International Monetary Fund

Portugal and the IMF

Press Release:
IMF Completes Third Review Under an EFF Arrangement with Portugal, Approves €5.17 Billion Disbursement
April 4, 2012

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Portugal: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

March 15, 2012

The following item is a Letter of Intent of the government of Portugal, which describes the policies that Portugal intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Portugal, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

PORTUGAL: LETTER OF INTENT

Lisbon, March 15, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde:

1. In the attached update to the earlier Memoranda of Economic and Financial Policies (MEFPs), we highlight key policy steps we have taken towards meeting the objectives of the economic program of the Portuguese government which is being supported by an Extended Arrangement.

2. Aided by one-off revenues, we met the end-year deficit target under the program, even as slippages emerged throughout the year. Nonetheless, fiscal consolidation in 2011 was sizeable—with the structural primary balance improving by some 3½ percent of GDP—and we have put in place a number of expenditure controls which already yielded results in late 2011. Although the continuous indicative target on the non-accumulation of new domestic arrears by the general government was breached in October and November, the overall stock of arrears declined in December. To prevent further breaches, we have approved and started to implement the new law on commitment controls and will ensure adequate budgetary allocations to the health sector through a supplementary budget. We have also met all but one of the ten structural benchmarks under the program, some with minor delays. We will now meet the benchmark on the regional finance law by December, allowing us to also include the changes stemming from the strengthened EU fiscal policy framework with one round of amendments.

3. Wide-ranging fiscal structural reform efforts will continue to reduce fiscal risks to the consolidation process. We have improved our budget monitoring system, and have successfully merged tax, customs, and IT services to improve the overall efficiency of our revenue administration. Beyond our commitments in the MEFP, we are also progressing well with a deep-seated reform of public administration, increasing the efficiency and cost-effectiveness of the public sector through consolidating administrative units and rationalizing managerial practices. Our plans to restructure the SOE sector are proceeding well, and we are confident we will reach our objective of operational balance for the sector as a whole by end-2012. In January, we signed a financial arrangement with the Autonomous Region of Madeira.

4. Our policy efforts to support financial system stability continue. We will continue to monitor the pace and composition of the deleveraging process, which needs to remain consistent with the program's macroeconomic framework. In particular, sufficient credit must be available to productive SMEs and exporting firms so that they can support economic recovery. Banks have so far been strengthening their capital positions without recourse to public funds. Going forward, we stand ready to support banks' efforts to meet their additional capital needs by end-June 2012, through the provision of public resources on appropriate terms.

5. We continue our reform efforts to increase competitiveness and promote growth and employment. We have reached an agreement with social partners for a broad and ambitious labor market reform, which increases flexibility by introducing banks of hours and reducing the cost of dismissals, promotes wage setting mechanisms that take account of economic conditions and raises productivity by cutting the number of holidays. We seek to improve the burden-sharing of the economic adjustment process, and commit to take measures that will reduce excess rents in the electricity sector and alleviate the pressure they place on consumer prices. Finally, we continue to improve economic framework conditions. We have sent a comprehensive revision to the Competition Law to Parliament (end-January structural benchmark), we are lifting the burden that government imposes on doing business, by, for example reducing licensing requirements and other legal requirements for firms. We have also revised the urban lease law with a view to promoting geographical mobility and have made good progress with reforming the judicial system.

6. On the basis of the policies defined in this letter, we request completion of the third review under the Extended Arrangement, the fourth purchase under the arrangement in the amount of SDR 4,443 million, and request waivers of applicability of the end-March performance criteria. The attached MEFP proposes a prior actions in the fiscal area and new structural benchmarks relating to the fiscal area (bringing the Large Taxpayer Office to full operation by December, and developing a strategy to unwind the public holding company Parpública, by April 2012), structural reform (in electricity, and both by April 2012, eliminate the Power Guarantee investment incentive for plants existing or licensed prior to the decree law governing the incentive, and set the new reference tariffs for the cogeneration regime, and in regulatory reform, implement the key recommendations from the independent report on the main sectoral regulators by mid August 2012), the financial sector (implement the amendments to the corporate insolvency law by mid-June 2012, and prepare a proposal on diversifying financing options for corporations by end-July 2012), and the judicial process (submit to Parliament amendments to the Code of Civil Procedure and a bill to implement the judicial roadmap to improve court structure, both by September 2012).

7. We remain confident that the policies described in the current and previous MEFPs are adequate to achieve the objectives under the program. We stand ready to take additional measures that may be needed to meet the objectives of the economic program and will

consult with the IMF, the European Commission, and the ECB, in advance of any necessary revisions to the policies contained in this letter and attached Memorandum.

8. This letter is copied to Messrs. Juncker, Rehn, and Draghi.

Sincerely yours,

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

Attachments: 1. Memorandum of Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

PORTUGAL: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

March 15, 2012

I. MACROECONOMIC OUTLOOK

1. **The good performance of exports led to a better than expected macroeconomic outcome in 2011, when compared to the initial and the two previous reviews' program projections.** Nevertheless, lower external demand in the context of domestic consolidation efforts has weakened somewhat the outlook for 2012 growth. With demand from key trading partners already contracting, we expect a decline in domestic output of about 3¼ percent, compared with 3 percent at the time of the second review last December. Uncertainty remains high. The sharp deterioration in the labor market in the fourth quarter of 2011 needs to be monitored carefully.

2. **After a sizeable 3½ percent of GDP improvement in the current account balance in 2011, further adjustment is expected in 2012.** We are encouraged by the strong and broad-based export growth seen in 2011 and the emerging signs that exporters are slowly increasing market shares outside of the EU area. However, given the prospects for a difficult year in Europe, our expectations for support to growth from exports in 2012 are prudently conservative. To ensure a durable structural adjustment in the external balance and a more dynamic export sector, we are implementing—and will continue to re-examine closely—policies reducing production costs, as outlined below.

II. FISCAL POLICY

3. **In 2011, we made significant progress toward our fiscal program objectives.** The central fiscal policy objective—bringing the primary balance up to over [2] percent of GDP and stabilizing debt by 2013—remains on track.

- *The general government deficit is estimated to have reached 4 percent of GDP—against a 5.9 percent of GDP target.* This over-performance reflects the one-off revenues from the partial transfer of banks' pension funds to the state social security system (3½ percent of GDP), which more than offset deviations with respect to the program target. Nevertheless, structural adjustment excluding one-off factors was very large (in the order of 3½ percent of GDP for the primary structural balance). Moreover, expenditure control improved tangibly in the second half of the year.

- Although the continuous indicative target on the non-accumulation of domestic arrears was breached in October and November, the overall stock of arrears was reduced by €300 million in December. This brought the end-year stock to below the September level (€5.3 billion).

4. **Downside risks to the 2012 fiscal outlook have increased, but we remain confident that our deficit objective (4.5 percent of GDP)—which entails another 4 percent of GDP of structural adjustment— is achievable.** The deterioration in the macroeconomic environment and labor market conditions will likely weigh on tax and social contributions revenues, and entail higher unemployment benefits. However, we expect these developments to be offset, namely by savings on net interest payments (as a result of the transfer of pension funds' assets as well as lower margins on EFSF/EFSM loans), and net project spending as a result of reprogramming of EU co-financing. A supplementary budget [will be] submitted to parliament, mainly to regularize a number of revenue and expenditure developments that largely offset each other. At this stage, no additional fiscal measures seem to be necessary to attain the 2012 fiscal objectives. However, we will remain vigilant and follow budgetary developments closely in order to ensure our fiscal target is met.

III. CONTAINING FISCAL RISKS

A. Public Financial Management

5. **We are intensifying our efforts in the area of public financial management reform.** We have improved our budgetary monitoring system through monthly assessments of deviations against fiscal targets, allowing for timely corrective interventions if needed. To further advance our reform, we will prepare by end-June 2012, a proposal to (i) reduce budget fragmentation and (ii) assess the scope to expand the coverage of the Single Treasury Account. The fiscal risks statement will be finalized by April 2012 and included in our Fiscal Strategy Program. Finally, we will reschedule lower priority measures, such as the move to full accrual-based IPSAS accounting, which should be adopted in 2014.

6. **Arresting and reversing domestic arrears accumulation is a priority objective.** Our two-pronged strategy includes: (i) the implementation of a new system of expenditure commitment controls to halt the flow of arrears; and (ii) a comprehensive plan to settle the stock of arrears over time.

- The new law on spending commitment controls is already in force, and we will now focus on swift implementation across general government and at SOE hospitals. We will ensure that all budgetary entities will start controlling expenditure against available funds. Through a proper risk-based approach, the Inspectorate General of Finance (IGF) will verify compliance of commitment control systems with the new law.

- A revised strategy document to clear the stock of arrears will be approved by the Council of Ministers (prior action), before the supplementary budget is submitted to Parliament. We will give priority to the settlement of the health sector arrears that were caused by chronic underfunding over the past years (€1.5 billion). We will ensure that local governments will reduce their stock of arrears by ten percent as envisaged in the 2012 budget. The strategy document will lay out the prioritization criteria for paying creditors, as well as governance arrangements to ensure a fair and transparent settling process. IGF will validate the claims (valuation, existence, title, age). We will put strong safeguards in place as payments will only be made in connection to arrears that have been properly validated and whose originating entity has changed its commitment system in accordance with the new law.

B. State-Owned Enterprises

7. **Our plans to restructure the SOE sector and privatize viable commercial firms are advancing.** We maintain our objective of reaching operational balance for the sector as whole by end-2012. Cost reductions are proceeding well, with, in particular, take-up of voluntary redundancy programs above expectations. These will have strong net benefits on firms' cost bases starting this year. Tariff increases have also substantially reduced the deficits in the transport sector. These developments have lowered our projections of the exceptional financing we need to provide to SOEs, to less than half of what was needed in 2011.

8. **We will continue our intensive efforts to make SOEs more productive, and eliminate the fiscal and financial pressures they are creating.** We will continue to maximize efforts to ensure that cost reductions in the largest area of spending—workers' benefits—are achieved through voluntary means, before proceeding to involuntary redundancies. Should unexpected developments put our final objective of operational balance by the end of 2012 in jeopardy, we will implement additional measures, as appropriate. We must now begin to address the debt overhang of several SOEs, bearing in mind the implications for the state's debt and deficit. Several firms—in particular the train operator Comboios de Portugal (CP) and the financial holding company Parpública—have liabilities that they are unlikely to be able to fully cover from their own resources over the next years. Based on the study on the financial conditions of SOEs (completed [in March]), we will develop specific programs for unwinding Parpública (structural benchmark for end-April 2012) and managing the liabilities of CP and other firms outside the General Government (by end-June 2012).

9. **We will continue to ensure the state retreats from commercial activities through privatizations.** Our privatization program has started strongly, with both EDP and REN attracting strong bids from international strategic investors and sales taking place at higher-than-expected prices. In both cases, the new investors will bring additional external financing for investment. Looking ahead, we will continue to ensure the state retreats from commercial activities through privatizations: we plan to launch privatization processes for the airport operator ANA and the airline TAP in the second and early in the third quarters this year, with a view to completing these transactions in 2012. We will launch the privatization/concession of the cargo handling subsidiary of CP (CP Carga) in the second quarter of 2012. The partial sale of a public television channel (RTP) is also being considered in 2012. In 2013, we are

considering privatization of the postal company CTT, once changes underway in regulation of this sector have their full impact. By the end of 2012, we will prepare a strategy assessing the competitive and regulatory environment, and the organisational consequences, of introducing private capital and management in the water company, Águas de Portugal.

C. Public-Private Partnerships

10. **A new fiscally-prudent PPP institutional framework will be adopted.** This framework to be approved by the Council of Ministers by end-March 2012 will significantly enhance the role of the MoF in managing PPPs at all stages of a project life-cycle. We launched a tender to hire a top-tier accounting firm to review all PPP contracts (end-2011 structural benchmark) and the winning bid was selected in March 2012. In order to increase transparency, all PPP contracts are now publicly available (except documents subject to confidentiality clauses).

D. Revenue Administration

11. **We have significantly strengthened our revenue administration framework**. The new *Autoridade Tributária e Aduaneira* was successfully created through the merger of the tax, customs, and IT services with a view to improve the overall efficiency of our operations. We are implementing the Plan to Combat Fraud and Evasion, and have taken targeted measures to curb non-compliance. The process of property evaluation—for which the support of local governments is paramount—is under way and should be finalized by end-December 2012. In 2011, a task force of judges has more than doubled the pace of its work on high-value tax cases in relation to the previous year. We remain committed to clear the remaining high-value tax cases in courts.

12. **We will develop a modern tax compliance management framework to curb non-compliance.** We will conclude the implementation of a full-fledged Large Taxpayers Office (LTO) (structural benchmark by end-December 2012). Based on the experience of the task force of judges, we will assess the need to create special chambers within the tax tribunals to handle such cases by mid-November 2012. We will analyze the impact of VAT issues on the backlog of enforcement cases and assess possible options, by end-April 2012, to address such cases, taking into account tax fraud and erosion risks. We will improve transparency by publishing quarterly reports on recovery rates, duration and costs of tax cases, starting in 2012 Q2 within four months after the end of each quarter.

E. Regional and Local Public Finances

13. **We have established a working group to revise the regional and local public finance laws on a new timeline**. Some goals of the regional finance law revision have already been accomplished through our program with the Autonomous Region of Madeira, which was concluded in January 2012. Nevertheless, the revision in the regional and local finance laws should now be designed in light of our new commitments at the European level

regarding the internalization of the new fiscal stability framework into Portuguese legislation. Against this background, we will submit to Parliament the revised regional and local finance laws by end-December 2012 (resetting the end-March structural benchmark that we cannot meet and adopting a new structural benchmark on the submission of the local finance law).

IV. Protecting the Financial System amidst Deleveraging and Sovereign Crises

14. **Deleveraging of the economy remains a key objective.** At the same time, this deleveraging has to be orderly in order to ensure that productive firms, in particular SMEs and firms operating in the tradable sector, do not face undue funding strains. A number of recent developments should mitigate this risk, including the easing of bank liquidity pressures, the recapitalization envisaged under the program, as well as the reduction in public sector financing needs as fiscal consolidation and the restructuring of SOEs continues. In addition, BdP will continue to discourage ever-greening of problematic loans, and is planning additional measures to this effect, with a view to facilitate an effective adjustment of bank balance sheets. These steps will be undertaken without burdening or posing risks to public finances. The Ministry of Finance, together with BdP and other stakeholders, will also prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector (end-July structural benchmark). Banks' funding and capital plans and broader credit market 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 necessary deleveraging remains consistent with the program's macroeconomic framework.

15. **Adequate bank liquidity remains critical to preserve financial stability.** Against the background of heightened risks across the euro area, recent measures announced by the ECB—consisting of longer-term refinancing operations, a reduction of the reserve ratio, and a broadening of the collateral eligibility criteria for Eurosystem refinancing—is helping ease potential constraints to bank lending. We continue to encourage banks to strengthen their collateral buffers on a sustainable basis and reduce their dependence on Eurosystem liquidity over the medium term.

16. **The proceeds of the partial transfer of the banks' pension funds will be used in agreement with the EC, ECB and IMF.** We have reached agreement with the banks on the modalities of the partial transfer of their pension plans, respecting EU state aid rules. The first tranche of the transfer been completed by end-2011, while the second tranche will be delivered by the banks during the first semester of 2012. At the current juncture, we intend to utilize the proceeds to augment our financing buffers under the program. We will carry out a credit assignment of up to €3 billion from the banks to the general government—subject to strict eligibility criteria—while maintaining the contractual obligations of the debtors.

17. **Banks have successfully strengthened their capital positions.** All but two banking groups subject to BdP supervision met the 9 percent Core Tier 1 target set under the program

for end-2011. Nevertheless, the target was met by all the eight largest banks of these banking groups (accounting for 83 percent of the banking system's assets). The BdP is reviewing the banks' plans for meeting additional capital needs by end-June 2012, stemming from the new requirements announced by the European Banking Authority (EBA) in December 2011, as well as the capital needs that are driven by the partial transfer of banks' pension funds and the special on-site inspections program (SIP).

18. **The Bank Solvency Support Facility (BSSF) remains available to support viable banks under the program.** While banks continue to seek private solutions to augmenting capital, some resources of the BSSF will need to be deployed to help some of the viable banks meet the additional capital needs. Meanwhile, the BdP will continue to assess the banking sector's resilience, inter alia via quarterly stress tests starting in June 2012, which are reviewed jointly with the EC, ECB and IMF.

19. **Work on the rules governing the provision of public capital support to banks has been completed.** The amended law on extending temporary public support to viable banks has entered into force on February 12, 2012 and the accompanying Ministerial Order ("Portaria") is being finalized, after consultation with all relevant stakeholders. The legislation and the range of instruments deemed acceptable for capitalization purposes by regulators will be consistent with EU state aid rules. Banks receiving public support will be subjected to strict conditionality, aimed at protecting the taxpayer's interests while enhancing the banks' resilience to future shocks, inter alia though fundamental restructuring and better risk control and corporate governance. The legislation foresees a public divestment period of maximum five years. The legislation allows for soundly run banks that continue to comply with their recapitalization plans to remain privately managed. The banks' shareholders have the possibility to redeem the public share during this period. BdP will closely monitor and supervise banks that receive public support and will provide quarterly status reports to the Minister of Finance.

20. **Efforts to streamline the state-owned Caixa Geral de Depósitos (CGD) are continuing.** CGD met the Core Tier 1 capital ratio target of 9 percent by end-2011 through internal resources within the given timeline. However, the EBA capital exercise, and the requirement to build an additional buffer for sovereign exposures, has created the need to raise additional capital that cannot be met through internal resources within the given timeline. In this context, we stand ready to support CGD in its efforts to meet its additional capital needs by end-June 2012, from cash buffers outside of the BSSF, in line with EU state aid rules. The Portuguese government will, in its role as shareholder, encourage CGD to finalize the sale of its insurance arm to a third party before end-2012, and to initiate the sale of non-strategic participations and a review of CGD's overall portfolio.

21. **Negotiations on the sale of Banco Português de Negócios (BPN) are expected to be completed by end-March 2012.** The separation of the distressed assets from BPN has been completed and the Portuguese government remains committed to a transaction that

minimizes the costs to the Portuguese taxpayers and the economy as a whole, while safeguarding financial stability. Once a final solution for BPN has been found, CGD's state guaranteed claim will be gradually settled in cash. Any recoveries in assets held by the state-owned SPVs will also be used promptly to repay CGD. We will develop and implement, by end-March 2012, a more effective strategy for the recovery of the distressed assets and the management of the SPVs. Moreover, we intend to commission an audit, while complying with procurement laws, to confirm the prospective recoverable value of the distressed assets held by the state-owned SPVs. This audit will be completed by the time of the fourth review.

22. **BdP continues to strengthen its supervisory capacity.** BdP is hiring specialist resources, and has established a new division tasked with the execution of multiple initiatives to (i) enhance the supervisory organization and further improve the competences of supervisory staff, (ii) optimize supervisory processes and (iii) maintain existing and develop and implement new supervisory methodologies and tools. As part of its activities, the new division will ensure that the experiences obtained via the SIP are properly disseminated across the supervisory functions of BdP. Furthermore, steps have been taken to improve the coordination with home and host country supervisors, both within and outside the EU.

23. **The early intervention, resolution, and deposit insurance framework has been strengthened.** Legislative amendments have been passed and we are examining the implementation details of the new legislative framework, particularly in relation to the operational details to render fully operational the recently established resolution fund and to put in place its funding arrangements. We will pass regulations relating to the resolution fund as well as notices for recovery and resolution plans by July-2012 and notices for the establishment of bridge banks by end-September 2012. We will implement the EU Directive on resolution as soon as it enters into force.

24. **We continue to improve the legal framework for corporate debt restructurings.** The corporate insolvency law amendments to support better early rescue of viable firms (end-December 2011 structural benchmark), were approved by the Council of Ministers in December 2011 and by Parliament on March 9th. These amendments will become effective by mid-June 2012 (structural benchmark). We also will step up actions to raise public awareness of the new restructuring tools.

25. **We are assessing and improving existing mechanisms to support SMEs.** A report assessing the overall consistency, effectiveness, and the impact of existing support measures will be revised by end-June 2012. The report will discuss policy actions aimed at improving and implementing support mechanisms to facilitate access to credit, encourage internationalization, and improve competitiveness of SMEs, while respecting EU competition rules. In addition, we are finalizing the amendments to the conciliation framework mediated by IAPMEI, a public entity, to facilitate extrajudicial corporate debt restructurings for viable SMEs.

V. Structural Reform: Growth and Competitiveness Agenda

A. Competition Framework

26. **We continue to deliver reforms in line with our commitment to increasing competition, encouraging innovation, and reducing rent-seeking in all sectors.** We have sent a comprehensive revision to the Competition Law to Parliament, which we expect to be approved by mid-year. We are reviewing the public procurement code to ensure transparency in the allocation of public contracts, to be approved by March 2012. The hiring of consultants for an independent report reviewing and benchmarking the responsibilities, resources, and independence of the main sectoral regulators has been delayed, but we remain committed to prepare a proposal to implement identified best international practices in order to reinforce the independence of regulators, by mid-August 2012 (structural benchmark).

B. Margins in Regulated Non-Tradable Sectors

27. **We are committed to addressing excessive mark-ups in network industries and non-tradable sectors**. Our policies aim to reduce price pressures on end-users that cascade through the economy, weaken the competitiveness of producers, or are ultimately borne by consumers and taxpayers. We have already made significant progress in some areas. For example, in the telecommunications sector, we continue to reduce high mobile termination rates which put small operators at a disadvantage, and we have conducted a successful spectrum auction which, while not attracting new entrants, has broadened access of all operators to existing networks. In the health sector, we have revised the margins of pharmacies and wholesalers and have set specific targets for the reduction of pharmaceutical expenditure.

28. **In the electricity sector, we have identified measures that will reduce mark-ups and eliminate by 2020 the tariff deficit.** We will now take measures that will reduce excess rents and alleviate the pressure they place on end-user electricity prices. We have studied the nature of all types of incentives under the existing energy policy, and have identified instances in the electricity sector where the link between the risk borne by generators and the magnitude of incentives granted is weak. On that basis, we will focus our efforts, including through multilateral negotiations with the stakeholders, on three compensation schemes, described below, which also have an important weight in final electricity prices. To achieve these goals we will appoint an independent negotiator, by end-March 2012, and will discuss progress in this area during the fourth program review.

***CMECs* (*Compensation for Early Termination of PPAs*)**

29. **We will take measures to limit the policy costs embedded in CMECs.** In particular, we will negotiate the revision of the rate of return to bring it in line with cost of capital at the moment the compensation was defined plus, if warranted, a risk premium. This

premium will be linked to the risk of the assets that the mechanism remunerates. The immediate objective will be to reduce rents and stabilize the tariff debt (*défice tarifário*).

Co-generation Incentives

30. **Our objective is to accelerate convergence to market-based pricing for co-generation operators**. The remuneration scheme for co-generation will be revised to improve efficiency of the support system and reduce explicit subsidies through creating a transitional regime during which the tariffs will decline at an increasing rate. We will publish the Executive Order defining the new reference tariff and the formula for updating tariffs in the future, by end-April 2012 (structural benchmark). These measures are estimated to reduce policy costs implicit in electricity prices starting at €25m per year in 2012, rising to €80m in 2020.

Power Guarantee Investment Incentives

31. We will eliminate, by end-April 2012, the incentive to invest in cases where investment decisions had already been taken without the expectation of an additional incentive, i.e. for the set of power plants existing or already licensed prior to the 2007 Decree Law governing this incentive (structural benchmark). We will redesign the Power Guarantee mechanism, establishing a new rationale that provides incentive to build additional generating capacity in the future which takes into account adequate security of supply levels and the existence of other mechanisms, such as interruptibility services. These measures are estimated to reduce policy costs by about €60 million per year.

C. Wage Competitiveness

32. **We recognize the need to promote wage developments consistent with improving firms' competitiveness—particularly for smaller firms,** and have taken the following steps:

- **We have suspended the previous practice of virtually automatic extension of most collective agreements.** Extensions shall only take place when the respective collective agreements are clearly shown to be representative. We will keep ensuring wage moderation by using the available discretion in the current legislation of not extending collective agreements until clear criteria are defined.

- **We have improved the conditions under which works councils can negotiate working time arrangements and remuneration**. Revisions to the Labor Code, currently in Parliament, provide for "organized decentralization": allowing that a collective agreement concluded at a higher level defines conditions under which works councils can engage in firm-level bargaining, without the need for further delegation to a specific works council.

- **We are eliminating four holidays and three paid holiday bonus days (that were due in the case of no absenses), contributing to the reduction in unit labor costs.**

33. **Given the need to ensure sufficient wage flexibility, we will assess the need to adjust policies further.**

- **We will assess the experience with actual use of the flexibility granted to firms under the revisions to the Labor Code**, allowing employers to negotiate with works councils at the firm level. Namely, we will provide evidence by end-March 2013 on how these measures are being applied in collective agreements. If needed, we will prepare an action plan, in consultation with social partners, by end-[June 2013] to ensure that works councils are given real possibility to negotiate wages at firm level.

- **We will explore the merits of and scope for more fundamental changes to the extension mechanism**. We are currently collecting data on the representativeness of social partners, to be part of a set of clear criteria to be followed for the extension of collective agreements. On the basis of this data, we will consider extending collective agreements subscribed by employer's associations representing at least 50 percent of workers in the sector. Once that threshold is reached, a decision on extension will consider criteria that will prevent an undue burden on the competitive position of non-affiliated firms in the sector—including the implication for external competitiveness.

D. Increasing Employment

34. **We are committed to taking measures to address rising cyclical and structural unemployment, particularly among young workers**.

- **Short term stimulus programs**. We have put in place a stimulus program, providing wage subsidies for firms that hire and train workers who have been registered with public employment services (PES) and fulfill some additional conditions.

- **We are considering measures to effectively lower the reservation wage for certain categories of unemployed**, providing incentives to take up lower paying job matches by topping up wages with a share of unemployment benefits.

- **Employability of young workers**. While some existing ALMPs cater specifically to the needs of the young unemployed, we will be tackling this challenge in the context of a cross-country task force.

- **Unemployment benefits duration**. We have amended the unemployment benefit system, introducing a declining profile for unemployment benefits, reducing the maximum monthly amount of benefits, and shortening the maximum benefits duration. However, given that the duration of benefits remain more generous than unemployment insurance schemes in Europe, we will prepare by end-December 2012 an analysis on benefit dependency and long-term unemployment with a view to assess whether further measures are needed. If needed, we will take measures that will minimize distortions to employability, by end-March 2013.

E. Housing Reform

35. **Progress has been achieved to promote the efficiency of the housing market, boost urban renovation, and foster labor mobility.** To these ends, changes in the Urban lease law and draft legislation to simplify administrative procedures for renovation have been submitted to Parliament as planned.

F. Judicial Reform

36. **We are pushing ahead with targeted measures to reduce the backlogged enforcement cases**. About 50,000 enforcement cases have been cleared since last November, and the inter-agency task force has set quarterly targets for closing enforcement cases by mid-May. In addition, we will develop measures by end-May to resolve pending small claim cases. We have prepared an action plan to strengthen the legal and institutional framework for enforcement agents and will refine the plan based on extensive consultation and cross country experience by mid-May. While the oversight body for enforcement agents currently has access to most enforcement case files, we will take additional measures to ensure full access by end-June. Finally, we continue overhauling the information system to facilitate the speedy processing of court cases.

37. **We are advancing the reforms to improve efficiency of the court system**. Ten court sections have been closed since November, and we have developed a comprehensive judicial roadmap to further reduce the number of courts and streamline the court structure. A bold proposal to amend the Code of Civil Procedure has been prepared to speed up the judicial process. We are conducting an extensive consultation with stakeholders on these proposals, including through workshops to be held in April with the IMF and EC technical assistance. In addition, we have also made significant progress in strengthening the alternative dispute resolution (ADR) framework. In particular, we have adopted measures to give priority to the ADR enforcement cases in courts, and arbitration centers have become fully operational (end-February structural benchmark). While the bill to improve the Justice for the Peace regime has been prepared, we will submit it to Parliament by end-September as the bill needs to be informed by the judicial roadmap.

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

	Performance Criteria (unless indicated otherwise)								Indicative Targets	
	Jun-11		Sep-11		Dec-11					
	Program	Actual	Program	Actual	Program	Actual	Mar-12	Jun-12	Sep-12	Dec-12
1. Floor on the consolidated General Government cash balance (cumulative)	-5.4	-5.1	-6.7	-5.7	-10.3	-7.1	-1.9	-4.4	-5.9	-7.6
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target)	…	…	0	0.2	0	Not met 1/	0	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	167.9	175.9	170.8	175.9	167.8	182.0	175.0	175.0	175.0
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government (continuous performance criterion)	0	0	0	0	0	0	0	0	0	0

1/ Domestic arrears increased by €159 million in October and €74 million in November. They decreased by €301 million in December.

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

	Measure	Timing	Status
Prior Actions			
1	Pass a resolution of the Council of Ministers on a strategy document to clear the stock of domestic arrears of the general government and SOE hospitals, establishing the governance arrangements for prioritization and payment decisions.		
Structural Benchmarks			
A. Strengthen financial stability			
2	Amend relevant legislation in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework, introduce a regime for restructuring of banks as a going concern under official control and strengthen deposit insurance framework.	End-Dec. 2011	Met
3	Amend the Insolvency Law to better facilitate effective rescue of viable firms. 1/	End-Dec. 2011	Met with delay
4	Amend the framework (Law No. 63-A/2008) for bank access to public capital	End-Jan. 2012	Met
5	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	
6	Prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector.	End-July 2012	
B. Enhance competitiveness and address bottlenecks to growth			
7	Submit to Parliament legislation revising the Competition Law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonized with the European Union competition legal framework.	End-Jan. 2012	Met with delay
8	Prepare a proposal on measures to be used to correct excessive rents in special (co-generation and renewables) and standard regimes (CMECs, PPAs, and power guarantee mechanism). The proposal will consider the merits of a full range of measures and cover all sources of rents.	End-Jan. 2012	Met with delay
9	Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011	Met
10	Take all necessary legal, administrative, and other steps to make arbitration fully operational.	End-Feb. 2012	Met
11	Eliminate the Power Guarantee investment incentive for the set of power plants existing or already licensed at the time of the approval of the 2007 Decree Law (264/2007) governing this incentive	End-April 2012	
12	Publish the Ministerial Order defining the new reference tariff and formula for updating tariffs in the future for the electricity co-genereration regime.	End-April 2012	
13	Prepare a proposal to implement identified best international practices in order to reinforce the independence of the main sectoral regulators.	mid-Aug. 2012	
14	Submit to Parliament amendments to the Code of Civil Procedure to streamline and speed up the court procedures	End-Sept. 2012	
15	Submit to Parliament the bill to implement the judicial roadmap to improve the court structure.	End-Sept. 2012	
C. Strengthen fiscal institutions and reduce fiscal risks			
16	Launch a tender to hire a top tier international accounting firm to review and complete a more detailed study of all 36 PPP contracts at the national level.	End-Dec. 2011	Met
17	Prepare a report on SOEs based on forecast financial statements assessing their financial prospects, potential government exposure, and scope for orderly privatization.	End-Feb. 2012	Met with delay
18	Develop a specific program for unwinding Parpublica.	End-April 2012	
19	Revise and submit to Parliament the draft regional and local public finance law.	End-Dec. 2012	Reset from end-March 2012
20	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	

1/ The amendments were approved by the Council of Ministers and submitted to Parliament in December 2011, but were approved by Parliament on March 9, 2012.

PORTUGAL: TECHNICAL MEMORANDUM OF UNDERSTANDING

March 15, 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.[1]

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.

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

- 5.2. Data on the cash balances of the other parts of General Government as defined in paragraph 4[2] 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

[2] 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.

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

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

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

6.3 Adjustor. If in IMF/EC/ECB's staff judgment (based on assessment during the third review) there are sufficient safeguards to prevent further accumulation of arrears and that part of the remaining funds (available after meeting the 2011 deficit target) from the envisaged 2011 banks pension fund transfer may be used to settle domestic arrears, the following adjuster will apply. The 2012 quarterly floors on the consolidated general government cash balance, as well as the accrual government balance objectives, will be adjusted, if necessary, by the amount of arrears to be cleared.

Other Provisions

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

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

9. **Supporting Material**.

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

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

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

10. **Definitions**. Commitment, liabilities, payables/creditors, and arrears can arise in respect of all types of expenditure. These include employment costs, utilities, transfer payments, interest, goods and services and capital expenditure. Commitments are explicit or implicit agreements to make payment(s) to another party in exchange for that party supplying goods and services or fulfilling other conditions. Commitments can be for specific goods and services and arise when a formal action is taken by a government agency, e.g., issuance of a purchase order or signing a contract. Commitment can also be of a continuing nature that require a series of payments over an indeterminate period of time and may or may not involve a contract, e.g. salaries, utilities, and entitlement payments. Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result

in an outflow from the entity of resources (usually cash) embodying economic benefits or service potential. In relation to commitment, the liability arises when a third party satisfies the terms of the contract or similar arrangement. Payables/creditors are a subset of liabilities. For the purposes of the program payables/creditors exclude provisions and accrued liabilities. Arrears are a subset of payables/creditors. For the purposes of the Program domestic arrears are defined as payables/creditors that have remained unpaid for 90 days or more beyond any specified due date (regardless of any contractual grace period). In case no due date is specified, arrears are defined as payables/creditors that have remained unpaid for 90 days or more after the date of the invoice or contract. Data on arrears will be provided within seven weeks after the end of each month. The continuous indicative target of non-accumulation of new domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the end of the previous month—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.

12. **Adjustor.** The monthly change in the stock of arrears will be adjusted for any stock adjustment related to the arrears clearance strategy. 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. €1 billion has been provided in cash and is made available in a separate dedicated account to be set up at the Bank of Portugal by end-June 2011. An additional €3 billion has been deposited so far in 2012. Future amounts for the bank support fund will be deposited into the dedicated account to the extent that there is a need for bank capital.

F. Overall Monitoring and Reporting Requirements

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.

PORTUGAL: LETTER OF INTENT TO THE EUROPEAN COMMISSION AND THE EUROPEAN CENTRAL BANK

Lisbon, 15 March 2012

Mr Jean-Claude Juncker
President
Eurogroup

Ms Margrethe Vestager
Minister for Economic Affairs and the Interior
Denmark

Mr Olli Rehn
Vice President
European Commission

Mr Mario Draghi
President
European Central Bank

Dear Madam, dear Sirs,

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

2. Aided by one-off revenues, we met the end-year deficit target under the programme, even as slippages emerged throughout the year. Nonetheless, fiscal consolidation in 2011 was sizeable – with the structural primary balance improving by some 3½ percent of GDP – and we have put in place a number of expenditure controls which already yielded results in late 2011. Although the continuous indicative target on the non-accumulation of new domestic arrears by the general government was breached in October and November, the overall stock of arrears declined in December. To prevent further breaches, we have approved and started to implement the new law on commitment controls and will ensure adequate budgetary allocations to the health sector through a supplementary budget. We have also met all but one of the ten structural benchmarks under the programme, some with minor delays. We will now meet the benchmark on the regional finance law by December, allowing us to also include the changes stemming from the strengthened EU fiscal policy framework with one round of amendments.

3. Wide-ranging fiscal structural reform efforts will continue to reduce fiscal risks to the consolidation process. We have improved our budget monitoring system, and have successfully merged tax, customs, and IT services to improve the overall efficiency of our revenue

administration. Beyond our commitments in the MoU and MEFP, we are also progressing well with a deep-seated reform of public administration, increasing the efficiency and cost-effectiveness of the public sector through consolidating administrative units and rationalising managerial practices. Our plans to restructure the SOE sector are proceeding well, and we are confident we will reach our objective of operational balance for the sector as a whole by end-2012. In January, we signed a financial arrangement with the Autonomous Region of Madeira.

4. Our policy efforts to support financial system stability continue. We will continue to monitor the pace and composition of the deleveraging process, which needs to remain consistent with the programme's macroeconomic framework. In particular, sufficient credit must be available to productive SMEs and exporting firms so that they can support economic recovery. Banks have so far been strengthening their capital positions without recourse to public funds. Going forward, we stand ready to support banks' efforts to meet their additional capital needs by end-June 2012, through the provision of public resources on appropriate terms.

5. We continue our reform efforts to increase competitiveness and promote growth and employment. We have reached an agreement with social partners for a broad and ambitious labour market reform, which increases flexibility by introducing banks of hours and reducing the cost of dismissals, promotes wage setting mechanisms that take account of economic conditions and raises productivity by cutting the number of holidays. We seek to improve the burden-sharing of the economic adjustment process, and commit to take measures that will reduce excess rents in the electricity sector and alleviate the pressure they place on consumer prices. Finally, we continue to improve economic framework conditions. We have sent a comprehensive revision to the Competition Law to Parliament (end-January structural benchmark), we are lifting the burden that government imposes on doing business, by, for example, reducing licensing requirements and other legal requirements for over 90 percent of firms. We have also revised the urban lease law with a view to promoting geographical mobility and have made good progress with reforming the judicial system.

6. On the basis of the policies defined in this letter, we request completion of the third review under the Economic Adjustment Programme. The attached MoU and MEFP propose a prior action in the fiscal area, and new structural benchmarks relating to the fiscal area (bringing the Large Taxpayer Office to full operation by December, and developing a strategy to unwind the public holding company Parpública by April 2012), structural reform (in electricity, and both by April 2012, eliminate the Power Guarantee investment incentive for plants existing or licensed prior to the decree law governing the incentive, and set the new reference tariffs for the cogeneration regime, and in regulatory reform, implement the key recommendations from the independent report on the main sectoral regulators by mid August 2012), the financial sector (implement the amendments to the corporate insolvency law by mid-June 2012, and prepare a proposal on diversifying financing options for corporations by end-July 2012), and the judicial process (submit to Parliament amendments to the Code of Civil Procedure and a bill to implement the judicial roadmap to improve court structure, both by September 2012).

7. We remain confident that the policies described in the current and previous MoUs and MEFPs are adequate to achieve the objectives under the programme. We stand ready to take additional measures that may be needed to meet the objectives of the Economic 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 Memoranda.

8. This letter is copied to Ms Christine Lagarde.

Sincerely yours,

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

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

PORTUGAL: MEMORANDUM OF UNDERSTANDING ON SPECIFIC ECONOMIC POLICY CONDITIONALITY

Third Update – 15 March 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 third 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.[1]

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 third quarterly review was carried out in February 2012. It assessed compliance with the conditions to be met by end-February and the need and scope for additional policy steps. This third update of the MoU reflects the findings of the third 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;

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

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.

A. 1. Fiscal policy

Objective

First, reduce the government deficit to below EUR 7,645 million (4½ percent of GDP) in 2012. This should allow to reach a deficit target of 3 percent of GDP by 2013. Second, bring the government debt-to-GDP ratio on a downward path as of 2013. Third, maintain fiscal consolidation over the medium term up to a balanced budgetary position, notably by containing expenditure growth. This consolidation will be achieved by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups.

Fiscal policy in 2012

In 2011, the general government deficit fell below the target of EUR 10,068 million on a European System of Accounts (ESA95) basis according to available data in February 2012. The deficit is now estimated at around 4 per cent of GDP compared to a target of 5.9 per cent of GDP. The target has been achieved mainly by means of a large one-off transfer of the banks' pension funds to the public social security system of around EUR 6 billion (3½ per cent of GDP). Without this one-off transfer, the fiscal gap is estimated to be 1½ percent of GDP. Primary expenditure overruns that occurred in the first half of the year have been reversed in the second half. The remaining fiscal gap has been caused mainly by non-recurrent factors at the level of sales of concessions and real estate, reclassification of capital operations and PPP investment. The recapitalisation costs of the troubled bank BPN added 0.3 per cent of GDP to the fiscal gap on an ESA95 basis.[2]

1.1. The government will achieve a general government deficit of no more than EUR 7,645 million (4½ per cent of GDP) in 2012.[3] **[Q4-2012]** The Government has not implemented the 'fiscal devaluation' as a tool to cut labour costs. As an alternative, the

[2] Transactions related to the banking sector support and restructuring strategy under the programme are excluded from the deficit definition of the TMU.

[3] In 2012, operations related to the banking sector support and restructuring strategy under the programme and lump-sum revenues from transfers of pension funds to the government sector will not be considered for the assessment of compliance with the programme target for the general government deficit. Conversely, if during the fourth review there is an agreement that there are sufficient safeguards to prevent further accumulation of arrears, part of the remaining funds from the 2011 banks pension transfer may be used to settle domestic arrears, the accrual government balance objectives may be adjusted.

government has introduced a number of other measures to boost the competitive position of Portuguese firms. Substantial efforts continue to be necessary to raise competitiveness which remains a central aim of the programme.

1.2. The Government will adopt a Supplementary Budget by **[Q1-2012].** Main elements to be included: i) the additional expenditure on pensions due to the banks' pension funds transfer in 2012 of about EUR 520 million; ii) the strategy for the settlement of arrears in the health sector; iii) budgetary costs of the Madeira programme; and iv) ways of addressing increased downside risks to economic activity by using additional interest savings, such as the interest received from deposits, the EFSF margin removal from loans disbursed in May/June and lower interest on EFSF/EFSM loans disbursed afterwards and savings from the reprogramming of EU structural funds.

1.3. The banks' pension funds transfer has created additional expenditure on pensions for the government that will have a negative impact, although decreasing in time, on the overall fiscal balances. The government will adopt measures to cover the additional expenditure and keep the fiscal balances unaffected. For 2012, these measures will be covered by the Supplementary Budget. For later years, these measures are still to be fully specified and will be included in the 2012 fiscal strategy document in compliance with the Stability and Growth Pact together with detailed medium-term fiscal projections and a list of contingency measures in case of budgetary slippages. [**April 2012]**

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

1.5. The discussion in Parliament of the 2012 Budget Law has led to a change in the salary and pension threshold to EUR 1,100 above which the 13th and 14th monthly payments are fully suspended, and to between EUR 600 and EUR 1,100 for implementing the progressive suspension. The change was done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital income (dividends and interest payments) from 21.5 per cent to 25 per cent.

1.6. The measures listed below, worth 5.3 percent of GDP, when compared with the estimated outturn for 2011 (and above 6 percent of GDP when compared with a scenario of unchanged policies), will be carried out as adopted in the 2012 Budget Law, unless elsewhere specified. Overall, expenditure reduction accounts for two thirds of that fiscal effort and revenue increases for one third.

Expenditure

1.7. Ensure that the public sector wage bill decreases in gross terms in 2012 by at least EUR 3,000 million:

i. reduce wages for all general government sector employees in 2012 by (i) suspending the 13^{th} and 14^{th} monthly salary payments for those workers with monthly salaries of EUR 1,100 or more, (ii) suspending on average and in a progressive way the equivalent of one of those two salaries for those workers with monthly salaries between EUR 600 and EUR 1,100. Similar measures will apply to all SOEs classified inside and outside the perimeter of the government sector, and in any other public entity even if falling outside the perimeter of the government sector;

ii. reduce the number of government employees by (i) limiting staff admissions in order to achieve annual decreases of 2 per cent (full-time equivalent) in 2012-2014 in the permanent staff of central, regional and local governments, (ii) decreasing the number of temporary positions in specific areas of public administration. To support these objectives, binding numeric targets for staff reductions per main area of the administration will be defined by **Q1-2012**;

iii. make room to reverse any possible slippage recorded in 2011;

iv. suspend all promotions in 2012;

v. reduce the overall budgetary cost of health benefits schemes for government employees schemes (ADSE, ADM and SAD) on the basis of the measures presented below under 'Health care system';

vi. savings from the public administration restructuring on the basis of the measures presented below under 'Public administration'.

1.8. Reduce pension expenditure in gross terms in 2012 by at least EUR 1,140 million by: (i) suspending the 13th and 14th monthly payments for those pensioners with monthly pension benefits of EUR 1100 or more, (ii) suspending on average and in a progressive way the equivalent of one of those monthly benefits for those with monthly pension benefits between EUR 600 and EUR 1100. The pensions of those receiving benefits below EUR 600 will be frozen and the lowest pensions will be marginally increased. In case a pensioner receives more than one pension, the consolidated pension income will be considered for the application of the thresholds defined here. These rules will also apply to subventions or subsidies paid by the government that take the nature of pensions even if designed otherwise.

1.9. Control costs in health sector on the basis of detailed measures listed below under 'Health-care system', achieving savings worth some EUR 1000 million.

1.10. Reduce costs with SOEs classified inside the perimeter of the general government on a ESA95 basis with the aim of saving at least EUR 500 million by means of:

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

ii. tightening compensation schemes and fringe benefits in line with the rest of the government sector;

iii. rationalising investment plans for the medium term. The increase in EU co-financing rates allowed for countries under an Economic Adjustment Programme and a re-programming of EU funds in the context of the current National Strategic Reference Framework (NSRF) will also give a contribution to this end;

iv. SOEs will also relieve pressure on government accounts by raising their revenue coming from market activities, including by raising tariffs and prices.

1.11. Reduce costs in the area of education, with the aim of saving EUR 380 million by rationalising the school network including by creating school clusters; lowering staff needs;

centralising procurement; and reducing and rationalising transfers to private schools in association agreements and making a more intensive use of EU funds to finance activities in the area of education.

1.12. Reduce capital expenditure by EUR 200 million by prioritising investment projects and making more intensive use of funding opportunities provided by EU structural funds. The increase in EU co-financing rates allowed for countries under an Economic Adjustment Programme and a re-programming of EU funds in the context of the current National Strategic Reference Framework (NSRF) will give an important contribution to this end.

1.13. Reduce cash social transfers (other than pensions) by at least EUR 180 million by tightening eligibility criteria and decreasing average benefits in selected cases.

1.14. Reduce transfers to local and regional authorities by at least EUR 175 million with a view to having these subsectors contributing to fiscal consolidation.

1.15. Improve the working of the central administration by increasing efficiency, reducing and eliminating services that do not represent a cost-effective use of public money. This should yield annual savings worth at least EUR 130 million. Detailed plans will be presented by the Portuguese authorities by **Q1-2012**; the budgetary impacts will spread beyond 2012. To this end, the government will:

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

ii. create a single revenue administration and promote services' sharing between different parts of general government;

iii. reorganise the provision of central administration services at local level and regularly assess the value for money of the various public services;

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

v. reduce transfers from the state to public bodies and other entities;

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

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

1.16. Reduce costs in other public bodies and entities and in transfers and subsidies to SOEs classified outside the perimeter of the general government on an ESA95 basis by at least EUR 90 million. These SOEs at the level of central, regional will carry out adjustment efforts similar to those SOEs classified inside the perimeter of the general government on a ESA95 basis as listed above, namely by: rationalising investment plans for the medium term; sustaining an average permanent reduction in operating costs by at least 15 per cent; tightening compensation schemes and fringe benefits; increasing revenues from market activities, including by raising tariffs and prices charged. These adjustments will also be instrumental to contain risks that the financial situation of some of these SOEs put to government accounts in 2012 and beyond.

Revenue

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

1.18. Raise VAT revenues through an increase in the efficiency of the VAT structure with a yield of at least EUR 2,024 million in 2012. For this purpose, a set of categories of goods and services were moved from the reduced and intermediate VAT rates to higher ones. This includes the additional impact of the increase in the VAT rate for natural gas and electricity to the standard rate introduced in October 2011.

1.19. Increase personal income taxes with a yield of at least EUR 265 million in 2012 (taking into account the losses of revenues as result of the reductions of public wages and pension incomes listed under 1.8 and 1.9 above) by:

i. capping and cutting substantially (by two thirds overall) tax allowances for health expenditure;

ii. (i) eliminating the deductibility of mortgage principal; (ii) eliminating interest income deductibility for new mortgages; (iii) phasing out the deductibility of mortgage interest payments for owner-occupied housing and of rents;

iii. harmonising personal income tax deductions applied to pensions and labour income;

iv. capping the maximum deductible tax allowances according to tax bracket for most of the income brackets except the bottom two with lower caps applied to higher incomes and a zero cap for the two highest income brackets;

v. revising the taxation of income in kind;

vi. introducing a surcharge on the income of the top tax bracket and increasing the tax rate on capital gains;

vii. the one-time surcharge in the context of the personal income tax in 2011 that will be collected in 2012.

1.20. Increase corporate tax revenues by at least EUR 330 million in 2012 by:

i. abolishing all reduced corporate income tax rates;

ii. limiting the deductions of losses in previous years to 75 per cent of the taxpayer's taxable profit;

iii. curbing tax benefits;

iv. increasing the rates and the basis of the state surcharge on corporate profits.

1.21. Increase excise taxes to raise at least EUR 200 million in 2012. In particular by:

i. raising taxes on car sales, tobacco and alcohol products;

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

iii. indexing excise taxes to core inflation.

1.22. Change property taxation to raise revenue by at least EUR 50 million by reducing substantially the temporary exemptions for owner-occupied dwellings acquired as of 2012 and by increasing rates.

1.23. Increase efforts to fight tax evasion, fraud and informality to raise revenue by at least EUR 175 million for various types of taxes inter alia by increasing means available for audits, increasing penalties for the most serious tax crimes and introducing electronically-transmitted invoices.

Fiscal policy in 2013

1.24. The government will achieve a general government deficit of 3 percent of GDP or below. **[Q4-2013]**

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

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

Expenditure

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

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

ii. wage bill: decrease of 2 per cent (full-time equivalent) in the permanent staff of central, regional and local governments and decrease the number of temporary positions in specific areas of public administration;

iii. health sector: EUR 375 million;

iv. capital expenditure: EUR 350 million;

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

vi. education and school network rationalisation: EUR 175 million;

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

viii. health benefits schemes for government employees: EUR 100 million;

ix. freeze wages and pensions except for the lowest pensions.

1.28. In addition, the government will extend the use of means testing and better target social support achieving a reduction in social benefits expenditure of at least EUR 250 million. Social transfers will also decline following the implementation of the measures on unemployment insurance listed below under 'Labour market and education'.

Revenue

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

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

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

iii. excise taxes: EUR 150 million.

1.30. Update the notional property value of all real estate assets for tax purposes to raise revenue by at least EUR 250 million in 2013. Transfers from the central to local governments will be reviewed to ensure that the additional revenues are fully used for fiscal consolidation**.**

Fiscal policy in 2014

1.31. The government will aim at achieving a general government deficit in 2014 in line with the Medium-Term Fiscal Strategy defined in August 2011. The necessary measures will be defined in the 2014 Budget Law. **[Q4-2013]**

1.32. 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]**

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

B. 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; bring closure to the Banco Português de Negócios case and streamline state-owned Caixa Geral de Depósitos; strengthen the bank resolution framework and reinforce the Deposit Guarantee Fund and the Guarantee Fund for Mutual Agricultural Credit Institutions; reinforce the corporate and household insolvency frameworks; ensure that the pension fund transfer from the banking sector into the social security system is done under conditions that are actuarially fair to all partners and the state.

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. Monitor the issuance of the government guaranteed bank bonds, which has been authorised up to EUR 35 billion in line with EU State aid rules. **[Ongoing]**

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 Bank of Portugal will take appropriate measures to discourage ever-greening of doubtful loans with a view to facilitating an effective adjustment of bank balance sheets respecting EU state aid rules and will adopt additional appropriate measures to this effect. These steps will be taken without burdening or posing risks to public resources. The Ministry of Finance, the BdP, and other stakeholders, will also prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector **by end-July**[4]. 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 necessary deleveraging remain consistent with the macroeconomic framework of the programme. **[Ongoing]**

Pension fund transfer

2.3. Ensure that proceeds associated with the pension transfer will be used respecting EU state aid rules **[Ongoing].** Additional capital requirements resulting from this transfer will be sought from private sources, as in other upcoming recapitalisation efforts. However, if necessary, help will be offered to banks to cover the loss and impact on capital by using part of the transfer itself in the context of the larger recapitalisation process and acquire common equity in banks under the conditions set in the recapitalisation framework. Authorities will carry out, under strict eligibility criteria, a credit assignment of up to EUR 3 billion from the banks to the general government, while maintaining the contractual obligations of the debtor.

Capital buffers

2.4. BdP is following closely the plans the banks presented to reach a core Tier 1 capital ratio of 10 percent at the latest by **Q4-2012**.

2.5. In addition to the targets and deadlines set under the program, further strengthen the banks' capital position. The capital exercise announced by the European Banking Authority (EBA) on 8 December 2012, including a new temporary buffer for sovereign exposures, requires substantial additional bank capital. Still more capital will be needed as a result of the partial transfer of banks' pension plans as well as from the special on-site inspections program (SIP).

2.6. The BdP has requested banks to present plans to augment their capital. In addition to the EBA requirements in this field, banks will provide plans by **end-February 2012** on how they intend to meet all their capital needs and the applicable deadlines, including their possible need for public capital. For the pension plan transfers and the SIP, the deadline for providing the capital will be the same as for the EBA exercise, namely by **Q2-2012**.

2.7. The amended law on extending temporary public support to viable banks has entered into force on 12 February 2012 and the accompanying Ministerial Order ('Portaria') is being

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

finalised, after consultation with all relevant stakeholders. The rules governing the provision of capital from public sources to banks state that whenever a beneficiary bank will cease to comply with the steps and deadlines agreed under the recapitalisation plan or does not manage to achieve the Core Tier 1 requirements within a time frame established by law, the government will start to exercise its full ownership rights. The price for shares issued as part of the public support will be in line with EU guidelines, and will include a sizeable discount to provide a large safety margin for the taxpayer. In order to avoid that the private shareholders are effectively subsidised by the public sector, and to enhance the prospects for capital injections, banks will be required to demonstrate that they have tried everything to achieve the capital increase via private sources before banks receive any public funds. It will also include increasing incentives for early repayment. The repurchase price incorporates an accrued remuneration plus a share of any increase in value. The BdP will closely monitor and supervise banks that receive public support, and will provide quarterly status reports to the Minister of Finance. **[Ongoing]**

Caixa Geral de Depósitos (CGD)

2.8. Continue to streamline the state-owned CGD group to increase the capital base of its banking arm as needed. The sale of the insurance arm is expected to take place **in 2012** directly to a final buyer and to contribute to meeting that year's additional capital needs, while a start is made to sell non-strategic participations and a review of CGD's overall portfolio is ongoing. Insofar as these needs cannot be met from internal group sources by **end-June 2012**, CGD will be provided with government capital support from cash buffers outside of the BSSF subject to EU state aid rules.

Monitoring of bank solvency

2.9. In the context of the stress test exercise planned for the **fifth review**, the BdP will ensure that banks incorporate the available results of the SIP. The exercise, based on the upgraded models of the banks following the SIP, will be performed quarterly with a three-year horizon and a 6% Core Tier 1 threshold. **[Ongoing]**

2.10. A scenario is prepared by the BdP and agreed with the EC/ECB/IMF and the quality of the results will be assessed by all parties. The BdP will continue to monitor on a **quarterly** basis the banks' potential capital needs with a forward looking approach under stress conditions.

Banking regulation and supervision

2.11. The BdP is asked to continue to strengthen its supervisory capacity, making progress in widening the ranks of its specialist staff, and establish a new division tasked with the maintenance and development of supervisory methodologies and tools, including the dissemination across its supervisory function of the experiences obtained via the SIP. **[Ongoing]**

2.12. Remain committed to close coordination with home and host country supervisors, both within and outside the EU. **[Ongoing]**

Banco Português de Negócios

2.13. The authorities are asked to resolve the case, taking into account the decision by the EC which has examined, inter alia, the transaction's legal certainty and the implications for the Portuguese taxpayer and the economy as a whole, including financial stability. **[Ongoing]**

2.14. Once the case is resolved, the CGD's state guaranteed claims on BPN and all related special purpose vehicles (SPVs) will be settled gradually in cash. Any recoveries on the assets held by the state-owned SPVs will also be used to promptly repay CGD. **[Ongoing]**

2.15. The authorities will develop and implement a more effective strategy for the recovery of the distressed assets and the management of the SPVs with the overarching objective to maximise returns for the tax payer within a reasonable timeframe **[end-March]**. Moreover, they will commission an audit, while complying with procurement laws, to confirm the prospective recoverable value of the distressed assets held by the SPVs by the time of the **[fourth review]**, in the context of the larger recapitalisation process

Bank resolution framework

2.16. The early intervention, resolution and deposit insurance framework has been strengthened. Legislative amendments have been passed and are effective as of mid-February 2012. The authorities are asked to prepare the implementing measures with a view to rendering the new legal framework fully operational at the latest by the **end of 2012**. In particular, the following actions will be taken: (a) setting-up of the Resolution Fund with a view to ensuring that it is fully operational by **July 2012**: (b) Recovery and Resolution Plans regulations will be adopted by **mid-2012** taking into account, to the extent possible in view of the deadline, the EBA recommendations and templates; (c) rules applicable to setting-up and operation of bridge banks in line with EU competitions rules will be adopted **end September 2012**.

2.17. 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

2.18. The corporate insolvency law amendments to support better early rescue of viable firms, which were approved by the Council of Ministers in December 2011, are being discussed in Parliament. These amendments will become effective, in principle, by **mid-June 2012**[5].

2.19. Implement an action plan to raise public awareness of the restructuring tools. **[Ongoing]**

Monitoring of corporate and household indebtedness

2.20. Continue to enhance the monitoring of the high indebtedness of the corporate and household sectors. The quarterly monitoring report will be further improved concerning its

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

information content. A report assessing the overall consistency, effectiveness, and the impact of existing support mechanisms to SMEs will be revised by **Q2- 2012.** The report will discuss policy actions aimed at improving and implementing support mechanisms to facilitate access to credit, encourage internationalisation, and improve competitiveness of SMEs in line with EU competition rules. In addition, finalise the amendments to the conciliation framework mediated by IAPMEI, a public entity, to facilitate extrajudicial corporate debt restructurings for viable SMEs.

C. 3. Fiscal-structural measures

Objectives
Improve the efficiency of the public administration by eliminating redundancies, simplifying procedures and reorganising services; regulate the creation and functioning of all public entities (e.g. enterprises, Public-Private Partnerships, foundations, associations); re-focus their activities to core public policy objectives and enhance their cost efficiency and fiscal sustainability; streamline the budgetary process through the newly approved legal framework, including by adapting accordingly the budgetary and legal frameworks of finance; 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 that took place in July 2011.

Public Financial Management framework

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

Reporting and Monitoring

3.1. Publish quarterly cash balance targets for the general government as defined in national accounts and corrective measures in case of deviation from targets. **[Q1-2012]**

3.2. 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. This year the fiscal risks report in the 2012 Budget will be enhanced, in cooperation with the EC and IMF staff and published by **April-2012**.

3.3. Following the inventory on tax expenditures, the authorities are making progress on the annual report on tax expenditures to be completed by **Q1-2012** in cooperation with EC and IMF staff. This tax expenditure report will be published each year as part of the budget, in line with international best practices. The report will cover central, regional and local administrations.

3.4. To further advance the reform of the budgetary monitoring system, a proposal to reduce budgetary fragmentation will be submitted by **[Q2-2012].**

Arrears

3.5. Implement any changes to the budget execution rules and procedures necessary to align them with the new law on commitments control. The law will be implemented across all general government entities including the regional and local administration and the SOE hospitals. The Inspecção Geral de Finanças (IGF) will carry out inspections to verify compliance of the commitment control system through a risk based approach. **[Q2-2012]**

3.6. The stock of domestic arrears will be significantly reduced by the end of the program period. To this effect, a revised strategy document will be approved by the Council of Ministers[6], **before the supplementary budget is submitted to Parliament**. The strategy document will lay out the prioritization criteria for paying creditors, as well as governance arrangements to ensure a fair and transparent settling process across all sectors. IGF will be responsible for validating the claims (valuation, existence, title, age). Payments will only be made in connection to arrears that have been properly validated and whose originating entity has changed its commitment system in accordance with the new law.

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. Ensure full implementation of the Budgetary Framework Law adopting the necessary legal changes to define in detail the proposed characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry-over rules, commitment controls, and appropriate contingency reserves and related access rules. **[Q2-2012]**

3.9. The Fiscal Council has been established and will be operational by **[Q1-2012]**.

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

[6] Prior action in the Memorandum of Economic and Financial Policies.

finance law[7] and the local finance law will be discussed with EC/IMF/ECB by **[Q2-2012]** and submitted to Parliament by **[Q4-2012]**. 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.

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.

3.12. The Government's financial arrangement with the Autonomous Region of Madeira (RAM), which is in full compliance with the Memorandum of Understanding, will be implemented. The Portuguese Government will monitor progress of implementation by RAM and present the results on a quarterly basis in advance of the reviews of the Memorandum of Understanding, with a first report due in **[April-2012].**

Public Private Partnerships

An assessment of 36 PPPs and 24 concessions that are under the responsibility of the central government, projecting future cash flows and risks, showed rapidly increasing spending pressures that is being reduced by increasing revenues and seeking renegotiation of contracts. In addition, the government will:

3.13. Sign a service contract to recruit a top tier international accounting firm to undertake a more detailed study to review PPP contracts of the central administration in consultation with National Statistical Institute (INE) and the Ministry of Finance. **[March-2012].** The review will identify and, where practicable, quantify major contingent liabilities and any

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

related amounts that may be payable by the government. It will assess the probability of any payments by government in relation to the contingent liabilities and quantify such amounts. The study, to be completed three months after the awarding of the contract**,** will assess the costs and benefits of renegotiating any PPP or concession contract to reduce the government financial obligations. The study will be the basis for a strategic plan specifying how to deal with existing PPPs and providing a framework for future engagements in PPPs. Until such a framework is in place the government will not engage in any new PPP.

3.14. In order to ensure a fiscally prudent model, put in place a strengthened legal and institutional framework, within the Ministry of Finance, for assessing fiscal risks *ex-ante* of engaging into PPP, concessions and other public investments, as well as for monitoring their execution. The Court of Auditors must be informed of this ex-ante risk assessment. **[Q1-2012].** It will be ensured that the same commitments apply for regional PPPs, and that local governments do not enter into any PPP contracts.

3.15. Enhance the annual PPP and concessions report prepared by the Ministry of Finance with a comprehensive assessment of the fiscal risks stemming from PPPs and concessions. The report will provide information and analysis at sectoral level. The annual review of PPPs and concessions will be accompanied by an analysis of credit flows channelled to PPPs through banks (loans and securities other than shares) by industry and an impact assessment on credit allocation and crowding out effects. This particular element will be done in liaison with the Bank of Portugal. **[Q3-2012]**

State-owned enterprises[8]

The government aims at implementing a strategy to restructure State-owned enterprise (SOE), to reduce their indebtedness and to ensure improved conditions for market financing. Focus should be on attaining the cost savings of the 2012 budget, notably to reduce operational costs across the sector by 15 percent with respect to 2009. While respecting EU competition and state aid rules, the government will make further progress in restructuring the SOE sector along the following lines:

3.16. 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 tariff structure and service provision of SOEs, with numerical targets on cost reductions, including measures to realign wages or reduce employment, and additional measures as appropriate. **[Q4-2012].** A progress report will be prepared by **[Q2-2012].**

3.17. The authorities will assess SOEs' financial prospects, potential government exposure, and scope for privatisation. On this basis they will prepare restructuring plans for SOEs with significant risks of not achieving operational balance. Most subsidiaries and shareholdings in non-core activities will be eliminated by 2014 on the basis of concrete proposals on these divestments. **[Q2-2012]**[9]

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

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

3.18. The excessive increase in the overall borrowing requirements of the SOE sector, both inside and outside general government, will be limited. In parallel with progress towards eliminating operational deficits, a strategy for managing the heavy debt load of SOEs will be developed, including the sale of assets in non-core areas of these firms, and in consultation with staff from EC, ECB and IMF. **[Q2-2012]**

3.19. Prepare a model to strengthen governance of SOEs in accordance with international best practices. It will review the existing shareholder approach, giving the Ministry of Finance a decisive role in financial matters of the enterprises, including in regional and local SOEs, while respecting the administrative autonomy as foreseen in the law. 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. To this end, the government will submit to Parliament a draft law to regulate the creation and the governance of SOEs. **[Q1-2012]** No additional SOEs will be created until this law is adopted.

3.20. Equivalent measures on operational results, debt, restructuring and governance will be taken at the local and regional levels. Progress on these measures will be reported in four annual SOEs reports at central, local and the two regional levels. On the basis of these reports, the government will include a fiscal risk analysis, including all (explicit and implicit) liabilities, in preparation for the annual budget. **[Q2-2012]**

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 program. The sale of the energy company (EDP) and the energy network company (REN) are being concluded. 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 launched in the **second quarter of 2012**. The privatisation process for the national air carrier (TAP) and the airport operator Aeroportos de Portugal (ANA) will be launched in the **second and early in the third quarters**, with a view to completing these transactions in 2012. 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 partial sale of a public television channel (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. The direct sale of CGD's insurance arm (Caixa Seguros) to a final buyer is expected to take place in 2012.

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. A strategy for the government's financial holding company Parpública will be prepared, given that its sources of income will be affected by privatisation. **[April-2012].** The strategy will reconsider the role of Parpública as a public company and the possibility of winding down the company or consolidating it with the general government. In the interim, the government will ensure that Parpública will have sufficient income-generating assets to manage its debt and financing needs. The process of winding down Parpública will begin in **2013**[10]**.**

3.24. In order to identify the scope for further privatisation, the Government will prepare an inventory of assets, including real estate, owned by municipalities and regional governments. **[Q2-2012]**

Revenue administration

3.25. The Government will conclude 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** and study the costs and benefits of including the revenue collection units of the social security administration in the new entity. **[Q1-2012].** It will proceed with the broader merger if the assessment is favourable. **[Q4-2013]**

3.26. Following the creation of 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. analyze the impact of VAT issues on backlog enforcement cases and assess possible options to address such cases, taking into account tax fraud and erosion risks. **[end-April 2012];**

v. publish quarterly reports on recovery rates, duration and costs of tax cases starting from **Q2-2012** within four months after the end of the relevant quarter.

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

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. The government will draft a proposal by **[Q2-2012]** to strengthen the auditing and enforcement powers of the central tax administration to exercise control over the whole territory of the Republic of Portugal including currently exempt tax regimes and to reserve to the central administration the power to issue interpretative rulings on taxes with national scope in order to ensure its uniform application. Based on this proposal, a draft law will be submitted to Parliament by **[Q4-2012]**.

3.29. The tax administration has concluded the strategic plan to combat fraud and evasion for 2012-2014 and has taken important steps for its implementation. In particular, e-invoicing mechanisms will be adopted in order to facilitate compliance and improve control. The authorities will finalise the assessment of the net financial impact of the proposed incentive scheme that grants up to 5 per cent rebate, subject to a limit per taxpayer, on VAT paid through electronically transmitted invoices in selected sectors **[Q1-2012]** and consult with the EC and IMF before implementing the scheme.

3.30. The tax administration will develop a modern tax compliance management framework as an important tool to curb non-compliance. As part of this effort, the focus on large taxpayers will be enhanced through the implementation, by **[Q4-2012]**, of a full-fledged Large Taxpayer Office (LTO)[11].

Public administration

The government has adopted steps towards the overall goal of rationalising the public administration and its perimeter. At the central level, the measures set out in the July PREMAC plan are being implemented and going significantly beyond initial plans. At the local level, following a "Green Paper for Local Administration Reform" in October draft law was submitted to Parliament with the objective of implementing a reorganisation of local government *by end-June 2012*. ***The government will take the following measures to increase the efficiency and cost-effectiveness of the public administration:***

Central, regional and local administration

3.31. Reduce management positions and administrative units in the central administration according to the PREMAC report of 15 September 2011 by 27 per cent and 40 per cent, respectively. Following the approval and publication of most organic laws of the ministries, the legislation of the remaining entities will be finalised. **[April 2012]**.

3.32. In view of improving the efficiency of the central administration and rationalising the use of resources, implement a second phase of the public administration restructuring

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

programme (PREMAC) that implies the definition of the internal organisation and the roster of each entity. **[Q2-2012]**

3.33. As stipulated in the 2012 State budget, each municipality will have to present its plan to attain the target of reducing their management positions and administrative units by at least 15 per cent by the end of 2012. **[Q2-2012]** In what concerns regions, the government will promote the initiatives needed so that each region will present its plan to attain the same target. **[Q1-2012]**

3.34. Prepare a detailed cost/benefit analysis of all public and quasi-public entities:

i. Based on the analysis on foundations, using the results of the compulsory census **[Q2-2012]** and recommendations, 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 applicable law (see below). **[Q3-2012]**

ii. 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]**

3.35. Regulate by law the creation and the functioning of foundations, associations, and similar bodies by the central, regional and local administration, facilitating the closure of existing entities when warranted. Such a law will be prepared in coordination with a similar framework to be defined for SOEs and define the monitoring and reporting mechanisms to be put in place to evaluate performance. **[Q2-2012]** Furthermore, the classification as general government revenues, on a case-by-case basis, of all own revenues of these funds that arise directly or indirectly from the use of the sovereign powers of the government (e.g. court fees, fines, fees for licenses or permits, and audit fees charged by the Court of Auditors) will be regulated by law. In addition, the government will promote the initiatives needed so that the same objective is achieved by the regions. **[Q2-2012]**

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

3.37. Carry out a study to identify potential duplication of activities and other inefficiencies between the central administration, local administration and locally-based central administration services. **[Q3-2012]** Based on this analysis, reform the existing framework to eliminate the identified inefficiencies. **[Q4-2012]**

Shared services

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

i. complete the implementation of the strategy of shared services in the area of financial resources (GeRFIP). **[Q4-2012];**

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-January 2013**. Other Ministries will follow in 2013;

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]**

3.39. 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

3.40. 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, will be reinforced as an instrument to manage human resources across administrations. **[Q2-2012]**

3.41. 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). 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]**

3.42. The government will prepare a comprehensive review of wage scales in the public sector, including entities classified outside the general government, to identify unwarranted differences in remuneration between the public and the private sector for similar types of qualifications **[Q4-2012]**.

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

3.43. 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]**

3.44. 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, and adjusting the scope of health benefits. The adjustment path will be assessed in the **fifth review**.

3.45. Produce a health sector strategic plan, in the context of and consistent with the Medium-Term Fiscal Strategy. **[Q1-2012]**

Pricing and reimbursement of pharmaceuticals

3.46. Enact legislation which automatically reduces the prices of medicines when their patent expires to 50 per cent of their previous price. **[Q1-2012]**

3.47. Complete the transfer of the responsibility of pricing medicines to the Ministry of Health (for example to Infarmed). **[Q1-2012]**

3.48. The government implements an annual revision of prices of medicines and of countries of reference in order to achieve cost savings. First price revision to be published in **[April 2012]**.

3.49. The government will monitor monthly pharmaceutical expenditures and ensure that 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

3.50. 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]**

3.51. Continue to devise and enforce a system of sanctions and penalties, as a complement to the assessment framework. **[Q1-2012]**

3.52. The Parliament approved legislation making it compulsory for physicians at all levels of the system, both public and private, to prescribe by International Nonproprietary Name (INN) to increase the use of generic medicines and the less costly available product. Enactment of legislation is expected by **[Q1-2012].**

3.53. Continue to publish prescription guidelines with reference to medicines and the realisation of complementary diagnostic exams on the basis of international prescription guidelines and integrate them in the electronic prescription system. **[Ongoing]**

3.54. 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]**

3.55. 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 and substantial further increases in 2013. **[Ongoing]**

Pharmaceutical retailers and wholesalers

3.56. Effectively implement the new legislation regulating pharmacies. **[Q1-2012]**

3.57. 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**].

3.58. 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. **[Q3-2013]**

3.59. 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.**

Centralised purchasing and procurement

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

3.61. Take further measures to increase competition among private providers and reduce by an additional 10 percent the overall spending (including fees) of the NHS with private providers delivering diagnostic and therapeutic services per cent. Regularly revise (at least every two years) the fees paid to private providers with the aim of reducing the cost of more mature diagnostic and therapeutic services. **[Q4-2012]**

3.62. 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. **[Ongoing]**

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

Primary care services

3.64. 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 (ARSs) 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. increasing 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

3.65. A strategy with a binding timetable to clear arrears in the health sector, within the overall strategy for settling and avoiding the re-emergence of arrears, will be implemented. The strategy will include the introduction of standardised and tight control procedures for all health sector entities to prevent the re-emergence of arrears. In addition, a mechanism is put in place to ensure strong coordination between the Ministry of Health and the Ministry of Finance for the application of the same monitoring and control criteria to all types of hospitals. **[Q1-2012]**

3.66. 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. **[Q4-2012]**

3.67. 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. **[Q1-2012]**

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

3.69. Improve selection criteria and adopt measures to ensure a more transparent selection of the chairs and members of hospital boards. Members will be required by law to be persons of recognised standing in health, management and health administration. **[Q2-2012]**

3.70. On the basis of the comprehensive set of indicators, produce regular annual reports comparing hospital performance (benchmarking). 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]**

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

3.72. 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]**

3.73. Reinforce the centralised monitoring of PPP contracts by the Treasury in cooperation with the ACSS **[Q2-2012]**.

3.74. 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. **[Q2-2012]**

3.75. 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. In this context, overtime compensation should be reduced by 20% in 2012 and another 20% in 2013. **[Q4-2012**].

Regional health authorities

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

Cross services

3.77. Finalise the set-up of a system of patient electronic medical records and ensure access to all relevant health care facilities. **[Q2-2012]**

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

D. 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 (DL 267/2011 and DL 268/2011 approved by the Council of Ministers of 19-01-2012 and awaiting promulgation and publication in Diário da República) - 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 submission of draft law n. 46/XII to Parliament (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.

i. by **Q1-2012**, in consultation with the social partners, the government will prepare a proposal aiming at:

  - aligning the level of severance payments to 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.

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

4.4. Following the changes to the dismissal rules as stated in draft law n. 46/XII, the government will prepare a report on the effects of these changes on relevant labour market indicators by **Q2-2013**.

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 than 50 per cent 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 by **Q2-2012**, with a view to entering into force by **Q1-2013**.

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

  - 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;

- 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 progress made until Q4-2011, the Government will present by **Q2-2012**:

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

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

Education and training

4.8. 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 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. present an action plan to improve the quality of secondary education services including via: (i) the generalisation of trust agreements between the government and public schools, establishing wide autonomy, a simple formula-based funding framework comprising performance evolution criteria, and accountability; (ii) a simple result-oriented financing framework for professional and private schools in association agreements based on fixed per-class funding plus incentives linked to performance criteria; (iii) a reinforced supervisory role of the General Inspectorate. **[Q1-2012];**

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

E. 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. Take further steps towards the full transposition of the Third EU Energy Package. In particular, submit to Parliament the law on the penalty system of the regulator and adopt the decree-laws transposing the electricity and gas directives by **Q2-2012.** This will ensure the National Regulator Authority's independence and all powers foreseen in the package.

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 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]**, with a view to the future elimination of pancaking for cross-border flows. Portugal will 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]**

5.4. Fulfill the obligations under the security of supply Regulation 994/2010 by submitting to the European Commission a Risk Assessment report **[Q1-2012].** Prepare a report addressing the harmonised mechanism for capacity allocation and congestion management of cross-border flows with Spain. **[Q1-2013]**

Ensure sustainability of the national electricity system

5.5. Take measures to reduce excessive rents and eliminate the tariff debt (defice tarifário) by 2020, alleviating the pressure on end-user electricity prices. Efforts, including through multilateral negotiations with the stakeholders, will focus on the following compensation schemes: power guarantee, special regime (renewables - excluding those granted under tender mechanisms – and cogeneration), CAE's (power purchase agreements) and CMECs, which have an important weight in final electricity prices. To achieve these goals the government will appoint an independent negotiator, by **Q1-2012**, and progress in this area will be discussed during the **fourth review**.

Policy costs associated with electricity ordinary regime

5.6. Take measures to limit the policy costs embedded in CMECs. In particular, negotiate the revision of the rate of return to bring it in line with the cost of capital at the moment the compensation was defined plus, if warranted, a risk premium. This premium will be linked to the risk of the assets that the mechanism remunerates. The immediate objective will be to reduce rents and stabilize the tariff debt (défice tarifário). Progress in this area will be discussed during the **fourth review**.

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

5.7. Accelerate convergence to market-based pricing for co-generation operators. The remuneration scheme for co-generation will be revised to improve efficiency of the support system and reduce explicit subsidies through creating a transitional regime during which the tariffs will decline at an increasing rate. Publish the Executive Order defining the new reference tariff and the formula for updating tariffs in the future, by **[April 2012]**[12] . These

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

measures are estimated to reduce policy costs implicit in electricity prices starting at EUR 25 million per year **in 2012**, rising to EUR 80 million **in 2020.** Ensure through audits that plants not fulfilling the requirements for co-generation do not receive the support, and report on the progress. **[Q2-2012, Q2-2013]**

5.8. 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**.

5.9. 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**.

Energy policy instruments and taxation

5.10. Modify tax and energy policy instruments to ensure that they provide incentives for rational use, energy savings and emission reductions. In particular:

i. subject to a cost-benefit analysis, eliminate the exemption from the tax on oil and energy products (ISP) applicable to certain industrial fuels used in cogeneration, which overlaps with the feed-in-tariff, as well as other energy and tax policy instruments, i.e. accelerated depreciation rate under the corporate income tax **[Q2-2012];**

ii. conduct a cost-benefit analysis to evaluate the effectiveness of the System for the Management of Energy-Intensive Consumption and the associated exemption from the tax on oil and energy products (ISP) for industrial fuels **[Q2-2012];**

iii. review, based on a cost-benefit analysis, the effectiveness of the other exemptions and reduced rates of the tax on oil and energy products (ISP) under the Excise Tax Code **[Q2-2012];**

iv. take measures to eliminate possible overlaps, and foster synergies, between the Plan for Promoting Efficient Consumption (PPEC) and the Energy Efficiency Fund (EEF). **[Q2-2012]**

Power Guarantee "Garantia de potencia"

5.11. Eliminate, by **April 2012**, the incentive to invest in cases where investment decisions had already been taken without the expectation of an additional incentive, i.e. for the set of power plants existing or already licensed prior to the 2007 Decree Law governing this incentive[13]. Redesign the Power Guarantee mechanism, establishing a new rationale that provides incentive to build additional generating capacity in the future which takes into

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

account adequate security of supply levels and the existence of other mechanisms, such as interruptibility services. These measures are estimated to reduce policy costs by about EUR 60 million per year.

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

5.12. 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). **[Q1-2012]**

5.13. Adopt measures to increase competition in the fixed communications market by reviewing barriers on entry and adopting measures to reduce them. **[Q1-2012]**

Postal services

5.14. Further liberalise the postal sector by i) concluding the adoption of the transposing law on the Third Postal Directive, recently submitted to Parliament, ensuring that powers and independence of the National Regulator Authority are appropriate in view of its increased role in monitoring prices and costs **[**expected by **Q1-2012]**; ii) subsequently 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 transposing the postal directive; ensuring in particular that the current designation period for the universal service provision is shortened to 2020 and that investment needs and return on investment are taken into account when setting new designation periods. **[Q2-2012]**

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.

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

Strategic Plan for Transport

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

i. introduce 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]**

5.16. Present a long term vision of the transport system and a list of actions to improve its efficiency and sustainability **[Q3-2012]**. It will specifically include:

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

ii. an in-depth analysis of the competitive position of the different transport modes vis-à-vis each other with the objective to reduce dependence on road transport;

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

iv. a set of priorities for investment on the basis of points i., ii and iii. taking also into account TEN-T networks, with an estimate of the financial needs and the foreseen sources of financing;

v. an assessment of energy savings and greenhouse gas emission reductions from the transport sector.

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

Railways sector

5.17. 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. implement the ongoing plans to bring the infrastructure manager to operational balance by **[Q4-2013]**, by focusing efforts on the reduction of operational costs. In particular, reduce 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. Provide annual progress reports on the implementation of balancing revenues and expenditures **[Q2-2012, Q2-2013]**;

iii. implement the plans of network and service rationalisation presented in the Strategic Plan for Transport **[Q1-2012].** Analyse the potential for further rationalisation in loss-making and low-demand lines and services **[Q3-2012]**;

iv. 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 **[Q2-2012].** 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]**;

v. make the performance scheme on infrastructure charges fully operational, in particular by effectively collecting payments from operators **[Q2-2012]**;

vi. apply yield management on long-distance passenger ticket prices. **[Q1-2012]**;

vii. privatise the freight branch of the state-owned rail operator. 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. **[Q2-2012].**

Ports

5.18. 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. **[Q2-2012]**

5.19. 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 strategy to be adopted. **[Q2-2012]**

Road pricing

5.20. 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

5.21. Adopt the remaining necessary amendments to the sector specific legislation to fully implement the Services Directive, easing the requirements related to establishment and reducing the number of requirements to which cross-border providers are subject. Adopt the remaining required amendments and submit them to Parliament by **[Q2-2012]** in view of approval by **[Q3-2012]**.

5.22. 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). Submit to Parliament by **[Q1-2012]** in view of approval by **[Q2-2012].**

Professional qualifications

5.23. Improve the recognition framework on professional qualifications by submitting to the Parliament an amendment proposal to Law 9/2009 on the recognition of professional qualifications and adopting the remaining executive orders (portarias) complementing the Law in compliance with the Professional Qualifications Directive by **[Q1 2012]**. Following the amendment of Law 9/2009, adopt the executive order (portaria) on the services provider prior declaration **[Q2-2012]**.

Regulated professions

5.24. Review and reduce the number of regulated professions and in particular eliminate reserves of activities on regulated professions that are no longer justified. Submit to Parliament the law for professions where regulation does not involve a professional body (*Ordens or Câmaras*) in **[April-2012]** in view of approval by **[July-2012]**.

5.25. 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 5.23, and 5.24; ii) eliminating restrictions to the use of commercial communication (advertising), as required by the Services Directive. To achieve the two conditions above the government will, after public consultation, submit a draft horizontal legal framework to Parliament by **[Q2-2012]**, 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

5.26. Continue the simplification reform effort by:

i. improving the quality of the translations (in two languages at least) of the information currently available on requirements applicable to established providers and to cross-border ones in the Point of Single Contact (PSC) which will ease the access for EU/EEA service providers by **[Q1-2012]**. Make available in the PSC single electronic forms, seamless of the municipality, for at least two procedures covered by the Services Directive of the responsibility of municipalities **[Q1-2012];**

ii. adapting the content and responsive to the new legislation to be adopted to ensure conformity with the Services Directive (see 5.21 and 5.22 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;

iii. 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 5.23, 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;

iv. making available in PSC on-line procedures for the registration of establishments covered by "Zero authorization" (DL 48/2011) by **[April 2012]**. 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 **[Q3-2012]**. The platform will be available to all levels of administration, including all municipalities **[Q4-2012]**;

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

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

F. 6. Housing market

Objectives

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

Rental market and administrative procedures for renovation

6.1. The Government submitted to the Parliament the Decree Law which amends the New Urban Lease Act Law 6/2006 and the Decree Law which simplifies the administrative procedures for renovation in view of their adoption by **May 2012**. Both Acts are a significant step forward to ensure balanced rights and obligations of landlords and tenants and reduce the perpetuity of lease agreements. The final adopted legislation will include all the objectives set out in the Memorandum. In particular, the rental market legislation will: i) broaden the conditions under which renegotiation of open-ended residential leases can take place, including to limit the possibility of transmitting the contract to first degree relatives; ii) introduce a framework to improve households' access to housing by phasing out rent control mechanisms, considering the socially vulnerable; iii) reduce the prior notice for termination of leases for landlords; iv) grant landlords the possibility to ask for termination of the lease contract for major renovation works (affecting the structure and stability of the building) with a maximum 6 months of prior notice; v) simplify rules for the temporary relocation of tenants of building subject to rehabilitation works with due regard of tenants needs and respect of their living conditions; vi) provide for an extrajudicial eviction procedure for breach of contract, aiming at shortening the eviction time to three months; and vii) strengthen the use of the existing extrajudicial procedures for cases of division of inherited property. The renovation works legislation will: i) simplify administrative procedures for renovation works, safety requirements, authorisation to use and formalities for innovations that benefit and enhance the building's quality and value (such as energy savings measures) The majority of apartment owners will be defined as representing the majority of the total value of the building; and ii) standardise the rules determining the level of conservation status of property and the conditions for the demolition of buildings in ruin.

Property taxation

6.2. 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 **by end 2012** the taxable value of all property is close to the market value and (ii) property valuation is updated regularly (every year for commercial real estate and once every three years for residential real estate as foreseen in the law). **[Q4-2012]**

6.3. 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. **[Q3-2012]** Temporary exemptions of IMI for owner-occupied dwellings were considerably reduced with the 2012 budget. This measure will be assessed with the annual tax expenditure report.

Comprehensive Review

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

G. 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 an inter-agency task force, with the second report to be completed by **15 May 2012**. In addition, provide data on small claim cases pending as of 31 December 2011 and a concept note on measures to resolve such cases by **end-March 2012**. Finalise an action plan on resolving the above cases with concrete measures and specific deadlines by **end-May 2012**.

7.3. Strengthen the legal and institutional framework for enforcement agents in line with international practice with a particular focus on the financing structure and authority of the oversight body. To improve the legal and institutional framework for the enforcement agents, prepare an action plan by **end-February 2012** to (i) identify measures over the next twelve months to achieve the objectives of strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, and (ii) include an analysis of the feasibility of a fee structure that incentivises speedy enforcement. In addition, make the oversight body's full access to the enforcement case files including financial data operational by **30 June 2012**. Finalise the above-mentioned Action Plan with concrete measures based on extensive stakeholder consultation and cross-country experience by **mid-May 2012**.

Management of courts

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

7.4. Building on the end-January 2012 proposal on judicial reform and taking into account stakeholder consultations and cross country experience, prepare a revised roadmap identifying, inter alia, key quarterly milestones to reduce the number of court districts and close down underutilised courts by **June 2012**. Submit a Bill to implement the judicial reform roadmap to Parliament by **end-September 2012**[14].

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 **September 2012**.

Civil law cases in the courts

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

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

7.7. Prepare by **June 2012** draft amendments to the Code of Civil Procedure, based on the end-2011 proposal which identified 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. Submit the above amendments to the Parliament by **September 2012.** [15]

Budget and allocation of resources

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

7.8. 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.

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

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

Competition, public procurement and business environment

Objectives

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

Competition and sectoral regulators

7.9. The Government shall take the necessary measures to ensure that the Portuguese State or any public bodies do not conclude, in a shareholder capacity, shareholder agreements the intention or effect of which hinder the free movement of capital or which influence the management or control of companies. Concerning the existing shareholder agreement of CGD in Galp, the Portuguese State will ensure that CGD alienates its participation in Galp. **[Q1-2012]**

7.10. 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].**

7.11. Take measures to improve the speed and effectiveness of competition rules' enforcement. In particular, following the already adopted legislation establishing specialised court for Competition, Regulation and Supervision, make it operational in the context of the reforms of the judicial system (see measure 7.6) **[Q1-2012].**

7.12. 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 7.13 (i), the financial model of the latter will be re-examined. **[Q3-2012]**

7.13. Ensure that the national regulator authorities (NRA) have the necessary independence and resources to exercise their responsibilities by **Q4-2012** for the main NRAs and by **Q1-2013** for the others. In order to achieve this:

i. provide an independent report (by internationally recognised specialists) on the responsibilities, resources and characteristics determining the level of independence of the main NRAs. The report will benchmark nomination practices, responsibilities, independence and resources of each NRA with respect to best international practice. It will also cover scope of operation of sectoral regulators, their powers of intervention, as well as the mechanisms of coordination with the Competition Authority. The report will be completed by **[Q2-2012]**;

ii. based on the report, present a proposal to implement the best international practices identified to reinforce the independence of regulators where necessary, and in full compliance with EU law by **mid-August 2012**[16].

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:

7.14. Adopt a law revising the Public procurement code by **Q1-2012** in line with the Public Procurement Directives. This revision will amend the provisions on errors and omissions, the award of contracts for additional works/services, eliminate the exemptions regarding public foundations as set out in Law n.º 62/2007 and all other exemptions permitting the direct award of public contracts, and repeal Art. 42 (7) (8) (9).

7.15. Submit a report analysing the effectiveness and impact of the above measures in [7.14] as well as of the enhanced role of the Court of Auditors in ensuring compliance with public procurement rules by **[Q1-2013].**

Business environment

7.16. Make operational the procedures for requesting VAT exemptions for exporting firms and to simplify procedures associated with indirect exports by **Q3-2012** as part of the "Simplex Exports" programme.

7.17. As a follow up to the report delivered in January, draft a report furthering the assessment of the overall consistency, the effectiveness, and the impact of existing financing and non-financing support measures designed to provide access to finance and encourage internationalization of companies, in particular for SMEs (therefore partially responding also to measure 2.20) by **Q2-2012**. Following results of the report, modify or adopt, where necessary, measures to facilitate access to finance and export markets for companies, in particular for SMEs. **[Ongoing]**

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

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

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