers in the future, which can bridge the financing needs. Other market-based strategies are under consideration to gradually prefund the large EUR 9.7 billion bond maturing in September 2013.

**Graph 13: Portugal – Maturing debt (EUR bn)**



Source: IGCP and Commission services

**ANNEXES**

## ANNEX 1: ASSESSMENT OF COMPLIANCE: MONITORING TABLE

<i>Actions for the fifth review (to be completed by end Q2-2012)</i>		<i>Status</i>
<b>Fiscal-structural</b>	[3.3] Submit a proposal to reduce budgetary fragmentation.	<b>Observed.</b> The public financial management action plan due by end-September will develop some of the proposals advanced by the report on budget fragmentation.
	[3.5] Full implementation of the commitments control law.	<b>Broadly observed.</b> IT systems have been adapted both in hospitals and in local governments. IGF is currently performing some audits to assess the application of the law. However data does not point yet to a reduction in the accumulation of new arrears.
	[3.7] Prepare a document concerning the monitoring, controlling and auditing of the programme agreed between the government and local authorities for the settlement of arrears.	<b>Observed.</b> Law 43/2012 of 28 August creates the Support Programme for Local Economy allowing the payment of the stock of arrears. The law was complemented by Portaria 281-A/2012 of 14 September which defines the practical implementation of the law.
	[3.12] Submit a draft proposal to revise the regional and local finance laws.	<b>Broadly observed.</b> Progress towards reforming the regional and local financing laws is on track and the end year target remains within reach. A draft proposal will be submitted to the EC/IMF/ECB for discussion before the sixth review.
	[3.16] Complete the study to assess the costs and benefits of renegotiating any PPP contract to reduce the government financial obligations.	<b>Observed.</b> Study submitted by end-June. Based on this study, the government will develop a detailed strategic plan before the sixth review for the renegotiation of PPPs in view of obtaining substantial fiscal gains, while minimising the debt burden, and ensure a sustainable reduction in government liabilities.
	[3.18] Prepare a progress report concerning the implementation of SOEs strategy.	<b>Partially observed.</b> A dedicated progress report was not prepared. However, some information regarding progress towards achieving operational balance was presented in the second quarter SOEs report disclosed during the mission. Despite substantial progress, further efforts are needed to improve SOEs reporting and monitoring.
	[3.19] Prepare strategy for managing the debt load of all SOEs, including Parpublica.	<b>Observed and ongoing.</b> The authorities presented various alternatives to manage SOEs debt. Given the complexity of the matter, the mission recommended to continue assessing options for managing the heavy debt load of SOEs, including Parpública.
	[3.20] Submit to Parliament a draft law to strengthen governance of SOEs in accordance with international practices.	<b>Broadly observed.</b> Draft law approved by Council of Ministers.

*Actions for the fifth review (to be completed by end Q2-2012)*

*Status*

<p>[3.21] Strengthen the annual and quarterly SOEs reports. Each autonomous region will provide similar reports. Those will serve as inputs for the fiscal risk analysis.</p>	<p><b>Partially observed.</b> The quarterly SOE report has been strengthened along the lines defined in the MoU and the government will work towards continuously improving the quality of the reports. Progress towards achieving the similar reporting standards at local and regional level is limited.</p>
<p>[3.26 i. and ii.] Prepare a draft proposal to enhance the exchange of information between the collection units of the Tax Authority and Social Security. Examine the scope of applying other measures to strengthen control and compliance.</p>	<p><b>Partially observed.</b> A dedicated draft proposal is being prepared. However, the review mission got information on the progress of the joint work between the Tax Authority and Social Security, as a result of which measures to simplify compliance and enhance information exchanges will be introduced as from 1 January 2013.</p>
<p>[3.27 iv] Prepare draft action plan with concrete measures to resolve VAT issues related to backlog enforcement cases.</p>	<p><b>Observed.</b> A proposal for a new regime to resolve VAT issues related to bad debt was prepared before the fifth review.</p>
<p>[3.29] Draft a proposal to strengthen the powers of central tax administration.</p>	<p><b>Partially observed.</b> This element will be embedded in the reform of the regional and local financing laws. Progress will be assessed during the sixth review.</p>
<p>[3.32] Conclude the public administration restructuring programme (PREMAC).</p>	<p><b>Observed.</b> By end-August, there were 144 out of 150 organic laws on public services approved and waiting for publishing. The publication of the specific legal acts on the internal organisation of services is already ongoing. The final report of the PREMAC will be available by end-September.</p>
<p>[3.33] Municipalities to present plans to reduce management positions and administrative units by at least 15% by the end of 2012.</p>	<p><b>Observed.</b> Law No. 49/2012 of 29 August defines the criteria to reduce the number of managers positions in local entities. The process is expected to yield a reduction between 23 percent and 36 percent of management positions.</p>
<p>[3.34 i] Prepare a detailed cost/benefit analysis of all public and quasi-public entities using the results of the compulsory census.</p>	<p><b>Observed.</b> A cost benefit analysis of foundations was published in early August. The authorities will take the necessary measures to reduce the fiscal burden of foundations and streamline the sector in the 2013 budget. A similar analysis for other public or quasi-public entities is still to be performed.</p>
<p>[3.35] Regulate by law the creation and the functioning of foundations, associations etc. by the central and local administrations. The government will promote that the same objective is achieved by the regions.</p>	<p><b>Observed.</b> Law No 24/2012 of 9 July defines the legal framework of foundations.</p>
<p>[3.40] Reinforce the mobility schemes of human resources across the administration.</p>	<p><b>Observed.</b> A proposal to enhance mobility in the public sector was submitted to Parliament on 3 July.</p>

<i>Actions for the fifth review (to be completed by end Q2-2012)</i>		<i>Status</i>
<b>Financial sector</b>	[2.3] Finalise by 30 June 2012 the capital augmentation aiming at a Core Tier 1 ratio of 9% for the major banks.	<b>Observed.</b> The four Portuguese banking groups subject to this requirement have increased their Core Tier 1 capital by EUR 7.4 billion, bringing their Core Tier 1 ratios to levels above 10 percent, which is the minimum required from 31 December 2012. Banif group, which is being restructured is delayed in achieving the 10 percent target.
	[2.13] Set up of the resolution fund with a view to ensuring its funding arrangement by July 2012.	<b>Observed.</b> The framework for bank resolution has been agreed in June and the funding arrangement has been set up in July 2012. The Bank Resolution Fund is now up and running.
	[2.16] Revise the report assessing the impact of existing support mechanism to SMEs.	<b>Observed.</b> The report on alternative financing for the Portuguese corporate sector was issued by mid-July and presented during the fifth review mission. Assistance from DGs Regional Development and Enterprise will be provided in order to help with the implementation of the findings of this report.
<b>Health care system</b>	[3.46] Complete the transfer of the responsibility of pricing medicines to the Ministry of Health.	<b>Observed.</b> Decree-Law 152/2012 has been approved and published and the transfer responsibility has taken place as of 1 <sup>st</sup> August.
	[3.55] Implement the new legislation regulating pharmacies.	<b>Observed.</b> Decree-Law 171/2012 and Decree-Law 172/2012 changed previous decrees on opening times, ownership, staff requirements, stock management and parallel trade, generic substitution etc.
	[3.68] Improve selection criteria of the members of hospital boards.	<b>Ongoing.</b> Decree-Law 8/2012 defined general framework. A new decree has been approved in Council of Ministers which adjusts the specific legislation applied in the health sector to the general framework.
	[3.72] Reinforce the centralised monitoring of PPP contracts.	<b>Observed.</b> Decree-Law 111/2012 defines a specific technical unit in the Ministry of Finance and ACSS collaborates with that unit providing necessary information. The monitoring role of ACSS over the PPPs in the health has been reinforced.
	[3.73] Update the inventory of all health staff and prepare annual reports on HR allocation.	<b>Observed.</b> ACSS has submitted an update of an earlier report providing an inventory of all medical staff by hospital and specialty in Portugal Continental.
	[3.76] Finalise the system of patient electronic medical records and ensure access to all relevant health care facilities.	<b>Ongoing.</b> The system has been set-up and needs now to be rolled-out to all SNS facilities.

<i>Actions for the fifth review (to be completed by end Q2-2012)</i>		<i>Status</i>
<b>Labour market and education</b>	[4.7] Present an assessment of the activation policies in tackling unemployment, and an action plan for improvements.	<b>Observed.</b> A report has been put forward to assess the effectiveness of ALMPs. An action plan for improving ALMPs is set in Council of Ministers Resolution n. 20/2012. The authorities are using the results of the evaluation report to improve the mix of ALMPs.
<b>Goods and services markets</b>	[5.1] Take further steps towards the full transposition of the Third EU Energy Package.	<b>Ongoing.</b> Some important legal acts such as the sanctionary regime of ERSE were adopted. In any case, the Portuguese authorities need to revise the by-laws on the functioning of the energy regulator (ERSE) as previously agreed with the EC/IMF/ECB in July.
	[5.4] Implement the measures approved in the Council of Ministers on 17 May 2012 reducing excessive rents. Present and assess estimation of cost reductions to be achieved as well as progress towards elimination of the tariff debt.	<b>Ongoing.</b> The revision will entail saving of at least EUR 1275 million up to 2020. Negotiations concerning the Sines and Pego power plants are ongoing. However the timing and final outcome of these negotiations remain undefined and represent an element of uncertainty for reducing the overall cost of electricity. Negotiations concerning wind power capacity not granted under tender procedures are well advanced.
	[5.5] Implement the announced measures to limit the policy costs embedded in CMECs and PPAs. Present and assess estimation of cost reductions to be achieved.	<b>Ongoing.</b> Measures to decrease the rents associated with CMECs (stranded costs from previous power purchasing agreement) have been announced. These include the change of the annuity discount rate from 7.55% to 5% which will be done in a manner ensuring legal certainty and will yield savings of EUR 165 million EUR up to 2020.
	[5.7] Implement the announced measures to limit the policy costs of renewables under the special regime. Present and assess estimation of cost reductions to be achieved.	<b>Ongoing.</b> The government concluded an agreement with 70% of wind farmers for capacity not granted under tender procedures yielding a reduction of costs up to EUR 100 million up to 2020. For small hydro, discussions are ongoing.
	[5.8] Ensure through annual audits that plants not fulfilling the requirements for co-generation do not receive the support.	<b>Observed.</b> A progress report on the audit of 36 (out of 161) co-generation units was prepared by end-June. No significant misuse of subsidies has been found until now.
	[5.9] Establish the new subsidy regime under the Power Guarantee mechanism. Present and assess estimation of cost reductions to be achieved.	<b>Observed.</b> Approval of Executive Order 139/2012 of 14 May and 251/2012 of 22 August establishing the new subsidy mechanism. Expected savings up to 2020 from the revision of the power guarantee mechanism are about EUR 440 million, which reduces its current total cost by 65%.
	[5.12 i] <b>Subject to a cost-benefit analysis,</b> eliminate the exemption from the ISP tax.	<b>Observed:</b> The result of the cost-benefit analysis was to maintain this exemption.

*Actions for the fifth review (to be completed by end Q2-2012)*

*Status*

<p>[5.12 ii] Conduct a cost-benefit analysis on the effectiveness of the System for the Management of Energy-Intensive Consumption.</p>	<p><b>Observed.</b> The result of the cost-benefit analysis was to maintain this exemption.</p>
<p>[5.12 iii] Review the effectiveness of the other exemptions and reduced rates of the ISP tax.</p>	<p><b>Observed.</b> The result of the cost-benefit analysis was to maintain this exemption.</p>
<p>[5.12 iv] Take measures to eliminate possible overlaps between PPEC and EEF.</p>	<p><b>Observed.</b> Measures already adopted by the Council of Ministers and now pending publication.</p>
<p>[5.13] Ensure an efficient mechanism for the designation of the universal service provider(s) and launch a new tender for their designation.</p>	<p><b>Not observed.</b> The tender for the designation of the universal service provider(s) foreseen for December 2011 has not been launched. The European Court Ruling of 7 October 2010 has not been complied with. The Compensation Fund designed to reimburse the universal service provider(s) net costs was approved by Law 35/2012 of 23<sup>rd</sup> of August.</p>
<p>[5.14] Further liberalise the postal sector by amending the law laying down the framework of the concession contracts.</p>	<p><b>Broadly observed.</b> There is a delay in amending the diploma regulating the concession scheme for the provision of universal service. However, Law 17/2012, April 26, which transposes the Third Postal Directive, is directly applicable to the postal sector.</p>
<p>[5.18 ii] Provide annual progress reports on the implementation of balancing revenues and expenditures of REFER.</p>	<p><b>Observed.</b> A progress report was submitted in August.</p>
<p>[5.18 v] Extend the performance scheme on infrastructure charges to other operators.</p>	<p><b>Delayed.</b> This measure has been postponed by one quarter because limited progress was demonstrated by the Portuguese authorities.</p>
<p>[5.18 viii] Present plans of transferring the rail terminals currently owned by CP Carga to another entity that will guarantee non-discriminatory access to all rail freight operators.</p>	<p><b>Delayed.</b> The transfer of CP Carga terminals to an independent entity (unbundling) has been postponed, with potentially negative consequence for functioning of competition in the cargo sector.</p>
<p>[5.19] Submit to Parliament a revised legal framework governing port work.</p>	<p><b>Ongoing.</b> The draft law was adopted by the Council of Ministers on 20<sup>th</sup> of September.</p>
<p>[5.20] Take further steps to improve the governance model of the ports system with the objective to enhance the competitiveness and the efficiency of ports.</p>	<p><b>Ongoing.</b> The Government has devised a comprehensive strategy to significantly reduce costs in Portuguese ports by around 25-30 per cent over the next years.</p>

*Actions for the fifth review (to be completed by end Q2-2012)*

*Status*

	<p>[5.22] Submit to the Parliament the remaining necessary amendment to the sector specific legislation to fully implement the Services Directive.</p>	<p><b>Ongoing.</b> About two thirds (out of 68) of the sector-specific legislations to complete the transposition of the Services directive have been adopted by the Council of Minister (e.g. car renting, non-fixed retail trade) and some other are being discussed with EC/ECB/IMF.</p>
	<p>[5.23] Submit to the Parliament the amendments in the areas of construction and real estate.</p>	<p><b>Partially observed.</b> The real estate law was submitted to Parliament on 1 August. An agreement with EC/ECB/IMF has been reached on a draft governing the construction activities in Portugal for private and public works.</p>
	<p>[5.24] Improve the recognition framework on professional qualifications through adoption by the Parliament of the amendment to Law 9/2009.</p>	<p><b>Observed.</b> The law amending Lei 9/2009 transposing the Professional Qualification Directive has been published in the Official Gazette on 28 August.</p>
	<p>[5.25] Submit to Parliament a law reviewing and reducing the number of regulated professions and eliminating reserves of activities for those professions where regulation does not involve a professional body.</p>	<p><b>Observed.</b> Draft Law adopted by the Council of Ministers on 16 August and submitted to Parliament on 3 September.</p>
	<p>[5.26] Submit to Parliament a draft legal framework concerning the requirements affecting the exercise of regulated professions with professional bodies and eliminate those not justified or proportional.</p>	<p><b>Observed.</b> The Government has submitted to Parliament on 27 July a new horizontal framework law aimed at lowering the degree of regulation of highly regulated professions governed by professional bodies such as lawyers, accountants or architects.</p>
	<p>[5.27 ii and iii] Extend on-line procedures in Point of Single Contact (PSC) to all sectors under the Services Directive and for each profession. Adapt PSC to incorporate new legislation in order to reduce administrative burdens for firms.</p>	<p><b>Not observed.</b> The adaptation of the PSC to sector-specific amendments and legislation to be adopted under MoU 5.22 and 5.24 lack of progress. Major staff and management changes took place mid-June in the agency responsible for administrative simplification and in charge of the PSC. A new work roadmap has been presented.</p>
<b>Competition, public procurement, and business environment</b>	<p>[7.8] The Portuguese State will ensure that CGD alienates its participation in Galp.</p>	<p><b>Not observed.</b> The sale of the 1 per cent share of CGD in Galp has been further postponed. Special rights of the State that are non-compliant with the EU law are maintained.</p>
	<p>[7.12 i] Complete an independent report on the responsibilities, resources and characteristics determining the level of independence of the main NRAs.</p>	<p><b>Observed.</b> The report on the majority of Portuguese regulators was submitted in July. The report on the Media Regulator (ERC) was submitted in August. Both reports set a range of recommendations on governance aspects of the National Regulators Authorities (NRA).</p>

<i>Actions for the fifth review (to be completed by end Q2-2012)</i>	<i>Status</i>
	<b>Observed.</b> Report presented in July.
<b>Judicial system</b>	<b>Observed.</b> By August 15, 2012, EC/ECB/IMF received a quarterly report reviewing a total of 167,056 backlogged enforcement cases.
	<b>Observed.</b> By mid-August 2012, EC/ECB/IMF received a draft bill for enforcement agent framework.
	<b>Observed.</b> By mid-August, EC/ECB/IMF received the main draft bill implementing the judicial reform map
	<b>Observed.</b> On July 6, 2012, EC/ECB/IMF received a new draft of Code of Civil Procedure (CPC). By mid-July, EC/ECB/IMF received a revised draft of the CPC for the purposes of discussing it on a TA.

## ANNEX 2: COMMISSION SERVICES MACROECONOMIC PROJECTIONS 2011 - 2016

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

<i>Annual % change</i>	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	-4.0	-5.9	-2.2	0.2	0.7	0.8
2. Government consumption expenditure	-3.8	-3.5	-3.2	-1.5	0.5	0.4
3. Gross fixed capital formation	-11.3	-14.1	-4.2	2.7	4.0	4.0
<b>4. Final domestic demand</b>	<b>-5.3</b>	<b>-6.8</b>	<b>-2.7</b>	<b>0.3</b>	<b>1.2</b>	<b>1.3</b>
5. Change in inventories	--	--	--	--	--	--
<b>6. Domestic demand</b>	<b>-5.6</b>	<b>-6.8</b>	<b>-2.7</b>	<b>0.2</b>	<b>1.2</b>	<b>1.2</b>
7. Exports of goods and services	7.5	4.3	3.5	5.5	5.3	4.9
7a. - of which goods	7.8	5.5	3.8	5.9	5.7	5.2
7b. - of which services	6.8	1.0	2.8	4.3	4.2	4.0
<b>8. Final demand</b>	<b>-2.7</b>	<b>-4.0</b>	<b>-1.0</b>	<b>1.8</b>	<b>2.5</b>	<b>2.4</b>
9. Imports of goods and services	-5.2	-6.5	-1.0	3.3	4.1	3.9
9a. - of which goods	-6.7	-7.5	-1.1	3.1	4.0	3.7
9b. - of which services	3.1	-1.0	-0.6	4.1	4.8	4.8
<b>10. Gross domestic product at market prices</b>	<b>-1.7</b>	<b>-3.0</b>	<b>-1.0</b>	<b>1.2</b>	<b>1.8</b>	<b>1.8</b>
<i>Contribution to change in GDP</i>						
11. Final domestic demand	-5.7	-7.1	-2.7	0.3	1.2	1.2
12. Change in inventories + net acq. of valuables	-0.4	0.1	0.0	0.0	0.0	0.0
13. External balance of goods and services	4.3	4.1	1.8	1.0	0.6	0.6

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

<i>Annual % change</i>	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	-0.5	-3.9	-1.5	1.2	2.1	2.2
2. Government consumption expenditure	-8.1	-10.4	-0.8	-1.4	1.1	1.4
3. Gross fixed capital formation	-9.4	-12.3	-2.8	3.9	5.4	5.3
<b>4. Final domestic demand</b>	<b>-3.7</b>	<b>-6.6</b>	<b>-1.6</b>	<b>1.2</b>	<b>2.5</b>	<b>2.6</b>
5. Change in inventories	--	--	--	--	--	--
<b>6. Domestic demand</b>	<b>-4.1</b>	<b>-6.3</b>	<b>-1.6</b>	<b>1.1</b>	<b>2.4</b>	<b>2.5</b>
7. Exports of goods and services	13.3	5.6	4.5	6.9	6.5	6.5
<b>8. Final demand</b>	<b>-0.2</b>	<b>-3.3</b>	<b>0.1</b>	<b>2.7</b>	<b>3.6</b>	<b>3.7</b>
9. Imports of goods and services	1.9	-4.9	-0.3	4.3	5.3	5.4
10. Gross national income at market prices	-1.4	-3.2	-0.3	1.7	3.2	3.2
11. Gross value added at basic prices	-1.2	-3.9	-0.1	2.1	2.9	3.0
<b>12. Gross domestic product at market prices</b>	<b>-1.0</b>	<b>-2.7</b>	<b>0.3</b>	<b>2.2</b>	<b>3.0</b>	<b>3.0</b>

**Table 3: Implicit price deflators**

<i>% change in implicit price deflator</i>	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	3.6	2.1	0.7	1.0	1.3	1.4
2. Government consumption expenditure	-4.4	-7.2	2.5	0.1	0.6	1.0
3. Gross fixed capital formation	2.2	2.1	1.5	1.2	1.4	1.2
<b>4. Domestic demand</b>	<b>1.6</b>	<b>0.5</b>	<b>1.2</b>	<b>0.8</b>	<b>1.2</b>	<b>1.2</b>
5. Exports of goods and services	5.4	1.2	0.9	1.3	1.2	1.5
<b>6. Final demand</b>	<b>2.5</b>	<b>0.7</b>	<b>1.1</b>	<b>1.0</b>	<b>1.2</b>	<b>1.3</b>
7. Imports of goods and services	7.5	1.7	0.8	1.0	1.1	1.5
<b>8. Gross domestic product at market prices</b>	<b>0.7</b>	<b>0.3</b>	<b>1.2</b>	<b>1.0</b>	<b>1.2</b>	<b>1.2</b>
<b>HICP</b>	<b>3.6</b>	<b>2.8</b>	<b>0.7</b>	<b>1.1</b>	<b>1.4</b>	<b>1.5</b>

**Table 4: Labour market and cost**

<i>Annual % change</i>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
1. Labour productivity (real GDP per employee)	-0.1	1.0	0.6	0.9	1.1	1.3
2. Compensation of employees per head	-0.9	-2.8	1.3	0.4	0.6	0.6
<b>3. Unit labour costs</b>	<b>-0.7</b>	<b>-3.7</b>	<b>0.7</b>	<b>-0.5</b>	<b>-0.6</b>	<b>-0.6</b>
4. Total population	0.1	0.0	0.0	0.0	0.0	0.0
5. Population of working age (15-64 years)	-0.3	-0.3	0.0	0.0	0.0	0.0
6. Total employment (fulltime equivalent)	-1.5	-3.9	-1.6	0.3	0.6	0.5
<b>7. Calculated unemployment rate - Eurostat definition (%)</b>	<b>12.9</b>	<b>15.5</b>	<b>16.4</b>	<b>15.9</b>	<b>15.3</b>	<b>14.8</b>

**Table 5: External balance**

<i>levels, EUR bn</i>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
1. Exports of goods (fob)	44.7	47.8	50.1	53.9	57.6	61.6
2. Imports of goods (fob)	57.0	53.7	53.6	55.8	58.8	61.9
<b>3. Trade balance (goods, fob/fob) (1-2)</b>	<b>-12.3</b>	<b>-5.9</b>	<b>-3.4</b>	<b>-2.0</b>	<b>-1.1</b>	<b>-0.3</b>
<i>3a. p.m. (3) as % of GDP</i>	<i>-7.2</i>	<i>-3.5</i>	<i>-2.1</i>	<i>-1.2</i>	<i>-0.7</i>	<i>-0.2</i>
4. Exports of services	16.0	16.3	16.8	17.7	18.6	19.6
5. Imports of services	10.2	10.2	10.1	10.6	11.2	11.9
<b>6. Services balance (4-5)</b>	<b>5.8</b>	<b>6.1</b>	<b>6.6</b>	<b>7.1</b>	<b>7.4</b>	<b>7.7</b>
<i>6a. p.m. 6 as % of GDP</i>	<i>3.4</i>	<i>3.7</i>	<i>4.0</i>	<i>4.2</i>	<i>4.2</i>	<i>4.3</i>
<b>7. External balance of goods &amp; services (3+6)</b>	<b>-6.5</b>	<b>0.2</b>	<b>3.2</b>	<b>5.1</b>	<b>6.3</b>	<b>7.4</b>
<i>7a. p.m. 7 as % of GDP</i>	<i>-3.8</i>	<i>0.1</i>	<i>1.9</i>	<i>3.0</i>	<i>3.6</i>	<i>4.1</i>
8. Balance of primary incomes and current transfers	-4.8	-5.5	-6.3	-7.3	-7.3	-7.3
<i>8a. - of which, balance of primary income</i>	<i>-6.3</i>	<i>-7.1</i>	<i>-8.0</i>	<i>-8.9</i>	<i>-8.8</i>	<i>-8.8</i>
<i>8b. - of which, net current Transfers</i>	<i>1.5</i>	<i>1.6</i>	<i>1.6</i>	<i>1.6</i>	<i>1.5</i>	<i>1.5</i>
<i>8c. p.m. 8 as % of GDP</i>	<i>-2.8</i>	<i>-3.3</i>	<i>-3.8</i>	<i>-4.3</i>	<i>-4.1</i>	<i>-4.0</i>
<b>9. Current external balance (7+8)</b>	<b>-11.3</b>	<b>-5.3</b>	<b>-3.1</b>	<b>-2.2</b>	<b>-1.0</b>	<b>0.1</b>
<i>9a. p.m. 9 as % of GDP</i>	<i>-6.6</i>	<i>-3.2</i>	<i>-1.9</i>	<i>-1.3</i>	<i>-0.6</i>	<i>0.1</i>
10. Net capital transactions	2.6	2.7	2.8	3.0	3.1	3.3
<b>11. Net lending (+)/ net borrowing (-) (9+10)</b>	<b>-8.7</b>	<b>-2.6</b>	<b>-0.3</b>	<b>0.8</b>	<b>2.1</b>	<b>3.4</b>
<i>11a. p.m. 11 as % of GDP</i>	<i>-5.1</i>	<i>-1.5</i>	<i>-0.2</i>	<i>0.5</i>	<i>1.2</i>	<i>1.9</i>

**Table 6: Fiscal accounts**

	2010	2011	2012	2013	2014	2015	2016
	<i>% of GDP</i>						
Indirect taxes	13.4	13.6	13.7	13.8	13.7	13.8	13.8
Direct taxes	8.8	9.9	9.5	11.0	10.9	10.8	10.8
Social contributions	12.2	12.3	11.7	11.6	11.6	11.4	11.3
Sales and other current revenue	4.3	4.4	5.2	5.3	5.3	5.3	5.3
<b>Total current revenue</b>	<b>38.7</b>	<b>40.3</b>	<b>40.2</b>	<b>41.7</b>	<b>41.4</b>	<b>41.3</b>	<b>41.1</b>
Capital transfers received	2.7	4.4	1.5	1.3	1.3	1.3	1.3
<b>Total revenue</b>	<b>41.4</b>	<b>44.7</b>	<b>41.7</b>	<b>43.0</b>	<b>42.7</b>	<b>42.5</b>	<b>42.4</b>
Compensation of employees	12.2	11.3	9.8	9.9	9.5	9.3	9.2
Intermediate consumption	5.1	4.6	4.5	4.4	4.1	4.0	4.0
Social transfers in kind via market producers	4.9	4.7	4.7	4.6	4.3	4.2	4.2
Social transfers other than in kind	17.0	17.4	17.4	17.8	17.4	17.4	17.3
Interest paid	2.9	3.9	4.5	4.7	5.0	5.0	5.0
Subsidies	0.7	0.7	1.0	1.0	0.8	0.7	0.8
Other current expenditure	2.8	2.5	2.4	2.3	1.8	1.7	1.8
<b>Total current expenditure</b>	<b>45.6</b>	<b>45.2</b>	<b>44.3</b>	<b>44.7</b>	<b>42.8</b>	<b>42.3</b>	<b>42.2</b>
Gross fixed capital formation	3.6	2.6	2.0	1.7	1.5	1.4	1.4
Other capital expenditure	2.0	1.2	0.4	1.0	0.9	0.7	0.7
<b>Total expenditure</b>	<b>51.3</b>	<b>48.9</b>	<b>46.7</b>	<b>47.5</b>	<b>45.2</b>	<b>44.5</b>	<b>44.3</b>
<b>General Government balance (EDP)</b>	<b>-9.8</b>	<b>-4.2</b>	<b>-5.0</b>	<b>-4.5</b>	<b>-2.5</b>	<b>-1.9</b>	<b>-1.9</b>
	<i>% change</i>						
Indirect taxes	7.8	0.7	-2.2	1.1	1.3	3.4	3.1
Direct taxes	0.3	11.2	-6.3	15.9	0.9	2.5	2.7
Social contributions	0.5	-0.3	-7.4	-0.8	1.9	1.4	2.1
Sales and other current revenue	-5.3	2.7	14.6	1.4	2.3	3.2	3.3
<b>Total current revenue</b>	<b>2.1</b>	<b>3.0</b>	<b>-2.9</b>	<b>4.1</b>	<b>1.5</b>	<b>2.6</b>	<b>2.7</b>
Capital transfers received	273.4	61.5	-66.2	-15.4	0.3	2.6	2.5
<b>Total revenue</b>	<b>7.2</b>	<b>6.8</b>	<b>-9.2</b>	<b>3.4</b>	<b>1.4</b>	<b>2.6</b>	<b>2.7</b>
Compensation of employees	-1.4	-8.2	-15.9	1.7	-2.5	1.4	1.5
Intermediate consumption	4.2	-10.1	-5.7	-0.9	-6.0	2.0	1.3
Social transfers in kind via market producers	1.5	-4.7	-3.1	-1.8	-5.0	1.0	3.0
Social transfers other than in kind	1.4	1.4	-2.5	2.5	0.0	2.5	2.5
Interest paid	3.6	32.6	13.9	3.4	9.1	4.2	3.1
Subsidies	-6.1	-0.9	36.0	2.0	-19.6	-5.1	14.5
Other current expenditure	14.3	-11.3	-8.1	-3.5	-19.1	-5.8	9.1
<b>Total current expenditure</b>	<b>2.1</b>	<b>-1.9</b>	<b>-4.6</b>	<b>1.3</b>	<b>-2.1</b>	<b>1.8</b>	<b>2.8</b>
Gross fixed capital formation	23.0	-28.9	-23.6	-14.0	-13.0	-4.5	3.0
Other capital expenditure	116.9	-44.1	-68.3	168.4	-12.0	-11.8	-4.9
<b>Total expenditure</b>	<b>5.6</b>	<b>-5.5</b>	<b>-7.1</b>	<b>1.9</b>	<b>-2.8</b>	<b>1.3</b>	<b>2.7</b>
Nominal GDP, EUR bn	172.7	170.9	166.3	166.8	170.4	175.5	180.8

**Table 7: Government debt developments**

	2010	2011	2012	2013	2014	2015	2016
<b>EDP deficit (% of GDP)</b>	<b>-9.8</b>	<b>-4.2</b>	<b>-5.0</b>	<b>-4.5</b>	<b>-2.5</b>	<b>-1.9</b>	<b>-1.9</b>
EDP gross debt (% of GDP)	93.3	107.8	119.1	123.7	123.6	121.2	118.5
<i>levels, EUR bn</i>							
<b>EDP deficit</b>	<b>-17.0</b>	<b>-7.2</b>	<b>-8.3</b>	<b>-7.5</b>	<b>-4.3</b>	<b>-3.4</b>	<b>-3.4</b>
Gross debt	161.1	184.3	198.1	206.4	210.6	212.7	214.2
Change in gross debt	21.2	23.2	13.8	8.3	4.2	2.1	1.5
Nominal GDP	172.7	170.9	166.3	166.8	170.4	175.5	180.8
Real GDP	162.1	164.8	169.7	171.3	169.3	166.3	163.3
<b>Real GDP growth (% change)</b>	<b>1.4</b>	<b>-1.7</b>	<b>-3.0</b>	<b>-1.0</b>	<b>1.2</b>	<b>1.8</b>	<b>1.8</b>
Change in gross debt (% of GDP)	12.3	13.5	8.3	5.0	2.4	1.2	0.9
Stock-flow adjustments (% of GDP)	2.4	9.3	3.3	0.5	-0.1	-0.7	-1.1
<i>% of GDP</i>							
<b>Gross debt ratio</b>	<b>93.3</b>	<b>107.8</b>	<b>119.1</b>	<b>123.7</b>	<b>123.6</b>	<b>121.2</b>	<b>118.5</b>
Change in gross debt ratio	10.3	14.5	11.2	4.7	-0.2	-2.4	-2.7
<i>Contribution to change in gross debt</i>							
Primary balance	7.0	0.4	0.5	-0.2	-2.5	-3.1	-3.1
"Snow-ball" effect	0.7	4.7	7.4	4.3	2.3	1.4	1.4
of which							
<i>Interest expenditure</i>	2.9	3.9	4.5	4.7	5.0	5.0	5.0
<i>Real growth effect</i>	-1.2	1.6	3.2	1.2	-1.5	-2.2	-2.2
<i>Inflation effect</i>	-1.0	-0.7	-0.4	-1.5	-1.2	-1.4	-1.4
<b>Stock-flow adjustments</b>	<b>2.4</b>	<b>9.3</b>	<b>3.3</b>	<b>0.5</b>	<b>-0.1</b>	<b>-0.7</b>	<b>-1.1</b>
<i>Implicit interest rate</i>	3.6	4.1	4.1	3.9	4.1	4.2	4.3

## ANNEX 3: INDICATIVE FINANCING NEEDS AND SOURCES

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

	2011 Jun-Dec	2012 Year	2013 Year	2014 Year	2011-2014 Total
<b>Public sector deficit</b>	<b>11.3</b>	<b>16.1</b>	<b>8.6</b>	<b>4.8</b>	<b>40.9</b>
Treasury balance <sup>1</sup>	7.1	9.0	7.5	4.3	28.0
Other public sector cash needs <sup>2</sup>	4.2	7.0	1.1	0.5	12.9
<b>Amortization <sup>3</sup></b>	<b>9.5</b>	<b>17.5</b>	<b>11.2</b>	<b>14.6</b>	<b>52.8</b>
Medium- and long-term debt	4.9	12.8	9.7	14.1	41.4
Other debt (retail, repos), net	4.6	4.8	1.5	0.5	11.4
<b>Banking support <sup>4</sup></b>	<b>1.0</b>	<b>12.6</b>	<b>4.4</b>	<b>0.4</b>	<b>18.4</b>
<b>Financing needs</b>	<b>21.8</b>	<b>46.2</b>	<b>24.2</b>	<b>19.8</b>	<b>112.1</b>
<b>Market financing</b>	<b>-6.4</b>	<b>6.9</b>	<b>9.3</b>	<b>14.1</b>	<b>23.8</b>
Medium- and long-term debt	0.0	1.3	6.0	14.1	21.4
T-Bills, net	-6.4	5.6	3.3	0.0	2.4
<b>Own resources <sup>5</sup></b>	<b>-5.7</b>	<b>12.0</b>	<b>5.1</b>	<b>-2.0</b>	<b>9.3</b>
<b>EU-IMF loan</b>	<b>34.0</b>	<b>27.3</b>	<b>9.8</b>	<b>7.8</b>	<b>78.9</b>
EFSM/EFSF	21.0	19.2	6.6	5.1	51.9
IMF <sup>6</sup>	13.0	8.1	3.2	2.7	27.0
<b>Financing sources</b>	<b>21.8</b>	<b>46.2</b>	<b>24.2</b>	<b>19.8</b>	<b>112.1</b>

SOURCE: Portuguese authorities and Commission services' estimates.

1/ Calendar-year cash basis.

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

3/ Central government, excl. T-Bills.

4/ Includes contributions to Bank Solvency Support Mechanism, projected costs for CGD recapitalization, costs related to BNP resolution and reassignment of bank loans to state-owned enterprises.

5/ Includes in particular privatisation receipts, and use of deposits and pension fund assets.

6/ Numbers do not add up to EUR 26 bn due to changes in EUR-SDR rate compared to beginning of programme.

**Table 9: Planned quarterly disbursements (EUR billion)**

Review	Period covered by disbursement	Approximate disbursement period	Loan disbursements <sup>1</sup>	of which IMF <sup>2</sup> (1/3)	of which EU (2/3)
Approval	Jun-Sept 2011	Jun 2011	<b>18.5</b>	6.1	12.4
1	Q4-2011	Sept 2011	<b>11.6</b>	4.0	7.6
2	Q1-2012	Dec 2011	<b>8.1</b>	2.8	5.3
3	Q2-2012	April 2012	<b>14.9</b>	5.2	9.7
4	Q3-2012	July 2012	<b>4.0</b>	1.4	2.6
5	Q4-2012	October 2012	<b>4.3</b>	1.5	2.8
6	Q1-2013	January 2013	<b>2.5</b>	0.9	1.6
7	Q2-2013	April 2013	<b>2.0</b>	0.7	1.3
8	Q3-2013	July 2013	<b>2.8</b>	1.0	1.8
9	Q4-2013	October 2013	<b>2.9</b>	1.0	1.9
10	Q1-2014	January 2014	<b>2.8</b>	1.0	1.8
11	Q2-2014	April 2014	<b>2.6</b>	0.9	1.7
12	Q3-2014	July 2014	<b>2.7</b>	1.0	1.7
<b>TOTAL</b>			<b>79.5</b>	27.5	52.0

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

## ANNEX 4: PROVISION OF DATA (REPORTING REQUIREMENTS)

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

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

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|----|---|---|
| 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 ( <i>Administrações Regionais and Locais</i> ); Regional and local government-owned enterprises or companies, foundations, cooperatives, and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government, as defined in paragraph 4 of the TMoU) – progressively enlarged | Monthly, as soon as the data are available and no later than 7 weeks after the end of the month |
| 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. | Publish information on: number of general government staff on a quarterly basis (no later than 45 days after the end of the quarter); stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, special mobility condition flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. The regional and local administration will transmit the necessary information. Information on employment in SOEs (central, local and regional) and other public entities and/or bodies will also be compiled  | Quarterly, no later than 30 days after the end of the quarter (as of March 2012)                |
| 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 (as of March 2012)                              |
| 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: <ul style="list-style-type: none"><li>• the General Government, detailed by subsector</li><li>• the incorporated (SOEs) government-owned hospitals that are not part of the General Government</li><li>• other non-financial SOEs that are not part of the General Government</li></ul>   | Monthly, 7 weeks after the end of each month (as of September 2011)                             |
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| 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<br>Quarterly for Regional and Local Government<br>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**

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| 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. |
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**To be provided by the Debt Management Office**

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| 15. | Accrual data on interest spending of the State | Quarterly, 7 weeks after the end of the quarter |
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**To be provided by the Ministry of Labour**

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| 16. | Data on labour market as follows:<br>a. layoffs by type<br>b. collective agreements by type and number of collective agreements that are extended by the Ministry of Labour to non-signatory firms<br>c. number of collective agreements that regulate the use of the Bank of Hours working time arrangement<br>d. proportion of unemployed receiving unemployment benefits<br>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)<br>f. unemployment duration | Every six months, 6 weeks after the end of each semester |
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**To be provided by Ministry of Justice**

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| 17. | Publishing quarterly reports on recovery rates, duration and costs of corporate insolvency cases | Quarterly, starting in 2011 Q3, within four months after the end of each quarter. |
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**ANNEX 5: PROGRAMME DOCUMENTS**

## PORTUGAL: LETTER OF INTENT

Lisbon, 14 October 2012

Mr Jean-Claude Juncker  
President  
Eurogroup

Mr Vassos Shiarly  
Minister of Finance  
Cyprus

Mr Olli Rehn  
Vice President  
European Commission

Mr Mario Draghi  
President  
European Central Bank

Dear Sirs,

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

While we remain strongly committed to the Programme's policies and objectives, the challenging domestic and external environment is weighing on Programme performance. The fiscal outlook has deteriorated considerably, reflecting mainly the impact of the economic rebalancing on tax bases and revenue performance and the more subdued growth projections. In spite of a rigorous budget implementation on the expenditure side, a large fiscal gap has now emerged and the initial programme targets are no longer achievable.

We have started to settle the stock of existing domestic arrears and have advanced the implementation of the new commitment control systems. Nevertheless, the underlying arrear position has continued to deteriorate—although with smaller increases in recent months, resulting in further breaches of the related indicative target under the Programme. The operational restructuring of SOEs is being successfully implemented and we are assessing options to strengthen their long-term financial viability. Our policy efforts to preserve financial stability have continued, and further steps have been taken to promote competitiveness, growth, and employment.

While the Programme strategy remains appropriate, a recalibration of the fiscal path is needed at this difficult juncture to avoid imposing too large a social and output cost. Additional corrective measures will be implemented this year to limit the deficit to 5 percent of GDP in 2012. The 2013 budget will aim at a deficit of 4.5 percent of GDP and will be underpinned by permanent measures designed to limit the impact of fiscal consolidation on growth and the poorest segments of the population. We endeavour to identify a set of measures to be used in case of deviations with respect to the 2013 target. We will aim at a deficit well below 3 percent of GDP in 2014. To this end, we are undertaking a comprehensive expenditure review to identify the necessary measures to present a preliminary version by the sixth review in November. We are implementing the new law on commitment control in order to avoid further accumulation of domestic arrears. Special attention is being given to local governments and the health sector where the main challenges are concentrated.

The achievement of an orderly deleveraging of the economy remains a key objective under our Programme and we are developing alternative options to facilitate credit to productive firms, in particular SMEs, by fostering the diversification of financing alternatives. The bank capital augmentation exercise due by June 2012 has been successfully completed and we will continue to closely monitor compliance with capital requirements and take prompt and appropriate actions if needed.

We are implementing the deep structural reforms already committed to under the Programme, and we will intensify efforts in areas with high potential to create jobs. For the fifth review, we present a new initiative to substantially streamline licensing requirements and procedures to create a business-friendly environment that should help spur new investment and relieve the heavy regulatory burden on small and medium firms. Building on the good results already secured in our privatization programme, we will broaden its scope, releasing more resources to the private sector.

On the basis of the strength of the policies defined in this letter, and in light of our performance under the Programme, including the corrective measures already taken as a prior action for this review, we request the completion of the fifth review under the Economic Adjustment Programme, the release of the sixth instalment under the Programme in the amount of EUR 2 800 million.

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

This letter is copied to Ms Christine Lagarde.

Sincerely yours,

/s/

/s/

\_\_\_\_\_  
Vitor Gaspar

\_\_\_\_\_  
Carlos da Silva Costa

Minister of State and Finance

Governor of the Banco de Portugal

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

## PORTUGAL: MEMORANDUM OF UNDERSTANDING ON SPECIFIC ECONOMIC POLICY CONDITIONALITY

Fifth Update – 14 October 2012

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

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

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

The fifth quarterly review was carried out in September 2012. It assessed compliance with the conditions to be met by end-July and the need and scope for additional policy steps. This fifth update of the MoU reflects the findings of the fifth review. The following reviews taking place in any given quarter will assess compliance with the conditions to be met by the end of the previous quarter or, where applicable, up to date of the mission.

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

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

### ***1. Fiscal policy***

#### **Objective**

The fiscal consolidation path under the programme is adjusted to accommodate the internal rebalancing of the economy, while safeguarding a steady decline of the debt-to-GDP ratio over the medium-term. The faster-than-expected rebalancing of growth away from domestic demand towards net exports and the more intense labour shedding has adversely affected tax revenues and the social security budget in 2012. Moreover, private domestic demand remains weak, with consumption tilted towards less-value added, lower tax-yielding goods. This reflects a correction of pre-crisis consumption excesses, which is good in the long run, but a drag on demand in the short run. Budgetary sustainability in the medium-term needs to be supported by a successful internal adjustment

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<sup>1</sup> On 8 April 2011, Eurogroup and ECOFIN Ministers issued a statement clarifying that financial support of the EU (European Financial Stabilisation Mechanism, EFSM) and the euro-area (European Financial Stability Facility, EFSF) would be provided on the basis of a policy programme supported by strict conditionality and negotiated with the Portuguese authorities, duly involving the main political parties, by the Commission in liaison with the ECB, and the IMF. Further to the EU support from the EFSM, loans from the EFSF will contribute to the financial assistance. The Loan Facility Agreement on the EFSF financing contribution specifies that the disbursements thereunder are subject to the compliance with the conditions of this Memorandum.

resulting in permanent competitiveness gains. The fiscal consolidation over the medium-term up to a balanced budgetary position will be maintained by containing expenditure growth. The consolidation will be achieved by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups.

### **Fiscal policy in 2012**

The planned 2012 general government headline deficit target of 4½ percent of GDP will be revised to 5 percent of GDP (EUR 8.3 billion) to partially accommodate the negative windfall from the deterioration in the macroeconomic outlook and facilitate the on-going internal adjustment of growth towards net exports alongside a sustained implementation of the budgetary and structural reform programmes. The SGP fiscal objective of reducing the budget deficit well below 3 percent of GDP will be achieved by 2014, with a projected budget deficit of 2½ percent of GDP in 2014.

1.1. The government will achieve a general government deficit of no more than EUR 8.3 billion (5 percent of GDP) in 2012.<sup>2</sup> **[Q4-2012]**

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

1.3. The revenue deviations compared to the 2012 supplementary budget (of about 2 percent of GDP) mostly explained by macro-economic developments will be partly off-set by lower net interest payments, the reprogramming of EU cohesion funds, interest gained on the bank recapitalisation support, a larger decrease in the wage bill expenditure, and a large receipt from the sale of a concession for the Lisbon airport. Moreover, the government will take additional measures to confine the deficit to 5% of GDP in 2012, as follows: i) some of the 2012 budget appropriations for investment projects not yet initiated will be frozen, stamp duties on high value properties will be raised, and tax rates on investment income will be slightly increased, generating savings of about 0.1% of GDP; ii) another 0.1% of GDP of savings will be generated by frontloading some of the 2013 budget measures affecting social benefits; and iii) other measures generating savings in intermediate consumption and revenues from sales will be implemented in order to ensure the achievement of a budget deficit target of 5.0% of GDP in 2012.

### **Fiscal policy in 2013**

1.4. The government will achieve a general government deficit target of no more than EUR 7.5 billion (4½ percent of GDP), revised upwards from 3 percent of GDP. **[Q4-2013]**

1.5. In addition to the effort necessary to close the fiscal gap carried forward from 2012, measures will be adopted to compensate the fiscal effects of the Constitutional Court's ruling on the 13th and 14th salaries and pensions. The 13th month public sector wage and 1.1 monthly pensions will be reinstated (about ¾% of GDP) and compensated by measures of equivalent budgetary impact, including the reform of the personal income tax structure. Throughout the year, the government will rigorously implement the Budget Law for 2013.

1.6. 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]**

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<sup>2</sup> In 2012, operations related to the banking sector support and restructuring strategy under the programme will not be considered for the assessment of compliance with the programme target for the general government deficit. Conversely, if during the sixth review there is an agreement that there are sufficient safeguards to prevent further accumulation of arrears and the implementation of the strategy for the arrears' settlement is on track, the accrual government balance objectives may be adjusted by the amount of settled arrears.

1.7. Permanent consolidation measures of about 3% of GDP were identified and will be adopted with the 2013 budget law to reach the 4 ½ % of GDP deficit target in 2013. The measures listed below will be detailed and carried out with the 2013 Budget Law [Q4-2012], unless otherwise specified:

#### *Expenditure*

1.8. Measures introduced in the 2013 Budget Law, other than the measures to compensate the fiscal effects of the Constitutional Court ruling, leading to a reduction in expenditure of at least 1.6 % of GDP in the following areas:

- i. Wage bill: EUR 630 million. Decrease of at least 2 per cent (full-time equivalent) in the permanent staff of central, regional and local governments and decrease in the number of temporary positions in specific areas of public administration; reduction in overtime pay;
- ii. Intermediate consumption: EUR 150 million. Reduction in operational cost of public administration, education and school network rationalisation, and operational cost of state-owned enterprises;
- iii. Social transfers and subsidies, all economy, public and private: EUR 1170 million;
- iv. Health sector: EUR 485 million;
- v. Capital spending of public enterprises: EUR 200 million;

#### *Revenue*

1.9. Measures introduced in the 2013 Budget Law, other than the measures to compensate the fiscal effects of the Constitutional Court ruling, leading to an increase in revenue in the following areas:

- i. Direct taxes: about ¾ % of GDP. The measures are aimed at: a) broadening the tax bases by reduction in personal income tax (PIT) benefits and tax deductions; b) reducing the tax brackets of the PIT and increasing the average tax rates in line with European standards, while delinking social benefits from tax benefits; c) introducing a surcharge on PIT; d) broadening of the corporate income tax (CIT) base; e) increases in investment income tax rate; f) base broadening by allowing taxation of social transfers;
- ii. Consumption taxes: about 0.1% of GDP;
- iii. Property taxes: about 0.4% of GDP. Broadening of the property taxation base by completing the update of all property values and introducing stamp tax surcharges for high-value property;
- iv. Social contributions: about 0.1% of GDP.

1.10. The government will look for ways to increase the weight of the expenditure reduction in the overall consolidation package of 3% of GDP to be included with the 2013 budget in order to ensure a medium-term growth-friendly fiscal adjustment tilted towards the expenditure side.

1.11. In the framework of 2013 budget proposal, the government will prepare a set of contingency measures, predominantly on the expenditure side, to use in the course of 2013 in case of need, given possible implementation risks.

### **Fiscal policy in 2014**

1.12. The government will achieve a general government deficit of no more than EUR 4.3 billion (2½ percent of GDP) in 2014. [Q4-2014]. To achieve this objective, further consolidation measures of about 1¾ % of GDP will be necessary in 2014. Savings will be generated through expenditure cuts (about 4 bn EUR over 2014-15). A comprehensive expenditure review to fully specify the additional sources of savings will be carried

out by the time of the sixth review and measures will be fully specified by mid-February 2013 in time for the seventh review. The fiscal consolidation plans for 2014-15 will be fully detailed in the 2013 Stability Programme.

1.13. 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]**

## ***2. Financial sector regulation and supervision***

Preserve financial sector stability; maintain liquidity and support a balanced and orderly deleveraging in the banking sector; ensure adequate financing and working capital for the productive sectors; strengthen banking regulation and supervision; optimise the process for recovering the assets transferred from BPN to the three state-owned SPVs; streamline state-owned Caixa Geral de Depósitos; complete the bank resolution framework 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 on a sustainable basis and to take full advantage of the broadening of the range of eligible collateral for the purpose of Eurosystem re-financing. The Banco de Portugal (BdP), in close cooperation with the ECB, will continue to monitor closely the liquidity situation of the banking system and stands ready to take the appropriate measures to maintain sufficient system liquidity. **[Ongoing]** A new platform for interbank unsecured lending has been launched and the BdP is expected to extend it to secured interbank lending by the beginning of next year.

### *Deleveraging in the banking sector*

2.2. The banking system should in the medium run eliminate its funding imbalances. Monitor the banks' implementation of the funding plans aiming at an indicative loan-to-deposit ratio of about 120% in 2014. It is important that the pace and composition of deleveraging should not jeopardise the provision of appropriate credit to finance productive investment and working capital in the private sectors of the economy, not least SMEs. Fiscal adjustment and an attendant reduction in the public sector's financing are crucial for reconciling potentially conflicting objectives. In addition, the BdP will implement the measures taken to discourage evergreening of doubtful loans with a view to facilitating an effective adjustment of bank balance sheets respecting EU state aid rules. In this context, banks are identifying and reporting recently restructured loans due to debtors' financial difficulties and the first report by the BdP is expected by end-November 2012. These steps will be taken without burdening or posing risks to public resources. Banks' funding and capital plans and broader credit developments will continue to be monitored closely. There is room for the necessary deleveraging to take place in an orderly manner and it is crucial that the pace and composition of the deleveraging remain consistent with the macroeconomic framework of the programme. **[Ongoing]**

### *Capital buffers*

2.3. Ensure that the programme target of a Core Tier 1 ratio of 10% by end-2012 target is reached including through the monitoring of the restructuring plans banks having received public capital support were requested to draw up, aiming at enhancing the banks' resilience.

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

2.5. Remain committed to provide further support to the banking system, if needed. Resources from the Bank Solvency Support Facility (BSSF) are available in line with state aid rules to further support viable banks, subject to strict conditionality. Avoid subsidizing private shareholders and prevent further migration of private

liabilities to the public sector balance sheet. In the event new capital needs were to arise, banks are encouraged to seek private solutions. **[Ongoing]**

#### *Caixa Geral de Depósitos (CGD)*

2.6. Continue to streamline the state-owned CGD group.

#### *Banking regulation and supervision*

2.7. The BdP will continue to strengthen its supervisory organisation, optimise its supervisory processes and develop and implement new supervisory methodologies and tools. The field work of a new onsite inspections program (OIP), launched in May 2012 by the BdP has already started in the major banking groups. This initiative is part of BdP regular supervisory activities, which are currently focused on assets classes that are more sensitive to existing market conditions.

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

2.9. BdP will remain committed to close coordination with home and host country supervisors, both within and outside the EU. **[Ongoing]**

#### *Monitoring of bank solvency*

2.10. The BdP will continue to monitor on a **quarterly** basis the banks' potential capital needs with a forward looking approach under stress conditions. In this context, banks will reflect the OIP findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies by **end-December 2012**, with the update of the treatment of collective impairments expected to be finalized at the latest by **end-June 2013**.

#### *Banco Português de Negócios*

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

2.12. Outsource the management of the credits currently held by Parvalorem to a professional third party, with a mandate to gradually recover the assets over time. Select the party managing the credits through a competitive bidding process, to be launched by **end-October 2012**, at the latest, and with a view to complete it by **end-March 2013**. Include proper incentives to maximise the recoveries and minimise operational costs into the mandate. Ensure timely disposition of the subsidiaries and the assets in the other two state-owned SPVs.

#### *Bank resolution framework*

2.13. The early intervention, resolution and deposit guarantee framework has been strengthened. The authorities are asked to conclude the implementing measures. In particular, the following actions will be taken: (a) setting-up of the resolution fund with a view to ensuring its funding arrangement through the approval of a decree-law on the banks' contributions to the resolution fund by **November 2012**; (b) adopt supervisory notices on recovery plans by **end-October 2012**; (c) adopt resolution plans regulations by **end-November 2012**, taking into account, to the extent possible in view of the deadline, the EBA recommendations and templates; (d) adopt rules applicable to setting-up and operation of bridge banks in line with EU competitions rules by **end-October 2012**. Give priority to the review of the recovery and subsequent resolution plans of the banks that are of systemic importance.

2.14. The legislator will closely follow the process of adoption of the EU Directive on resolution and revise the national resolution framework as soon as the Directive enters into force. **[Ongoing]**

#### *Corporate and household debt restructuring framework*

2.15. Establish a framework for financial institutions to engage in out-of-court debt restructuring for households and implement an action plan to raise public awareness of the restructuring tools. **[Ongoing]**

### *Monitoring of corporate and household indebtedness*

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

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

2.17. The Ministry of Finance, the BdP, and other stakeholders, have put forward a set of preliminary proposals to encourage the diversification of financing alternatives to the corporate sector<sup>3</sup>.

- i. Develop and evaluate the different options put forward with a view to set priorities. **[Ongoing]**
- ii. Consider in this exercise also the measures to facilitate access to finance for SMEs **[Ongoing]** and assess the effectiveness of EU-compatible government-sponsored export credit insurance schemes with a view to take appropriate measures to promote exports. **[Q1-2013]**

## **3. Fiscal-structural measures**

### **Objectives**

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

### **Public Financial Management framework**

#### *Reporting and Monitoring*

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

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

3.3. Prepare, in consultation with the EC and the IMF, a dedicated document, which will accompany the budget report, assessing reform progress in the area of public financial management, including the reduction of budget fragmentation and delineating next steps over the next three years. [Q3-2012]<sup>4</sup>

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

#### *Arrears*

3.5. The stock of domestic arrears will be significantly reduced by the end of the programme period. A significant part of the existing arrears will be reduced as laid down in the strategy for the settlement of arrears. The Inspeção Geral de Finanças (IGF) will carry out inspections throughout the process to verify compliance of the commitment control system through a risk-based approach. **[Q3-2012]**

<sup>3</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>4</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

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

#### *Budgetary framework*

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

3.8. Review the Budget Framework Law to take account of the reinforced EU fiscal framework and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (fiscal compact). The revised law will also accommodate the developments in the regional and local financing laws. **[Q4-2012]**

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

### **Regional and local budgetary frameworks**

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

3.11. The budgetary frameworks at local and regional levels will be considerably strengthened, in line with recommendations by the IMF/EC technical assistance mission of July 2011 and the new EU fiscal policy framework. A draft proposal to revise the regional finance law and the local finance law will be discussed with EC/IMF/ECB by **[Q3-2012]** and submitted to Parliament by **[Q4-2012]**<sup>5</sup>. They will include the following main elements:

- i. fully adapt the local and regional budgetary frameworks to the principles and rules in the revised Budgetary Framework Law, namely in what concerns (i) the inclusion of all relevant public entities in the perimeter of local and regional government; (ii) the multi-annual framework with expenditure, budget balance and indebtedness rules, and programme budgeting; and (iii) the interaction with the function of the Fiscal Council. The revision will also foresee that: (i) the Fiscal Council reviews local and regional governments own revenue projections and multi-annual fiscal plans (ii) a contingency reserve is included under the overall current expenditure envelope as a buffer against negative revenue surprises or erroneous expenditure planning, and (iii) the revised legal and institutional PPP framework is applied (see below);
- ii. strengthen fiscal accountability, in particular by: (i) tighter financial requirements for regional and local SOEs and other regional and local public bodies; (ii) a revision of the regime of transfers between the State and the regions and the local authorities; (iii) strengthening the supervisory power from the State on budgetary execution and (iv) apply tighter debt ceilings combined with the adoption of a multi-tiered monitoring system as suggested by the July 2011 technical assistance mission. This reform should follow international best practices;

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<sup>5</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

- iii. limit the scope for lower tax rates in the Autonomous Regions vis-à-vis the rates applied in the mainland and ensure that the resulting additional revenues from increasing the regional rates are used as a priority for fiscal consolidation.
  - iv. strengthen the auditing and enforcement powers of the central tax administration to exercise control over the whole territory of the Republic of Portugal including currently exempt tax regimes.
- 3.12. Create a working group with representatives from the Ministry of Finance, the Autonomous Regions and the local authorities to prepare a proposal for common revenue forecasting guidelines for subnational governments. **[Q3-2012]**
- 3.13. Proceed with identifying data needs to support the revenue projections, balancing the need to preserve tax secrecy and the elaboration of sound forecasts by subnational governments. **[Q3-2012]**
- 3.14. The Government's financial arrangement with the Autonomous Region of Madeira (RAM), which is in full compliance with the Memorandum of Understanding, will be implemented. The Portuguese Government will monitor progress of implementation by RAM and present the results on a quarterly basis in advance of the reviews of the Memorandum of Understanding **[Ongoing]**.

### **Public Private Partnerships**

- 3.15. The renegotiation of PPP sub-concession contracts was completed; the final results of the agreements will be reported to EC, ECB and IMF. Based on the study to assess the costs and benefits of renegotiating any PPP contract to reduce the government financial obligations, the government will develop a detailed strategic plan **before the sixth review** for the renegotiation of PPPs in view of obtaining substantial fiscal gains, while minimising the debt burden, and ensure a sustainable reduction in government liabilities. **[Q4-2013]**.
- 3.16. The government will further work towards implementing the PPP framework law and making the new technical unit in the Ministry of Finance fully operational. No PPP will be launched until this new legal and administrative framework is fully effective. **[Ongoing]** Regions will be encouraged to design a similar framework for assessing fiscal risks derived from PPP, concessions and other public investments, as well as for monitoring their execution. **[Q4-2012]**
- 3.17. The annual PPP report will provide a comprehensive assessment of the fiscal risks stemming from PPPs and concessions. The report will provide information and analysis at sectoral level and 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 Banco de Portugal. The report will serve as input to the fiscal risks assessment for the budget. **[Q3-2013]**

### **State-owned enterprises**

- 3.18. SOEs with commercial activity will reach operational balance by **end of 2012**. This will be achieved by substantially reducing operational costs and raising revenues. To this end the government is implementing the comprehensive SOEs strategy by reviewing the revenue structure and service provision of SOEs, with numerical targets on cost reductions, including measures to realign wages, reduce employment, and additional measures as appropriate. **[Q4-2012]** The authorities will inform the EC, IMF and ECB on progress before the **sixth review**. The government is further assessing options for managing the heavy debt load of SOEs, including Parpública. **[Ongoing]**
- 3.19. The government submitted to Parliament a draft law to strengthen the governance of SOEs in accordance with international best practices. It reviews the existing shareholder approach, giving the Ministry of Finance a decisive role in financial matters of the enterprises, including monitoring of local SOEs. This will

enhance the monitoring powers of the central administration over all SOEs. In addition, the timing and content of financial and operational reporting will be defined. The decisions adopted at central level to improve the efficiency of the enterprises while reducing their financial burden will be implemented at all SOEs, taking into account their specificities. It will include the prohibition for SOEs within the general government to incur new debt with the private sector. No additional SOEs will be created until this law is adopted. **[Ongoing]**

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

## **Privatisation**

3.21. The government is implementing its privatisation programme under the new framework law for privatisation. The privatisation plan targets front-loaded proceeds of about EUR 5 billion through the end of the programme. The sale of GALP and the small remaining stake in REN on the free market have been delayed until market conditions improve. The privatisation or concession of the cargo handling subsidiary of CP (CP Carga) will be concluded by the **second quarter of 2013**. The tenders for the privatisation of the national air carrier (TAP) and the airport operator Aeroportos de Portugal (ANA) were launched in the third quarter, with a view to final decisions by end-2012 and the financial completion of these transactions in **early 2013**. The privatisation of Correios de Portugal (CTT) will be launched, once changes underway in regulation of this sector have their full impact, in order to complete the sale in 2013. The sale or concession of a television channel and radio station belonging to RTP and concessions for transport operators in Lisbon and Porto upon completion of restructuring of the public transport firms in these cities are being considered. CGD's health insurance will be sold in 2012 and the process to sell its insurance arm (Caixa Seguros) to a final buyer is ongoing. The privatisation programme will be expanded to include additional companies and assets for sale or concession in 2013.

3.22. With a view to introducing private capital and management in the water company Águas de Portugal (AdP), a strategy will be prepared. This strategy will include considerations of the competitive and regulatory environment and organisational consequences. **[Q4-2012]**

3.23. The government will work together with the municipalities and regional governments in order to identify the scope for further privatisation, by preparing an inventory of their assets, including real estate. **[Q4-2012]** Progress will be reported in the **sixth review**.

## **Revenue administration**

3.24. The Government is concluding the implementation of the undergone merger of the tax administration, customs administration and the information technology service (DGITA) in a single entity, *Autoridade Tributária e Aduaneira* (AT) by **Q4-2012**.

3.25. Following the creation of *Autoridade Tributária e Aduaneira* (AT), the focus in 2012 will be to merge central and support functions and reduce the number of branches. The reform will be deepened in **2013** by targeting a business function-type structure. In particular, the following elements will be implemented:

- i. review the experience with the task force of tax judges for cases with value above EUR 1 million and assess the need to establish special chambers within the tax tribunals to handle such cases **[mid-November 2012]**;
- ii. reducing the number of municipal offices by at least 20 per cent 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 per cent of the total staff, mostly through reallocations of staff within the tax administration and other parts of the public administration. The threshold should be attained by **Q4-2012**;
- iv. publish quarterly reports on recovery rates, duration and costs of tax cases starting from **Q4-2012** within four months after the end of the relevant quarter.

3.26. To strengthen control and simplify compliance, exchange of information between the collection units of the Tax Authority and the Social Security administration will be significantly strengthened by means, among others, of a unified monthly tax return covering withholding information [**Q1-2013**] as well as a unified form on Independent Workers annual revenue [**Q2-2013**].

3.27. The government will address the bottlenecks in the tax appeal system by progressing with clearing cases worth above EUR 1 million [**Q4-2012**] with the support of the tax court judges.

3.28. With the aim of curbing down fraud and evasion, the Government has approved a reform on the invoicing system in Portugal that will enter into force on 1<sup>st</sup> January 2013. The reform implies mandatory invoicing across all sectors and transactions, a centralized VAT monitoring database, a system to electronically monitor goods in circulation and a tax incentive for final consumers to ask for invoices in hard-to-tax sectors. An evaluation report of the measures will be prepared [**Q2-2013**].

3.29. Also as part of the development of a modern tax compliance management framework, a fully-fledged Large Taxpayer Office (LTO) will be operational by [**Q4-2012**]<sup>6</sup>.

## **Public administration**

### *Central, regional and local administration*

3.30. Conclude the public administration restructuring programme (PREMAC). The final report, comprising the internal organisation and the roster of each entity, including the reallocation of human resources, will be presented in [**Q3-2012**].

3.31. Based on the cost/benefit analysis on foundations, the central, regional or local administration responsible for each foundation or its financial support will decide accordingly whether to maintain, reduce or extinguish them in respect of the new legislation. The government will promote that the same objective is achieved by regions. [**Q3-2012**]

3.32. The approach on foundations – the compulsory census and the subsequent analysis, adjusted as needed - will also be applied to associations and extended later to other public and quasi-public entities across all levels of government. [**Q4-2012**]

3.33. Reorganise local government administration. There are currently 308 municipalities and 4,259 parishes. The government will reorganise and significantly reduce the number of such entities. 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. [**Q3-2012**]

3.34. Building on the study carried out by the inter-ministerial working group for territorial issues an identification of potential duplication of activities and other inefficiencies between the central administration, local administration and locally-based central administration services will be made by the **sixth review**. Based on this analysis, reform the existing framework to eliminate the identified inefficiencies. [**Q4-2012**]

### *Shared services*

3.35. 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:

<sup>6</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

- i. complete the implementation of the strategy of shared services in the area of financial resources (GeRFIP). **[Q1-2013]** GeRFIP will also be implemented in the Autonomous Region of Madeira and in the Autonomous Region of Azores **[Q4-2013]**;
- ii. fully implement the strategy of shared services in the area of human resources (GeRHuP) in the Ministry of Finance's entities **[Q4-2012]**, with the exception of the Tax Authority for which this is scheduled for **end-June 2013**. Other Ministries will follow in 2013. The Autonomous Region of Madeira will implement GeRHuP gradually;
- iii. 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 in line with the "Overall Strategic plan to rationalise and reduce costs on ICT in Public Administration". **[Q4-2012]**

3.36. 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*

3.37. The 2012 budget promotes flexibility, adaptability and mobility of human resources across the administration, including by providing training and requalification where appropriate. In addition, the mobility schemes, namely geographic mobility and the regulation on mutual agreement on contract termination, will be reinforced as an instrument to manage human resources across administrations. The human resource instruments (geographic mobility, special mobility and overtime compensation rules) are to be applied to all sectors of Public Administration, including teachers and health professionals. **[Ongoing]**

3.38. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 2 per cent per year (in full-time equivalents) in the staff of central administration and 2 per cent in local and regional administrations (in full-time equivalents); including a significant reduction of fixed-term contracts. The government will ensure the implementation of this measure at local administration level and will promote the initiatives needed so that each region will present its plan to achieve the same target. **[Ongoing]**

3.39. The government will prepare a comprehensive review of wage scales in the general government, to identify unwarranted differences in remuneration between the public and the private sector for similar types of qualifications. **[Q4-2012]** The comprehensive study of SOEs will follow in **Q2-2013**.

3.40. Acceleration the convergence of the system of social protection for staff that are in the Regime de Proteção Social Convergente (RPSC) to the rules of Regime Geral de Segurança Social. **[Q4-2013]**

### **Health care system**

#### **Objectives**

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

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

#### *Financing*

3.41. The revision of NHS moderating fees (*taxas moderadoras*) will result in additional revenues of EUR 150 million in 2012 and an additional 50 million in 2013. **[Q4-2012]**

3.42. In the light of the urgency and size of the savings needed in the health sector to address large arrears and budget limitations, plans to achieve a self-sustainable model for health-benefits schemes for civil servants will be accelerated. The current plan foresees that the overall budgetary cost of existing schemes - ADSE, ADM

(Armed Forces) and SAD (Police Services) - will be reduced by 30 per cent in 2012 and by further 20 per cent in 2013 at all levels of general government. The system would become self-financed by 2016. The costs of these schemes for the public budget will be reduced by lowering the employer's contribution rate to 1.25% in 2013 and by adjusting the scope of health benefits. **[Q3-2012]**.

#### *Pricing and reimbursement of pharmaceuticals*

3.43. Enact legislation which automatically reduces the prices of medicines when their patent expires to 50 per cent of their previous price. **[Q4-2012]**

3.44. The government implements an annual revision of prices of medicines and of countries of reference in order to achieve cost savings. Second price revision to be published in **January 2013**.

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

#### *Prescription and monitoring of prescription*

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

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

3.48. Strictly monitor the implementation of the legislation making it compulsory for physicians at all levels of the system, both public and private, to prescribe by International Non-proprietary Name (INN) to increase the use of generic medicines and the less costly available product. An implementation report will be published by **December 2012**.

3.49. Continue to publish prescription guidelines with reference to medicines and the realisation of complementary diagnostic exams on the basis of international prescription guidelines, audit their implementation and integrate them in the electronic prescription system. A first set of guidelines is introduced in the e-prescription system by **Q2 2013**.

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

3.51. The above measures should aim at gradually and substantially increasing the share of generic medicines to at least 30 per cent of all outpatient prescription (in volume) in 2012. Targets for substantial further increases in 2013 will be agreed in the **sixth review**.

#### *Pharmaceutical retailers and wholesalers*

3.52. The Government will produce an intermediate assessment of the savings related to the revision of the calculation of profit margins for wholesale companies and pharmacies. **[Q3-2012]**.

3.53. If the revision does not produce the expected reduction in the distribution profits of at least EUR 50 million, an additional contribution in the form of an average rebate (pay-back) will be introduced, which will be calculated on the mark-up. The rebate will reduce the new mark-up on producer prices further by at least 2 percentage points on pharmacies and 4 percentage points on wholesalers. The rebate will be collected by the government on a monthly basis through the Centro de Conferência de Facturas, preserving the profitability of small pharmacies in remote areas with low turnover. **[Q4-2013]**

### *Centralised purchasing and procurement*

3.54. Reinforce the centralised acquisition of vehicles, utilities, external services and other cross functional goods and services by all entities included in the NHS, in order to reduce costs through price volume agreements and fighting waste. A detailed action plan will be published by **November 2012**.

3.55. INFARMED will continue implementing the uniform coding system and a common registry for medical supplies. **[Ongoing]**

3.56. Take further measures to increase competition among private providers and reduce by an additional 10 percent the overall spending of the NHS with private providers delivering diagnostic and therapeutic services (with particular reference to dialysis and rehabilitation). Regularly evaluate and if necessary revise (at least every two years) the remuneration paid to private providers with the aim of reducing the cost of more mature diagnostic and therapeutic services. **[Q4-2012]**

3.57. 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. Assess the possibility of implementing the compulsory use of a formulary in all hospitals to monitor the stock and flows of hospital medicines and medical supplies and monitor compliance with central purchasing. **[Ongoing]**

3.58. Conduct an analysis of the market characteristics of relevant areas of service provision such as dialysis and the pharmacies sector in view of ensuring competition and fair prices in private markets. **[Q4-2013]**

### *Primary care services*

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

- i. increasing the number of USF (*Unidades de Saúde Familiares*) units contracting with regional authorities (ARs) using a mix of salary and performance-related payments as currently the case. Extend performance assessment to the other primary care units (UCSPs). Make sure that the new system leads to a reduction in costs and more effective provision;
- ii. setting-up a mechanism to guarantee the presence of family doctors in needed areas to induce a more even distribution of family doctors across the country;
- iii. moving human resources from hospital settings to primary care settings and reconsidering the role of nurses and other specialties in the provision of services;
- iv. updating patients' registration lists and the national register in order to increase by at least 20 per cent the maximum number of patients per primary care/family doctor for health centres and by 10 per cent for the USF.

### *Hospital services*

3.60. Implement the strategy to clear arrears in the health sector, within the overall strategy for settling and avoiding the re-emergence of arrears. Ensure standardised and tight control procedures for all health sector entities to ensure expenditure commitments stay within the budget allocated to each entity and therefore prevent the re-emergence of arrears. **[Q3-2012]**

3.61. Hospital SOEs will 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. **[Q4-2013]**

3.62. Implement measures aimed at achieving a reduction of at least EUR 200 million in the operational costs of hospitals **in 2012**. This is to be achieved through the reduction in the number of management staff, concentration and rationalisation in state hospitals and health centres with a view to reducing capacity. **[Q4-2012]**

3.63. Continue the publication of clinical guidelines and set in place an auditing system of their implementation. **[Ongoing]**

3.64. On the basis of the comprehensive set of indicators, produce regular annual reports comparing hospital performance (benchmarking). Establish a web-portal with publicly available information. The first report is to be published **by end 2012** and its results should be used to establish targets for less performing hospitals. **[Q4-2012]**

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

3.66. Continue with the reorganisation and rationalisation of the hospital network through specialisation, concentration and downsizing of hospital services, joint management (building on the Decree-Law 30/2011) and joint operation of hospitals. The aim is to adjust hospital provision within the same health region, notably in the presence of newly established PPP hospitals, adjust the activity of some hospitals from curative care towards areas such as rehabilitation, long-term and palliative care and revise emergency and transplantation structures. These improvements aim at eliminating unnecessary duplication, achieving economies of scale and deliver additional cuts in operating costs by at least 5 percent in 2013 while improving the quality of care provided. A detailed action plan is published **by 30 November 2012** and its implementation is finalised **by end-2013**. Overall, from **2011 to 2013**, hospital operational costs must be reduced by at least 15 per cent compared to 2010 level. **[Q4-2012]**

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

3.68. Update the current legal framework applying to the organisation of working time of healthcare staff, including introduction of rules to increase mobility within and across Health Regions, adoption of flexible time arrangements and review of payment mechanisms for emergency work, the prevention regime and per call payments, notably by aligning overtime remuneration in the health care sector with the general legal framework recently adopted. In this context, overtime compensation should be reduced by 20% in 2012 and another 20% in 2013. **[Q4-2012]**.

#### *Regional health authorities*

3.69. Improve monitoring, internal control and fiscal risks management systems of the Administrações Regionais de Saúde. **[Q4-2012]**

#### *Cross services*

3.70. Roll-out the system of patient electronic medical records and ensure access to all relevant health care facilities. **[Ongoing]**

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

## **4. Labour market and education**

### **Labour market**

#### **Objectives**

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

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

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

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

#### *Unemployment benefits*

4.1. Following the reform of the unemployment benefit system (Decree-law 64/2012 and Decree-law 65/2012 of 15 March) - which introduces a declining profile for unemployment benefits, reduces the maximum monthly amount of benefits, reduces the maximum unemployment benefits duration and increases coverage by reducing the contribution period for eligibility and by extending the system to a clearly-defined category of self-employed - the government will prepare by **Q4-2012** an analysis on benefit dependency and long-term unemployment with a view to assessing whether further measures are needed to address possible deficiencies by **Q1-2013**.

#### *Employment protection legislation*

4.2. The government will carry out reforms in the employment protection system aimed at tackling labour market segmentation, fostering job creation, and easing adjustment in the labour market. **[Ongoing]**

4.3. Severance payments **[Ongoing]**. Following the entry into force of law n. 53/2011 concerning the reform in the severance payments for new hires in line with the MoU (which reduces severance payments to 20 days per year of work for both open-ended and fixed-term contracts, while introducing a cap of 12 months of pay and eliminating the 3 months of pay irrespective of tenure for permanent contracts, and makes compulsory the partial financing of severance payments via a compensation fund) and the entry into force of law n. 23/2012 (which aligns the level of severance payments to current employees), the government will further reduce severance payments and implement the compensation fund to partly finance severance payments. Until the fund is operational, the employers remain responsible for the total of severance payments. In consultation with social partners, the Government will, submit to Parliament by **Q3-2012** draft legislation aiming at:

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

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

#### *Wage setting and competitiveness*

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

- i. commit that, over the programme period, any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of the programme review **[Ongoing]**;
- ii. ensure wage moderation by using the available discretion in the current legislation of not extending collective agreements until clear criteria are defined as foreseen by point 4.5(iii);

- iii. define clear criteria to be followed for the extension of collective agreements and commit to them. The representativeness of the negotiating organisations and the implications of the extension for the competitive position of non-affiliated firms will have to be among these criteria. The representativeness of negotiating organisations will be assessed on the basis of quantitative indicators. To that purpose, the government will take the necessary steps to collect data on the representativeness of social partners. Based on this data, a collective agreement subscribed by employers' associations representing less 50 percent of workers in a sector cannot be extended. When that threshold is reached a decision on extension will have to take into consideration the implications on competitiveness of firms in the sector. Draft legislation defining criteria for extension and modalities for their implementation will be submitted to Parliament or published as a Council of Ministers resolution by **Q3-2012**<sup>7</sup>, with a view to entering into force by **Q1-2013**;
- iv. prepare an independent review by **Q4-2012** on:
  - o how the tripartite concertation on wages can be reinvigorated with a view to defining 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;
  - o the desirability of shortening the survival (*sobrevigência*) of contracts that are expired but not renewed (art 501 of the Labour Code).

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

#### *Active labour market policies*

4.7. The Government will ensure good practices and an efficient amount of resources to activation policies to strengthen job search effort by the unemployed and to other Active Labour Market Policies (ALMPs) to improve the employability of the young and disadvantaged categories and ease labour market mismatches. Following the preparation of a report assessing the effectiveness of ALMPs and the publication of the Council of Ministers Resolution n.20/2012, which sets a plan to improve ALMPs, including the role of Public Employment Services (PES) , the Government by **Q4-2012** will present a report:

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

#### *Education and training*

4.8. 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

<sup>7</sup> Structural benchmark in the Memorandum of Economic and Financial Policies

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). Following the progress made until Q4-2011, the government will continue to improve the system with a view to having an operational management tool by **Q3-2012**;
- ii. in line with the action plan to improve the quality of secondary education the Government, by **Q3-2012**, will: (i) implement the legislation to promote trust agreements with public schools and report about progress; (ii) define and implement a simple formula-based funding framework comprising performance evaluation criteria and accountability for public schools and schools under autonomy agreements; (iii) present an assessment of the new inspection model;
- iii. in line with action plan on vocational and educational training (VET) the Government will present a progress report on: (i) ways to promote the involvement of businesses in the provisions of traineeships [**Q3-2012**]; (ii) action taken to reorganise modalities for the provision of VET, improve the quality and attractiveness of VET, and to enhance students' orientation and career guidance [**Q4-2012**]; (iii) the establishment of "professional schools of reference". [**Q1-2013**]

## ***5. Goods and services markets***

### **Objectives**

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

### **Energy markets**

#### **Objectives**

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

#### *Liberalisation of electricity and gas markets*

5.1. Fully transpose the Third EU Energy Package. In particular, adopt the law on the penalty system of the regulator and of the decree-laws transposing the electricity and gas directives by **Q3-2012**. To ensure the National Regulatory Authority's independence, autonomy and all powers foreseen in the package, adopt by [**Q3-2012**] the new regulators' bylaws agreed in July 2012, consulting the EC/ECB/IMF if changes are introduced,

and ensure that they are effective before end of year in time for the liberalisation of the electricity and gas market [Q4-2012]. Progress towards this end will be monitored during the **sixth review**.

5.2. Take measures to accelerate the establishment of a functioning Iberian market for natural gas (MIBGAS), through regulatory convergence and the harmonisation of the tariff structures in Portugal and Spain. In particular, in accordance with the roadmap of 30 September 2011 agreed with the Spanish authorities, the regulators of each country will:

- i. present proposals to harmonise the tariffs for access to the interconnection networks taking into account the outcome of the public consultation conducted in January 2012 [Q3-2012];
- ii. prepare a report analysing and developing options to improve the harmonised mechanism for capacity allocation and congestion management of cross-border flows with Spain, including the introduction of virtual reverse flows and other mechanisms allowing smaller players to make efficient use of the LNG Sines facility [Q1-2013];
- iii. apply a harmonised allocation and congestion management mechanism to all the interconnection capacity between Portugal and Spain, in line with the EU network codes and guidelines in this respect [Q1-2013].

5.3. Clarify the national legal framework with respect to the scope of competencies of the logistics operator and define based on a cost-benefit analysis a way of convergence of the existing two platforms for electricity and natural gas. [Q4-2012]

#### *Ensure sustainability of the national electricity system*

5.4. Conclude the measures approved in the Council of Ministers on 17 May 2012 to reduce excessive rents and to address the sustainability of the national electricity system. Cost reduction measures address the following compensation schemes: power guarantee, special regime (renewables - excluding those granted under tender mechanisms – and cogeneration), CAE's (power purchase agreements) and CMECs, and will reduce policy cost by at least EUR 1275 million in Net Present Value (NPV)<sup>8</sup> [Q3-2012]. The updated estimation of cost reductions that will be achieved as well as progress towards elimination of the tariff debt (defice tarifário) by 2020 will be presented and assessed in the **sixth review**.

5.5. Conclude the announced measures to limit the policy costs embedded in CMECs and PPAs by **October 2012**. In particular, as an element in revising the rate of return to bring it in line with the cost of capital at the moment the CMEC compensation was defined plus, if warranted, a risk premium of the assets that the mechanism remunerates: (i) reduce the CMEC annuity discount rate from 7.55% to 5% (yielding a NPV of EUR 120 million) in a legally certain manner; and (ii) set a compensation for the extension of exploitation licences of the power plants in Sines and Pego<sup>9</sup> yielding NPVs of EUR 55-75 million and EUR 30-50 million respectively, providing details on the valuation methodology leading to these figures. The updated estimation of cost reductions that will be achieved will be presented and assessed in the **sixth review**.

5.6. Present a report on the CMEC scheme including the foreseen annual compensation amounts to each beneficiary and past payments since 2007 and the forecast of future payments. The report will also describe the process for the extension of the concession of the public hydro resource by the former CAE hydro power plants, its correspondent economic valuation, and the rationale for the direct award instead of a tender process. The report will assess and consider all the information available within the governmental and the official bodies (General Directorates, Regulator, State representative in the contracts). [Q3-2012]

5.7. Conclude the announced measures to limit the policy costs of renewables under the special regime - excluding those granted under tender mechanisms, in particular (i) the compensation to be paid by the generators (yielding a NPV of EUR 85 to 103 million); and (ii) the introduction of a maximum duration for the feed in tariff

<sup>8</sup> Computed using a discount rate of 7.55% back to June 2012.

<sup>9</sup> Pego power plant compensation will not be included when determining the reduction of the rate of return of the CMEC.

in small hydro plants (yielding an NPV of EUR 200 to 250 million). The updated estimation of cost reductions that will be achieved will be presented and assessed in the **sixth review**.

5.8. Accelerate convergence to market-based pricing for co-generation operators in parallel with electricity market developments under the EU internal electricity and gas market legislation. The remuneration scheme for co-generation will be further revised to improve efficiency of the support system in ensuring continued guaranteed access of operators to electricity networks and markets with the calculation of explicit subsidies based on relevant price factors in the context of a competitive electricity market. The revision should ensure that the design of the support scheme allows a dynamic correlation between electricity market prices and the efficiency premium when the values of avoided externalities are not adequately reflected in electricity and other factor prices. This revision will be undertaken in line with the framework of the transposition of the energy efficiency directive **[Q1-2013]**. Ensure through annual audits that plants not fulfilling the requirements for co-generation do not receive the support, and report on the progress. **[Q2-2013]**

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

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

## **Telecommunications and postal services**

### **Objectives**

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

#### *Telecommunications*

5.11. Ensure an efficient, objective, transparent and non-discriminatory mechanism for the designation of the universal service provider(s), in compliance with the Court of Justice ruling of 7 October 2010. Re-negotiate the concession contract with the undertaking currently providing the universal service, by reducing the scope of the services covered, so as to exclude the universal service and launch a new tender process for designation of universal service provider(s). **[Q3-2012]**

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

#### *Postal services*

5.13. Following the transposition of the Third Postal directive, further liberalise the postal sector by amending the decree-law laying down the framework of the concession contract and renegotiating the amendment of said contract with CTT, in order to reflect the new law (Law 17/2012) transposing the Third Postal Directive; ensuring in particular that the current designation period for the universal service provision is shortened to 2020 and that investment needs and return on investment are taken into account when setting new designation periods. **[Q3-2012]**

## **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.

#### *Strategic Plan for Transport*

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

- i. continue the reforms in the transport SOEs to achieve their EBITDA balance, by focusing efforts on the reduction of operational costs;
- ii. reduce the forecast debt burden of Estradas de Portugal through the reduction of PPP contracts' scope still in the construction phase, revision of shadow-toll schemes and the adjustment of the CSR (Road Service Contribution) to the inflation level. Analyse additional measures to further reduce the forecast debt burden of Estradas de Portugal;
- iii. attract new low-cost airline companies and/or routes, making use of the existing infrastructures;
- iv. focus the investment priorities in projects that present a positive cost-benefit ratio and contribute to the competitiveness of Portuguese exports, namely in the port and freight rail sectors;
- v. reform the transport and infrastructures' regulatory framework in order to improve the effectiveness, efficiency and independence of the entities regulating the transport sector. **[Q1-2013]**

5.15. Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability **[Q4-2012]**. It will specifically include an assessment of the existing rail, road and port networks and present a set of investment priorities for the 2020 and 2030 horizons, taking also into account TEN-T networks, with an estimate of the financial needs and the foreseen sources of financing **[Q2-2013]**.

#### *Railways sector*

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

- i. ensure that the rail regulator enjoys the independence required under the EU rail Directives, in particular regarding the rules of appointment and dismissal of the director of the rail regulator. Strengthen the capacities of the railway regulator to fulfil its regulatory mandate effectively, including by exploring synergies with other transport regulators in the context of the revision of national regulatory agencies. **[Q4-2012]**;
- ii. continue to implement the plans to bring the infrastructure manager to operational balance, in particular by reducing operational costs by at least 23 per cent in 2012 compared to 2010 **[Q4-2012]**. On the revenue side, track access charges for freight services should not be increased in order to prevent a deterioration of the competitiveness of rail freight services. Reintroduce incentives to REFER to reduce costs and access charges. Provide annual progress reports on the implementation of balancing revenues and expenditures **[Q2-2013]**;
- iii. ensure that the new Public Service Obligation (PSO) contracts concluded on rail passenger transport respect EU legislation including Regulation (EC) No 1370/2007, and in particular provide a detailed breakdown of state contributions for each line under PSO **[Q3-2012]**.

- Develop administrative capacity for a stepwise introduction of competitive tendering of PSOs starting with some suburban services. Ensure that the awarding authority has the required level of independence and competence and guarantees fair conditions of tendering [Q4-2012];
- iv. extend the performance scheme on infrastructure charges to other operators [Q4-2012];
  - v. review and render more effective the yield management on long-distance passenger ticket prices. [Q1-2013];
  - vi. to prepare the privatisation of the freight branch of the state-owned rail operator, carry out an analysis for transferring part or whole of CP Carga's rolling stock to a rolling stock operating company [Q2-2013];
  - vii. ensure that the rail terminals currently owned by CP Carga are transferred to another entity that will guarantee non-discriminatory access to all rail freight operators. [Q4-2012]; Plans will be presented and assessed in the **sixth review**.

### *Ports*

5.17. In cooperation with EC/IMF/ECB prepare and submit to Parliament a revised legal framework governing port work to make it more flexible, including narrowing the definition of what constitutes port work, bringing the legal framework closer to the provisions of the Labour Code. [Q3-2012] The revised legal framework is expected to come into force by [Q4-2012]. A review of the overall savings generated and the impact of the introduction of the law on port usage cost will be made by **August 2013**.

5.18. Take further steps to improve the governance model of the ports system with the objective to enhance the competitiveness and the efficiency of ports in line with the Strategic Plan of Transport 2011-2015. The Government will deliver and enforce policies that ensure strong integrated policy-making, strategic planning and surveillance functions common to all ports in the country. Moreover, policy decisions will be taken and enforced so that (i) efficiency gains and cost-savings are passed through to port customers; and (ii) concession-holders of terminals and land facilities in ports respect minimum performance criteria. [Q4-2012]

### *Road pricing*

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

## **Other services sector**

### **Objectives**

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

### *Sector-specific legislation of Services*

5.20. Further to the adoption of a significant number of amendments to the sector specific legislation, complete the adoption of the outstanding sectorial amendments necessary 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. Adopt the remaining required amendments and submit them to Parliament by [October 2012] in view of approval by [January 2013].

5.21. Adopt the necessary sector-specific amendments in the areas of construction and real estate to make both regimes fully compatible with the Services Directive and with the Treaty on the Functioning of the

European Union. 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). For real estate, submission to the Parliament took place on 1 August in view of approval by [Q3-2012]. For construction services, submit to Parliament by [Q3-2012] in view of approval by [Q4-2012].

#### *Professional qualifications*

5.22. Improve the recognition framework on professional qualifications, in particular through the adoption of the executive order (portaria) on the services providers' prior declaration alongside the entry into force of amendment to Law 9/2009. [Q3-2012]

#### *Regulated professions*

5.23. Review and reduce the number of regulated professions and in particular eliminate reserves of activities on regulated professions that are no longer justified, through adoption by the Parliament of the law for professions where regulation does not involve a professional body (Ordens or Câmaras) by [October-2012]. Following the final report by the Comissão de Regulação do Acesso a Profissões (CRAP), launch by [Q1-2013] a second phase investigation of the review of regulated professions to eliminate unjustified requirements by [Q2-2013].

5.24. Further improve the functioning of the regulated professions (such as accountants, lawyers, notaries) for which regulation involves a professional body (Ordens or Câmaras) by carrying out a comprehensive review of requirements affecting the exercise of activity and eliminate those not justified or proportional, including: (i) adopting the measures included in 5.22 and 5.23; (ii) eliminating restrictions to the use of commercial communication (advertising), as required by the Services Directive. To achieve the two conditions above the government has, following the public consultation, submitted a draft horizontal legal framework to Parliament in view of approval by [Q3-2012]. Upon enactment, the professional bodies will make the necessary changes in their statutes by [Q4-2012].

#### *Administrative burden*

5.25. Continue the simplification reform effort by:

- i. adapting the content and information available at the Point of Single Contact (PSC) for the 44 amended regimes to ensure conformity with the Services Directive and for those that have not required amendments so far by [January 2013] and make available online forms for the completion of procedures by [Q1-2013]. Constantly adapting the content and information available at the PSC to the remaining 24 sector-specific regimes that are about to be adopted to ensure conformity with the Services Directive (see 5.20 and 5.21 above) at the latest 1 month after the adoption of each sector-specific regime, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by making available online forms and extend on-line procedures for all sectors covered by the Services Directive no later than 2 months after adoption of the sector-specific regime;
- ii. adapting the content and information available at the PSC for the 13 regimes approved to ensure conformity with the Professional Qualifications Directive by [January 2013] and online forms by [Q1-2013]. Constantly adapting the content and information available at the PSC to the new legislation to be adopted to ensure conformity with the Professional Qualifications Directive at the latest 1 month after the adoption of amendments mentioned in 5.22, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by extending on-line forms and procedures for each profession no later than 2 months after adoption of amendments;
- iii. making available in PSC on-line procedures for the registration, installation, modification, occupation of public space regimes, and closing up of restaurants, bars and other establishment for the 5 municipalities (Porto, Águeda, Abrantes, Portalegre and Palmela) covered by "Zero Authorisation" pilot project (DL 48/2011) by [Q4-2012]. Foster collaboration from municipalities in providing the content for the working hours map for the stores and

establishments services and advertisement regimes for which they have full competence to make the PSC operational [Q4-2012]; Identify and classify municipalities where the availability of those procedures through the PSC would have the most significant economic impact by [November-2012] to prepare for the extension of this tool to major municipalities by [January-2013]. Make fully operational the "Zero Authorisation" project that abolishes authorisations/licensing and substitute them with a declaration to the PSC for the wholesale and retail sector and restaurants and bars by [Q2-2013]. The platform will be available to all levels of administration, including all municipalities [Q2-2013];

- iv. extending PSC to services not covered by the Services Directive [Q4-2013];
- v. extending the "Zero Authorisation" project to other services sectors of the economy [Q4-2013].

5.26. Submit an updated detailed work programme of AMA to fulfil 5.25 by [October 2012] and to be regularly updated on a **monthly** basis.

## ***6. Housing market***

### **Objectives**

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

#### *Property taxation*

6.1. The government will continue to step up the appraisal of the taxable value of the housing stock. In particular, the measures will: (i) ensure that the taxable value of all property in 2012 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). [Q4-2012]

6.2. The government will gradually rebalance property taxation towards the recurrent real estate tax (IMI) and away from the transfer tax (IMT), while considering the socially vulnerable. [Q3-2013]

#### *Comprehensive review of the housing market*

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

## ***7. Framework conditions***

### **Judicial system**

#### **Objectives**

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

#### *Court backlog*

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

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

7.2. Implement targeted measures to achieve steady reduction of the backlogged enforcement cases. In particular, set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, by inter-agency task forces with the fourth report to be completed by **mid-November 2012**.

7.3. Present a revised draft bill for enforcement agent's framework (i) strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, and (ii) to include a fee structure that incentivises speedy enforcement to be further refined by extensive consultation including with the IMF/EU technical assistance by **mid-November 2012** which will be approved by the government by **end-February 2013**.

#### *Management of courts*

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

7.4. Having submitted an initial draft bill on judicial reform mid-August 2012 it will be further refined by extensive consultation by end-September 2012. Submit a Bill to implement the judicial reform roadmap to Parliament by **end-November 2012**<sup>10</sup>.

#### *Alternative dispute resolution for out-of-court settlement*

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

7.5. Submit the Bill to improve the Justices for Peace regime to Parliament by **end-November 2012**.

#### *Civil law cases in the courts*

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

7.6. Having prepared an initial draft of the new Code of Civil Procedure by 6 July 2012, it will be further refined by extensive consultation by **end-September 2012**. By **end-November 2012**<sup>11</sup> submit to Parliament the Code of Civil Procedure which addresses the key areas for improvement, including (i) to consolidate legislation for all aspects of enforcement cases before the court, (ii) to give the judge the power to expedite cases, (iii) to restrict the administrative burdens for judges, (iv) to enforce statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases and (v) to establish a single judge procedure for small claims, and taking into account stakeholder consultation and comparative law analysis.

#### *Budget and allocation of resources*

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

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

## **Competition, public procurement and business environment**

### **Objectives**

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

<sup>10</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

<sup>11</sup> Structural benchmark in the Memorandum of Economic and Financial Policies.

dealing with export promotion and access to finance and support the reallocation of resources towards the tradable sector.

#### *Competition and sectoral regulators*

7.8. The Government shall take the necessary measures to ensure that the Portuguese State or any public bodies do not conclude, in a shareholder capacity, shareholder agreements the intention or effect of which hinder the free movement of capital or which influence the management or control of companies **[Ongoing]**. The Portuguese State will ensure that CGD alienates its participation in Galp. **[Q3-2012]**

7.9. 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. **[Ongoing]**

7.10. Monitor the inflow of cases and report on the functioning of the specialised court for Competition, Regulation and Supervision, assessing the situation in terms of risk of potential court backlogs. **[Q4-2012]**

7.11. Following up on the adoption of the executive order (portaria) concerning the transfers of payments from regulators to the Competition Authority and the report prepared under measure 7.12 (i), the financing model of the latter will be re-examined resulting in a technical proposal by **[Q1-2013]** to be implemented by **[Q2-2013]**. Given the enlarged scope of action of the Competition Authority, review with key stakeholders the conditions for the proper execution of its mandate. **[Q3-2012]**

7.12. Building on the independent report on the main National Regulator Authorities, the government will prepare a framework law for regulators in broad consultation with the Regulator Authorities. This law will establish a regulatory environment that protects the public interest and promotes market efficiency. The law will guarantee the Regulator's independence and financial, administrative and management autonomy to exercise their responsibilities, in full compliance with EU law. The law will also contribute towards the effectiveness of the competition authority in enforcing competition rules therefore supporting and complementing the effect of the recently adopted competition law. The framework law will be submitted to parliament by **[Q1-2013]**.

#### *Public procurement*

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

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

#### *Business environment*

7.14. Make operational the procedures for requesting VAT exemptions for exporting firms and to simplify procedures associated with indirect exports as part of the "Simplex Exports" programme. **[Q4-2012]**

7.15. As a follow up to the report delivered on access to finance and internationalisation of companies, present an action plan with measures to facilitate access to finance and to export markets for companies, in particular for SMEs. **[Q3-2012]**

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

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

## Licensing environment

### Objectives

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

#### *Regulatory simplification*

7.18. To deal with the legacy of excessive licences procedures and other administrative burdens, carry out a full inventory and an analysis of the costs of all regulations in the economy (at central, regional and local levels). **[Q2-2013]** On the basis of the analysis the government will devise a roadmap for a regulatory simplification.

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

7.20. Create a working group to analyse and fast-track applications for the licensing of planned investment projects which are left unresolved or undecided for more than 12 months **[Q4-2012]**.

#### *Environment and territory planning*

7.21. In consultation with the relevant stakeholders, review the legal regimes at all levels of Government in the area of territorial planning, in order to increase and facilitate the establishment of investors while at the same time limiting urban sprawl. In particular, review the following legal regimes, in the area of territorial planning:

- i. new Base Law of Soil and Territorial and Urbanism Planning (Lei dos Solos), that should be aligned with the new Industrial Licensing regime (measure 7.24 ii) **[Q4-2012]**;
- ii. National Ecological Reserve/ Risks (REN): (1) Changes to Decree-Law 166/2008 (RJREN); (2) Publication of strategic orientations regarding modifications of REN's municipal delimitations; (3) Revocation of Ordinance 1356/ 2008 (Compatible REN actions); 4. Joint Dispatch of the Secretaries of State of Environment and Territorial Planning and of Internal Administration in order to determine the creation of Risk Sectorial Plan **[Q4-2012]**;
- iii. review the legal regimes of the Territorial Management Instruments (RJIGT) and of the related regulations **[Q4-2012]**;
- iv. diploma for the regularization of activities not in accordance with Territorial Management Instruments **[Q4-2012]**;
- v. diploma for the harmonization of Territorial Planning Regional Plans – new generation **[Q4-2012]**;
- vi. review the Legal Regime for Urbanism and Building (RJUE) , that should be aligned with, the new Industrial Licensing regime (measure 7.24 ii) **[Q1-2013]**

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

- i. implement a Legal Regime of Land Registration (registo cadastral) **[Q4 2013]**;
- ii. create a diploma on Land Registration and Land Registration Experts **[Q4-2013]**;
- iii. review the cartography for plans regime **[Q4-2013]**, and the diploma on Cartography **[Q4-2013]**;

- iv. enforce the Council of Ministers Resolution 56/2012 by **Q4-2013**, to collect all land registration procedures, currently scattered in various departments.

7.23. Change the legal regime for Environment Impact Evaluation in order to increase the speed and effectiveness of this regulation and reduce associated monetary and time costs. **[Q4-2012]**.

#### *Industrial Licensing*

- 7.24. Implement the new Industrial Licensing regime by means of:
- i. fully implement the approved Programme of Responsible Industry (“PIR - Programa da Indústria Responsável” **[Q2-2013]**);
  - ii. review the following legal norms and regimes that are crucial for a successful implementation of the approved System of Responsible Industry (“SIR - Sistema da Indústria Responsável”):
    - a. implement zero licensing procedures for Type 3 and Type 2 industries **[Q4 2012]**, including fully integration of these procedures in the one-stop shop (“Balcão do empreendedor”). Implement fast-track procedures for Type 1 industries **[Ongoing]**;
    - b. define and establish the Zones of Responsible Enterprises (ZER – Zonas da Indústria Responsável) by **[Q1-2013]**, which will allow the installation of industries in areas previously licensed with all industrial, building and environmental provisions required by national and European law;
    - c. create and define standardized industrial licenses **[Q1-2013]**;
    - d. ensure that the new Industrial Licensing is aligned with, and strengthened by, the review of the New Base Law of Soil and Territorial and Urbanism Planning while at the same time limiting urban sprawl (measure 7.21 i) **[Q4-2012]**;
    - e. ensure that the new Industrial Licensing is aligned with, and strengthened by, the review of the Legal Regime for Urbanism and Building (RJUE - measure 7.21 vi) **[Q1-2013]**.

#### *Commercial licensing*

7.25. Review the commercial licensing regime. Approval of a new legal regime for commercial activities and establishment of the Program for the Competitiveness of Commerce and Services activities (“Programa para a Competitividade do Comércio e Serviços), which will simplify and condense in a single law more than 20 dispersed existing legal regimes **[Q4-2012]**.

#### *Geology*

- 7.26. Reviewing the geological licensing regimes, including:
- i. revision of the legal regime concerning the licensing of mining and geological production and investment in line with international best practices in this field **[Q4-2012]**;
  - ii. simplify the legal and bureaucratic procedures pertaining to mining and geological investments, especially in terms of assessment, search, development, and production activities **[Q4-2012]**.

#### *Tourism*

- 7.27. Review the Licensing in Tourism regime:
- i. eliminate or transforming into a voluntary regime the mechanism of prior communication in the Regime for Urbanism and Building **[Q1-2013]** Simplify the legal regime for touristic establishments **[Q4-2012]**;

- ii. expand the range of ex post control mechanisms in urban operations, significantly reducing administrative procedures and costs for developers [Q4-2012];
- iii. simplified and transparent requirements on the classification of the several types of touristic establishments (number of stars) [Q4-2012];
- iv. review of the sanction legislation on the touristic establishments regime as a way to fight informal touristic economy, giving more powers to ASAE (Authority for Economic and Food Safety). [Q4-2012]

## PORTUGAL: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

14 October 2012

### I. Macroeconomic Outlook

1. **GDP growth and inflation for the year as a whole are expected to remain in line with the program framework.** In the second quarter of 2012, real GDP contracted by 1.2 percent over the previous quarter, with a strong contribution of net exports offsetting the deterioration in domestic demand. More recently, confidence indicators have been steady, albeit at historically low levels, and labor market adjustment has continued. Output is expected to contract by 3 percent in 2012. Despite weaker domestic demand and falling unit labor cost, headline consumer price inflation is expected to average 2¾ percent in 2012, mainly reflecting the remaining effects of the tax measures in the context of the fiscal consolidation effort.

2. **External adjustment is proceeding rapidly.** The current account deficit has improved by five percentage points of GDP over the past year, and nine points from the trough in late 2008, with exports making the largest contribution to the improvement. Sustained adjustment will be needed to reduce Portugal's very large net external debts. Despite the weakening external environment, growing exports to non euro area trade partners with better growth prospects over the next year will help maintain some momentum. Over the medium-term, we are committed to ensuring the sustainability of the strong performance to date through a reform program that facilitates the adjustment of relative prices across our economy, enabling our firms to become more competitive, grow and create employment.

### II. Advancing Fiscal Adjustment

3. **The downside risks to revenue collections highlighted at the time of the Fourth Review have fully materialized.** These developments have become particularly apparent since May, after weak performance under the quarterly VAT regime became visible and the 2011 final tax returns proved disappointing. Significant tax and social contributions revenue deviations—of about 2 percent of GDP compared to the supplementary budget—have now emerged, reflecting the following factors:

- *Changes in the macroeconomic environment.* The faster-than-expected rebalancing of growth away from domestic demand and imports, more intense labor shedding, and the lower prices and wages have weighed on tax and social security contribution bases and receipts, and the ex-post yield of the various tax measures.
- *Unfavorable composition effects.* The squeeze in incomes has prompted a re-allocation toward lower tax brackets and tilted consumption in favor of less tax-yielding goods.
- A small part of the deviation is explained by one-offs and other factors.

4. **Despite tight spending controls and favorable one-off factors, these developments have opened a significant gap with respect to the fiscal targets.** Notwithstanding an increase in unemployment benefits, expenditure has been under very tight control, with large savings on employee compensation. Moreover, lower net interest payments, the reprogramming of EU cohesion funds, and a large receipt expected from the airport concession will help offset the revenue deviation. In spite of this, the 2012-13 fiscal deficit objectives—of 4½ percent of GDP in 2012 and 3 percent of GDP in 2013—are no longer achievable.

5. **In light of this, the fiscal path under the program needs to be recalibrated.** At the current juncture, the additional measures necessary to reach the initial program objectives would entail large output and social costs. Some degree of front-loading is, however, still necessary to maintain confidence and the credibility of fiscal policy. In order to strike a balance between these two objectives, we intend to contain the deficit to 5 percent of GDP in 2012 and 4½ percent of GDP in 2013. The fiscal consolidation needed to achieve the SGP's fiscal objective—of reducing the deficit to below 3 percent of GDP—would then be completed by 2014, with the projected deficit of 2½ percent of GDP. In spite of the wider deficits, the debt peak (about 124 percent of GDP

in 2014) would be contained by the broadening of the scope of the privatization program (see MEFP paragraph 15).

6. **We are taking a number of measures to limit the fiscal deficit in 2012 to 5 percent of GDP.** We have frozen some of the 2012 budget appropriations and frontloaded a broadening of the public sector contributions base, an increase in the tax on investment income, and a stamp duty on high value properties, generating savings of about 0.2 percent of GDP. In addition, the measures affecting social benefits described below will be frontloaded for 2012; these measures are expected to generate resources of about 0.1 percent of GDP over two months.

7. **Fiscal measures of the order of 3¼ percent of GDP are necessary to achieve the new 2013 deficit target.** This includes 3 percent of GDP of consolidation measures, as well as measures to accommodate the fiscal effect of the Constitutional Court ruling on some articles of the 2012 Budget Law (¾ percent of GDP).

8. **The fiscal measures will be designed with a view to limiting their impact on growth and protecting the poorest segments of the population.** They will also aim at advancing toward our medium-term objectives of making the public sector more efficient, attracting investment, and boosting private sector activity. This includes refocusing expenditure on the key tasks of the public sector and moving toward a more effective tax system. Most of the measures will be implemented in the context of the 2013 budget, which will be submitted to Parliament on October 15 (prior action). The main measures include:

On the expenditure side:

- *Compensation of public employees.* Savings of about 0.4 percent of GDP will be generated through (i) an acceleration in the reduction of the number of government sector employees, including cuts in short-term contracts, (ii) a reduction in overtime, and (iii) cuts in non-wage compensation.
- *Social transfers.* We will improve the targeting of, and scale down, social programs and pension benefits and apply the recent reform of unemployment benefits to all future unemployed. Savings of the order of ¾ percent of GDP are expected from these measures.
- *Health sector reform* will proceed according to plans, generating savings of 0.3 percent of GDP, of which about two-thirds on pharmaceutical products.
- *The ongoing SOE operational restructuring and a further reduction in capital spending in public enterprises* will allow for further savings of about 0.2 percent of GDP.

On the revenue side:

- *We will reduce the number of PIT tax brackets to 5 and increase the average effective rates,* aligning our PIT system with European standards. In addition, a surcharge of 4% on the part of taxable income above minimum wage *will be imposed* at least until the end of the program and until permanent expenditure cuts to offset its elimination can be identified. These measures will generate some 1½ percent of GDP in additional revenue, more than offsetting the measures to accommodate the fiscal effect of the Constitutional Court ruling—reinstatement of the 13th public sector wage and slightly above one month of pension. Social benefits will be delinked from tax benefits.
- *We will further reduce the debt-bias in the CIT system* by limiting interest deductibility and update a number of excise rates (0.1 percent of GDP).
- *Property taxes.* We will work toward completing the taxable property valuation (see MEFP paragraph 18) and remove the general safeguard clause (0.3 percent of GDP).

Given the implementation risks related to such a large adjustment, we stand ready to introduce contingency measures, as needed, during the course of 2013.

9. **We will launch a comprehensive expenditure review to identify potential sources of additional savings to reach our medium-term fiscal objectives.** We are fully committed to stabilizing the general government structural deficit below ½ percent of GDP by 2015. To achieve this objective, a further consolidation—of about 2¼ percent of GDP in primary structural terms—will be necessary in 2014-15. Savings will be generated mainly through expenditure cuts to be specified by mid-February 2013.

### III. Containing Fiscal Risks

#### A. Public Financial Management

10. **We continue to press ahead with our PFM reforms with a particular focus on halting arrears accumulation.** We have intensified efforts to implement the new commitment control systems over the past months. The new software complying with the law has been rolled out to all national health system (HNS) entities. In parallel, we have concluded negotiations on the €1.5 billion debt settlement program for the health sector in line with the announced strategy. We reaffirm our strong commitment to halting the accumulation of new arrears in hospitals. We will also continue to work closely with local governments to ensure that the commitment control systems have been effectively implemented across all municipalities. Any disbursement under the €1 billion credit line (PAEL) will only be made after IGF has certified the full working functionality of the commitment systems. Given that the Autonomous Region of Madeira has not yet fulfilled the program requirement to revise its arrears settlement strategy, we will ensure that no claims will be paid before such a document is finalized and all arrears validated by IGF.

11. **We have finalized our PFM strategy document (mid-September structural benchmark), which outlines our reform priorities over the next three years.** We remain committed to adapting our legislation to the new European Union fiscal governance rules by end-2012. We will focus on further reducing budgetary fragmentation, notably by streamlining the autonomous funds (SFA) sector. With a view to increasing the central government's general revenues, we will deepen this reform, reviewing the classification of SFA's own revenues, and those of other budgetary entities, by end-September 2013.

#### B. State-Owned Enterprises

12. **Our efforts to restore financial viability to state-owned enterprises are beginning to pay off.** We now expect to exceed our objective of reaching operational balance for the state-owned enterprises (SOE) sector on aggregate by the end of 2012. Several SOEs—including in the problematic transport and infrastructure sectors—already reached operational balance in the first half of the year, and others are performing better than expected. While achieving further gains in operational balances will be challenging, we remain committed to furthering financial discipline in these firms. With further reductions in costs to be achieved over the remainder of the year and in 2013, some SOEs will be in a position to start reducing their debts over the medium-term. A new law reforming the governance framework for SOEs will soon come into force, giving the Ministry of Finance increased control over their finances. Firms consolidating in government will not be able to borrow from the private sector, and borrowing by those not consolidating will be subject to prior approval, ensuring unsustainable debt burdens will not be built up in future. The law also allows for improved monitoring of SOEs' financial operations, including local government SOEs.

13. **Nonetheless, financial risks stemming from SOEs remain significant.** With high existing debts, operational balances continue to be too low to cover interest payments in many firms, resulting in still-rising debt. Even with further restructuring, restoring financial viability to some of these firms will require managing excessive historical debt burdens. Despite unfavorable market conditions, we are exploring options for selling SOE assets and repurchasing debt, respecting our financing constraints, and continue to actively manage liabilities falling due to avoid unbudgeted financial support.

14. **We are expanding the privatization program.** Privatizations are advancing. Non-binding offers have already been received for the airline, TAP, and are expected by end-October for the airport concessionaire, ANA. We expect final decisions to be taken by end-2012, with the financial completion of these transactions in early 2013. Interest in both companies has been strong. In the first quarter of 2013, we expect to advance with

the privatizations of the postal company CTT once the universal service provision concession in this sector is granted. We also expect to proceed with the privatization of the waste management operations of the water company Águas de Portugal in the first quarter of 2013, and we are developing a strategic plan by the end of 2012 with other stakeholders—notably local governments—to restructure the broader water sector. We have sought strategic advice on preparing a sale or concession of a television channel and radio station belonging to RTP. The sale of the rail cargo firm CP Carga is expected in the second quarter of 2013. Finally, and while the bulk of eligible assets have already been considered, we are indentifying further public companies and assets that could be privatized.

### *C. Public-Private Partnerships*

15. **Our PPP reform is entering its final phase.** Following the reform of the institutional and legal PPP framework, and the conclusion of the third-party report, we have concluded negotiations of the PPP subconcessions, which aimed at cutting capital and operational costs of about €1 billion (in NPV terms). This renegotiation will result in reduced availability payments starting in 2014. Looking ahead, by the sixth review we will prepare a detailed strategic plan to renegotiate the remaining PPP contracts. We aim to reduce the government's financial obligations, obtaining substantial upfront savings while minimizing the consequences for public debt. We will also work swiftly to ensure that the MOF's technical PPP unit is fully operational by end-December. We will not engage in any further contracts until the technical PPP unit and the new legal framework are in place and able to limit fiscal risks.

### *D. Revenue Administration*

16. **We have been proactive in strengthening revenue administration (AT) to fight noncompliance.** A key reform to curb tax fraud and evasion will enter into force on January 1<sup>st</sup>, 2013 with the following objectives: (i) invoicing will be mandatory across all sectors and transactions; (ii) businesses will be obliged to report the relevant content of invoices to a centralized VAT monitoring database; (iii) goods in circulation will be electronically monitored; and (iv) a tax incentive scheme to encourage taxpayers to ask for the issuance of invoices—notably in hard-to-tax sectors—will be launched. This model will enhance the AT's capacity to access information and enable automatic cross-checks. Moreover, we will enhance the exchange of information between AT and the Social Security Administration, especially by adopting a unified monthly return on withholding of wages and a single form on independent workers' annual income.

17. **We remain committed to implementing our reform agenda.** We are on track to meet the end-December structural benchmark on implementing the Large Taxpayer Office. On the judicial front, the task force of judges has increased the pace of its work on high-value tax cases while the State success ratio in the tax courts is increasing. We reaffirm our commitment to clearing the remaining tax cases. Finally, we will deepen our efforts to conclude the property evaluation process by year end, despite limited access to the buildings blueprints. In order to minimize fiscal risks under the program, we will ensure that the new value of all properties will serve as a basis for the tax levied in 2013.

### *E. Regional and Local Public Finances*

18. **We have made significant progress regarding the local administration reform.** We have approved a law that establishes a new regime for local SOEs and we will start working towards the dissolution of all local SOEs that do not comply with legal requirements. We have also passed legislation with a view to streamlining management positions at the local level. Work on the reduction of the number of parishes is proceeding. Finally, our working group for the revision of the local and regional finance laws is advancing with the draft proposals, and has started discussions with external stakeholders. Despite a slight delay in the timetable, the submission of the draft finance laws to Parliament (end-December structural benchmark) remains on track.

## **IV. Preserving Financial Stability**

19. **Orderly deleveraging of the economy remains a key objective under the program.** Eased liquidity conditions and strengthened capital buffers are helping alleviate risks of an excessive credit contraction. While

the needed deleveraging process proceeds, it is crucial to ensure that the most productive segments are not subject to undue funding strains and can effectively support the economic recovery. To this purpose, we are taking measures to facilitate credit to productive firms, in particular SMEs, while continuing to ensure that these steps do not burden or pose risks to public finances. As part of these efforts, the Ministry of Finance, together with BdP and other stakeholders, have put forward a set of proposals and are currently evaluating different options to enhance information sharing and foster the diversification of financing alternatives to the corporate sector. In parallel, the supervisory work of Banco de Portugal (BdP) is helping promote an orderly adjustment of banks' balance sheets. Recent initiatives to avoid evergreening and promote prompt restructuring of problem loans include new instructions by the BdP for banks to report restructured loans due to financial difficulties of the borrower, with the first report expected by end-November.

20. **Adequate bank liquidity remains critical to preserve financial stability.** The exceptional liquidity support provided by the Eurosystem is playing a pivotal role in easing liquidity pressures and mitigating potential constraints to bank lending. Portuguese banks are making significant use of the recent measures by the Eurosystem to support collateral availability. Going forward, we encourage banks to continue their efforts to strengthen collateral buffers on a sustainable basis. In parallel, to facilitate reallocation of liquidity among domestic banks, the BdP has recently launched a new platform for interbank unsecured lending, which is expected to be extended to secured transactions by the beginning of next year. We believe that these ongoing efforts can contribute to an orderly deleveraging of the economy, with a view to reduce banks' dependence on Eurosystem liquidity over the medium term.

21. **The bank capital augmentation exercise due by June 2012 has been successfully completed.** The envisaged capital augmentation measures, including the public injection of capital, have been completed as planned, allowing banks to meet the capital needs stemming from the EBA 2011 Capital Exercise, the Special On-Site Inspection Program (SIP), and the pension fund transfer. In line with EU rules, banks having received public capital support have been required to draw up restructuring plans, aimed at enhancing the banks' resilience. These measures are also expected to enable these banks to meet the Core Tier 1 program target of 10 percent by end-2012, which applies to all banks. BdP is closely monitoring compliance with the capital requirements, with a view to promptly take appropriate action if needed.

22. **As part of its regular supervisory activities, the BdP continues to update its evaluation of banks' impairment levels and assess the resilience of the banking sector.** The field work of a new onsite inspections program (OIP), launched last May by the BdP, has already started in the major banking groups and is on track. This initiative is part of BdP regular supervisory activities, which are currently focused on assets classes that are more sensitive to existing market conditions. In parallel, the BdP will continue to update its quarterly stress test exercise. In this context, banks will reflect the OIP findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies by end-December 2012, with the update of the treatment of collective impairments expected to be finalized at the latest by end-June 2013.

23. **We remain committed to providing further support to the banking sector, if needed.** In the event new capital needs were to arise, we continue to encourage banks to seek private solutions. Nevertheless, resources from the Bank Solvency Support Facility (BSSF) remain available to support viable banks if needed, in line with state aid rules and subject to strict conditionality aiming to avoid subsidizing private shareholders and prevent migration of private liabilities to the public sector balance sheet. The remaining resources in the BSSF will solely be utilized to provide public support, if needed, to the banking system.

24. **We are implementing the strategy for managing the distressed assets from Banco Português de Negócios (BPN).** We intend to outsource the management of the credits currently held by Parvalorem to a professional third party. We are finalizing the terms of reference for the mandate of the party managing the credits to ensure maximization of recoveries, while minimizing operational costs. The competitive bidding process to select the asset manager will be launched by end-October at the latest, with a view to complete the tender process by end-March 2013. We will also ensure timely disposition of the subsidiaries and the real assets in the other two state-owned SPVs. CGD's state guaranteed claim will be gradually settled in cash, according to the schedule agreed with the EC, ECB, and IMF. Any net recoveries realized on the assets will also be applied towards the settlement of CGD's claim.

25. **Progress is being made towards strengthening the early intervention and resolution framework.** We are finalizing the implementation of the measures necessary for completion of the new legislative framework for banking resolution. We have established the regulation governing the organization and operation of the resolution fund. The decree law on the banks' contributions to the resolution fund is expected to be approved by end-November. The BdP will have approved by then the two supervisory notices on recovery plans and bridge banks (end-October) and will finalize the supervisory notice on resolution plans by end-November. Moreover, we will swiftly transpose the new EU Directive on bank resolution as soon as it enters into force.

26. **We have concluded the improvements to the legal framework for corporate debt restructuring.** After the entry into effect of the amendments to the Insolvency Code in May 2012, we have adopted the conciliation framework (SIREVE) mediated by IAPMEI, a public entity, to facilitate extrajudicial corporate debt restructurings for viable SMEs which entered into effect on September 1, 2012. We will continue to step up actions to raise public awareness of the new restructuring tools.

27. **Resolving household sector indebtedness in an orderly fashion remains a key priority.** We continue monitoring the evolution of household indebtedness closely and are establishing a framework for financial institutions to engage in out-of-court debt restructuring for households which will enter into effect soon. A nationwide network of duly accredited structures will also be developed, based on existing structures, in order to provide financial advice to households in debt distress.

## V. Boosting Competitiveness and Growth

### A. Promoting Employment

28. **Unemployment continues to be a priority concern, and we are delivering on commitments to support employment as the economy adjusts.** Our strategy focuses on effective active labor market policies. *Vida Ativa*, our new targeted training initiative, has reached out to over 150,000 unemployed, of which more than 50,000 are already involved in training. We have also stepped up our efforts towards activation by sending notifications to over 250,000 unemployed with good results: about 5,000 unemployed have been placed in jobs, and over 125,000 unemployed have been integrated in an occupational or other training program. We are conducting a real-time evaluation of the effectiveness of these targeted training programs and, based on the results, we will look to enlarge eligibility.

29. **Important reforms of labor market institutions are nearing completion.** The new Labor Code entered into force on August 1 and positions all workers and all firms to benefit from a more dynamic and efficient labor market, particularly as the cycle turns and hiring resumes.

- *By reforming the wage setting mechanism, we have reduced substantially the scope for large incumbent firms to unduly burden the competitive position of other firms in the sector.* We have formalized the criteria for extending collective agreements, ensuring that in sectors where employers' associations represent less than 50 percent of the total work force, collective agreements reached by those associations will not be extended to all firms in the sector. The government resolution defining these criteria and the modalities for their implementation was adopted on October 10 (structural benchmark).
- *We have made important efforts in reducing one of the highest levels of employment protection in Europe.* Building on the changes in the Labor Code regarding individual dismissals, and following the first step we took in November 2011, we will by mid-November 2012 lower severance payments further to 8-12 days per year of service, bringing them in line with relevant comparators in the euro area.

### B. Business Environment: Slashing Licensing Requirements

30. **We are launching a comprehensive program to tackle excessive licensing procedures, regulations and other administrative burdens –a key bottleneck to economic activity.** These explicit and implicit barriers to the establishment, operation, and expansion of firms create substantial uncertainty, discourage investment and

limit job growth. By alleviating these costs—which represent a particular burden for small and medium firms—we also hope to encourage foreign direct investment, with all its positive spillovers. To that end,

- We will start with a decisive first step—by end-June 2013 we commit to deal with the legacy of excessive licensing by carrying out a full inventory of all regulations at all levels of government, with a view to eliminating overlapping and redundant regulations.
- To prevent the problem from re-emerging in the future, we will study the feasibility of putting in place a “one-in, one-out” rule that prohibits the creation of a new regulation without the elimination of an existing regulation or regulations with an equivalent cost.
- By end-year we will put in place a working group (*Gabinete do Investimento*) to analyze and to fast-track planned existing investment opportunities unresolved or undecided for more than 12 months.
- We will advance the availability of zero-licensing procedures for industrial and commercial activities via an online portal, alongside work being done for firms in the services sector (see MEF ¶32). A wide range of further changes to the licensing regime are described in the fifth update of the Memorandum of Understanding (MoU).

### ***C. Product Markets, Competition, and Regulation Framework***

31. **Through bold reforms in ports, we aim to reduce the port bill for exporters by 25-30 percent.** A landmark revision of the Ports Work Law, which was submitted to Parliament in September, substantially lowers wage costs and removes constraints to optimizing the use of labor. To ensure the transmission of lower unit labor costs to end-user costs of port services, we are revising incentives for port operators by adopting a new performance-based model for concession contracts as they expire, and we are looking to encourage entry of new operators. Finally, responding to exporters’ concern, we will reduce by end-December fees on port use (*TUP-Carga*), aiming to lower these fees by 20 percent.

32. **Work on removing legal and administrative barriers to trade in the economically very significant services sector is well advanced.** We have accelerated the drafting of the needed legislation, and, as a result, over half of the amendments to sector-specific legislation have already been approved either by government or by Parliament and are now in effect. The remaining 23 amendments required to complete this effort will be submitted to Parliament by end-October 2012. We will step up the efforts to establish a well-functioning online platform (Point of Single Contact) which simplifies the procedures for establishing and operating firms in these sectors. In addition, we have submitted to Parliament a new horizontal framework law concerning the *professional bodies of highly regulated professions* (such as lawyers, accountants, architects), easing access to these professions and limiting anti-competitive practices.

33. **We are creating a strong and stable legal framework for regulation to ensure market efficiency and protect public interests.** Given the limited scope for greater competition through entry of new operators in a number of industries, particularly in energy and telecommunications, we recognize that strong, independent, and effective regulators are key to preventing anti-competitive outcomes, with the attendant effects on prices, innovation, and resource allocation. To that end, we are preparing a framework law for regulation that draws on the findings and recommendations of the recently completed expert report, benchmarking the responsibilities, resources, and independence of the main sectoral regulators against international best practices. The framework law will guarantee independence, as well as financial, administrative and management autonomy, benefitting from broad consultation with the regulatory bodies concerned. While this important law is being prepared, we will soon amend the statutes of the electricity regulator (ERSE) to give it the appropriate powers, independence, and autonomy ahead of full market liberalization in January 2013.

### ***D. Judicial Reform***

34. **We continue pushing ahead with targeted measures to reduce the backlogged enforcement cases.** Despite the challenges in addressing the backlog court cases, an additional 25,000 enforcement cases have been

cleared, bringing down the total number by about 95,000 enforcement cases since November 2011. The inter-agency task forces have set quarterly targets for reviewing enforcement cases to be closed by mid-November 2012. To this end, we have stepped up our efforts by expanding the task forces to small claims court cases in specific courts. We will prepare revised draft bills to strengthen the legal and institutional framework for enforcement agents and to include a fee structure that incentivizes speedy enforcement by mid-November 2012 based on extensive consultation including IMF/EU technical assistance and informed by cross country experience and which will be approved by the government by end-February 2013. We continue overhauling the information system to facilitate the speedy processing of court cases.

35. **We are advancing the reforms to improve efficiency of the court system.** We have refined the comprehensive judicial roadmap to reduce the number of courts and streamline the court structure and the new draft Code of Civil Procedure to speed up the judicial process with extensive stakeholder consultation and also informed by IMF/EU technical assistance.

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

	Performance Criteria (unless indicated otherwise)								Dec-12	Mar-13	Indicative
	Dec-11		Mar-12		Jun-12		Sep-12				Targets
	Program	Actual	Program	Actual	Program	Actual	Program	Actual			Jun-13
1. Floor on the consolidated General Government cash balance (cumulative)	-10.3	-7.1	-1.9	-0.45	-4.4	-4.1	-5.9	-7.9	-9.0	-1.9	-4.5
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 1/	0	Not met	0	Not met	0	Not met	0	N/A	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	167.8	182.0	171.2	175.0	170.9	177.5	N/A	180.0	182.2	184.1
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government (continuous performance criterion)	0	0	0	0	0	0	0	0	0	0	0

1/ Domestic arrears for the purpose of the program remained broadly stable between end-March and end-July 2012. They increased by about €200 million between end-March and end-June, and decreased by about €200 million in July.

**Table 2. Portugal: Structural Conditionality: Fifth Review Under the EFF**

<b>Measure</b>	<b>Timing</b>	<b>Status</b>
<b>Prior action</b>		
Submit to Parliament the 2013 budget consistent with ¶5-9 of the MEFP.		
<b>Structural Benchmarks</b>		
<b>A. Strengthen financial stability</b>		
1 Make effective the amendments to the Corporate Insolvency Law to better support rescue of viable firms (after completing all necessary legislative and publication requirements)	Mid-June 2012	Met
2 Prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector.	End-July 2012	Met
<b>B. Enhance competitiveness and address bottlenecks to growth</b>		
3 Submit to Parliament draft legislation defining the criteria for extension of collective agreements (including a majority representation threshold) and the modalities for their implementation.	End-Sept 2012	Met with delay
4 Prepare a proposal to implement identified best international practices in order to reinforce the independence of the main sectoral regulators.	End-Sept 2012	Met
5 Submit to Parliament a new Code of Civil Procedure to streamline and speed up the court procedures.	End-Nov 2012	
6 Submit to Parliament the bill to implement the judicial roadmap to improve the court structure.	End-Nov 2012	
<b>C. Strengthen fiscal institutions and reduce fiscal risks</b>		
7 Develop a PFM strategy covering the next three years, to be attached to the 2013 budget.	Mid-Sept 2012	Met
8 Revise and submit to Parliament the draft regional and local public finance law.	End-Dec. 2012	
9 Implement a full-fledged Large Taxpayer Office (LTO), to cover audit, taxpayer services, and legal functions concerning all large taxpayers, including the adoption of account managers.	End-Dec. 2012	

## PORTUGAL: TECHNICAL MEMORANDUM OF UNDERSTANDING

14 October 2012

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 2012, shall not include entities nor operations (including pension funds) that are re-classified into the General Government during 2012, but shall include those reclassified in 2011.<sup>1</sup>

## 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<sup>2</sup> will be provided to the EC, the ECB and the IMF by the MoF within seven weeks after the end of the month. Data will include detailed information on revenue and expenditure items. Data will also include detailed information on PPP-related revenues and expenditures for those PPP reclassified within the General Government sector according to ESA 95, and called guarantees.

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

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

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

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

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

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

<sup>1</sup> An operation refers to part of a legal entity that is involved in the production or delivery of goods and services—including government services provided on a nonmarket basis. As such, it does not include transactions relating to the assets or liabilities of an entity. For example, should an entity handle a number of PPPs, reclassifying only one PPP would be considered as reclassifying an operation. In contrast, taking over part of an entity's debt by the government would not qualify for the exclusion. On this issue, see also paragraph 13.

<sup>2</sup> 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.

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

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

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

**6.3 Adjustor.** The 2012 and 2013 quarterly floors on the consolidated general government cash balance will be adjusted for the cumulative amount of arrears settled in the context of the arrears clearance strategy. This includes the health sector arrears settled with the banks' pension funds transfers' resources, as well as local government arrears settled through the €1 billion credit facility created in May 2012.

## **Other Provisions**

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

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

## **9. Supporting Material**

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

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

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

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

11. **Supporting Material.** The stock of arrears will be measured through a survey. Reports on the stock of arrears of the General Government are being published monthly. The MoF will provide consistent data on monthly expenditure arrears of the General Government, as defined above. Data will be provided within seven weeks after the end of each month and will include total arrears classified by the different constituent sectors of the General Government sub-sector as defined in paragraph 4, as well as the monthly amounts of (i) health sector arrears settled with the banks' pension funds transfers' resources, and (ii) local government arrears settled through the €1 billion credit facility created in May 2012.

12. **Adjustor.** The monthly change in the stock of arrears will be adjusted for any stock adjustment related to the arrears clearance strategy. This includes the health sector arrears settled with the banks' pension funds transfers' resources, as well as local government arrears settled through the €1 billion credit facility created in May 2012. This will allow monitoring the underlying flow of new arrears.

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

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

14. **Adjusters.** For 2012, 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 2011 general government debt of EUR183.33 billion. From 2013 onwards, the ceiling of the overall stock of General

Government debt will be adjusted upward (downward) by the amount of any upward (downward) reclassification of entities or operations that affects the stock at end-December of the previous year.

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

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

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

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

#### **E. Bank Solvency Support Facility**

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

#### **F. Overall Monitoring and Reporting Requirements**

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

## ANNEX 6: INDICATIVE TIMELINE

### Indicative timeline of financial sector and structural measures in the Memorandum of Understanding on specific economic conditionality<sup>1</sup>

<i>Actions for the sixth review (to be completed by end Q3-2012)</i>	
<b>Fiscal-structural</b>	<p>[3.1] Publish a comprehensive report on fiscal risks as part of the budget.</p> <p>[3.2] Publish a tax expenditure report as part of the budget.</p> <p>[3.3] Prepare a document assessing reform progress and specifying areas of action over the next three years in the area of public financial management, including the reduction of budget fragmentation.</p> <p>[3.5] IGF will carry out inspections to verify compliance with the commitment control law and ensure a continued reduction of the stock of arrears in line with the strategy for the settlement of arrears.</p> <p>[3.6] IGF will reinforce the verification of local government's arrears claims and commitment control systems. Disbursements under the PAEL will take place where IGF has certified the commitment control systems.</p> <p>[3.11] Prepare a draft proposal to revise the regional finance law and the local finance law.</p> <p>[3.12] Create a working group to prepare a proposal for common revenue forecasting guidelines for subnational governments.</p> <p>[3.13] Proceed with identifying data needs to support the revenue projections.</p> <p>[3.14] Follow up of the Government's economic adjustment programme with the Autonomous Region of Madeira.</p> <p>[3.17] Enhance annual PPP and concessions report to provide information and analysis at sectoral level together with credit flows channelled through banks.</p> <p>[3.18] Inform on progress towards achieving the operational balance target by the end of the year.</p> <p>[3.19] Advance draft law on SOEs governance.</p> <p>[3.20] Enhance the annual and quarterly SOEs report to include information on operational results, debt, restructuring and governance at central and local level.</p> <p>[3.23] Assess progress on an inventory of assets, including real estate, owned by municipalities and regional government, examining scope for privatisation.</p> <p>[3.30] Present a final report on PREMACE.</p> <p>[3.31] Based on the cost/benefit analysis decide to maintain, reduce or extinguish foundations.</p> <p>[3.33] Reorganise and reduce the number of the municipalities and parishes.</p>
<b>Financial sector</b>	[2.3] Ensure that the target programme of CT1 ratio of 10% is reached.
<b>Health sector</b>	[3.42] Accelerate the plans to achieve a self-sustainable model for health-benefits schemes for civil servants.

<sup>1</sup> Square brackets identify paragraph numbers in the MoU as signed on 15 April 2012. 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.

	<b>[3.60]</b> Implement the strategy to clear arrears and avoid their re-emergence.
<b>Labour market</b>	<p><b>[4.3]</b> Draft legislation submitted to Parliament to: i) align the level of severance payments to the EU average; and ii) implement the compensation fund for severance payments</p> <p><b>[4.5 iii]</b> Submit to Parliament a draft legislative proposal containing criteria and modalities for the extension of collective agreements.</p> <p><b>[4.8 i]</b> Set up an operational management tool for schools.</p> <p><b>[4.8 ii]</b> Implement the legislation to promote trust agreements with public schools and present a new inspection model.</p> <p><b>[4.8 iii]</b> Present a progress report on the involvement of businesses in the provisions of traineeships.</p>
<b>Goods and services markets</b>	<p><b>[5.1]</b> Adopt the new regulators' bylaws agreed in July 2012.</p> <p><b>[5.2 i]</b> Present proposals to harmonise the access tariffs to the interconnection networks.</p> <p><b>[5.4]</b> Conclude the measures to reduce excessive rents and to address the sustainability of the national electricity system.</p> <p><b>[5.5]</b> Conclude the measures to limit the policy costs embedded in CMECs and PPAs.</p> <p><b>[5.6]</b> Present a report on the CMEC scheme.</p> <p><b>[5.7]</b> Conclude the measures to limit the policy costs of renewables under the special regime.</p> <p><b>[5.9]</b> Annual report on revising downward the feed-in tariffs and ensuring that the tariffs do not over-compensate renewable producers.</p> <p><b>[5.10]</b> Annual report containing an analysis in terms of costs and consequences for energy prices of future investments in renewables.</p> <p><b>[5.11]</b> Renegotiate the telecommunication concession contract by reducing the scope of the services covered so as to exclude the universal service and launch a new tender to designate the universal service provider(s).</p> <p><b>[5.13]</b> Further liberalise the postal sector by amending the decree-law and renegotiate the amendment with CTT.</p> <p><b>[5.16 iv]</b> Ensure that the new railway Public Service Obligation (PSO) contracts respect EU legislation.</p> <p><b>[5.20]</b> Approval by Parliament of the remaining necessary amendment to the sector specific legislation to fully implement the Services Directive.</p> <p><b>[5.21]</b> Approval by Parliament of the amendments in the areas of real estate.</p> <p><b>[5.21]</b> Submit to Parliament amendments in the area of construction services.</p> <p><b>[5.22]</b> Adopt the executive order (<i>portaria</i>) on the services provider prior declaration following the adoption of amendment of Law 9/2009.</p> <p><b>[5.23]</b> Approval by Parliament of the law for professions where regulation does not involve a professional body.</p> <p><b>[5.24]</b> Approval by Parliament of the draft horizontal legal framework concerning the requirements affecting the exercise of regulated professions with professional bodies.</p> <p><b>[5.27 iii]</b> Foster collaboration from municipalities to make the Point of Single Contact operational.</p> <p><b>[5.27 v]</b> Extend the "Zero Authorisation" project to other services sectors.</p> <p><b>[5.26]</b> Submit an updated detailed work programme of AMA.</p>
<b>Competition, public</b>	<b>[7.8]</b> Ensure that CGD alienates its participation in Galp.

<b>procurement, and business environment</b>	<p>[7.11] Review with key stakeholders the conditions for the proper execution of the Competition Authority mandate.</p> <p>[7.15] Make operational the procedures for requesting VAT exemptions for exporting firms.</p>
<b>Judicial system</b>	<p>[7.2] Set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, with the fourth report to be completed by mid-November 2012.</p> <p>[7.4] Refine by extensive consultation an initial draft bill on judicial reform.</p> <p>[7.4] Submit a Bill to implement the judicial reform roadmap to Parliament by end-November 2012.</p> <p>[7.5] Submit the Bill to improve the Justices for Peace regime to Parliament by end-November 2012.</p> <p>[7.6] Refine by extensive consultation an initial draft of the new Code of Civil Procedure.</p>
<i>Actions for the seventh review (to be completed by end Q4-2012)</i>	
<b>Fiscal-structural</b>	<p>[3.8] Revise the Budget Framework Law to take account of the reinforced EU fiscal framework.</p> <p>[3.11] Submit to Parliament the draft proposal to revise the regional finance law.</p> <p>[3.16] Design framework for assessing fiscal risks derived from PPP, concessions and other public instruments.</p> <p>[3.18] Reach operational balance for SOEs.</p> <p>[3.18] Implement the SOEs strategy.</p> <p>[3.22] Prepare a strategy for Aguas de Portugal (AdP).</p> <p>[3.23] Prepare an inventory of municipalities and regional governments's assets including real estate.</p> <p>[3.24] Complete the implementation of the new structure that merges tax, customs and DGITA.</p> <p>[3.25 ii] Reduce the number of municipal tax offices by 20%.</p> <p>[3.25 iii] Increase to 30% the number of auditors in the tax administration.</p> <p>[3.27] Clear cases above EUR 1 million with the support of the tax court judges.</p> <p>[3.29] Implement a full-fledged Large Taxpayer Office (LTO).</p> <p>[3.32] Apply the approach on foundation, the compulsory census and subsequent analysis to association and later to other public and quasi-public entities.</p> <p>[3.34] Reform the existing framework of central, local and locally-based administration services.</p> <p>[3.35 ii] Fully implement the strategy of shared services in central administration in the area of human resources.</p> <p>[3.35 iii] Implement shared services in IT.</p> <p>[3.39] Prepare a comprehensive review of wage scales.</p>
<b>Financial sector</b>	<p>[2.2] Identify and report recently restructured loans due to debtors' financial difficulties with a first report by the BdP by end-November 2012.</p> <p>[2.10] Reflect the OIP findings in the implementation of the SIP recommendations on asset quality and stress testing methodologies.</p> <p>[2.12] Launch the bidding process in order to select the party managing the credits currently held by Parvalorem.</p> <p>[2.13 a] Approve the decree-law on the banks' contributions to the resolution fund by November 2012. Approve a supervisory notice on the specific periodic contributions</p>

	<p>by banks.</p> <p>[2.13 b] Adopt supervisory notices on recovery plans by end-October 2012.</p> <p>[2.13 c] Adopt resolution plan regulations by end-November 2012.</p> <p>[2.13 d] Adopt rules applicable to bridge-banks in line with EU rules by end-October 2012.</p>
<b>Health care system</b>	<p>[3.41] Additional revenue of EUR 150 million following the revision of NHS moderating fees.</p> <p>[3.43] Enact legislation which automatically reduces the price of medicines when the patent expires to 50% of their previous price.</p> <p>[3.48] Publish implementation report of the legislation making compulsory the prescription by INN to increase the use of generic medicines.</p> <p>[3.54] Publish an action plan concerning the reduction of costs and fighting waste.</p> <p>[3.56] Take measures to increase competition among private providers and reduce by 10% the overall spending.</p> <p>[3.61] Change existing accounting framework and adopt accounting standards in line with the requirements for private companies and other SOEs.</p> <p>[3.62] Implement measures aiming at reducing the operational costs by at least EUR 200 million.</p> <p>[3.64] Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators and regular reports.</p> <p>[3.66] Reduce hospital operational costs by at least 15%.</p> <p>[3.66] Set up a system for comparing hospital performance on the basis of a comprehensive set of indicators – first regular report.</p> <p>[3.66] Publish detailed action plan to deliver additional cuts in the hospitals network operating costs of at least 5% in 2013.</p> <p>[3.68] Adopt for all staff flexible time arrangements, to reduce by at least 20% spending on overtime compensation in 2012 and another 20% in 2013.</p> <p>[3.69] Improve monitoring, internal control and fiscal risks management systems of the Administrações Regionais de Saúde.</p> <p>[3.71] Reduce costs for patient transportation by 1/3.</p>
<b>Labour market</b>	<p>[4.1] Prepare an analysis on benefit dependency and long-term unemployment.</p> <p>[4.5 iv] Prepare an independent review on defining wage norms that into account competitiveness and on the desirability of shortening the survival of contracts that are expired but not renewed.</p> <p>[4.7] Present a report on expenditure and financing of ALMPs, the role of job counselling and propose actions to improve the effectiveness of employment and training measures.</p> <p>[4.8 iii] Reorganise modalities for the provision of VET, enhance students' orientation and career guidance.</p>
<b>Goods and services markets</b>	<p>[5.3] Clarify the national legal framework with respect to the scope of competencies of the logistics operator.</p> <p>[5.14] Implement the Strategic Plan for Transport for 2011-2015.</p> <p>[5.15] Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability.</p> <p>[5.16 i] Ensure that the rail regulator enjoys the independence required under the EU rail Directives.</p> <p>[5.16 ii] Reduce operational costs of REFER by at least 23% in 2012 compared to</p>

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	<p>2010.</p> <p>[5.16 iii] Analyse the potential for further rationalisation in loss-making and low-demand lines and services.</p> <p>[5.16 iv] Ensure that the awarding authority for PSO contracts has the required level of independence and competence.</p> <p>[5.16 viii] Ensure that the rail terminals (owned by CP Carga) are transferred to another entity guaranteeing non-discriminatory access to all rail freight operators.</p> <p>[5.17] Enforce the revised legal framework governing port.[5.18] Deliver and enforce policies that ensure strong integrated policy-making, strategic planning and surveillance functions common to all ports in the country.</p> <p>[5.19] Adopt the necessary legislative amendments to achieve full compliance with Directive 1999/62/EC and EU Treaty.</p> <p>[5.21] Adopt amendments in the area of construction services.</p> <p>[5.23] Adopt the law for professions where regulation does not involve a professional body (Ordens or Câmaras).</p> <p>[5.24] Make the necessary changes in the statutes of professional bodies.</p> <p>[5.25 iii] Make available in PSC on-line procedures for the registration of establishments covered by "Zero Authorisation".</p>
<b>Housing market</b>	[6.1] Bring value of all property stock close to market value and ensure that property valuation is updated regularly.
<b>Competition, public procurement, and business environment</b>	<p>[7.10] Monitor the inflow of cases and report on the functioning of the specialised court for Competition, Regulation and Supervision.</p> <p>[7.12] Ensure that remaining NRAs have the necessary independence and resources to exercise their responsibilities.</p>
<b>Judicial system</b>	<p>[3.25] Assess the need to establish special chambers within the tax tribunals to handle cases with value above EUR 1 million.</p> <p>[7.2] Prepare quarterly reports on implementation status of measures to achieve reduction of the backlogged enforcement cases.</p> <p>[7.4] Submit a Bill to Parliament to implement the judicial reform roadmap.</p> <p>[7.5] Submit to Parliament the Bill to improve the Justices for Peace regime.</p> <p>[7.6] Submit the Code of Civil Procedure to Parliament.</p>
<b>Licensing</b>	<p>[7.20] Create a working group to analyse the licensing of planned investment projects which are left unsolved or undecided for more than 12 months.</p> <p>[7.22] Review the legal regimes at all levels of Government in the area of territorial planning.</p> <p>[7.24] Change the legal regime for Environment Impact Evaluation to increase the speed and effectiveness of this regulation and reduce associated money and time costs.</p> <p>[7.25 ii a] Implement zero licensing procedures for Type 3 and Type 2 industries.</p> <p>[7.25 ii d] Ensure that the new Industrial Licensing is aligned with the review of the New Base Law of Soil and Territorial and Urbanism Planning.</p> <p>[7.26] Review the geological licensing regimes.</p> <p>[7.27] Simplify the legal regime for touristic establishments.</p> <p>[7.28] Review the licensing in tourism.</p>

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*Actions for the eighth review (to be completed by end Q1-2013)*

<b>Fiscal structural</b>	[3.35 i] Complete the implementation of the strategy of shares services in the area of financial services (GeRFIP).
<b>Health care system</b>	[3.44] Publish second price revision for medicines (January 2013). [3.50] Produce a report assessing the legislation aimed at removing all effective entry barriers for generic medicines.
<b>Labour market</b>	[4.1] Assess if further measures are needed in relation with benefit dependency and long-term unemployment. [4.5 iii] Enforce the legislative proposal. [4.6] Assess in a report the effects of the organised decentralisation. [4.8 iii] Establish "professional schools of reference".
<b>Goods and services markets</b>	[5.2 ii] Prepare a report analysing options to improve the harmonised mechanism for capacity allocation and congestion management of cross-border flows with Spain. [5.2 iii] Apply a harmonised congestion management mechanism to all the interconnection capacity between Portugal and Spain. [5.14 v] Reform the transport and infrastructure's regulatory framework. [5.16 v] Review and render more effective the yield management on long-distance passenger ticket prices. [5.20] Approve the remaining required amendments to the sector specific legislation. [5.23] Launch a second phase of investigation of the review of regulated professions to eliminate unjustified requirements. [5.25 i] Adapt the content and information available at the PSC for the 44 amended regimes to ensure conformity with the Services Directive. [5.25 ii] Adapt the content and information available at the PSC for the 13 regimes to ensure conformity with the Professional Qualifications Directive. [5.25 iii] Prepare the extension of the PSC to major municipalities.
<b>Competition, public procurement, and business environment</b>	[7.11] Re-examine the financial model concerning the transfers of payments from regulators to the Competition Authority which should result in a technical proposal. [7.12] Present a proposal to reinforce the independence of regulators in full compliance with EU law. [7.12] Ensure that the other national regulator authorities have the necessary independence and resources to exercise their responsibilities. [7.13] Submit a report analysing the impact of the amendments to the revised Public Procurement Code as well as of the enhanced role of the Court of Auditors. [7.16] Implement the New Late Payments Directive. [7.17] Include all municipalities and all levels of public administration within the scope of the Simplex Programme.
<b>Judicial system</b>	[7.3] Approve the bill for enforcement agent's framework.
<b>Licensing</b>	[7.19] Study the feasibility of a rule that prohibits at all levels of government the creation of a new regulation generating costs for businesses without elimination of an existing regulation. [7.21 vi] Review the RJUE that should be aligned with the new Industrial Licensing regime. [7.22 ii b] Define and establish the Zones of Responsible Enterprises.

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*Actions for the eighth review (to be completed by end Q1-2013)*

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- [7.24 ii c] Create and define standardized industrial licenses.
- [7.24 ii e] Ensure that the new Industrial Licensing is aligned with the review of the RJUE.
- [7.27 i] Eliminate or transforming into a voluntary regime the mechanism of prior communication in Regime for Urbanism and Building.
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*Actions for the ninth review (to be completed by end Q2-2013)*

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<b>Fiscal structural</b>	<p>[3.21] Conclude the privatisation or concession of the cargo handling subsidiary of CP Carga.</p> <p>[3.28] Develop the plan to implement e-invoicing.</p> <p>[3.49] Introduce in the e-prescription system a first set of guidelines.</p> <p>[3.67] Prepare annual reports on plans to reallocate qualified and support staff within the NHS.</p>
<b>Financial sector</b>	<p>[2.10] Finalise the update of the treatment of collective impairments expected to be finalised at the latest by end-June 2013.</p>
<b>Labour market</b>	<p>[4.6] If needed, prepare an action plan to ensure works council can negotiate wages at firm level.</p>
<b>Goods and services markets</b>	<p>[5.8] Ensure through annual audits that plant not fulfilling the requirements for co-generation do not receive the support scheme.</p> <p>[5.15] Assess the existing rail, road and port networks and present a set of investment priorities for the 2020 and 2030 horizons.</p> <p>[5.16 ii] Provide annual progress reports on the implementation of balancing revenues and expenditures.</p> <p>[5.16 vi] Prepare the privatisation of the freight branch of the state-owned rail operator.</p> <p>[5.25 iii] Make fully operational the "Zero Authorisation" project.</p> <p>[5.25 iii] Make the "Zero Authorisation" platform available to all levels of administration, including municipalities.</p>
<b>Housing market</b>	<p>[6.3] Review of the impact of all housing market reforms.</p>
<b>Judicial system</b>	<p>[7.1] Eliminate the court backlog.</p>
<b>Competition, public procurement, and business environment</b>	<p>[7.11] Implement the technical proposal on the regulator financing model.</p>
<b>Licensing</b>	<p>[7.19] Carry-out a fully inventory and an analysis of the costs of all regulations in the economy (at central, regional and local levels).</p> <p>[7.20] If feasible, put in place the rule that prohibits at all levels of government the creation of the new regulation generating costs for businesses without the elimination of an existing regulation.</p> <p>[7.21 i] Fully implement the approved Programme of Responsible Industry (PIR).</p>

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

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

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<b>Fiscal structural</b>	<p>[1.25] Quarterly ceilings for the consolidated General Government cash balance to be assessed.</p> <p>[3.4] Reduce the number of Servicos e Fundos Autonomos (SFA) in view of reducing budget fragmentation.</p> <p>[3.17] Provide annual PPP report on the risks stemming from PPPs and concessions.</p>
<b>Labour market</b>	<p>[4.4] Prepare a report on the effects of the changes to the dismissal rules on labour market indicators.</p>
<b>Health care system</b>	<p>[3.57] 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.</p>
<b>Housing</b>	<p>[6.2] Rebalance property taxation towards the recurrent real estate tax (IMT), while considering the socially vulnerable.</p>
<b>Goods and services markets</b>	<p>[5.9] Annual report on new contracts in renewables.</p> <p>[5.10] Annual report on new investments in renewables.</p> <p>[5.27 v] Extend the "Zero Authorisation project" abolishing licenses to other sectors of the economy.</p>

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

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<b>Fiscal-structural</b>	<p>[1.24] Quarterly ceilings for the consolidated General Government cash balance to be assessed.</p> <p>[3.15] Ensure a sustainable reduction in government liabilities.</p> <p>[3.25] Merge the revenue collection units of social security administration, if cost-benefit assessment is favourable.</p> <p>[3.35 i] GeRFIP to be implemented in the Autonomous region of Madeira and in the Autonomous Region of Azores.</p> <p>[3.36] Reduce the number of local branches of line ministries.</p> <p>[3.40] Accelerate the convergence of the system of social protection for staff that are in the RPSC to the rules of Regime Geral de Segurança Social.</p>
<b>Licensing</b>	<p>[7.23] Increase a nationwide land registration regime to allow a more equal distribution of benefits and costs in the execution of urban planning.</p>

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