International Monetary Fund

Portugal and the IMF

Press Release:
IMF Completes Second Review Under an EFF with Portugal, Approves €2.9 Billion Disbursement
December 19, 2011

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

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

December 9, 2011

> 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

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

Lisbon, December 9, 2011

Dear Ms. Lagarde:

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

2. Policy implementation is broadly on track. In particular, we believe that the recent adoption of a bold and comprehensive 2012 budget will decisively set public finances on a sustainable path and bolster market confidence in our program. All the quarterly quantitative performance criteria for the second review were met, along with the continuous criterion on external arrears. However, our end-September indicative target on the non-accumulation of new domestic arrears by the general government was breached. As a corrective measure, to avoid further arrears accumulation, we are strengthening commitment controls and ensuring adequate budgetary allocations to the health sector.

3. Expenditure overruns and the materialization of fiscal risks have complicated the attainment of end-2011 fiscal deficit target. However, we intend to meet the target through a partial transfer of bank pension funds to the social security system—a one-off revenue item.

4. Fiscal-structural reform is addressing deep-seated problems with expenditure control. To this end, we are strengthening public financial management, halting new PPP contracts, fundamentally restructuring the SOE sector and limiting its capacity to incur further market debt, and reforming revenue administration and the health sector. We are also revising our inter-governmental fiscal framework to enhance fiscal responsibility. We will require a statement of affairs for Madeira ahead of a financial arrangement with the region.

5. Our policy efforts to support financial system stability continue. Bank deleveraging is progressing, and we will continue to ensure that their plans provide a level of credit consistent with the program's macroeconomic framework. The legal framework for temporary capital increase of viable banks will be significantly improved by early 2012 with a view to ensuring financial stability while protecting tax payers. The structural benchmark on amending legislation to strengthen the early intervention framework and adopting the new bank resolution framework will be met by year-end.

6. Our ambitious structural reform agenda to foster higher and sustainable growth is on track, although we did not implement a fiscal devaluation given the large fiscal consolidation. We are working to give firms the flexibility to respond to changing demand conditions without disruptive changes in employment, which is particularly important at this point in the economic cycle. We are continuing to advance legislation and practices to enhance the competition framework and facilitate market entry.

7. On the basis of the policies defined in this letter, we request completion of the second review under the Extended Arrangement, and the third purchase under the arrangement in the amount of SDR 2,425 million. The attached MEFP proposes new structural benchmarks relating to the fiscal area (reforming the regional finance law, assessing PPPs, and priority elements of SOE restructuring plans), structural reform (developing a proposal to correct excessive rents in energy markets), the banking sector (the rules governing the provision of public capital to banks), and the judicial process.

8. 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.

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

Sincerely yours,

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

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

ATTACHMENT I. PORTUGAL—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

December 9, 2011

A. Macroeconomic Outlook

1. **While activity has been stronger than expected in 2011, projections for 2012 have been revised down.** The contraction in domestic demand so far in 2011, resulting from fiscal consolidation and tightening credit and financial market conditions, has been buffered by stronger-than-expected export performance. The economy is expected to contract by 1.6 percent for the year as a whole. In 2012, with more limited support from exports and a larger fiscal adjustment than at the time of the program, activity is projected to fall by 3 percent. The path of inflation during 2012, as in 2011, will continue to be largely influenced by revenue measures (VAT and tariff adjustments) in the context of the fiscal consolidation effort, with inflation projected at 3.2 percent despite the weak cyclical position. While the external current account is expected to improve by close to 2 percent of GDP in 2012, it will remain high.

B. Fiscal Policy

2. **Although the end-September cash deficit target was met, slippages have opened a gap for the year as a whole.** The additional revenue measures taken during the summer are insufficient to cover the significant slippages caused by a lack of expenditure control (both current and capital), and shortfalls in sales of real estate and concessions and non-tax revenue. As a result, a remaining projected gap of about 1.6 percent of GDP on an accrual basis has emerged, with 1.3 percent of GDP carrying over into 2012. In spite of this, we intend to meet the end-year fiscal deficit target of 5.9 percent of GDP through a partial transfer of banks' pension funds to the state social security system (see paragraph 19). Under ESA95 accounting rules the assets transferred in this context will be recognized as revenue.

3. **We have maintained our ambitious target for deficit reduction in 2012.** We are aiming at a general government deficit of 4.5 percent of GDP in 2012. This will bring the cumulative structural adjustment over 2011–12 to about 7½ percent. To achieve this, the 2012 budget approved by Parliament in late November (*prior action*) includes discretionary measures of over 6 percent of GDP against a no-policy- change scenario. These measures cover the gap already identified at the time of the program request, the carry-over of the 2011 slippages, as well as the impact of higher market interest costs and the downward revision in growth projections. Over two-thirds of the measures are on the expenditure side, in line with the objectives agreed under the program. Two key measures are: (i) suspending the 13th and 14th months' salaries and pensions in 2012 while protecting the lowest salaries and pensions; and (ii) a sharp decline in the number of goods and services subject to reduced VAT rates.

4. **We are committed to clear the stock of domestic arrears over time.** Despite our efforts, the continuous indicative target on non-accumulation of domestic arrears was breached in September, bringing the total increase to over €170 million since end-August and the stock to about 3.2 percent of GDP. To avoid further accumulation of arrears, the 2012 budget ensures adequate allocations to the health sector—where about 40 percent of the arrears are concentrated. Strengthened commitment controls will also help avoid accumulating new arrears (see below). We need more time to finalize our strategy to settle existing arrears for local and regional governments and the health sector, which will be presented by end-December 2011. This will include validation plans and a road map which will be discussed with the EC and the IMF. The speed of arrears clearance will depend on availability of financing. Various options will be considered, including using the financing generated by banks' pension fund transfers. The settlement process will give priority to arrears in hospitals, to improve the liquidity position of suppliers and likely allow hospitals to obtain discounts when re-negotiating delivery contracts.

C. Streamlining the Public Sector

Public Financial Management (PFM)

5. **We will continue implementing public financial reforms aimed at improving fiscal reporting and strengthening the budget process.** In line with the program, we have published our Medium-Term Fiscal Strategy and implemented a monthly survey on arrears (both end-August SBs). We also have included in the 2012 budget information on tax expenditures and fiscal risks. We will strengthen our analysis by publishing a Tax Expenditure Report and a Fiscal Risk Statement by end-March 2012 in coordination with IMF/EC. Thereafter the reports will be submitted annually together with the budget proposal. We will also enhance fiscal transparency by publishing the level of State guarantees in our monthly budget execution bulletin. Consolidated general government cash-based reports will be published monthly starting in February 2012, and progressively enlarging the scope as indicated in the MoU.

6. **Given the 2011 expenditure slippages, we will ensure strict enforcement of expenditure plans through the adoption of stronger commitment controls.** In order to ensure tight control of budget execution in 2012, we will present appropriate legislation on public accounting by end-December 2011. Our objective is to adjust the current legal framework to reflect the new procedure through which we will control expenditure commitments in the 2012 budget execution—namely by starting to control commitments against the availability of funds.

Public-Private Partnerships (PPPs)

7. **Assessment and monitoring of PPPs is being strengthened.** We have published a comprehensive assessment of 36 PPPs (above the initial commitment of 20 PPPs) and 24 concessions, projecting future cash flows and risks. This assessment has shown rapidly increasing spending pressures affecting, in particular, the financial sustainability of Estradas de Portugal. We will reduce these pressures by increasing revenues and seeking renegotiation of contracts, already identified in our SOE strategy considering the costs and benefits of renegotiation. To increase transparency, we will, by December 15, publish all PPP contracts on the MOF website (with the exception of statements subject to confidentiality clauses).

8. **Due to difficulties in the bidding preparation, the end-December structural benchmark on hiring a top tier accounting firm to review PPP contracts is being delayed.** We are now planning to launch the tender by end-December (new structural benchmark) with a view to signing the service contract by end-March 2012 subject to legal contingencies associated with the procurement process. The conclusion of the study will be completed three months after the awarding of the contract. We remain firmly committed not to enter in new PPP contracts depending on the results of the study and, looking ahead, we will revise our current PPP framework in order to ensure a fiscally prudent model. We will ensure that the same commitments apply for regional PPPs, and that local governments do not enter into any PPP contracts.

State-Owned Enterprises (SOEs)

9. **We are fundamentally restructuring the SOE sector to enhance efficiency, restore its financial sustainability, and re-focus its activities on core public policy objectives**. We have prepared a strategic plan detailing how to (i) bring SOEs with commercial activities to operational balance by end-2012; (ii) close or privatize firms providing non-essential services or goods; and (iii) deal with the specific problems of the heavily indebted transport sector companies. The plan will be implemented with the aim of reducing SOE indebtedness and restructuring to ensure improved conditions for market financing. The 2012 budget incorporates cost savings (including the budgeted wage cuts) and tackles the financial burden of the central government SOEs. In order to further streamline the SOE sector, we will eliminate most subsidiaries and shareholdings in non-core activities by 2014. Concrete proposals on these divestments will be included in the report that will assess SOE's financial prospects, potential government exposure, and scope for orderly privatization (end-February 2012 structural benchmark). We are also addressing SOE problems at the local and regional levels (see below).

10. **Growth in SOE indebtedness has been excessive**. Additional efforts are necessary. We commit to limiting the increase in the overall borrowing requirements of the SOE sector,

including those inside and outside general government. We are preparing the new legal framework for SOEs to be submitted to Parliament by end-January 2012, in which we will include the prohibition for SOEs within the general government from incurring new debt with the private sector. We are also developing a strategy to manage the heavy debt load of these firms, including the sale of assets in non-core areas of these firms.

Revenue Administration

11. **We have made significant progress in implementing the program measures on revenue administration.** Our goals are to modernize and merge the tax and customs administrations; strengthen the audit function; improve tax compliance; and facilitate the efficient resolution of tax cases disputed in court. In particular:

- Plans for the creation of a new revenue authority—*Autoridade Tributária e Aduaneira* (AT) are advancing well. The AT will be operational starting January 1, 2012, and our focus in 2012 will be to merge central and support functions, adopt a full-fledged large taxpayers unit, and reduce the number of branches by 20 percent. We will continue deepening the reform in 2013 by introducing a business function-type structure and by reducing the number of offices by additional 20 percent.

- The 2012–14 Strategic Plan to Combat Tax and Customs Fraud and Evasion has been prepared. We will intensify our efforts to curb non-compliance, including through the full use of our anti-money laundering framework, focusing attention on high-evasion sectors and taxpayers and will adopt e-invoicing mechanisms to facilitate compliance and improve control. We will finalize the assessment of the net financial impact of the proposed incentive scheme that grants a rebate of up to 5 percent on the VAT paid, subject to a limit per taxpayer, on electronically transmitted invoices in selected sectors, and consult with the EC/IMF before implementing the scheme.

- We have undertaken a comprehensive assessment of our Information Technology (IT) systems. Based on this assessment, and with support from IMF/EC technical assistance, we will prepare an IT Strategic Plan for the AT by December 2011.

Health Sector

12. **We are undertaking reforms to make our health system more efficient and financially sustainable.** As specified in the MoU, we are implementing measures to generate savings in pharmaceutical expenditures and hospital operating costs. We have also enacted legislation increasing moderating fees (*taxas moderadoras*) and reducing exemptions by end-January 2012. We have established a working group to promote efficiency gains and rationalize the health system, in order to address long-term expenditure pressures, and we

will finalize a proposal by end-March 2012. We aim to implement these measures while maintaining the high quality and universal coverage of the Portuguese health care system.

Regional and Local Governments

13. **The inter-governmental fiscal framework needs to be thoroughly revised to enhance fiscal responsibility and transparency across the general government.** We will need more time to submit the regional and local public finance laws to Parliament than originally envisaged (end-December 2011). Therefore, we will re-phase our commitment and, by end-December, prepare a document setting out the key elements of the reform. Based on this document and with IMF/EC technical assistance, we will submit to Parliament a draft regional public finance law by end-March 2012 (structural benchmark) and a draft local public finance law by end-June.

14. **We will seek a financial arrangement with the Autonomous Region of Madeira.** The region poses a significant drag on the Portuguese public finances. The arrangement will include quantitative criteria on fiscal performance and structural reforms – the latter in line with the recommendations of the September technical assistance mission. As a pre-condition for signing the arrangement, the Madeira government will present a Statement of Affairs, which will be reviewed by the authorities and sent to the Court of Auditors (MoU paragraph 3.17). The 2012 Madeira budget should be fully consistent with the State budget. Under the program, we will ensure that all arrears are audited before any settlement strategy is implemented. Until the arrangement is in place, we will enhance our monitoring of Madeira's budget execution.

15. **An assessment of local and regional SOEs is being prepared.** Based on this analysis and in line with the Strategic Plan for the central government SOEs, we will prepare restructuring plans for the local SOE sector by end-January 2012. Regarding regional SOEs, restructuring in Madeira will start under the above-mentioned program, while work has already started in Azores.

Public Administration Reform

16. **Plans to streamline the public administration (including SOEs and foundations) are on track.** At the central level, we will fully implement the measures set out in the July PREMAC (Central Administration Restructuring and Modernization Plan), targeting a reduction of 40 percent in administrative structures and of 27 percent in management positions (which is above the 15 percent reduction agreed in the May 2011 MEFP). At the local level, we approved the "Green Paper for Local Administration Reform" in October and will submit the related draft laws to Parliament by end-June 2012.

Privatization

17. **We are entering the final stages of the privatization of EDP and REN.** Four bidders were selected for EDP, out of a shortlist of 6, and the second phase will be completed before end-2011. The financial closing of this privatization will occur in January 2012. As for REN, we will select the bidders and initiate the second phase of the privatization before end-2011. This transaction shall also be completed by early 2012. Bidders for both privatizations include large international strategic investors. We will proceed with the sale of GALP and the small remaining stake in REN on the free market, which we have delayed until market conditions improve. We expect to launch the sale of CP Cargo by mid-2012; are initiating the privatization process for ANA and TAP with a view to completing their sale in late 2012; and will launch the CTT privatization in the second half of 2012 and plan to complete the sale in early 2013. We are further considering the partial sale of RTP and Aguas de Portugal, and concessions for transport operators in Lisbon and Porto upon completion of restructuring of the public transport firms in these cities. We will begin to wind down Parpublica in 2013.

D. Protecting the Financial System amidst Deleveraging and the Sovereign Crises

18. **Bank liquidity remains under pressure.** We continue to encourage banks to strengthen their collateral buffers on a sustainable basis. Banco de Portugal (BdP), in consultation with the ECB, will continue to monitor closely the liquidity situation of the banking system and stands ready to take appropriate measures to maintain sufficient system liquidity.

19. **Policies must strike an appropriate balance between potentially conflicting objectives**. On the one hand, it is important that the banking system eliminates its funding imbalances, with a view to reducing its high dependence on Euro system liquidity as planned. On the other hand, the pace and composition of deleveraging should not jeopardize the provision of appropriate credit to finance productive investments in the economy, not least SMEs. Fiscal adjustment and an attendant reduction in the public sector's financing are crucial for reconciling potentially conflicting objectives. So far, the deleveraging has been facilitated by a reduction in banks' foreign activities, and there is no evidence of a domestic credit crunch. Moreover, deposits have been resilient throughout the crisis, reflecting the public's trust in the domestic banking system. We will continue to monitor credit market developments closely, and the periodic revisions of the medium-term funding plans will provide a tool for ensuring that the necessary deleveraging takes place in an orderly manner, consistent with the program's macroeconomic framework.

20. **The partial transfer of the banks' pension plans to the social security system will be done under balanced conditions.** The plan is to transfer, in 2011, only the assets/liabilities relating to already-retired bank employees. The interest of all stakeholders, including the taxpayer, will be protected by ensuring that the pension liabilities and

corresponding assets are taken over at a fair value, also respecting EU competition and state aid law. Additional capital requirements resulting from this transfer will be sought from private sources, as in other upcoming recapitalization efforts. However, if necessary, we will also offer to help banks cover the loss and the impact on capital by using part of the transfer itself and acquire common equity in banks. This would eliminate the need to use funding under the program for bank recapitalization. We will also ensure that the remainder of the transferred funds will be deposited in a blocked account until the completion of the third review.

21. **Pressures on bank capital have increased.** In addition to the targets and deadlines set under the program for end-2011, which banks are on track to meet from private sources, further strengthening in their capital position has become necessary. The capital exercise announced by the European Banking Authority (EBA) on October 26, including a new temporary buffer for sovereign exposures, requires substantial additional bank capital. Still more capital will be needed as a result of the planned partial transfer of banks' private pension plans as well as from the special on-site inspections program (SIP).

22. **The BdP has requested banks to present plans on how 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 end-June 2012. In the meantime, the impact of the pension plan transfers and the SIP on their end-2011 regulatory capital ratios will be temporarily neutralized.

23. **We are finalizing the rules governing the provision of capital from public sources to banks.** The draft law in the process of approval by Parliament and its implementing legislation are designed to extend temporary public support to viable banks, under strict conditions and with strong protection of the interests of the taxpayer. The legislation will ensure that the whole range of instruments deemed acceptable by the regulators, including EBA, will be available in Portugal. Whenever a beneficiary bank ceases to comply with the steps and deadlines agreed under the recapitalization plan, or does not manage to achieve the Core Tier 1 capital 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. It will also include increasing incentives for early repayment. The repurchase price will be based on the issue price plus an accrued remuneration plus a share of any increase in value. In order to avoid that the private shareholders are effectively subsidized 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 they receive any public funds. The framework for access to public capital will be finalized by end-January 2012 (structural benchmark) and will be consistent with EU state aid rules.

24. **We are continuing to streamline the state-owned CGD group to increase the capital base of its banking arm as needed.** Additional efforts will be deployed to meet the Core Tier 1 capital ratio target of 9 percent by end-2011, without relying on the sale of the insurance arm. This sale is expected to take place in 2012 directly to a final buyer and to contribute to meeting that year's additional capital needs. Insofar as these needs cannot be met from internal group sources, CGD will be provided with government capital support outside of the Bank Solvency Support Facility (BSSF).

25. **The BdP has enhanced its assessment of the banking sector's resilience under stress.** The recommendations made in June 2011 by a joint team of experts from the EC/ECB/IMF for the BdP's Solvency and Deleveraging Assessment Framework (SDAF) have been addressed. In the context of the assessment exercise planned for the third review, banks will incorporate the available results of the SIP, and the BdP will use the SDAF as a top-down benchmark as scheduled. The exercise will be performed in the context of the last step of the SIP and based on a three-year horizon, a 6 percent Core Tier 1 threshold, and a scenario prepared by the BdP and agreed with the EC/ECB/IMF, who will assess the quality of the results of the SDAF in that review. The BdP will continue to monitor on a quarterly basis the banks' potential capital needs with a forward looking approach under stress conditions.

26. **The BdP continues to strengthen its supervisory capacity.** It is making progress in widening the ranks of its specialist staff, and intends to establish a new division tasked with the maintenance of supervisory methodologies and tools, including the dissemination across its supervisory function of the experiences obtained via the SIP. Disclosure on non-performing loans has been improved by adding a new ratio in line with international practices to the current ratio that covers only overdue loan payments. Furthermore, the BdP remains committed to close coordination with home and host country supervisors, both within and outside the EU.

27. **Final negotiations to complete the sale of Banco Português de Negócios (BPN) are proceeding.** The conclusion of the transaction is pending a decision by the EC to ensure, inter alia, the transaction's legal certainty and to ensure minimum cost to the Portuguese taxpayers and the economy as a whole, including in relation to financial stability. The Portuguese government is fully co-operative in these matters with the relevant authorities.

28. **Progress continues to strengthen the early intervention, resolution, and deposit insurance framework.** The end-November 2011 structural benchmark for the legislative amendments will be met by end-year at the latest. Enabling legislation to strengthen the framework in these areas has already been passed by the Parliament and is awaiting promulgation by the President. The Decree Law implementing the detailed framework will thereafter need to be approved by the Council of Ministers and promulgated by the President. The Portuguese legislator, in establishing the legal framework for the resolution fund, is

further examining the operational details, including the funding of such a fund, and will take into account the EU Directive on resolution more broadly as soon as it becomes available. .

29. **We remain committed to strengthening the legal framework for corporate and household debt restructurings.** We are finalizing the corporate insolvency law amendments to support better early rescue of viable firms (end-December 2011 structural benchmark). Voluntary out of court restructuring guidelines in line with international best practices were issued in September 2011. We are also implementing an action plan to raise public awareness of restructuring tools.

30. **We will continue to enhance the monitoring of the high indebtedness of the corporate and household sectors.** The first quarterly monitoring report has been published and we will continue to improve its information content. The work of the task force will continue on detailing the pressure funding points of companies and households and suggesting policy actions to mitigate them. The Ministry of Economy will, in by end-December 2011, provide the EC/ECB/IMF with an assessment of existing support mechanisms to SMEs and details of policy measures on financial and non-financial support to this sector.

D. Enhancing Competitiveness and Efficiency through Structural Reforms

31. **Competitiveness gains are critical to ensure a sustainable adjustment of the economy to a higher and more balanced growth path**. The adjustment in the current account so far has been a result of a compression in domestic demand; going forward, it must be driven by a more dynamic export sector. While we have decided against fiscal devaluation as a policy tool to cut labor costs to firms, we are pushing ahead with other measures to boost the competitive position of Portuguese firms.

Labor Markets

32. **We recognize that Portuguese firms' limited ability to match their workforce to their needs is a key constraint to a well-functioning labor market.** Portugal ranks high on both the generosity of severance pay and on the restrictiveness of conditions for fair individual dismissal. We have already implemented legislation to reform severance payments for new hires, reducing significantly dismissal costs to 20 days per year of service, eliminating the three month minimum payment, and capping payments at 12 months of pay. To further alleviate relevant constraints, and in consultation with social partners, we are:

- giving careful consideration to ways of (i) extending the severance pay adjustment to include current employees without reducing accrued-to-date entitlements (law proposal to be submitted to Parliament by end-March 2012), (ii) benchmarking benefits to the EU average of 8–12 days per year of work, and (iii) introducing an employer-financed severance pay fund Draft legislation will be submitted to Parliament no later than end-September 2012.

- developing proposals, to be submitted to Parliament by end-March 2012, which would ease the requirements for dismissals based on the extinction of the work position and based on a worker's unsuitability.

33. **To promote wage developments consistent with improving firms' competitiveness, we will not grant automatic extensions of collective agreements during 2012, while we redesign the features of the extension mechanism**. This should reduce pressures on firms facing tight profit margins and reduced demand, so as to avoid disruptive declines in employment. In the meantime, we will continue to work on developing clear criteria for the extension of collective agreements by end-June 2012, so that the new mechanism can enter into force by end-January 2013 (MoU paragraph 4.7).

34. **We are pushing ahead with measures to address the rise of long-term unemployment.** Our dialogue with social partners has been productive, and we are well advanced in formulating proposals for reforming the unemployment insurance system. Our proposals aim to increase incentives to work and reduce the risk of long-term unemployment. To affect incentives in a decisive way, we aim to reduce the maximum duration of unemployment insurance benefits to no more than 18 months, while strengthening the role of the contributory careers vis-à-vis the workers age in determining benefits. At the same time, we will broaden social safety nets by granting access to unemployment benefits sooner, after 12 months of work, and extending coverage to self-employed (MoU paragraph 4.1 iv).

Competition Framework

35. **We are reducing the scope for rent-seeking behavior and removing clearly identified competitive distortions**.

Telecommunications

- We are committed to further lowering mobile termination rates, thus encouraging market entry by smaller operators and correcting the competitive disadvantage of smaller mobile operators. Two reductions have already taken place in 2011, and a decision to further lower mobile termination rates by over 60 percent by end-2012, as compared with 2010 termination rates, has been submitted to public consultation.

- Recommendations made by the Competition Authority in the fixed communications market have been adopted, including dissemination of tools to compare pricing and other characteristics for the majority of services, standardization of contracts, and publication of a consumer guide. We will examine the need for further action (MoU paragraph 5.17).

- We have published the spectrum auction rules in line with our commitments in the MoU. A number of important features of the auction rules should encourage new entry and ensure a level playing field. We will conduct an assessment of the state of play in the market and address any resulting anti-competitive practices or distortion (within two years of the auction). We are committed to use the enforcement mechanisms inscribed in the auction rules to ensure fair and reasonable access to national roaming agreements, which is critical for potential new entrants.

- We will renegotiate by end-2011 the concession contract with PT Telecom as it pertains to providing universal service, in order to award the contract through a tender procedure.

Competition Authority and Regulators

- The draft new Competition Law will be submitted to Parliament by end-January 2012 (structural benchmark). We will invite three qualified entities to submit proposals for the study of nomination practices, responsibilities, independence, and resources of the National Regulatory Authorities. The study, to be completed by April 2012, will be used to address any deficiencies in the regulatory framework. In the meantime, we will continue to strengthen sectoral regulators, ensuring they enjoy the independence they require to carry out their tasks (in line with our commitments under MoU paragraph 5.18 and 5.21).

Services and regulated professions

- **We are committed to more integrated and open services markets.** We will implement reforms in the services sector and regulated professions to facilitate the establishment and cross-border provision of services and to remove unjustified restrictions to access and activity exercise in regulated professions.

Rental market reform

- We have identified measures to amend the urban rental law and simplify procedures for renovation to promote mobility and foster an efficient housing market as detailed in the MoU. Draft legislation will be submitted to Parliament by end-December 2011.

Energy Markets

36. **Recognizing the need to address competitiveness comprehensively and across all sectors, we will take bold steps to reduce excessive rents in energy markets.** High rates of return granted to generators in the standard and special regimes are recovered from electricity consumers and represent a significant share of the total electricity payment and weighing on input costs in energy-intensive industries. In line with our decision to avoid excessively large increases in electricity prices, these policy costs are not currently fully compensated by electricity tariffs. The associated debt (“tariff deficit”) to distributors is expected to rise steadily, potentially posing risks to cash flows or crowding out credit as the debt is securitized with banks. To that end, we will adopt measures to set the national electricity

system on a sustainable path leading to the elimination of the tariff debt (*déficit tarifário*) by 2020 and ensure that it will stabilize by 2013. The latter deadline is subject to review, based on the specific measures that will be taken. To that end, by end-January 2012 (structural benchmark), we will prepare a proposal which specifically corrects excessive rents in special (co-generation and renewables) and standard regimes (CMECs, PPAs, and power guarantee mechanism). This proposal will consider the merits of a full range of concrete measures, and will cover all sources of rents.

Judicial Reforms

37. **We are implementing targeted measures to achieve a steady reduction of the backlogged enforcement cases.** An inter-agency task force will be established by end-November 2011 to set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, with the first report to be completed by February, 15 2012.To improve the legal and institutional framework for enforcement agents, we will 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 incentivizes speedy enforcement. In addition, the oversight body's full access to the enforcement case files, including financial data, will become operational by March 15, 2012.

38. **We remain committed to streamlining the court structure and improving efficiency of the judicial process.** To this end, we will strive for timely implementation of the end-January 2012 measures on a judicial roadmap to reduce the number of court districts and close down underutilized courts, an assessment of court management, a new personnel management plan, separate chambers within the Commercial Courts and allocation of resources based on court by court quantitative data. A revised judicial roadmap based on stakeholder consultations and cross country experience will be prepared by end-May 2012, and a bill to implement the roadmap will be submitted to Parliament by end-September 2012 (structural benchmark). We are also finalizing a proposal to improve the Code of Civil Procedure, including a single-judge procedure for small claims. Based on this proposal and comparative law analysis, the draft amendments to the Code of Civil Procedure will be prepared by end-June 2012, and submitted to Parliament by end-September 2012 (structural benchmark). Finally, the Ministry of Justice will submit to Parliament a bill to improve the Justices for the Peace regime by end-March 2012.

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

	Performance Criteria (unless indicated otherwise)						Indicative Targets		
	Jun-11		Sep-11						
	Program	Actual	Program	Actual	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
1. Floor on the consolidated General Government cash balance (cumulative) 1/	-5.4	-5.1	-6.7	-5.7	-10.3	-1.9	-4.4	-5.9	-7.6
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 2/	…	…	0	0.2	0	0	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	167.9	175.9	170.8	175.9	182.0	182.0	182.0	182.0
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government. 3/	0	0	0	0	0	0	0	0	0

1/ Corresponds to an overall deficit of the General Government of €10,042 million on ESA 95 basis. Cumulative from January 1, 2011 for 2011, and cumulative from January 1, 2012 for 2012.
2/ Applies on a continuous basis from September onwards. Insufficient information for application in June.
3/ Applies on a continuous basis.

Table 2. Portugal: Structural Conditionality 1/

	Measure	Timing	Status
Prior Actions			
1	Parliamentary approval of a 2012 budget consistent with the program, in line with paragraph 3 of the MEFP.		
Structural Benchmarks			
A. Strengthen financial stability and enhance banking sector monitoring:			
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 2/	
3	Amend the Insolvency Law to better facilitate effective rescue of viable firms .	End-Dec. 2011	
4	Amend the framework (Law No. 63-A/2008) for bank access to public capital. 4/	End-Jan. 2012	
B. Enhance competitiveness:			
5	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 3/	
6	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 3/	
7	Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011	
8	Take all necessary legal, administrative, and other steps to make arbitration fully operational.	End-Feb. 2012	
C. Strengthen public financial management and reduce fiscal risks:			
9	Publish a fiscal strategy document for the general government which will specify 4-year medium-term economic and fiscal forecasts, supporting analysis and underlying assumptions, and 4-year costings of new policy decisions.	End-Aug. 2011	Met
10	Conduct and publish the results of a survey of arrears of general government entities and SOEs for all categories of expenditure as at end-June 2011.	End-Aug. 2011	Met
11	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	
12	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	
13	Revise and submit to Parliament the draft regional public finance law. 4/	End-Mar. 2012	

1/ Includes structural benchmarks through Q1 2012.
2/ Previously set for end-November 2011, delayed until end-December 2011.
3/ Previously set for end-December 2011, delayed until end-January 2012.
4/ New structural benchmarks.

ATTACHMENT II. PORTUGAL—TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

December 9, 2011

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

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

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

General Government

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

- 4.1. The Central Government. This includes:
    - 4.1.1. The entities covered under the State Budget, which covers the budgets of the Central Administration, including the agencies and services that are not administratively and financially autonomous, agencies and services that are administratively and financially autonomous (*Serviços e Fundos Autónomos* – SFA).

      4.1.2. Other entities, including Incorporated State-owned enterprises (ISOE), or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government.

- 4.2. Regional and Local Governments, that include:
  - 4.2.1. Regional Governments of Madeira and Azores and Local Governments (*Administrações Regionais and Locais*);
  - 4.2.2. Regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government.
- 4.3. Social Security Funds comprising all funds that are established in the general social security system.
- This definition of General Government also includes any new funds, or other special budgetary and extra budgetary programs or entities that may be created during the Program period to carry out operations of a fiscal nature and which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE in the correspondent subsector. The MoF will inform the EC, ECB, and IMF of the creation of any such new funds, programs, entities or operations at the time of its creation or statistical re-classification or, in the case of Regional and Local Governments, at the time the Government acknowledges its creation.
- The General Government, as measured for purposes of Program monitoring in 2011, shall not include entities nor operations that are re-classified into General Government during the remainder of 2011.[1] In 2012, it shall not include entities or operations (including pension funds) that are re-classified into General Government during 2012, but shall include those reclassified in 2011.[2]

5. **Supporting Material**

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

---

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

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

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

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

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

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

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

of the MoF, and in line with the corresponding line items established in the State Budget. Budget expenditures will exclude amortization payments but include salaries and other payments to staff and pensions; grants to Social Security Funds, medical care and social protection; operational and other expenditure, interest payments; cash payments for military equipment procurement; and EU expenses.

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

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

6.4. **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. Furthermore, in line with quantitative targets to be established at the time of the first review, the existing stock of arrears will be settled or otherwise reduced. This also includes arrears that are being accumulated by the SOEs not includes in the General Government under ESA95 and ESA95 Manual on Government Deficit and Debt rules classification.

11. **Supporting material.** 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.

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

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

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

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

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

15. **Definition**. For the purposes of the Program, the definition of debt is the same as in paragraph 12. An external debt payment arrear will be defined as a payment on debt to

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.

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

E. Bank Solvency Support Facility

17. €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. Future amounts for the bank support fund will be deposited into the dedicated account to the extent that there is a need for bank capital.

F. Overall Monitoring and Reporting Requirements

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

PORTUGAL: LETTER OF INTENT

Lisboa, December 9, 2011

Mr. Jean-Claude Juncker
President
Eurogroup

Mr. Jan Vincent Rostowski
Minister of Finance
Poland

Mr. Olli Rehn
Vice President
European Commission

Mr. Mario Draghi
President
European Central Bank

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. Policy implementation is broadly on track. In particular, we believe that the recent adoption of a bold and comprehensive 2012 budget will decisively set public finances on a sustainable path and bolster market confidence in our programme. All the quarterly quantitative performance criteria for the second review were met, along with the continuous criterion on external arrears. However, our end-September indicative target on the non-accumulation of new domestic arrears by the general government was breached. As a corrective measure, to avoid further arrears accumulation, we are strengthening commitment controls and ensuring adequate budgetary allocations to the health sector.

3. Expenditure overruns and the materialization of fiscal risks have complicated the attainment of the end-2011 fiscal deficit target. However, we intend to meet the target through a partial transfer of bank pension funds to the social security system—a one-off revenue item.

4. Fiscal-structural reform is addressing deep-seated challenges with expenditure control. To this end, we are strengthening public financial management, halting new PPP contracts, fundamentally restructuring the SOE sector and limiting further debt increases, and reforming revenue administration and the health sector. We are also revising our inter-governmental fiscal framework to enhance fiscal responsibility. We will require a statement of affairs for Madeira ahead of a financial arrangement with the region.

5. Our commitment to support financial system stability remains unchanged. Banks' deleveraging is progressing, and we will continue to ensure that funding plans are consistent with the level of credit implied by the programme's macroeconomic framework. The legal framework for temporary capital increase of viable banks will be significantly improved by early 2012 with a view to ensuring financial stability while protecting tax payers. The structural benchmark on amending legislation to strengthen the early intervention framework and adopting the new bank resolution framework will be met by year-end.

6. Our ambitious structural reform agenda to foster higher and sustainable growth is on track, although we did not implement a fiscal devaluation given the large fiscal consolidation. We are working to give firms the flexibility to respond to changing demand conditions without disruptive changes in employment, which is particularly important in the current adjustment process . We are continuing to advance legislation and practices to enhance the competition framework and facilitate market entry. We are also making progress on the other structural reforms foreseen in the programme, including the energy, telecommunication and services sector, of the housing market and of the judicial system. We remain committed to an ambitious and frontloaded structural reform agenda to support the rebalancing of the economy.

7. On the basis of the policies defined in this letter, we request completion of the second review under the Economic Adjustment Programme. The attached MEFP and MoU propose new structural benchmarks relating to the fiscal area (reforming the regional finance law, assessing PPPs, and priority elements of SOE restructuring plans), structural reform (developing a proposal to correct excessive rents in energy markets), the banking sector (the rules governing the provision of public capital to banks), and the judicial process.

8. We remain confident that the policies described in the previous MEFPs and MoU and in the attached updates are sufficient to achieve the objectives under the programme. We stand ready to take additional measures that may be needed to meet the objectives of the economic programme and will consult with the European Commission, the ECB, and the IMF in advance of any necessary revisions to the policies contained in this letter and attached Memorandum.

9. This letter is copied to Ms. Christine Lagarde.

Sincerely yours,

/s/

Vítor Gaspar
Minister of State and Finance

/s/

Carlos da Silva Costa
Governor of the Banco de Portugal

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

Attachment I. Portugal—Memorandum of Understanding on Specific Economic Policy Conditionality

Second Update—December 9, 2011

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism (EFSM), and in particular Article 3(5) thereof, the second 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 second quarterly review was carried out in November 2011. It assessed compliance with the conditions to be met by end-October and the need and scope for additional policy steps. This second update of the MoU reflects the findings of the second 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. To this effect the authorities commit to provide all required information as soon as

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

available. In areas where there are risks of significant delays in the implementation of policies under this programme the authorities in cooperation with the EC, the ECB and the IMF consider making use of technical assistance.

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

1. Fiscal policy

Objective

First, reduce the Government deficit to below EUR 10,068 million (equivalent to 5.9 percent of GDP based on current projections) in 2011 and 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 2011

1.1. The Government will achieve a general government deficit of no more than EUR 10,068 million in 2011 on a European System of Accounts (ESA95) basis. The Government will also reach the (cumulative) quarterly ceiling for the consolidated General Government cash balance in the MEFP, as defined in the Technical Memorandum of Understanding (TMU). **[Q4-2011]**

1.2. With the information available as of early November, the Government has estimated a shortfall for the year 2011 as a whole of some 2¼ percent of GDP before the consideration of any corrective measure to achieve the 2011 fiscal target on an ESA 95 basis. Excluding the impact of selling the troubled bank BPN, the shortfall amounts to 2 percent of GDP.[2] A part of this shortfall had already been ascertained by August, while another part has been identified more recently, including slippages at the level of sales of concessions and real estate and higher capital spending.

1.3. The Government took some measures against the emergence of the shortfall, namely, a one-time surcharge in the context of the personal income tax and an increase in the VAT rates for natural gas and electricity to the standard rate was brought forward to October 01, 2011.

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

1.4. Despite these measures, a large gap remains to meet the General Government target in 2011. Therefore, already in August the authorities put forward a limited transfer of banks' pension funds to the Government sector, which were intended to be used exceptionally to meet the 2011 deficit target. The latest information indicates that the size of these transfers needs to be some 1.8 percent of GDP, substantially higher than projected in August, to allow the government to meet the target.[3] The Government is committed to transfer the assets of these pension funds in full compliance with EU state aid rules.

Fiscal policy in 2012

1.5. The government will achieve a general government deficit of no more than EUR 7,645 million (4½ percent of GDP) in 2012.[4] **[Q4-2012]** The Government has not implemented the 'fiscal devaluation' as a tool to cut labour costs. The large fiscal consolidation and the associated risks to the projections of tax bases suggested postponing the fiscal devaluation to a later stage of the programme when uncertainties are reduced. Meanwhile, the government has introduced a number of other measures to boost the competitive position of Portuguese firms.

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

1.7. 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 with the 2012 Budget Law **[Q4-2011]**, unless elsewhere specified. Overall, expenditure reduction accounts for two thirds of that fiscal effort and revenue increases for one third. In addition, the Government will aim at reversing the expenditure overruns recorded in 2011.

---

[3] In order to meet the government deficit on an ESA95 basis. Excluding transactions related to the banking sector support and restructuring strategy under the programme as foreseen in the Technical Memorandum of Understanding, the size of the needed transfers would be 1.6 percent of GDP as the costs related to the sale of the troubled bank BPN are excluded.

[4] 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 third review there is an agreement that there are sufficient safeguards to prevent further accumulation of arrears and that part of the remaining funds (after meeting the 2011 deficit target) from the envisaged 2011 banks pension transfer may be used to settle domestic arrears, the accrual government balance objectives may be adjusted, if necessary, by the amount of arrears to be cleared.

Expenditure

1.8. Ensure that the public sector wage bill decreases in gross terms in 2012 by at least EUR 3,000 million (EUR 1,620 million taking into account the losses of government revenues at the level of income taxes and social contributions):

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 1,000 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 the minimum wage of EUR 485 and EUR 1,000. 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;[5]

ii. reduce the number of government employees by (i) limiting staff admissions in order to achieve annual decreases of 2% (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 December 2011;

iii. make room to reverse the slippage in personnel costs 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);

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

1.9. Reduce pension expenditure in gross terms in 2012 by at least EUR 1,260 million (EUR 950 million taking into account the losses of government revenues at the level of income taxes): by (i) suspending the 13^{th} and 14^{th} monthly payments for those pensioners with monthly pension benefits of EUR 1000 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 485 and EUR 1000. The pensions of those receiving benefits below EUR 485 will be frozen and the lowest pensions will be marginally increased. In case

[5] The discussion in Parliament of the 2012 Budget Law has led to a change in the salary threshold to EUR 1,100 for suspending both the 13^{th} and 14^{th} monthly salaries, and to between EUR 600 and EUR 1,100 for implementing the progressive suspension. The change has been done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital gains and investment income (e.g. dividends and interest payments) from 21.5% to 25%.

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.[6]

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

1.11. 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%;

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.

1.12. 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.

1.13. 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.

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

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

---

[6] The discussion in Parliament of the 2012 Budget Law has led to a change in the pension threshold to EUR 1,100 for suspending both the 13th and 14th monthly payments, and to between EUR 600 and EUR 1,100 for implementing the progressive suspension. The change has been done in a budgetary neutral way, financed through an increase in the tax rate applicable to capital gains and investment income (e.g. dividends and interest payments) from 21.5% to 25%.

1.16. 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.

1.17. Reduce costs in other public bodies and entities and in transfers and subsidies to SOEs classified outside the perimeter of the general government on a 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%; 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

1.18. 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.

1.19. Raise VAT revenues through an increase in the efficiency of the VAT structure with a yield of at least EUR 2,040 million in 2012. This will be done by moving categories of goods and services 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.

1.20. 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.

1.21. 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% of the taxpayer's taxable profit;

iii. curbing tax benefits;

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

1.22. Increase excise taxes to raise at least EUR 180 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.

1.23. 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.

1.24. 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.

<u>Fiscal policy in 2013</u>

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

1.26. 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]**

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

Expenditure

1.28. 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% (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.

1.29. 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

1.30. 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.

1.31. 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

1.32. 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]**

1.33. 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.

2. Financial sector regulation and supervision

Objectives

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 the planned 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. 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 the EU State aid rules. **[Ongoing]**

Deleveraging in the banking sector

2.2. The banking system should eliminate its funding imbalances, with a view to reducing its high dependence on Euro system liquidity, as planned. Monitor the banks' implementation of the funding plans aiming at a loan-to-deposit ratio of about 120% in 2014. 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. Continue to monitor credit market developments closely and the periodic revisions of the medium-term funding plans will provide a tool for ensuring that the necessary deleveraging takes place in an orderly manner, consistent with the macroeconomic framework of the programme. **[Ongoing]**

Pension fund transfer

2.3. Ensure that the partial transfer of the banks' pension plans to the social security system will be done under balanced conditions. Only the assets/liabilities relating to the already retired bank employees will be transferred in 2011. The interest of all stakeholders, including the taxpayer, will be protected by ensuring that the pension liabilities and corresponding assets are taken over at a fair value, also respecting EU competition and state aid law **[Q4-2011].** Additional capital requirements resulting from this transfer will be sought from private sources, as in other upcoming recapitalization 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 and acquire common equity in banks. This would eliminate the need to use funding under the programme for bank recapitalisation. The remainder of the transferred funds will be deposited in a blocked account until the completion of the third review[7].

Capital buffers

2.4. BdP will follow closely the plans the banks presented to reach a core Tier 1 capital ratio of 9 percent by **Q4-2011** and 10 percent at the latest by **Q4-2012**.

2.5. In addition to the targets and deadlines set under the program for **Q4-2011**, which banks are on track to meet from private sources, further strengthen the banks' capital position. The capital exercise announced by the European Banking Authority (EBA) on October 26, including a new temporary buffer for sovereign exposures, requires substantial additional bank capital. Still more capital will be needed as a result of the planned partial transfer of banks' private pension plans as well as from the special on-site inspections program (SIP).

[7] As soon as the details of the transfer are defined, and no later than before the third quarterly review, the Government will present the estimated budgetary impact of this transfer over the programme period and corrective measures in case the transfer leads to gaps in and risks to government deficits.

2.6. The BdP will request 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**. In the meantime, the impact of the pension plan transfers and of SIP on their **Q4-2011** regulatory capital ratios will be temporarily neutralised.

2.7. Finalise the rules governing the provision of capital from public sources to banks. The draft law in the process of approval by Parliament and its implementing legislation are designed to extend temporary public support to viable banks, under strict conditions and with strong protection of the interests of the taxpayer. The legislation will ensure that the whole range of instruments deemed acceptable by the regulators, including EBA, will be available in Portugal. 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 will be based on the issue price plus an accrued remuneration plus a share of any increase in value. The framework for access to public capital will be finalised by **end-January 2012**[8] and will be consistent with EU state aid rules.

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. Additional efforts will be deployed to meet the Core Tier 1 capital ratio target of 9 percent by **end-2011**, without relying on the sale of the insurance arm. This sale is expected to take place **in 2012** directly to a final buyer and to contribute to meeting that year's additional capital needs. Insofar as these needs cannot be met from internal group sources, CGD will be provided with government capital support outside of the BSSF.

Monitoring of bank solvency

2.9. In the context of the assessment exercise planned for the third review, the BdP will ensure that banks incorporate the available results of the SIP, and the BdP will use the SDAF as a top-down benchmark as scheduled. The exercise will be performed in the context of the last step of the SIP with a three-year horizon and a 6% Core Tier 1 threshold. **[Ongoing]**

---

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

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 of supervisory methodologies and tools, including the dissemination across its supervisory function of the experiences obtained via the SIP. **[Ongoing]**

2.12. Publish the new non-performing loans ratio in addition to the current ratio that covers only overdue loan payments **[Q4-2011]**.

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

Banco Português de Negócios

2.14. The authorities are asked to conclude the sale, pending a decision by the EC which is examining, inter alia, the transaction's legal certainty and to ensure minimum cost to the Portuguese taxpayer and the economy as a whole, including in relation to financial stability. The Portuguese government is fully co-operative in these matters with the relevant authorities. **[Ongoing]**

2.15. Once a decision by the EU Competition authorities is taken, the CGD's state guaranteed claims on BPN and all related special purpose vehicles will be taken over by the state according to a timetable to be defined at that time. **[Ongoing]**

Bank resolution framework

2.16. Strengthen the early intervention, resolution, and deposit insurance framework. The **end-November 2011** deadline for the legislative amendments will be met by end-year at the latest. Enabling legislation to strengthen the framework in these areas has already been passed by the Parliament and is awaiting promulgation by the President. The Decree Law implementing the detailed framework will thereafter need to be approved by the Council of Ministers and promulgated by the President.

2.17. The legislator establishes the legal framework for the resolution fund and further examines the operational details, including the funding of such a fund and will take into account the EU Directive on resolution more broadly as soon as it becomes available. **[Ongoing]**

Corporate and household debt restructuring framework

2.18. Finalise the corporate insolvency law amendments to support better early rescue of viable firms by **end-December 2011**[9]. As voluntary out of court restructuring guidelines in line with international best practices were issued in September.

2.19. Implement an action plan to raise public awareness of 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 first quarterly monitoring report has been published and will be further improved concerning its information content.. The work of the task force will continue on detailing the pressure funding points of companies and households and suggesting policy action to mitigating them. The Ministry of Economy will, by **December 2011**, provide the EC/ECB/IMF with an assessment of existing support mechanisms to SMEs and details of policy measures on financial and non-financial support to this sector**.**

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

3.1. Apply the recently approved standard definition of arrears and commitments at all levels of general government. **[Ongoing]**

---

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

3.2. The existing survey of arrears will be covering all general government entities and SOEs classified outside the general government and all transactions (including employment costs, utilities, interest costs, transfers to local and regional governments, goods and services, capital expenditure, and transfers of withheld taxes and social contributions to respective responsible collection agencies and institutions). Following the survey, the authorities prepare a consolidated monthly report on arrears for the general government sector to be published in the monthly budgetary execution bulletin. **[Q4-2011]**

3.3. Enhance the existing monthly reporting on budgetary execution on a cash basis for the general government, on a consolidated basis. The monthly reporting perimeter currently includes the State, Other public bodies and entities, Social Security, regional and local governments and it will be progressively expanded, in line with the Technical Memorandum of Understanding, to include all SOEs and PPPs reclassified within the general government, regional and local governments. **[February 2012]**

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

3.5. Develop intra-annual targets, and corrective measures in case of deviation from targets, for **[Q4-2011]**:

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

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

3.6. Implement any changes to the budget execution rules and procedures necessary to align them with the standard definition of arrears and commitments. The commitment control procedures will be enforced and where necessary strengthened for all types of expenditure across the general government including the regional and local administration. All necessary legislation will be adopted by **end-2011** to ensure implementation of the commitment control procedures in accordance with the instructions issued to general government units in September 2011. In particular, the draft legislation will ensure:

i. from 1 January 2012:

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

ii. systems and procedures will comply, by end-December 2011, with the revised budget execution rule, as set out in the above instruction;

iii. the Inspecção-Geral de Finanças (IGF) will carry out regular reviews of the commitment control system by **[Q2-2012]**.

3.7. Publish information on: number of general government staff on a quarterly basis (no later than 45 days after the end of the quarter); stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, special mobility condition flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. The regional and local administration will transmit the necessary information. Information on employment in SOEs (central, local and regional) and other public entities and/or bodies will also be compiled. **[Q1-2012]**

Monitoring

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

3.9. 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 **Q1-2012**.

3.10. Following the inventory on tax expenditures, an annual report on tax expenditures will 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.

Arrears

3.11. The stock of domestic arrears will be significantly reduced by the end of the program period. To this effect, a strategy for the validation and settlement of arrears for the entities inside the general government as well as for SOEs classified outside the general government will be prepared. In this strategy, a roadmap will be provided setting out how and when the stock of arrears will be stabilised. Moreover, various options of settling arrears will be explored, providing appropriate incentive mechanisms including the potential of rebates for early settlements and rewarding entities that no longer accumulate new arrears. **[Q4-2011]**

Budgetary framework

3.12. Publish a fiscal strategy document for the general government annually in April. The document will be in compliance with the requirements of the 2011 revised Stability and Growth Pact and 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.

3.13. Following the recommendations of the July 2011 technical assistance mission, ensure full implementation of the Budgetary Framework Law adopting the necessary legal changes: **[Q4-2011]**

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

ii. Define in detail the proposed characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry-over rules, commitment controls; and appropriate contingency reserves and related access rules. **[Q2-2012]**

3.14. The Fiscal Council will be operational by **[Q4-2011]**.

<u>Regional and local budgetary frameworks</u>

3.15. 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]**

3.16. 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. A proposal to revise the regional finance law **[Q1-2012]**[10] and a proposal to revise the local finance law **[Q2-2012]** will be submitted to Parliament. A document setting out a roadmap and the main elements and options for the revision of the laws will be presented to **[Q4-2011]**:

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

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

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 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**.**

3.17. The Government will prepare a financial arrangement with the Autonomous Region of Madeira (RAM) given the significant drag that the region has caused on the Portuguese public finances and the high level of fiscal risks still remaining **[Q4-2011].** Responsibility for compliance with the measures and objectives laid down under the arrangement will be solely incumbent upon the RAM pursuant to the regional political autonomy granted under the Portuguese Constitution. This arrangement will comprise a debt sustainability analysis and will be designed similarly, and consistent with, the financial program between the Republic of Portugal and the EC/ECB/IMF. It will include quantified measures for fiscal performance and structural reforms which are in line with the recommendations set out in the September Technical Assistance mission. This arrangement will include in particular the following:

i. the 2012 RAM budget will be fully consistent with the State budget. Revenues will be increased through a significant reduction of the differences in rates to the mainland in corporate income tax, personal income tax and VAT, the introduction of road charging, and an adjustment of public services tariffs to cost recovery levels. The Fiscal Council will validate the revenue estimates of the RAM budget. Expenditure will be reduced according to the measures agreed in this MoU regarding public sector employment, wages, and administration;

ii. The central government will exert control of commitments and manage RAM's debt. All arrears will be audited before any settlement strategy is implemented.

iii. RAM's SOE sector will be significantly restructured in line with the requirements of this MoU. Public Private Partnerships will be evaluated with regard to the legality of contracts and the scope for their renegotiation identified.

3.18. As a pre-condition for signing the arrangement, the RAM will present a Statement of Affairs, which will be reviewed by the Republic's authorities and sent to the Court of Auditors. Until the arrangement has been agreed and its implementation by the RAM budget started, the Government will closely monitor the execution of the RAM budget, will keep its transfers to the RAM government suspended, and will not honour any new commercial or financial debt or guarantees by the RAM government and its SOEs that are not approved by the Ministry of Finance. **[Ongoing]**

Public Private Partnerships

Going beyond the obligation to assess the 20 most significant PPP contracts, the authorities provided an assessment of 36 PPPs and 24 concessions that are under the responsibility of the central government, projecting future cash flows and risks, showing rapidly increasing spending pressures that affect, in particular, the financial sustainability of Estradas de Portugal. These pressures will be reduced by increasing revenues and seeking renegotiation of contracts. Following this report and before end of December, all PPP contracts with the exception of statements subject to confidentiality clauses will be published. In particular, the Government will:

3.19. Commit to not enter into any new PPP agreement before the study results on existing PPPs and the legal and institutional reforms proposed become available (see below). **[Ongoing]**

3.20. Launch a tender, with a view to signing the service contract by **March 2012** subject to legal contingencies associated with the procurement process, 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.[11] **[Q4-2011]** The review will identify and, where practicable, quantify major contingent liabilities and any related amounts that may be payable by the Government. It will assess the probability of any payments by Government in relation to the contingent liabilities and quantify such amounts. The study, to be completed 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.

3.21. 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. Technical assistance may be provided if necessary. **[Q1-2012]** It will be ensured that the

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

same commitments apply for regional PPPs, and that local governments do not enter into any PPP contracts. **[Ongoing]**

3.22. 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. **[Q2-2012]**

State-owned enterprises[12]

The Government presented in November 2011 a strategy on how to restructure the State-owned enterprise (SOE) sector with the aim to enhance efficiency, restore its financial sustainability, and re-focus its activities on core public policy objectives. The strategy will be implemented with the aim of reducing SOE indebtedness and restructuring to ensure improved conditions for market financing. The 2012 budget incorporates cost savings (including the budgeted wage cuts) and tackles the financial burden of the central government SOEs. However, efforts to reduce operational costs across the sector by 15 percent with respect to 2009 have been met with mixed success. In order to make further progress in restructuring the SOE sector, while respecting EU competition and state aid rules, the Government will:

3.23. Fully implement ongoing plans to reduce operational costs of central government SOEs outside the health care sector by at least 15% on average compared with 2009 by the end of 2011. Most subsidiaries and shareholdings in non-core activities will be eliminated by 2014. Concrete proposals on these divestments will be included in the report that will assess SOE's financial prospects, potential government exposure, and scope for orderly privatization. **[February-2012]** Equivalent measures will be implemented for local and regional government SOEs. **[Ongoing]**

3.24. SOEs with commercial activity will reach operational balance by **[Q4-2012].** To this end the government will implement 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 further tariff increases as needed. Equivalent measures will be implemented for local and regional government SOEs. **[Q4-2012]**

3.25. Growth in SOE indebtedness has been excessive and additional efforts are necessary. The increase in the overall borrowing requirements of the SOE sector, both inside and

---

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

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. A new legal framework for SOEs will be submitted to Parliament by **January 2012**, which will include the prohibition for SOEs within the general government to incur new debt with the private sector.[13]

3.26. Prepare a report reviewing the operations and finances of SOEs at central, regional and local government levels. The report will assess each company's business financial prospects, the potential exposure of the government and scope for orderly privatisation. The government will adopt the necessary legal changes to fulfil this requirement. Technical assistance will be provided.[14] **[February 2012]**

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

3.28. The Government will submit to Parliament a draft law to regulate the creation and the functioning of SOEs at the central level. No additional SOEs will be created until this law is adopted. The law will enhance the monitoring powers of the central administration over all SOEs. In addition, the timing and content of financial and operational reporting will be defined. The decisions adopted at central level to improve the efficiency of the enterprises while reducing their financial burden will be implemented at all SOEs, taking into account their specificities. The government will promote the initiatives needed so that the same objective is achieved by the regions. **[Q1-2012]**

3.29. The authorities will prepare restructuring plans on local SOEs and the SOEs of each region by **January 2012**. As of next year, four annual SOEs reports will be prepared: for SOEs at central, local and the two regional levels. On the basis of these reports, MoF will present in its annual July report on SOEs a fiscal risk analysis of all SOEs at central, local and regional levels, including all liabilities (explicit and implicit). **[July-2012]**

Privatisation

3.30. The Government is implementing its privatisation programme under the new framework law for privatisation. The privatisation plan targets front-loaded proceeds of about €5 billion through the end of the program. Four bidders were selected for the electricity company (EDP), out of a shortlist of 6, and the second phase will be completed before end-2011. The financial closing of this privatization will occur in **January 2012**. As for the

[13] The special case of Estradas de Portugal is still being analysed and may thus be excluded.

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

electricity network company (REN), the bidders will be selected and the second phase of the privatization initiate before **end-2011**. This transaction shall also be completed by **early 2012**. Bidders for both privatizations include large international strategic investors. The sale of GALP and the small remaining stake in REN on the free market have been delayed until market conditions improve. The complete sale of the railway freight branch (CP Cargo) will be launched by mid-2012. The privatisation process for Aeroportos de Portugal (ANA) and the national air carrier (TAP) will be completed in late 2012. The privatisation of Correios de Portugal (CTT) will be launched in the second half of 2012 in order to complete the sale in early 2013. The partial sale of a public television channel (RTP) and Aguas de Portugal (AdP), 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.

3.31. A strategy for Parpublica will be prepared, given that its sources of income will be affected by privatisation. **[Q4-2011]** The strategy will reconsider the role of Parpublica as a public company, including eliminating the obligation to remit the proceeds of the sale of assets to the Treasury in return for new assets, and considering the possibility of winding down the company or consolidating it with the general government. In the interim, the government will ensure that Parpublica will have sufficient income-generating assets to manage its debt and financing needs. The process of winding down Parpublica will begin in 2013.

3.32. 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]**

<u>Revenue administration</u>

3.33. The Government will merge the tax administration, customs administration and the information technology service DGITA in a single entity [complete design of the new structure by **Q4-2011** and implement it by **Q4-2012**] and study the costs and benefits of including the revenue collection units of the social security administration in the merge. **[Q1-2012]** It will proceed with the broader merger if the assessment is favourable. **[end-2013]**

3.34. Further comprehensive reform plans will be prepared, the focus in 2012 will be to merge central and support functions, adopt a full-fledged large taxpayers unit, 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. establishing special chambers within the tax tribunals, specialised to handle large cases and assisted by a specialised technical staff pool; **[Q2-2012]**

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

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

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

i. reviewing the assessment of audit performance based on both qualitative and quantitative indicators; **[Q4-2011]**

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

iii. apply the new tax arbitration law; **[Ongoing]**

iv. establishing an integrated IT system between the revenue administration and the tax courts; **[Q1-2012]**

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

3.36. The Government will submit to Parliament a law to strengthen the auditing and enforcement powers of the central tax administration to exercise control over the whole territory of the Republic of Portugal including currently exempt tax regimes and to reserve to the central administration the power to issue interpretative rulings on taxes with national scope in order to ensure its uniform application**. [Q1-2012]**

3.37. Following the report assessing the current state of the information systems in the tax administration, an IT Strategic Plan will be prepared for the new merged revenue authority, with support from IMF/EC technical assistance. **[Q4-2011]**

3.38. The tax administration has concluded a strategic plan to combat fraud and evasion for 2012-2014. Additional efforts will be made for enforcement actions focused on high-evasion sectors and taxpayers. 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 percent rebate, subject to a limit per taxpayer, on VAT paid through electronically transmitted invoices in selected sectors and consult with the EC and IMF before implementing the scheme. **[Ongoing]**

Public administration

The Government has adopted steps towards the overall goal of rationalizing 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, a “Green Paper for Local Administration Reform” was presented in October with a view to submitting the related draft laws to Parliament 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

3.39. Reduce management positions and administrative units in the central administration according to the PREMAC report of 15 September 2011 by 27% and 40%, respectively. Following the organic laws of the ministries, the legislation of the entities will be finalised. **[Q4-2011]**.

3.40. In view of improving the efficiency of the central administration and rationalising the use of resources, implement a second phase of the public administration restructuring programme (PREMAC). **[Q1-2012]**

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

3.42. Prepare a detailed cost/benefit analysis of all public and quasi-public entities, starting with the foundations and extend later on to other bodies, across all levels of government. **[Q4-2011]** Based on the results of this analysis of the foundations, the administration (central, regional or local) responsible for the public entity will decide to close or to maintain it in respect of the law (see below). **[Q1-2012**]

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

3.44. 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.

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

Shared services

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

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

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

3.47. 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

3.48. In the context of the annual budget, promote flexibility, adaptability and mobility of human resources across the administration, including by providing training where appropriate. **[Q4-2011]** The mobility schemes, namely geographic mobility, will be reinforced as an instrument to manage human resources across administrations. **[Q2-2012]**

3.49. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 2% per year (in full-time equivalents) in the staff of central administration and 2% 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]**

3.50. 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

3.51. Following the approval of NHS moderating fees (*taxas moderadoras*), enact legislation reviewing and increasing overall NHS moderating fees (*taxas moderadoras*) by **end December 2011** through:

i. a substantial revision of existing exemption categories, including stricter means-testing in cooperation with Minister of Social Security;

ii. an increase of moderating fees in certain services while ensuring that primary care moderating fees are lower than those for outpatient specialist care visits and lower than emergency visits;

These measures should result in additional revenues of EUR 150 million in 2012 and an additional 50 million in 2013.

3.52. 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% in 2012 and by further 20% in 2013 at all levels of general government. The system would become self-financed by 2016. The budgetary costs of these schemes will be reduced by lowering the employer's contribution and adjusting the scope of health benefits. **[Q4-2011]**

3.53. Produce a health sector strategic plan, in the context of and consistent with the Medium-Term Fiscal Strategy. **[Q4-2011]**

Pricing and reimbursement of pharmaceuticals

3.54. The Government has approved legislation on setting the maximum price of the first generic introduced in the market to 50% of the branded product with the same active substance, and its enactment is expected by **[Q4-2011]**. Enact legislation which automatically reduces the prices of medicines when their patent expires. **[Q4-2011]**

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

3.56. The Government has approved legislation regarding the revision of the existing reference-pricing system based on international prices by using as countries of reference the three EU countries with the lowest price levels or countries with comparable GDP per capita levels; the enactment of this legislation is expected by **[Q4-2011]**. Countries of reference will be revised every year. **[Ongoing]**

Prescription and monitoring of prescription

3.57. Continue to improve the monitoring system of prescription of medicines and diagnostic and set in place a systematic assessment by individual doctors in terms of volume and value, vis-à-vis prescription guidelines and peers. The assessment will be done through a dedicated unit under the Ministry of Health such as the Centro de Conferência de Facturas. 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, starting from **Q4-2011**.

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

3.59. The Government has submitted 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 **[Q4-2011].**

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

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

Pharmaceutical retailers and wholesalers

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

3.63. The Government has approved legislation changing the calculation of profit margin into a regressive mark-up and a flat fee for wholesale companies and pharmacies on the basis of the experience in other Member States. The new system should ensure a reduction in public spending on pharmaceuticals and encourage the sales of less expensive pharmaceuticals. The aim is that lower profits will contribute at least EUR 50 million to the reduction in public expenditure on drugs distribution in 2012. Its enactment is expected by **[Q4-2011**]. Additional measures leading to further savings in public expenditure on the distribution of medicines should be taken by **Q3-2012**.

3.64. If the new system of calculation of profit margin will not produce the expected savings in the distribution profits, 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]**

Centralised purchasing and procurement

3.65. The Government has approved legislation regarding the administrative framework for a centralised procurement system for the purchase of medical goods in the NHS (equipments, appliances, medicines and services), through the recently created Central Purchasing Authority (SPMS), in order to reduce costs through price-volume agreements and to fight waste. Its enactment is expected by **[Q4-2011].**

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

3.67. Take measures to increase competition among private providers and reduce by at least 10 percent the overall spending (including fees) of the NHS with private providers delivering diagnostic and therapeutic services to the NHS by end 2011 and by an additional 10% by end 2012, regardless of the savings achieved in 2011. **[Q4-2011]**

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

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

3.70. 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

3.71. 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 **[Q1-2012]**. 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. Make sure that the new system leads to a reduction in costs and more effective provision;

ii. set-up a mechanism to guarantee the presence of family doctors in needed areas to induce a more even distribution of family doctors across the country;

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. Increase by at least 20% the maximum number of patients per primary care/ family doctor for health centres and by 10% for the USF.

Hospital services

3.72. To avoid further accumulation of arrears, the 2012 budget ensures adequate allocations to the health sector. The settlement process will give priority to arrears in hospitals, improve the liquidity position of suppliers and likely allow hospitals to obtain discounts when re-negotiating delivery contracts. A strategy with a binding timetable to clear all arrears in the health sector, within the overall strategy for 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. **[Q4-2011]**

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

3.74. Implement measures aimed at achieving a reduction of at least EUR 200 million in the operational costs of hospitals in 2012 (EUR 100 million in 2012 in addition to savings of over EUR 100 million already in 2011). This is to be achieved through the reduction in the number of management staff, concentration and rationalisation in state hospitals and health centres with a view to reducing capacity. **[Q1-2012]**

3.75. Continue the publication of clinical guidelines and set in place an auditing system of their implementation. **[Q4-2011]**

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

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

3.78. 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]**

3.79. Continue with the reorganisation and rationalisation of the hospital network through specialisation, concentration and downsizing of hospital and emergency services, joint management (building on the Decree-Law 30/2011) and joint operation of hospitals. These improvements will deliver additional cuts in operating costs by at least 5 percent in 2013. A detailed action plan is published by 30 November 2012 and its implementation is finalised by the first quarter 2013. Overall, from 2011 to 2013, hospital operational costs must be reduced by at least 15% compared to 2010 level. **[Q1-2012]**

3.80. Move some hospital outpatient services to primary care units (USF). **[Q1-2012]**

3.81. Annually update the inventory of all health staff by specialty, age, region (including autonomous regions), health centre and hospital, public and private sector so as to be able to identify practising, professional and licensed staff and current and future staff needs. **[Q1-2012]**

3.82. 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]**

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

3.84. Review the payment mechanism for the prevention regime and per call payment ("*pagamento por chamada*") in the light of promoting efficiency and reducing costs in the health system. **[Q2-2012]**

Regional health authorities

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

Cross services

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

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

4. Labour market and education

Labour market

Objectives

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

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

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

Unemployment benefits

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

i. reducing the maximum duration of unemployment insurance benefits to no more than 18 months, while strengthening the length of the contributory careers vis-à-vis the workers age in determining benefits. The reform will not concern those currently unemployed and will not reduce accrued-to-date rights of employees;

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

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

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

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

Employment protection legislation

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

4.4. Severance payments **[ongoing]**. Following the entering into force of the 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), the Government will align severance payments to current employees, 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. the Government will align severance payment entitlements for current employees in line with the reform for new hires, (taking into account the revised link between entitlement and seniority and the cap to total entitlements) without reducing accrued-to-date entitlements. A draft plan has been presented. This plan will lead to draft legislation to be submitted to Parliament by **[Q1-2012]**.

ii. By **Q1-2012**, 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**.

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

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

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

iii. Individual dismissals for the above reasons should not be subject to the obligation to attempt a transfer for a possible suitable position (art. 368, 375 Labour Code).

Working time arrangements

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

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

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

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

Wage setting and competitiveness

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

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

ii. ensure wage moderation by using the available discretion in the current legislation of not extending collective contracts until a clear criteria is defined as foreseen in point 4.7.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. Draft legislation defining criteria for extension and modalities for their implementation will be submitted by **Q2-2012**, with a view to entering into force by **Q1-2013**. Such legislation shall in particular provide criteria for the exclusion of the extension in cases where wage agreements are not representative;

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

- how the tripartite concertation on wages can be reinvigorated with the view to define norms for overall wage developments that take into account the evolution of the competitive position of the economy and a system for monitoring compliance with such norms**;**
- the desirability of shortening the survival (sobrevigência) of contracts that are expired but not renewed (art 501 of the Labour Code).

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

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

ii. promote the inclusion in sectoral collective agreements of conditions under which works councils can conclude firm-level agreements without the delegation of unions. As requested by the MoU, a first proposal for an action plan has been presented by **Q4-2011**.

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

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

Active labour market policies

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

i. a report on the effectiveness of current activation policies and other ALMPs in tackling long-term unemployment, improving the employability of the young and disadvantaged categories, and easing labour market mismatch. A descriptive report is to be presented by Q4-2011. Following this, an evaluation report with econometric modelling is to be delivered by **Q2-2012**.

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

Education and training

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

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

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

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

5. Goods and services markets

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

Liberalisation of electricity and gas markets

5.1. Regulated electricity tariffs will be phased out **by 1 January 2013**. Following the approval in the resolution of Council of Ministers of 28 July 2011 of a roadmap setting the main principles for the liberalisation of electricity markets, the government will implement it through legislation by **[Q4-2011].** The provisions will:

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

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

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

5.3. 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 **[Q4-2011]** with a view to the future elimination of pancaking for cross-border flows, and will apply a harmonised congestion management mechanism to all the interconnection capacity between Portugal and Spain. **[Q1-2013]**

5.4. Regulated gas tariffs are to be phased out by **1 January 2013**. The government will implement, through legislation, the roadmap proposed in the resolution of Council of Ministers of 28 July 2011 by **[Q4-2011].**

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

Additional costs associated with electricity production under the ordinary regime

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

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

5.7. Review the efficiency of support schemes for co-generation and propose possible options for adjusting downward the feed-in tariff used in co-generation (reduce the implicit subsidy). **[January 2012]**

5.8. Review in a report the efficiency of support schemes for renewables, covering their rationale, their levels, and other relevant design elements. **[January 2012]**

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

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

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

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

Energy policy instruments and taxation

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

i. Eliminate fiscal incentives to promote investment in renewable energy equipment, energy efficiency in buildings and electric vehicles overlapping with other financing mechanisms or energy and tax policy instruments, such as the enhanced tax allowances under the personal income tax and taxation at the intermediate rate of VAT of acquisitions of solar and renewable energy equipment. **[Q4-2011]**

ii. 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]**

iii. 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]**

iv. 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]**

v. take measures by **[Q2-2012]** to phase out the power guarantee mechanism and reduce the associated policy costs. Incentives for power plants to invest should be revised downwards and phased out in light of the current situation of low electricity consumption, excess production capacity, and the overlapping interruptibility service mechanism, while taking into account developments in the Iberian electricity market and energy security considerations.

vi. 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]**

5.14. Increase excises for electricity (presently below the minima required by EU legislation). **[Q4-2011]**

Ensure sustainability of the national electricity system

5.15. Measures to set the national electricity system on a sustainable path leading to the elimination of the tariff debt (déficit tarifário) by 2020 and ensuring that it will stabilise by 2013 will be adopted. The latter deadline is subject to a review based on a government proposal which will also specify how excessive rents in the standard (CMECs, PPAs, and power guarantee mechanism) and special regimes (co-generation and renewables) will be corrected. This proposal will consider the merits of a full range of measures which will cover all sources of rents. **[January 2012]**[15]

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

5.16. 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). **[Q4-2011]**

5.17. 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

5.18. Further liberalise the postal sector by i) transposing the Third Postal Directive ensuring that powers and independence of the National Regulator Authority are appropriate in view of its increased role in monitoring prices and costs **[Q4-2011]**; ii) amending the 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**;**

---

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

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. **[Q1-2012]**

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

5.19. 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.

5.20. 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

5.21. 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. **[Q3-2012]**;

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% 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

5.22. Define a strategy to integrate ports into the overall logistic and transport system. Specify the objectives, scope and priorities of the strategy, and the link to the overall Strategic Plan for the Transport sector. **[Q4-2011]**

5.23. 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. **[January 2012]**

5.24. Develop a legal framework to facilitate the implementation of the strategy and to improve the governance model of the ports system. In particular, define the necessary measures to ensure the separation of regulatory activity, port management and commercial activities. **[Q4-2011]**

5.25. Specify in a report the objectives, the instruments and the estimated efficiency gains of initiatives such as the interconnection between CP Cargo and Ex-Port, the Port Single Window and Logistic Single Window. **[Q4-2011]**

Road pricing

5.26. 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.

<u>Other services sector</u>

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

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

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

Professional qualifications

5.29. Improve the recognition framework on professional qualifications by adopting the remaining legislation complementing the Portuguese Law 9/2009 on the recognition of professional qualifications in compliance with the qualifications directive. Adopt the law concerning professions not regulated by Parliament **[Q4-2011]** and present to Parliament the law for those regulated by Parliament but where regulation does not involve a professional body (*Ordens or Câmaras*) **[Q4-2011]** to be approved by **[Q1-2012]**.

Regulated professions

5.30. Review and reduce the number of regulated professions and in particular eliminate reserves of activities on regulated professions that are no longer justified. Adopt the law for professions not regulated by Parliament **[Q4-2011]** and present to Parliament the law for those regulated by Parliament but where regulation does not involve a professional body (*Ordens or Câmaras*) **[Q4-2011]** to be approved by **[Q1-2012]**.

5.31. Adopt measures to liberalise the access and exercise of regulated professions by professionals qualified and established in the European Union. Adopt the law for professions not regulated by Parliament **[Q4-2011]** and present to Parliament the law for those regulated by Parliament but where regulation does not involve a professional body (*Ordens or Câmaras*) **[Q4-2011]** to be approved by **[Q1-2012]**.

5.32. 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 5.29, 5.30 and 5.31; ii) eliminating restrictions to the use of commercial communication (advertising), as required by the Services Directive; iii) to achieve the two conditions above the government will present a draft of a horizontal legal framework by **January 2012**, to be submitted to Parliament by **Q1-2012**, and expected to be adopted and enacted by **Q2-2012**.

Upon enactment, the professional bodies will make the necessary changes in their statutes by **[Q3-2012]**.

Administrative burden

5.33. Continue the simplification reform effort by:

i. progressing further on making available the Points of Single Contact (PSC) in three languages with general information covering all relevant aspects of the Services Directive and of the Professional Qualifications Directive. In particular improve PSC access for EU/EEE service providers by more clearly differentiating information on requirements applicable to established providers and to cross-border ones **[Jan 2012]** and 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. making the (PSC) more user-friendly and responsive to SMEs needs, extending on-line procedures to all sectors covered by the Services Directive and to Professional Qualifications Directive as well as adapt the content and information available at the PSC to the new legislation to be adopted **[Q1-2012]**;

iii. making available in PSC procedures on-line of establishments registration covered by "Zero authorization" (DL 48/2011, April 1st, Art 14º) by February 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 **[Q2-2012]**. The platform will be available to all levels of administration, including all municipalities **[Q3-2012]**;

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

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

6. Housing market

Objectives

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

Rental market

6.1. The Government will present draft legislation to amend the New Urban Lease Act Law 6/2006 by **end-November 2011**. The draft legislation will ensure balanced rights and obligations of landlords and tenants, considering the socially vulnerable, and review all aspects referred to in the urban rental reform guidelines adopted by the Council of Ministers in September 2011. The draft legislation will be submitted to Parliament for adoption by **Q4-2011**. In particular, the specific measures will introduce measures to: i) broaden the conditions under which renegotiation of open-ended residential leases can take place, including to limit the possibility of transmitting the contract to first degree relatives; ii) introduce a framework to improve households' access to housing by phasing out rent control mechanisms, considering the socially vulnerable; iii) reduce the prior notice for termination of leases for landlords; iv) 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.

Administrative procedures for renovation

6.2. The draft legislation to simplify administrative procedures for renovation presented in September 2011 is expected to be adopted by Parliament by **Q4-2011**. In particular, the specific measures will: i) simplify administrative procedures for renovation works, safety requirements, authorisation to use and formalities for innovations that benefit and enhance the building's quality and value (such as energy savings measures). The majority of apartment owners will be defined as representing the majority of the total value of the building; 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

6.3. The Government will adopt the necessary changes to the legislation to review the framework for the valuation of the housing stock and land for tax purposes in line with the report presented on 30 September 2011. 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). These measures could include enabling municipal officers, in addition to tax officers, to evaluate the taxable value of property and the use of statistical methods to monitor and update valuations. **[Q4-2011]**

6.4. The Government will modify property taxation with a view to level incentives for renting versus acquiring housing. **[Q4-2011]** In particular, the Government will: i) limit income tax deductibility of rents and mortgage interest payments as of **1 January 2012**, except for low income households. Principal payments will not be deductible as of **1 January 2012**; ii) rebalance gradually property taxation towards the recurrent real estate tax (IMI) and away from the transfer tax (IMT), while considering the socially vulnerable.

Temporary exemptions of IMI for owner-occupied dwellings will be considerably reduced and the opportunity cost of vacant or non-rented property will be significantly increased.

Comprehensive Review

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

7. Framework conditions

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, to establish an inter-agency task force by end-November 2011 to set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, with the first report to be completed by **15 February 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. Adopt a regulation by end-December 2011 to ensure the oversight body's full access to the enforcement case files. 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 **15 March 2012**.

Management of courts

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

7.4. To improve efficiency of the court system, develop a roadmap by **[January 2012]** on judicial reform map identifying key quarterly milestones to reduce the number of court districts and close down underutilised courts. Prepare a revised roadmap by [**June 2012]** on judicial reform taking into account consultations with stakeholders and cross country experience. Submit a Bill to implement the judicial reform roadmap to Parliament by end-September 2012.

7.5. Conduct an assessment of court management with a view to speeding up court proceedings and improving cost efficiency. **[January 2012]**

7.6. Develop a new personnel management plan to support judicial specialisation and mobility of court officials. **[January 2012]**

Alternative dispute resolution for out-of-court settlement

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

7.7. Adopt measures to give priority to the ADR enforcement cases in the courts by **end-2011**. The Government is committed to take all necessary legal, administrative, and other steps to make arbitration fully operational by **February 2012**.[16]

7.8. Submit the Bill to improve the Justices for Peace regime to Parliament by **March 2012**.

Civil law cases in the courts

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

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

7.10. Assess the need for separate Chambers within the Commercial Courts with specialised judges to enhance efficient and effective expedition of insolvency cases. **[January 2012]**

7.11. Prepare a proposal in a consultative manner, based on a review the Code of Civil Procedure, **by end-2011,** analysing the experience with the new experimental civil procedure regime, and building on such experience, identifying the key areas for refinement, 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

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

small claims[17]. Prepare by **June 2012** draft amendments, and submit them to the Parliament by **September 2012**.

7.12. Adopt measures for an orderly and efficient resolution of outstanding tax cases and, in particular, assess the scope for measures to expedite the resolution of tax cases such as: i) creating a special procedure for high value cases **[Q2-2011]**; ii) establishing criteria for prioritizing; iii) extending statutory interests for the entire the court proceeding and iv) imposing a special statutory interest payment on late compliance with a tax court decision. **[Q4-2011]**

Budget and allocation of resources

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

7.13. Prepare a report on the allocation of resources based on court by court quantitative data. **[January 2012]**.

7.14. 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. Provide **quarterly** reports on recovery rates, duration and costs of tax cases starting from the third quarter of 2011 within two months after the end of the relevant quarter.

Competition, public procurement and business environment

Objectives

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

Competition and sectoral regulators

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

7.16. 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

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

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 privatization operation and thus used in such a proportionate manner that privatization's implementing laws will not set or allow holding or acquisition caps beyond the privatization transaction**. [Ongoing].**

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

i. following the already adopted legislation establishing specialised court for Competition, Regulation and Supervision, make it operational in the context of the reforms of the judicial system (see measure 7.9) **[Q1-2012]**;

ii. propose a revision of the competition law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonised with the European Union competition legal framework, in particular:[18] **[January 2012]**

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

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

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

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

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 call for tender for the report will be launched by **end-November 2011** and the report will be completed by **April 2012**;

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

Public procurement

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

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

7.20. Eliminate all special, permanent or temporary exemptions, permitting the direct award of public contracts below the Public Procurement Directives thresholds to ensure full compliance with the principles of the TFEU by the end of **Q4-2011**.

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

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

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

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

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

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

Business environment

7.27. Adopt the "Simplex Exports" programme, including establishing in tax legislation measures to accelerate the procedures for requesting VAT exemption for exporting firms and to simplify procedures associated with indirect exports. **[Q4-2011]** The above mentioned procedures will be fully operational by **[Q3-2012]**.

7.28. Reinforce measures to facilitate access to finance and export markets for companies, in particular for SMEs. This will include a review of the overall consistency and effectiveness of existing measures. This review, as well as the assessment of existing financing and non-financing support measures (therefore partially responding also to measure 2.20) will be the object of a report by **[Q4-2011]**.

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

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