

## International Monetary Fund

[Portugal](#) and the IMF

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

**Press Release:**

[IMF Completes Sixth Review Under an EFF Arrangement with Portugal, Approves €838.8 Million Disbursement](#)

January 16, 2013

December 19, 2012

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

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## PORTUGAL: LETTER OF INTENT

Lisbon, December 19, 2012

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

Dear Ms. Lagarde:

1. The attached Memorandum of Economic and Financial Policies (MEFP) describes the progress made in recent months towards the objectives laid out in our program supported by the Extended Arrangement. It also updates previous MEFPs and highlights the policy steps to be taken in the next months.
2. The end-September deficit and debt performance criteria were met and the two end-November structural benchmarks on the submission to Parliament of the new Code of Civil Procedure and the reform of the court organization were also met.
3. We remain strongly committed to the program's policies and objectives and expect the agreed 5 percent deficit target for 2012 to be achieved. The 2013 budget was approved by the Parliament, including a range of tax and spending measures that should ensure the general government deficit of 4½ percent of GDP will be achieved next year. To advance with the additional fiscal adjustment that is required in coming years, we have initiated a comprehensive public expenditure review exercise to be completed early in 2013.
4. Consistent with our commitment to implement a multi-year strategic plan to strengthen fiscal discipline, we are intensifying our efforts to prevent the increase in the stock of existing domestic arrears. We are reforming the SOE sector, which has been brought to overall operational balance, as per our commitment, after many years of chronic deficits. We will continue this restructuring effort, and to actively manage their high legacy debt burden. Moreover, the privatization is proceeding as scheduled and we are advancing our strategy to put the PPPs on a sustainable financial path.
5. Our policy efforts to preserve financial stability will continue, as banks are on track to meet the 2012 capital requirements, following the recent capital exercise. Banco de Portugal (BdP) continues on its supervisory effort to ensure adequate recognition of impairment levels, as evidenced by the successful completion of the latest on-site inspection. In addition, the recapitalization and resolution framework will be further strengthened. The Portuguese authorities are preparing a proposal for the setting-up of a mechanism to securitize high-quality mortgage credit with a supranational guarantee. Moreover, we are exploring a new proposal to rationalize and redirect to the most productive segments of the economy existing government initiatives, including the setting up of a revolving mechanism to leverage EU structural funds. Finally, we will also

continue consultation with the European Commission on the rate of remuneration of financial instruments used for recapitalization purposes. In pursuing this route, we are motivated by concerns on local funding and lending conditions.

6. We have made important advances in many dimensions of our ambitious structural reform agenda, and will continue to press ahead with measures to improve the business environment and help spur investment. Measures to actively promote employment and improve education are being expanded. With the completion of the reduction of severance payments, to be soon submitted to Parliament, we will have reduced the rigidity of labor contracts substantially. A landmark revision of the Ports Work Law in discussion in the Parliament will increase efficiency and help reduce costs for exporters. Going forward, we will continue to pursue a streamlined and more effective licensing and regulatory framework along with a reform in corporate taxation, as part of our strategy to attract more investment and boost competitiveness.

7. On the basis of the strength of the policies defined in this letter, and in light of our performance under the program, we request the completion of the sixth review under the Extended Arrangement, the seventh purchase under the arrangement in the amount of SDR 724 million, as well as a waiver of applicability for the end-December deficit and debt performance criteria.

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 should they 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/

\_\_\_\_\_  
Vítor Gaspar  
Minister of State and Finance

/s/

\_\_\_\_\_  
Carlos da Silva Costa  
Governor of the Banco de Portugal

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

# ATTACHMENT I. PORTUGAL: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

December 19, 2012

1. **Activity.** The outlook for growth and inflation remains broadly in line with the program framework. In the third quarter of 2012, real GDP contracted by 0.8 percent (over the previous quarter), somewhat smaller than the 1 percent assumed under the baseline. The main drag on growth remains the ongoing private sector deleveraging, ongoing fiscal adjustment, and, in more recent months, the marked slowdown in activity in the euro area. Looking ahead, we expect output to trough in the first half of 2013 followed by a gradual recovery in activity from the third quarter, limiting the contraction in output on average to 1 percent in 2013. The decline in investment is expected to slow down, as the strong export growth of recent quarters is expected to foster some increase in capacity utilization. The current account deficit is projected to continue narrowing from 6.5 percent of GDP last year to under 3 percent in 2012 and under 1 percent in 2013. The employment outlook unfortunately looks set to remain difficult, with projected average unemployment rates of 15½ percent this year and 16½ percent in 2013. Moreover, downside risks to both the output and employment outlook are significant, and avoiding still weaker outcomes will depend greatly on developments in the euro area.

## FISCAL POLICY

2. **Budget 2012.** Revenue performance has been somewhat weaker than envisaged in recent months. This is explained by macroeconomic developments (continued rebalancing of activity from domestic demand to net exports) and some temporary factors such as an unanticipated increase in tax reimbursements). Tight spending execution is being maintained, ensuring the end-September government cash deficit was met. While there are downside risks, the general government deficit objective of 5 percent of GDP for 2012 should be achieved reflecting our plans to sustain firm spending discipline. This is after the inclusion of revenue from the one-off sale of the ANA concession, which is expected to generate 0.7 percent of GDP. Overall, in 2012, the structural primary deficit is estimated to have improved by some 2½ percentage points of GDP.

3. **Budget 2013.** The 2013 budget was approved by Parliament on November 28. It includes a range of tax and spending measures: increases in personal income tax (PIT) rates and introduction of the streamlined PIT structure; increases in property and excise tax collection; changes to the corporate income tax to reduce debt bias; the streamlining of public services, and improved targeting of social transfers (see MEFP for the fifth review for a fuller description). Reflecting the discussions in the Parliament, we have been able to improve the composition of the adjustment, allowing us to reduce the surcharge on personal income tax by from 4 to 3½ percent, offset mainly by spending cuts. Overall, the measures adopted in the budget should ensure that the general government deficit to 4½ percent of GDP next year is achieved. As customary, we stand ready to take additional measures, if need be, to ensure this deficit objective is met.

4. **Expenditure Review.** To underpin the additional fiscal adjustment that is required in coming years, we have initiated a comprehensive public expenditure review exercise—to be discussed at the seventh review—with contributions from a broad range of stakeholders in the Portuguese society. Once the initial assessment is completed, we intend to initiate a consultation with social and political partners to ensure that this review has the broad-based support to reform the role and functions of the Portuguese state. The objective will be to refocus the role of the State in Portugal in order to ensure the sustainability, the effectiveness, and the equity of its social functions. This will allow generating spending savings of about €4 billion in 2013 and 2014. To this end, this exercise will aim at ensuring better value-for-money from the public sector. Furthermore, a crucial consideration will be to reallocate resources toward growth-friendly spending areas.

5. **CIT.** In parallel with the expenditure review we are launching a comprehensive reform of our corporate income taxation, so as to make Portugal a more attractive investment destination and boost competitiveness. We will analyze the competitiveness of the Portuguese corporate income tax system in comparison to peers—including its rates, tax expenditures, depreciation, loss-carryover rules, holding regimes, and group taxation rules. In addition, we will reform our tax policy in order to promote the internationalization of Portuguese groups and attract FDI, as well as the effectiveness of existing tax incentives schemes, particularly in tradable and high value-added sectors. The results of this analysis, which will be discussed during the 7<sup>th</sup> review, will help us devise strategic reform objectives for the CIT system. The 2013 budget foresees the possibility of broadening the scope of existing tax benefits aimed at boosting investment. We will ensure that any new initiative implemented under the budget provisions be fully consistent with our strategic reform objectives as well as EU State Aid rules, while assuring that this reform will be budget neutral.

## CONTAINING FISCAL RISKS

6. **Public Financial Management.** We are committed to implement our 2013-2015 PFM Strategic Plan in order to strengthen fiscal accountability and transparency, reduce budgetary fragmentation, and build institutional capacity. To this end, we will proceed to transpose the new EU economic and fiscal governance framework by year-end and conduct a review of the Budgetary Framework Law in 2013, streamlining budget procedures. We will intensify our efforts to prevent the underlying increase in the stock of domestic arrears of the health sector, which still reflects commitments in excess of funding. We will work closely with the Autonomous Region of Madeira to ensure that the region's commitment control system is in full compliance with the new commitment control law. We are on track to submit the Regional and Local Finance Laws to Parliament by year-end (structural benchmark).

7. **Revenue Administration.** We will continue to strengthen our tax compliance strategy and to modernize the revenue administration. In particular, our VAT invoicing reform will enter into force on January 1st, 2013. We will also phase-in a new tax compliance management approach over a three-year period, with the implementation of two pilot projects on key risk sectors—the High Net Wealth Individuals and the Self-employed Professionals—by July 2013. The new approach will be guided by a comprehensive tax compliance report, including a risk analysis by economic sector and

taxpayer size, to be discussed in the 7<sup>th</sup> review. We are on track to fully implement the Large Taxpayer Office by year-end (structural benchmark). The streamlining of the revenue administration's local offices will be completed by June 2014, aiming at closing down half of the existing branches. We are accelerating efforts to successfully conclude the property revaluation process and we expect to reach about 4 million properties by year-end. This far-reaching project will be finalized by March 2013. Finally, the tax administration has systematically improved its performance in tax courts' decisions.

8. **Public Administration.** Our public administration reform is advancing and we will continue to press ahead with the objective to shape a more efficient State. The PREMAC program, which reduced around 27 percent of management positions and 40 percent of administrative units across the central administration, was successfully concluded. The reduction in the number of public employees is projected at 3.5 percent in 2012, well above the 2 percent program target. Looking ahead, we remain committed to continue streamlining excess employment in a targeted way. We will also improve training and qualification of public employees and reinforce human resources management policies across all administrations. In this context, labor and social protection regimes will converge to private sector rules, increasing productivity and improving the quality of public services.

9. **State-Owned Enterprises.** We continue to make progress in restructuring the SOE sector. We have achieved our objective of restoring operational balance to the sector as a whole before the end of 2012. Completion of cost cutting programs at firms still in deficit, consolidation of functions at merged firms, voluntary redundancies and efforts to raise non-core revenues will ensure this significant turnaround is sustained and deepened in 2013. We will continue to actively manage the high legacy debt burdens of these companies. Some small SOEs with non-essential functions are being wound down, and we are developing a strategy to sell or rent non-vital real estate assets.

10. **Privatization.** The privatization program remains on-track. We will accept final bids for the airport concession company ANA and the airline TAP soon, successfully meeting our development and financial objectives, with financial completion expected early in 2013. With the completion of this sale, 80 percent of the program objective to raise €5 billion will have been met. We will launch the privatization process for the postal company CTT in the second quarter of 2013, with a view to completing the process by the end of the year. The sale of the rail cargo firm CP Carga will be launched early in 2013, to be completed in the second or third quarter. A strategic plan for the water sector, which envisages the sale or concession of the waste management business, is being prepared.

11. **Public-Private Partnerships.** We are advancing our strategy to put the PPPs financial model on a sustainable path. The first stage of the road PPPs strategy has been concluded and is expected to lead to savings in excess of €1 billion, in NPV terms, starting in 2014. This will be reached by reducing maintenance costs of the sub-concessions contracts. However, a sustainable solution to the Portuguese road model will only be achieved after the completion of the ongoing second phase, which includes a gradual change in the risk matrix of some PPP projects, resulting in a significant

reduction in the availability payments by the State starting in March 2013. The newly-created PPP Unit will technically support and monitor all phases of the renegotiation process.

## SAFEGUARDING FINANCIAL STABILITY

12. **Credit and Funding Conditions.** Reflecting both demand and supply factors, aggregate credit continues to decline. But within this overall picture, there are large differences between domestic and foreign sources of financing and among firms. Credit to large firms has continued to expand, supported by successful bond issuances in both the domestic and international markets, whereas loans by domestic banks to SMEs exposed to the non-tradable sector continued to contract significantly. Demand for credit by firms remains conditioned by the need to reduce the large debt burdens they face. The supply of credit is being affected *inter alia* by the banking system's need to move to a sustainable business model. In particular, very low rates on the legacy mortgage portfolios are proving a drag on banks' profitability, pushing up lending rates on new loans to companies, including in the more dynamic export sector. The combination of measures being taken by us and at the euro area level, including non-standard measures by the ECB to restore the proper transmission of monetary policy, have started to stabilize conditions. Tentative signs of progress include the recent issuance of a bond abroad by two commercial banks—the first such issuance since mid- 2010.

13. **Liquidity.** Exceptional Eurosystem liquidity support is playing a pivotal role in limiting liquidity pressures and mitigating the lingering risk of excessive credit contraction. Moreover, the eligibility of additional collateral has allowed Portuguese banks to reinforce buffers and is playing a critical role in supporting their resilience against potential adverse shocks. In parallel, to facilitate the functioning of the domestic interbank market, the BdP has launched a platform for interbank unsecured lending and is developing a new one for secured transactions, which is expected to be launched by in early 2013. Banks are expected to gradually reduce their dependence on the Eurosystem liquidity over the medium term, as the deleveraging process smoothly runs its course and collateral buffers are successfully strengthened on a sustainable basis.

14. **Orderly Corporate Deleveraging.** As the required corporate sector deleveraging process advances, it is also crucial that the most productive and innovative segments of the economy, notably among SMEs, are not subject to undue funding strains and can effectively support the economic recovery. To this end, the Ministry of Finance, together with BdP and other stakeholders, are developing a range of measures that seek to facilitate credit to productive firms, foster the diversification of firms' financing alternatives, and reduce information asymmetry and promote more efficient financing allocation. These could include the aggregation of SMEs' debt instruments to promote access to capital markets; initiatives to help mitigate risks to lenders by upgrading and promoting sharing of information on SMEs; the rationalization and redirection to the most productive segments of the economy of existing government initiatives. We will continue to ensure that these steps do not burden or pose risks to public finances.

15. **Private Sector Restructuring.** Private sector debt restructuring plays an essential role in the recovery of viable but financially vulnerable corporates and households. We continue facilitating a smooth application of the newly adopted or amended legal frameworks for corporate debt restructuring (such as the fast track in court restructuring tool, PER or SIREVE, mediated by IAPMEI). In particular, we continue raising public awareness about the new restructuring tools to promote early access by viable debtors in financial distress, while facilitating solutions to any remaining obstacles to their effective application. We will also evaluate the potential impact of the recently adopted household debt restructuring mechanisms on banks' balance sheets. These efforts are being supported by BdP's initiatives to avoid banks' evergreening and promote prompt restructuring of problem loans.

16. **Bank Supervision.** Efforts to strengthen the resilience of the banking system are continuing. The BdP's new onsite inspections program (OIP), launched last May and focused on assets related to the construction and commercial real estate sectors, has been completed, with the banks being expected to reflect the OIP findings in their 2012 annual accounts. This initiative is part of BdP regular supervisory activities, which are currently focused on assets classes that are more sensitive to existing market conditions. In parallel, the BdP has completed the next round of quarterly stress tests, while banks' implementation of the earlier recommendations on stress testing is progressing. Banks that have completed the capital augmentation exercise—including through successful private issuances—and despite higher impairment levels, are on track to meet the end-2012 capital targets under the program. The BdP continues to closely monitor compliance with the capital requirements, with a view to promptly take appropriate action if needed.

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

18. **Bank Recapitalization and Resolution Frameworks.** We will enhance the legal framework governing banks' access to public capital while continuing to strengthen the early intervention and resolution framework. The decree law on the banks' contributions to the resolution fund is expected to be approved by end-December, and the supervisory notice on resolution plans will be finalized by the same date. We will swiftly transpose the new EU Directive on bank resolution as soon as it enters into force. The government will, in consultation with the ECB, and the EC and the IMF, submit to Parliament by end-January 2013 (structural benchmark) amendments to the law governing banks' access to public capital so as to allow the State, under strict circumstances, to exercise control over an institution and to perform mandatory recapitalizations. Such amendments will be in line with EU State Aid rules and will strike an appropriate balance between preserving the private structure of the banking system and safeguarding the use of public resources.



19. **BPN SPVs.** We are implementing the strategy for managing the distressed assets from Banco Português de Negócios (BPN). We are finalizing the terms of reference for the mandate of the professional third party that will manage the credits currently held by Parvalorem, with the aim to maximize recoveries while minimizing operational costs. The competitive bidding process to select the asset manager will be launched by end-2012, with a view to complete the tender process by mid-2013. We will also ensure timely disposal of the subsidiaries and the assets in the other two state-owned SPVs. CGD's state guaranteed claim will be gradually settled in cash, according to the schedule agreed with the EC, ECB, and IMF staff. Any net recoveries realized on the assets will also be applied towards the settlement of CGD's claim.

## **BOOSTING EMPLOYMENT, COMPETITIVENESS, AND GROWTH**

20. **ALMPs.** We are delivering on commitments to support employment through Active Labor Market Policies and to improve education. The objective is to improve the employability of the young and disadvantaged categories and ease labor market mismatches. Continuous progress is being made in broadening the reach of *Vida Ativa*, our new targeted training initiative, and improving the role of public employment services. On the education front, we are focusing our efforts on the quality of secondary education and vocational training.

21. **Labor Market Institutions.** Significant steps have been taken over the past six months to make the labor market more dynamic and efficient—including the adoption of a new labor code, the reform of unemployment benefits and, more recently, the reform of the wage-setting mechanism. By mid-December 2012, we will submit to parliament a law to lower severance payments further to 12 days per year of service, bringing them in line with relevant comparators in the European Union. The law will be applied to all contracts while protecting acquired rights and maintaining the cap at 12 months of pay. Once this step is complete, the government will have reduced the restrictiveness of employment protection legislation significantly.

22. **Ports and Energy.** A landmark revision of the Ports Work Law, which was submitted to Parliament in September, substantially lowers wage costs and removes constraints to optimizing the use of labor. The Law is to be adopted by yearend. Follow-up measures to ensure the effective transmission of lower unit labor costs to end-users of port services include (i) encouraging price reductions under existing contract, (ii) revising incentives for port operators by adopting a new performance-based model for future concessions, and (iii) encouraging entry of new operators. Finally, responding to exporters' concern, we have reduced fees on port use (*TUP-Carga*) by 10 percent. Another 10-percent cut will be made effective in January. We are pursuing our efforts to cut energy costs, including by reducing excessive rents in the electricity sector.

23. **Business Environment.** Initiatives to tackle excessive licensing procedures, regulations and other administrative burdens—which are impeding the establishment, operation, and expansion of firms—are advancing in line with the sixth update of the Memorandum of Understanding (MoU).

24. **Regulation.** We are preparing a framework law for regulation that draws on the findings and recommendations of the recently completed expert report, benchmarking the responsibilities,

resources, and independence of the main sectoral regulators against international best practices. The framework law, which will guarantee independence, as well as financial, administrative and management autonomy, and benefit from broad consultation with the regulatory bodies concerned, will be submitted to parliament by end-March 2013. While this important law is being prepared, we are amending the statutes of the electricity regulator (ERSE) to give it the appropriate powers, independence, and autonomy ahead of full market liberalization in January 2013.

25. **Judicial.** We have further advanced the reforms to improve the efficiency of the judicial system, including by meeting the two end-November structural benchmarks on the judicial roadmap and the new Code of Civil Procedure. Moreover, despite the challenges in addressing the backlog court cases, an additional 17,000 enforcement cases have been cleared, bringing down the total number by about 113,000 enforcement cases since November 2011. We have adopted a decree law for a set of urgent measures designed to combat the court case backlog. The inter-agency task forces have set quarterly targets for reviewing enforcement cases to be closed by mid-February 2013. To this end, we have further stepped up our efforts by expanding the task forces to small claims court cases in specific courts. Finally, and in order to relieve civil courts from mandatory intervention to determine bad debt status for VAT purposes, a comprehensive reform of the VAT rules applicable to bad debts was approved in Parliament.

**Table1. Portugal: Quantitative Performance Criteria**  
(In billions of euros, unless otherwise specified)

	Performance Criteria (unless indicated otherwise)						Dec-12	Mar-13	Jun-13	Indicative Targets
	Mar-12		Jun-12		Sep-12					Sep-13
	Program	Actual	Program	Actual	Program	Actual				
1. Floor on the consolidated General Government cash balance (cumulative)	-1.9	-0.45	-4.4	-4.1	-5.9	-5.5	-9.0	-1.9	-4.5	6.0
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 1/	0	Not met	0	Not met	0	Not met	0	0	0	0
3. Ceiling on the overall stock of General Government debt	182.0	171.2	175.0	170.9	177.5	174.2	180.0	182.2	185.3	186.8
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government (continuous performance criterion)	0	0	0	0	0	0	0	0	0	0

1/ Domestic arrears for the purpose of the program increased by €65 between end-July and end-September.

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

Measure	Timing	Status
<b>Structural Benchmarks</b>		
<b>A. Strengthen financial stability</b>		
1 Make effective the amendments to the Corporate Insolvency Law to better support rescue of viable firms (after completing all necessary legislative and publication requirements)	Mid-June 2012	Met
2 Prepare a proposal for encouraging the diversification of financing alternatives to the corporate sector.	End-July 2012	Met
3 Submit to Parliament amendments to the law governing banks' access to public capital (MEFP ¶18).	End-January 2013	
<b>B. Enhance competitiveness and address bottlenecks to growth</b>		
4 Submit to Parliament draft legislation defining the criteria for extension of collective agreements (including a majority representation threshold) and the modalities for their implementation.	End-Sept 2012	Met with delay
5 Prepare a proposal to implement identified best international practices in order to reinforce the independence of the main sectoral regulators.	End-Sept 2012	Met
6 Submit to Parliament a new Code of Civil Procedure to streamline and speed up the court procedures.	End-Nov 2012	Met
7 Submit to Parliament the bill to implement the judicial roadmap to improve the court structure.	End-Nov 2012	Met
<b>C. Strengthen fiscal institutions and reduce fiscal risks</b>		
8 Develop a PFM strategy covering the next three years, to be attached to the 2013 budget.	Mid-Sept 2012	Met
9 Revise and submit to Parliament the draft regional and local public finance law.	End-Dec 2012	
10 Implement a full-fledged Large Taxpayer Office (LTO), to cover audit, taxpayer services, and legal functions concerning all large taxpayers, including the adoption of account managers.	End-Dec 2012	

## ATTACHMENT II. PORTUGAL: TECHNICAL MEMORANDUM OF UNDERSTANDING

December 19, 2012

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the tables annexed to the Memorandum of Economic and Financial Policies. It also describes the methods to be used in assessing the Program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the EC, the ECB, and the IMF before modifying measures contained in this letter or adopting new measures that would deviate from the goals of the Program, and provide the EC, the ECB, and the IMF with the necessary information for Program monitoring.
2. For Program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "Program exchange rates" as defined below, with the exception of the items affecting government fiscal balances, which will be measured at spot exchange rate (i.e., the rate for immediate delivery) prevailing on the date of the transaction. The Program exchange rates are those that prevailed on May 5, 2011. In particular, the exchange rates for the purposes of the Program are set €1 = 1.483 U.S. dollar, €1 = 116.8390 Japanese yen, €1.09512 = 1 SDR.
3. For reporting purposes, the MoF and BdP will employ the reporting standards and templates considered to be appropriate given the transmission of data covered by this TMU, unless otherwise stated or agreed with the EC, the ECB and the IMF.

### General Government

4. **Definition.** For the purposes of the Program, the General Government, as defined in the Budget Framework Law, Law No. 91/2001 of August 20, amended by Law 22/2011 of May 20, includes:
  - 4.1. The Central Government. This includes:
    - 4.1.1. The entities covered under the State Budget, which covers the budgets of the Central Administration, including the agencies and services that are not administratively and financially autonomous, agencies and services that are administratively and financially autonomous (*Serviços e Fundos Autónomos* – SFA).
    - 4.1.2. Other entities, including Incorporated State-owned enterprises (ISOE), or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government.

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

## 5. Supporting Material

- 5.1. Data on cash balances of the State Budget will be provided to the EC, the ECB and the IMF by the MoF within three weeks after the end of the month. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published by the MoF.
- 5.2. Data on the cash balances of the other parts of General Government as defined in paragraph 4<sup>2</sup> will be provided to the EC, the ECB and the IMF by the MoF within seven weeks

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

<sup>2</sup> In 2011, data exclude regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government, i.e., entities referred in paragraph 4.2.2.

after the end of the month. Data will include detailed information on revenue and expenditure items. Data will also include detailed information on PPP-related revenues and expenditures for those PPP reclassified within the General Government sector according to ESA 95, and called guarantees.

- 5.3. Data on domestic and external debt redemptions (securities), new domestic and external debt issuance (securities), change in the domestic and foreign currency assets and liabilities of the Central Government at the BdP and other financial institutions will be provided to the EC, the ECB, and the IMF by the BdP within 40 days after the closing of each month.
- 5.4. BdP will provide to the EC, the ECB, and the IMF detailed monthly data on the financing of the General Government, as defined in ESA95, within seven weeks after the closing of each month.
- 5.5. Data on the revenues, operating expenses, capital expenditure, remuneration of personnel, EBITDA, and number of staff will be provided for state-owned enterprises (SOEs) on a quarterly basis, within 7 weeks after the end of each quarter. Aggregate data for the SOEs within the perimeter will be provided, with company-specific information for REFER, Estradas de Portugal, Metro de Lisboa, and Metro de Porto. Furthermore data for Comboios de Portugal and Parública (outside the perimeter) will also be provided.

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

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

6. **Definition.** The consolidated General Government cash balance (CGGCB) is defined as the sum of the cash balances of the entities covered by the State Budget, the ISOE, the Regional and Local Governments, and the Social Security Funds, and other entities and EBFs, as defined in paragraph 4. Privatization receipts will be excluded from cash receipts. In 2012 and beyond, revenues from the reclassification of pension funds into the general government will not be accounted for as cash revenues for the purpose of the calculation of the consolidated general government cash balance. In 2012-13, the cash proceeds from the sale of the ANA airport concession will be accounted for as cash expenditure-reducing transactions. The net acquisition of financial assets for policy purposes, including loans and equity participation will be recorded as cash expenditures, except for transactions related to the banking sector support and restructuring strategy under the Program. Called guarantees (excluding those related to the banking sector support and restructuring strategy), where entities of the General Government make cash payments on behalf of entities that are not part of the General Government, will be recorded as cash expenditures.

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

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

**6.3. Adjustor.** The 2012 and 2013 quarterly floors on the consolidated general government cash balance will be adjusted for the cumulative amount of arrears settled in the context of the arrears clearance strategy: (i) health sector arrears (up to €1.95 billion), and (ii) local government arrears settled through the €1 billion credit facility created in May 2012. The targets will also be adjusted for the clearance of other arrears provided an agreement to this effect was reached with IMF staff.

## Other Provisions

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

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



## 9. Supporting Material

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

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

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

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

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

12. **Adjustor.** The monthly change in the stock of arrears will be adjusted for any stock adjustment related to the arrears clearance strategy: (i) health sector arrears, as well as local government arrears settled through the €1 billion credit facility created in May 2012. This will allow monitoring the underlying flow of new arrears.

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

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

14. **Adjusters.** For 2012, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock at end-December 2011 general government debt of EUR183.33 billion. From 2013 onwards, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) reclassification of entities or operations that affects the stock at end-December of the previous year.

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

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

16. **Definition.** For the purposes of the Program, the definition of debt is the same as in paragraph 12. An external debt payment arrear will be defined as a payment on debt to nonresidents, contracted or guaranteed by the general government, which has not been made

within seven days after falling due (taking into account any applicable contractual grace period). The performance criterion will apply on a continuous basis throughout the Program period.

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

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

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

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

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

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

Lisbon, 20 December 2012

Mr Jean-Claude Juncker  
President  
Eurogroup

Mr Vassos Shiarly  
Minister of Finance  
Cyprus

Mr Olli Rehn  
Vice President  
European Commission

Mr Mario Draghi  
President  
European Central Bank

Dear Sirs,

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

We remain strongly committed to the programme's policies and objectives and expect the agreed 5 percent deficit target for 2012 to be achieved. The 2013 budget was approved by the Parliament, including a range of tax and spending measures that should ensure that the general government deficit of 4½ percent of GDP will be achieved next year. To advance with the additional fiscal adjustment that is required in coming years, we have initiated a comprehensive public expenditure review exercise to be completed early in 2013.

Consistent with our commitment to implement a multi-year strategic plan to strengthen fiscal discipline, we are intensifying our efforts to prevent the increase in the stock of existing domestic arrears. We are reforming the SOE sector, which has been brought to overall operational balance, as per our commitment, after many years of chronic deficits. We will continue this restructuring effort and actively manage their high legacy debt burden. Moreover, the privatisation is proceeding as scheduled and we are advancing our strategy to put the PPPs on a sustainable financial path.

Our policy efforts to preserve financial stability will continue, as banks are on track to meet the 2012 capital requirements, following the recent capital exercise. Banco de Portugal (BdP) continues on its supervisory effort to ensure adequate impairment levels, as evidenced by the successful completion

of the latest on-site inspection. In addition, the recapitalisation and resolution framework will be further strengthened. The Portuguese authorities are preparing a proposal for the setting-up of a mechanism to securitise high-quality mortgage credit with a supranational guarantee. Moreover, we are exploring a new proposal to rationalise and redirect to the most productive segments of the economy existing government initiatives, including the setting up of a revolving mechanism to leverage EU structural funds. Finally, we will also continue consultations with the European Commission on the rate of remuneration of financial instruments used for recapitalisation purposes. In pursuing this route, we are motivated by concerns on local funding and lending conditions.

We have made important advances in many dimensions of our ambitious structural reform agenda, and will continue to press ahead with measures to improve the business environment and help spur investment. Measures to actively promote employment and improve education are being expanded. With the completion of the reduction of severance payments, to be soon submitted to the Parliament, we will have reduced the rigidity of labour contracts substantially. A landmark revision of the Ports Work Law in discussion in the Parliament will increase efficiencies and help reduce costs for exporters. Going forward, we will continue to pursue a streamlined and more effective licensing and regulatory framework along with a reform in corporate taxation, as part of our strategy to attract more investment and boost competitiveness.

On the basis of the strength of the policies defined in this letter, and in light of our performance under the Programme, we request the completion of the sixth review under the Economic Adjustment Programme and the release of the seventh instalment under the Programme in the amount of EUR 1 600 million.

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

This letter is copied to Ms Christine Lagarde.

Sincerely yours,

/s/

\_\_\_\_\_  
Vítor Gaspar  
Minister of State and Finance

/s/

\_\_\_\_\_  
Carlos da Silva Costa  
Governor of the Banco de Portugal

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

## ATTACHEMENT I. MEMORANDUM OF UNDERSTANDING ON SPECIFIC ECONOMIC POLICY CONDITIONALITY

Sixth Update – 20 December 2012

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

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

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

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

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

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

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

## 1. Fiscal policy

### Objectives

Reduce the Government deficit to 5% of GDP in 2012, 4½ % of GDP in 2013 and 2½ % of GDP in 2014 by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups. The fiscal consolidation over the medium-term up to a balanced budgetary position will be maintained, notably by containing expenditure growth. Growth-friendly tax policy will be pursued through, among others, a comprehensive reform of corporate taxation to promote investment and competitiveness.

### **Fiscal policy in 2012**

1.1. The government will achieve a general government deficit of no more than EUR 8.3 billion (5 percent of GDP) in 2012 on ESA95 basis.<sup>2</sup> **[Q4-2012]**

1.2. Throughout the year, the government will rigorously implement the Budget Law for 2012, as amended by the Supplementary Budget. In addition, the government has adopted measures to confine the deficit to 5% of GDP in 2012 by freezing budget appropriations for investment projects not yet initiated, generating savings in intermediate consumption and raising stamp duties on high value properties and withholding tax rates on capital income. 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. **[Q4-2012]**

1.3. The authorities will frontload to 2012 some of the 2013 budget measures affecting social benefits to obtain savings worth at least 0.1% of GDP. These include, inter alia, cuts in reimbursements of funeral expenses, transfers in case of death, and dependency supplements.

### **Fiscal policy in 2013**

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

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

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<sup>2</sup> In 2012, operations related to the banking sector support and restructuring strategy under the programme will not be considered for the assessment of compliance with the programme target for the general government deficit.

1.6. Permanent consolidation measures of slightly above 3% of GDP have been proposed with the 2013 Budget Law to reach the 4 ½ % of GDP deficit target in 2013. The measures listed below will be detailed and carried out with the 2013 Budget Law **[Q4-2012]**, unless otherwise specified:

*Expenditure*

1.7. Reduce the public sector wage bill in gross terms by at least EUR 700 million by, among others:

- i. decreasing the number of government employees by; (i) limiting staff admissions in order to achieve annual decreases at least of 2 percent (full-time equivalent) in 2013-2014 in the permanent staff of central, regional and local governments; (ii) a 50 percent reduction of fixed-term contracts; (iii) optimizing the allocation of resources as specified below under the section on the Public Administration/Human Resources, mainly as regards the special mobility scheme.
- ii. other measures such as reducing over-time payments, enforcing private sector sickness benefit regime in the public sector and reducing compensation during extraordinary leave.

1.8. Savings in the national health service (at least EUR 180 million) by further rationalisation of available resources and pharmaceuticals' policy. Further savings, in particular in hospitals SOEs, are specified below under the section on the health-care system.

1.9. Reduce pension expenditure in a progressive manner by at least EUR 400 million.

1.10. Streamline social benefits expenditure by strengthening control and better targeting social support (at least EUR 450 million).

1.11. Reduce intermediate consumption (at least EUR 375 million) through efficiency gains in the general government administration and the renegotiation of PPP contracts.

1.12. Reduction in transfers, among others to foundations and SOEs (at least EUR 120 million)

1.13. Reduce capital expenditure, particularly in SOEs (at least EUR 250 million)

*Revenue*

1.14. Amend the personal income tax (yielding at least EUR 3 billion) by:

- i. reducing the number of tax brackets and increasing the average tax rate in line with European standards, while preserving progressivity of the tax and delinking social benefits from the tax structure;
- ii. introducing a surcharge of 3.5 % on the part of taxable income above minimum wage, and a solidarity surcharge of 2.5% on the income of the top tax bracket and of 5% on the income exceeding EUR 250 000;
- iii. increasing the tax rate on capital income;
- iv. equalizing the tax rates on capital income between residents and non-residents;
- v. lowering the basic personal deduction;
- vi. reducing deductibility of mortgage interest payments;



- vii. curbing some fiscal benefits.
- 1.15. Increase corporate tax revenues by at least EUR 200 million by:
- i. limiting the deductibility of interest costs;
  - ii. curbing tax benefits;
  - iii. reducing the threshold for application of the highest tax rate on profits;
  - iv. amending the method for special prepayment applicable to companies under the regime for taxation of groups of companies.
- 1.16. Increase other indirect taxes (by at least EUR 685 million), such as:
- i. excises by raising taxes on tobacco, alcohol and natural gas;
  - ii. property taxes by broadening the property taxation base after revaluation, and stamp tax surcharges for high-value properties;
  - iii. financial transaction tax.
- 1.17. Maintain the standstill rule for tax expenditures at central, regional or local level, except for the possibility of introducing additional tax benefits aimed at boosting investment.
- 1.18. Increase social contributions (at least EUR 270 million), by including supplementary payments to public employees and unemployment benefits in the social contributions' calculations.
- 1.19. Strengthen efforts to fight tax evasion, fraud and informality for various types of taxes inter alia by increasing means available for audits, increasing penalties for the most serious tax crimes and introducing a new VAT invoicing system.
- 1.20. With a view to addressing risks of budgetary execution in 2013 the authorities will prepare contingency measures worth at least ½ percent of GDP. Most of these will come from a frontloading of the measures of the comprehensive expenditure review and will be further specified at the seventh review. A significant share of these measures will consist in additional reductions in the wage bill and increased efficiency in the functioning of public administration, namely as regards working time organisation. Moreover, budgetary appropriations will be adjusted in case budgetary execution risks materialise.

#### **Fiscal policy in 2014**

- 1.21. The government will achieve a general government deficit of no more than EUR 4.3 billion (2½ percent of GDP) in 2014. **[Q4-2014]**.
- 1.22. A comprehensive expenditure review has been initiated with the objective to enhance the efficiency and equity of public policy, while generating spending savings of about EUR 4 billion in 2014. In the framework of this review, the identification, quantification and timetable of implementation of measures will be fully specified by mid-February 2013 in time for the **seventh review**. The exercise will aim at reducing redundancies across the public sector functions and entities, and reallocating resources toward growth-friendly spending areas. **[Q1-2013]** The fiscal consolidation plans for 2014-15 will be fully detailed in the 2013 Stability Programme. **[Q2-2013]**

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

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

Preserve financial sector stability; maintain liquidity and support a balanced and orderly deleveraging in the banking sector; ensure adequate financing and working capital for the productive sectors; strengthen banking regulation and supervision; develop and implement solutions that provide financing alternatives to traditional bank credit for the corporate sector; optimise the process for recovering the assets transferred from BPN to the three state-owned SPVs; streamline state-owned Caixa Geral de Depósitos; complete the bank resolution framework and reinforce the Deposit Guarantee Fund and the Guarantee Fund for Mutual Agricultural Credit Institutions; complete the corporate and household insolvency frameworks and smoothen their implementation.

### *Maintaining liquidity in the banking sector*

2.1. Encourage banks to strengthen their collateral buffers on a sustainable basis and to take full advantage of the broadening of the range of eligible collateral for the purpose of Eurosystem re-financing. The Banco de Portugal (BdP), in close cooperation with the ECB, will continue to monitor closely the liquidity situation of the banking system and stands ready to take the appropriate measures to maintain sufficient system liquidity. **[Ongoing]** A new platform for interbank unsecured lending has been put in place and the BdP is expected to extend it to secured interbank lending by the beginning of next year.

### *Deleveraging in the banking sector*

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

*Capital buffers*

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

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

2.5. Remain committed to provide further support to the banking system, if needed. Resources from the Bank Solvency Support Facility (BSSF) are available in line with state aid rules to further support viable banks, subject to strict conditionality. Avoid subsidizing private shareholders and prevent further migration of private liabilities to the public sector balance sheet. In the event new capital needs were to arise, banks are encouraged to seek private solutions. **[Ongoing]**

*Caixa Geral de Depósitos (CGD)*

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

*Banking regulation and supervision*

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

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

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

*Monitoring of bank solvency*

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

*Banco Português de Negócios*

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

2.12. Outsource the management of the credits currently held by Parvalorem to a professional third party, with a mandate to gradually recover the assets over time. Select the party managing the credits through a competitive bidding process, to be launched by **end-2012**, at the latest, and with

a view to complete it by mid-**2013**. Include proper incentives to maximise the recoveries and minimise operational costs into the mandate. Ensure timely disposal of the subsidiaries and the assets in the other two state-owned SPVs.

*Bank resolution framework*

2.13. The early intervention, resolution and deposit guarantee framework has been strengthened. The authorities are asked to conclude the implementing measures. In particular, the following actions will be taken: (a) the approval of a decree-law on the banks' contributions to the resolution fund by **end-2012** and (b) the approval of a supervisory notice on the resolution plans by the same date, taking into account, to the extent possible in view of the deadline, the EBA recommendations and templates. The implementation of the recovery and resolution plans of the banks will give priority to those of systemic importance.

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

*Bank recapitalisation framework*

2.15. The Government will, in consultation with the ECB, and the EC and the IMF staff, submit to Parliament by **[end-January 2013]**<sup>3</sup> amendments to the legal framework governing access to public capital to allow the State, under strict circumstances and in accordance with state aid rules, to exercise control over an institution and to perform mandatory recapitalisations.

*Corporate and household debt restructuring framework*

2.16. Implement the recently established framework for financial institutions to engage in out-of-court debt restructuring for households, smoothen the application of the framework for restructuring of corporate debt and implement an action plan to raise public awareness of the restructuring tools. **[Ongoing]**

*Monitoring of corporate and household indebtedness*

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

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

2.18. The Ministry of Finance, the BdP, and other stakeholders, have put forward a set of preliminary proposals to encourage the diversification of financing alternatives to the corporate sector<sup>4</sup>.

- i. Develop and evaluate the different options put forward with a view to set priorities **[Ongoing]** and submit a detailed assessment on the proposal concerning the grouped issuance of corporate debt, in particular of SMEs, to obtain capital markets financing **[end-January]**.

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

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

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

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

#### **Objectives**

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

#### **Public Financial Management framework**

##### *Reporting and Monitoring*

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

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

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

##### *Arrears*

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

3.5. IGF will reinforce the verification of local governments' arrears claims and commitment control systems. Disbursements under the "*Programa de Apoio à Economia Local*" (PAEL) will only take place where IGF has certified the full functioning of the commitment control system. Transparency of the use of the credit line will be ensured through the monthly publication of the

amounts lent, disbursed, and used to settle arrears and other liabilities by municipality in the framework of the PAEL. **[Ongoing]**

#### *Budgetary framework*

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

3.7. Review the Budget Framework Law to take account of the reinforced EU fiscal framework and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (fiscal compact). The revised law will also accommodate the developments in the regional and local financing laws. **[Q4-2012]** Conduct a review of the Budget Framework law to enhance budgetary procedures and principles of budgetary management, reinforce accountability, transparency and simplification. **[Q4-2013]**

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

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

3.9. 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]**

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

- i. fully adapt the local and regional budgetary frameworks to the principles and rules in the revised Budgetary Framework Law, namely in what concerns (i) the inclusion of all relevant public entities in the perimeter of local and regional government; (ii) the multi-annual framework with expenditure, budget balance and indebtedness rules, and programme budgeting; and (iii) the interaction with the function of the Fiscal Council. The revision will also foresee that: (i) the Fiscal Council reviews regional governments own revenue projections and multi-annual fiscal plans (ii) a contingency reserve is included under the overall current expenditure envelope as a buffer against negative revenue surprises or erroneous expenditure planning, and (iii) the revised legal and institutional PPP framework is applied (see below);

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

- ii. strengthen fiscal accountability, in particular by: (i) tighter financial requirements for regional and local SOEs and other regional and local public bodies; (ii) a revision of the regime of transfers between the State and the regions and the local authorities; (iii) strengthening the supervisory power from the State on budgetary execution and (iv) apply tighter debt ceilings combined with the adoption of a multi-tiered monitoring system as suggested by the July 2011 technical assistance mission. This reform should follow international best practices;
- iii. limit the scope for lower tax rates in the Autonomous Regions vis-à-vis the rates applied in the mainland and ensure that the resulting additional revenues from increasing the regional rates are used as a priority for fiscal consolidation.
- iv. Strengthen the auditing and enforcement powers of the central tax administration to exercise control over the whole territory of the Republic of Portugal including currently exempt tax regimes.
- v. Include requirements for data provision to support the revenue projections, balancing the need to preserve tax secrecy and the elaboration of sound forecasts.

3.11. Create a working group with representatives from the Ministry of Finance, the Autonomous Regions and the local authorities to prepare a proposal for common revenue forecasting guidelines for subnational governments. **[Q2-2013]**

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

### **Public Private Partnerships**

3.13. Following the strategic plan presented by the government, PPP road contracts will be renegotiated in order to obtain substantial fiscal gains, notably in 2013, while ensuring a sustainable reduction in government liabilities. **[Ongoing]**

3.14. The government will further work towards implementing the PPP framework law and making the new technical unit in the Ministry of Finance fully operational by completing staffing and developing the tools for managing and monitoring all PPPs. No PPP will be launched until the institutional framework measures are fully effective. **[Ongoing]** Regions will be encouraged to design a similar framework for assessing fiscal risks derived from PPP, concessions and other public investments, as well as for monitoring their execution. **[Q4-2012]**

3.15. The annual PPP report will provide a comprehensive assessment of the fiscal risks stemming from PPPs and concessions. The report will provide information and analysis at sectoral level and an analysis of credit flows channelled to PPPs through banks (loans and securities other than shares) by industry and an impact assessment on credit allocation and crowding out effects. This particular element will be done in liaison with the Banco de Portugal. The report will serve as input to the fiscal risks assessment for the budget. **[Q3-2013]**

### **State-owned enterprises**

3.16. SOEs with commercial activity will reach operational balance from **end of 2012 onwards**. This will be achieved by substantially reducing operational costs and raising revenues. To this end the government is implementing the comprehensive SOEs strategy by reviewing the revenue structure and service provision of SOEs, with numerical targets on cost reductions, including measures to realign wages, reduce employment, and additional measures as appropriate. The government is further assessing options for managing the heavy debt load of SOEs, including Parpública. **[Ongoing]**

3.17. The government submitted to Parliament a draft law to strengthen the governance of SOEs in accordance with international best practices. It reviews the existing shareholder approach, giving the Ministry of Finance a decisive role in financial matters of the enterprises, including monitoring of local SOEs. This will enhance the monitoring powers of the central administration over all SOEs. In addition, the timing and content of financial and operational reporting will be defined. The decisions adopted at central level to improve the efficiency of the enterprises while reducing their financial burden will be implemented at all SOEs, taking into account their specificities. It will include the prohibition for SOEs within the general government to incur new debt with the private sector. No additional SOEs will be created until this law is adopted. **[Ongoing]**

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

### **Privatisation**

3.19. The government is implementing its privatisation programme under the new framework law for privatisation. The privatisation plan targets front-loaded proceeds of about EUR 5 billion through the end of the programme. The sale of GALP and the small remaining stake in REN on the free market have been delayed until market conditions improve. The privatisation or concession of the cargo handling subsidiary of CP (CP Carga) will be concluded by the **[Q2-2013]**. The tenders for the privatisation of the national air carrier (TAP) and the airport operator Aeroportos de Portugal (ANA) were launched in the third quarter, with a view to final decisions by end-2012 and the financial completion of these transactions in **early 2013**. The privatisation of Correios de Portugal (CTT) will be launched, once changes underway in regulation of this sector have their full impact, in order to complete the sale in 2013. The sale or concession of a television channel and radio station belonging to RTP and concessions for transport operators in Lisbon and Porto upon completion of restructuring of the public transport firms in these cities are being considered. CGD's health insurance will be sold in 2012 and the process to sell its insurance arm (Caixa Seguros) to a final buyer is ongoing. The privatisation programme will be expanded to include additional companies and assets for sale or concession in 2013.



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

3.21. The government is working together with the municipalities and regional governments in order to identify the scope for further privatisation, by preparing an inventory of their assets, including real estate. **[Q4-2012]**

### **Revenue administration**

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

3.23. The reform of the AT will be deepened in **2013** by targeting a business function-type structure. In particular, the following elements will be implemented:

- i. reduce the number of municipal offices by at least 25 per cent in 2013 **[Q4-2013]** and 25 per cent in 2014 **[Q2-2014]**;
- ii. increase in the resources devoted to auditing in the tax administration to at least 30 per cent of the total staff, mostly through reallocations of staff within the tax administration and other parts of the public administration. The threshold should be attained by **Q4-2012**;
- iii. publish quarterly reports on duration and costs of tax cases starting from **Q4-2013** within four months after the end of the relevant quarter.

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

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

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

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

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

3.28. The authorities will continue to focus on measures to combat fraud and evasion and strengthen taxpayers' compliance. To this end the authorities will:

- (i) prepare a report to analyse the current tax compliance situation, including a risk analysis of different economic sectors and categories of taxpayers by **the seventh review**. Following the results of the report, appropriate steps will be taken if necessary to reinforce tax compliance.
- (ii) continue building capacity in revenue administration by phasing in a more modern approach to managing compliance over a three-years period.

### **Public administration**

#### *Central, regional and local administration*

3.29. The government will monitor and promote streamlining of foundations at the local and regional level. **[Ongoing]**

3.30. Review the regulation on the creation and the functioning of associations and observatories. The revised regulation will also facilitate the closure of existing associations and observatories and define the monitoring and reporting mechanisms to be put in place. **[Q2-2013]**

3.31. Building on the study by the inter-ministerial working group for territorial issues, potential duplications of activities and other inefficiencies between the central administration, local administration and locally-based central administration services will be identified and the existing framework to eliminate the identified inefficiencies reformed. **[Q4-2012]**

#### *Shared services*

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

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

3.33. 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*

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

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

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

3.37. The Special Mobility scheme will be reviewed aiming at being more oriented to support Public Administration Reform, addressing training and requalification for a better allocation of Human Resources. The existing Special Mobility Law need to be revised: (i) to ease/simplify the procedures for the management of the employees that can be targeted with this tool; (ii) to address the compensation that would be set to decline further over time and its duration; and (iii) to be applied to all sectors of Public Administration, including teachers and health professionals. **[Q2-2013]**

### **Health care system**

#### **Objectives**

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

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

#### *Financing*

3.38. The revision of NHS moderating fees (*taxas moderadoras*) and improvements in the billing and collection of payments from insurance companies and fees for the treatment of cross-border/foreign patients will result in additional revenues of EUR 150 million in 2012 and an additional 50 million in 2013. **[Q4-2012]**

3.39. 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 50 per cent of the employers contribution in 2013 through transfer of resources to the NHS in exchange for the provision of services by **Q4-2012**. The employer's contribution rate will be reduced to 1.25% in 2014 and will be accompanied by an adjustment in the scope of health benefits **[Q3-2013]**. The system would become self-financed by 2016.

*Pricing and reimbursement of pharmaceuticals*

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

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

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

*Prescription and monitoring of prescription*

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

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

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

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

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

3.48. The above measures should aim at gradually and substantially increasing the share of generic medicines to at least 30 per cent of all outpatient prescription (in volume) in 2012. In 2013

the target for NHS reimbursed medicines will be 45% of all outpatient prescription (in volume) and will increase to 60% in 2014.

*Centralised purchasing and procurement*

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

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

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

3.52. 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. Continue to implement the compulsory use of a formulary in all hospitals to monitor the stock and flows of hospital medicines and medical supplies and monitor compliance with central purchasing. **[Ongoing]**

3.53. Take further measures to increase competition among private providers and between private and public providers in relevant areas of service provision such as dialysis and the pharmacies sector in view of ensuring competition and fair prices in private markets. **[Q4-2013]**

*Primary care services*

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

- i. increasing the number of USF (*Unidades de Saúde Familiares*) units contracting with regional authorities (ARSs) using a mix of salary and performance-related payments as currently the case. Extend performance assessment to the other primary care units (UCSPs). Make sure that the new system leads to a reduction in costs and more effective provision;
- ii. setting-up a mechanism to guarantee the presence of family doctors in needed areas to induce a more even distribution of family doctors across the country;
- iii. moving human resources from hospital settings to primary care settings and reconsidering the role of nurses and other specialties in the provision of services;

- iv. updating patients' registration lists and the national register in order to increase by at least 20 per cent the maximum number of patients per primary care/family doctor for health centres and by 10 per cent for the USF.

#### *Hospital services*

3.55. Implement the strategy to clear arrears in the health sector, within the overall strategy for settling and avoiding the re-emergence of arrears. Ensure standardised and tight control procedures for all health sector entities to ensure expenditure commitments stay within the budget allocated to each entity and therefore prevent the re-emergence of arrears. **[Q4-2012]**

3.56. Hospital SOEs will change the existing accounting framework and adopt accounting standards and appropriate IT systems in line with the requirements for private companies and other SOEs. This will help improving the management of the enterprises and the quality of the financial oversight by the general government. **[Q4-2013]**

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

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

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

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

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

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

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

*Regional health authorities*

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

*Cross services*

3.65. Continue to develop the system of patient electronic medical records and ensure access to all relevant health care facilities. **[Ongoing]**

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

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

##### **Labour market**

##### **Objectives**

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

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

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

##### *Unemployment benefits*

4.1. Following the reform of the unemployment benefit system (Decree-law 64/2012 and Decree-law 65/2012 of 15 March) - which introduces a declining profile for unemployment benefits, reduces the maximum monthly amount of benefits, reduces the maximum unemployment benefits duration and increases coverage by reducing the contribution period for eligibility and by extending the system to a clearly-defined category of self-employed - the government will prepare by **Q4-**

**2012** an analysis on benefit dependency and long-term unemployment with a view to assessing whether further measures are needed to address possible deficiencies by **Q1-2013**.

*Employment protection legislation*

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

4.3. Severance payments **[Ongoing]**. Following the entry into force of law n. 53/2011 concerning the reform in the severance payments for new hires in line with the MoU and the entry into force of law n. 23/2012, the government will further reduce severance payments. In consultation with social partners, the Government will:

- submit to Parliament by **mid-December** draft legislation aiming at aligning the level of severance payments with the EU average of 12 days, applied to all contracts while protecting accrued-to-date entitlements and maintain the cap of 12 month of pay;
- consider the implementation of a compensation fund for severance payments possibly allowing the severance pay entitlements financed from the fund to be transferable to different employers.

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

*Wage setting and competitiveness*

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

- i. commit that, over the programme period, any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of the programme review **[Ongoing]**;
- ii. ensure wage moderation when deciding on the extension of collective agreements that fulfil the criteria set out in Council of Ministers Resolution 90/2012, by taking into account the implications of the extension on competitiveness of non-affiliated firms **[Ongoing]**;
- iii. prepare an independent review by **Q4-2012** on:
  - how the tripartite concentration on wages can be reinvigorated with a view to defining norms for overall wage developments that take into account the evolution of the competitive position of the economy and a system for monitoring compliance with such norms;
  - the desirability of shortening the survival (*sobrevigência*) of contracts that are expired but not renewed (art 501 of the Labour Code).



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

#### *Active labour market policies*

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

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

#### *Education and training*

4.8. The government will continue action to tackle low education attainment and early school leaving and to improve the quality of secondary education and vocational education and training, with a view to increase 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). The tool should be fully operational by **Q2-2013**;
- ii. in line with the action plan to improve the quality of secondary education the Government will: (i) continue to promote trust agreements with public schools and report about progress [**ongoing**]; (ii) define and implement a simple formula-based funding framework comprising performance evaluation criteria and accountability

for public schools and schools under autonomy agreements [Q4-2012]; (iii) present an assessment of the new inspection model, including the planned follow up to recommendations of previous external evaluations [Q4-2012];

- iii. in line with action plan on vocational and educational training (VET) the Government will report on: (i) involvement of businesses in the provisions of traineeships [ongoing]; (ii) action taken to reorganise modalities for the provision of VET, improve the quality and attractiveness of VET, and to enhance students' orientation and career guidance [Q4-2012]; (iii) the establishment of "professional schools of reference". [Q1-2013]
- iv. present an assessment on the latest developments in the apprenticeship system. [Q1-2013]

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

### **Objectives**

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

### **Energy markets**

#### **Objectives**

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

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

5.1. In order to fully transpose the Third EU Energy Package: a) adopt the law on the penalty system of the regulator and b) ensure the National Regulatory Authority's independence, autonomy and all powers foreseen in the package by adopting by [November-2012] the new regulators' bylaws agreed in July 2012, consulting the EC/ECB/IMF if changes are introduced. Ensure that the new bylaws are effective before end of year in time for the liberalisation of the electricity and gas market [Q4-2012].

5.2. Take measures to accelerate the establishment of a functioning Iberian market for natural gas (MIBGAS), through regulatory convergence and the harmonisation of the tariff structures in

Portugal and Spain. In particular, in accordance with the roadmap of 30 September 2011 agreed with the Spanish authorities, the regulators of each country will:

- i. present proposals to harmonise the tariffs for access to the interconnection networks taking into account the outcome of the public consultation conducted in January 2012 **[Q1-2013]**;
- ii. prepare a report analysing and developing options to improve the harmonised mechanism for capacity allocation and congestion management of cross-border flows with Spain, including the introduction of virtual reverse flows and other mechanisms allowing smaller players to make efficient use of the LNG Sines facility **[Q4-2012]**;
- iii. apply a harmonised allocation and congestion management mechanism to all the interconnection capacity between Portugal and Spain, in line with the EU network codes and guidelines in this respect **[Q1-2013]**.

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

*Ensure sustainability of the national electricity system*

5.4. Conclude the measures approved in the Council of Ministers on 17 May 2012 to reduce excessive rents and to address the sustainability of the national electricity system. Cost reduction measures address the following compensation schemes: power guarantee, special regime (renewables - excluding those granted under tender mechanisms – and cogeneration), CAE's (power purchase agreements) and CMECs, and will reduce policy cost by at least EUR 1275 million in Net Present Value (NPV)<sup>7</sup> **[Q4-2012]**. The updated estimation of cost reductions that will be achieved as well as progress towards elimination of the tariff debt (dívida tarifária) by 2020 will be presented and assessed in the **seventh review**.

5.5. Conclude the announced measures to limit the policy costs embedded in CMECs and PPAs by **Q4 2012**. In particular, as an element in revising the rate of return to bring it in line with the cost of capital at the moment the CMEC compensation was defined plus, if warranted, a risk premium of the assets that the mechanism remunerates: (i) approve the pieces of legislation that reduce the CMEC annuity discount rate from 7.55% to below 5% in terms that do not allow the increase of the new established rate (yielding a NPV of EUR 120 million); and (ii) set a compensation for the extension of exploitation licences of the power plants in Sines and Pego<sup>8</sup> yielding NPVs of EUR 55-75 million and EUR 30-50 million respectively, providing details on the valuation methodology leading to these figures. The updated estimation of cost reductions that will be achieved will be presented and assessed in the **seventh review**.

<sup>7</sup> Computed using a discount rate of 7.55% back to June 2012.

<sup>8</sup> Pego power plant compensation will not be included when determining the reduction of the rate of return of the CMEC.

5.6. Present a report on the CMEC scheme including the foreseen annual compensation amounts to each beneficiary and past payments since 2007 and the forecast of future payments. The report will also describe the process for the extension of the concession of the public hydro resource by the former CAE hydro power plants, its correspondent economic valuation, and the rationale for the direct award instead of a tender process. The report will assess and consider all the information available within the governmental and the official bodies (General Directorates, Regulator, State representative in the contracts). **[Q4-2012]**

5.7. Conclude the announced measures to limit the policy costs of renewables under the special regime - excluding those granted under tender mechanisms by **[Q4-2012]**. In particular (i) following the agreement in principle with wind power producers, approve the legislation to implement the compensation to be paid by the producers (yielding a NPV of EUR 110 million); and (ii) introduce a maximum duration for the feed in tariff in small hydro plants (yielding an NPV of EUR 200 to 250 million). The updated estimation of cost reductions that will be achieved will be presented and assessed in the **seventh review**.

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

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

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

### **Telecommunications and postal services**

#### **Objectives**

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

*Telecommunications*

5.11. Ensure an efficient, objective, transparent and non-discriminatory mechanism for the designation of the universal service provider(s), in compliance with the Court of Justice ruling of 7 October 2010. Re-negotiate the concession contract with the undertaking currently providing the universal service, by reducing the scope of the services covered, so as to exclude the universal service and following the launch of a new tender process in October, proceed with the designation of universal service provider(s). **[Q2-2013]**

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

*Postal services*

5.13. Following the transposition of the Third Postal directive, further liberalise the postal sector by amending the decree-law laying down the framework of the concession contract and renegotiating the amendment of said contract with CTT, in order to reflect the new law (Law 17/2012) transposing the Third Postal Directive; ensuring in particular that the current designation period for the universal service provision is shortened to 2020 and that investment needs and return on investment are taken into account when setting new designation periods. **[Q4-2012]**

**Transport**

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

*Strategic Plan for Transport*

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

- i. continue the reforms in the transport SOEs to achieve their EBITDA balance, by focusing efforts on the reduction of operational costs;
- ii. reduce the forecast debt burden of Estradas de Portugal through the reduction of PPP contracts' scope still in the construction phase, revision of shadow-toll schemes and the adjustment of the CSR (Road Service Contribution) to the inflation level. Analyse additional measures to further reduce the forecast debt burden of Estradas de Portugal;
- iii. 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;
- iv. reform the transport and infrastructures' regulatory framework in order to improve the effectiveness, efficiency and independence of the entities regulating the transport sector. **[Q1-2013]**

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

#### *Railways sector*

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

- i. ensure that the rail regulator enjoys the independence required under the EU rail Directives, in particular regarding the rules of appointment and dismissal of the director of the rail regulator. Strengthen the capacities of the railway regulator to fulfil its regulatory mandate effectively, including by exploring synergies with other transport regulators in the context of the revision of national regulatory agencies. **[Q1-2013]**;
- ii. continue to implement the plans to bring the infrastructure manager to operational balance, in particular by reducing operational costs by at least 23 per cent in 2012 compared to 2010 **[Q4-2012]**. On the revenue side, track access charges for freight services should not be increased in order to prevent a deterioration of the competitiveness of rail freight services. Reintroduce incentives to REFER to reduce costs and access charges. Provide annual progress reports on the implementation of balancing revenues and expenditures **[Q2-2013]**;
- iii. ensure that the new Public Service Obligation (PSO) contracts concluded on rail passenger transport respect EU legislation including Regulation (EC) No 1370/2007, and in particular provide a detailed breakdown of state contributions for each line under PSO. Develop administrative capacity for a stepwise introduction of competitive tendering of PSOs starting with some suburban services. Ensure that the awarding authority has the required level of independence and competence and guarantees fair conditions of tendering **[Q4-2012]**;
- iv. extend the performance scheme on infrastructure charges to other operators **[Q4-2012]**;
- v. review and render more effective the yield management on long-distance passenger ticket prices. **[Q1-2013]**;
- vi. to prepare the privatisation of the freight branch of the state-owned rail operator, carry out an analysis for transferring part or whole of CP Carga's rolling stock to a rolling stock operating company **[Q2-2013]**;
- vii. ensure that the main rail terminals currently owned by CP Carga are transferred to another entity that will guarantee non-discriminatory access to all rail freight operators. **[Q4-2012]**.

#### *Ports*

5.17. Adopt the revised legal framework governing port work as presented to Parliament by **[Q4-2012]**. A review of the overall savings generated and the impact of the introduction of the law on port usage cost will be made by **August 2013**.

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

#### *Road pricing*

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

### **Other services sector**

#### **Objectives**

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

#### *Sector-specific legislation of Services*

5.20. Further to the adoption of a significant number of amendments to the sector specific legislation, complete the adoption of the outstanding sectorial amendments (such as construction, universities and higher education courses) necessary to fully implement the Services Directive and submit them to Parliament where necessary by **[Q4-2012]** in view of approval by **[Q1-2013]**. For those amendments already submitted to the Parliament (such as real estate) approval is expected by **[Q4-2012]**.

#### *Regulated professions*

5.21. Review and reduce the number of regulated professions and in particular eliminate reserves of activities on regulated professions that are no longer justified, through adoption by the Parliament of the law for professions where regulation does not involve a professional body (Ordens or Câmaras) by **[Q4-2012]**. Following the final report by the Comissão de Regulação do Acesso a Profissões (CRAP), launch by **[Q1-2013]** a second phase investigation of the review of regulated professions to eliminate unjustified requirements by **[Q2-2013]**.

5.22. Further improve the functioning of the regulated professions (such as accountants, lawyers, notaries) for which regulation involves a professional body (Ordens or Câmaras) by (i) carrying out a comprehensive review of requirements affecting the exercise of activity with a view to eliminating those not justified or proportional, such as those restrictions to the use of commercial communication (advertising) prohibited by the Services Directive, and (ii) by adopting measures to further improve the recognition of professional qualifications in compliance with the Professional Qualifications Directive To achieve the objectives referred to above the government has, following the public consultation, submitted a draft horizontal legal framework to Parliament in view of approval by **[Q4-2012]**. Upon enactment, the professional bodies will make the necessary changes in their statutes by **[Q1-2013]**.

*Administrative burden*

5.23. Continue the simplification reform effort by:

- i. adapting the content and information available at the Point of Single Contact (PSC) for the 48 amended regimes to ensure conformity with the Services Directive and for those that have not required amendments so far by **[January 2013]** and make available online forms for the completion of procedures by **[Q1-2013]**. Constantly adapting the content and information available at the PSC to the remaining 20 sector-specific regimes that are about to be adopted to ensure conformity with the Services Directive (see 5.20 above) at the latest 1 month after the adoption of each sector-specific regime, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by making available online forms and extend on-line procedures for all sectors covered by the Services Directive no later than 2 months after adoption of the sector-specific regime;
- ii. adapting the content and information available at the PSC for the 15 regimes approved to ensure conformity with the Professional Qualifications Directive by **[January 2013]** and online forms by **[Q1-2013]**. Constantly adapting the content and information available at the PSC to the new legislation to be adopted to ensure conformity with the Professional Qualifications Directive at the latest 1 month after the adoption of amendments, clearly differentiating information on requirements applicable to established providers and to cross-border ones, and by extending on-line forms and procedures for each profession no later than 2 months after adoption of amendments;
- iii. making available in PSC on-line procedures for the registration, installation, modification, occupation of public space regimes, and closing up of restaurants, bars and other establishment for the 5 municipalities (Porto, Águeda, Abrantes, Portalegre and Palmela) covered by "Zero Authorisation" pilot project (DL 48/2011) by **[Q4-2012]**. Foster collaboration from municipalities in providing the content for the working hours map for the stores and establishments services and advertisement regimes for which they have full competence to make the PSC operational **[Q4-2012]**; Identify and classify municipalities where the availability of those procedures through the PSC would have the most significant economic impact by **[November-**



**2012]** to prepare for the extension of this tool to major municipalities by **[January-2013]**. Make fully operational the "Zero Authorisation" project that abolishes authorisations/licensing and substitute them with a declaration to the PSC for the wholesale and retail sector and restaurants and bars by **[Q2-2013]**. The platform will be available to all levels of administration, including all municipalities **[Q2-2013]**;

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

5.24. Provide a monthly update of the detailed work programme of AMA to fulfil 5.23.

## **6. Housing market**

### **Objectives**

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

#### *Property taxation*

6.1. The government will continue to step up the appraisal of the taxable value of the housing stock. In particular, the measures will: (i) ensure that the taxable value of the properties in **2012** is close to the market value and (ii) property valuation is updated regularly (every year for commercial real estate and once every three years for residential real estate as foreseen in the law).

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

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

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

## **7. Framework conditions**

### **Judicial system**

#### **Objectives**

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

*Court backlog*

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

- 7.1. Aim to resolve the backlog of court cases by **Q2-2013**.
- 7.2. Implement targeted measures to achieve steady reduction of the backlogged enforcement cases. In particular, set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status, by inter-agency task forces with the fifth report to be completed by mid-**February 2013**.
- 7.3. Present a revised draft bill for enforcement agent's framework (i) strengthening the authority and financing structure of the oversight body and enhancing the accountability of enforcement agents, and (ii) to include a fee structure that incentivises speedy enforcement which will be approved by the government by **end-February 2013**.
- 7.4. Publish quarterly reports on recovery rates, duration and costs of corporate insolvency cases starting from **[Q3-2011]**, within four months after the end of the relevant quarter.

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

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

*Competition and sectoral regulators*

- 7.5. The Government shall take the necessary measures to ensure that the Portuguese State or any public bodies do not conclude, in a shareholder capacity, shareholder agreements the intention or effect of which hinder the free movement of capital or which influence the management or control of companies **[Ongoing]**. The Portuguese State will ensure that CGD alienates its participation in Galp. **[Q4-2012]**
- 7.6. Going beyond elimination of special rights of the State, the authorities also commit to ensure that obstacles to free movement of capital will not be created by their action. The authorities acknowledge that the discretion granted under the amended article 13(2) of the Framework Law of Privatisations (Law 11/90 amended by Decree 3/XII of the Parliament of 5 August 2011), if used, shall be restricted solely to the concrete privatisation operation and thus used in such a proportionate manner that privatisation's implementing laws will not set or allow holding or acquisition caps beyond the privatisation transaction. **[Ongoing]**
- 7.7. Monitor the inflow of cases and report on the functioning of the specialised court for Competition, Regulation and Supervision, assessing the situation in terms of risk of potential court backlogs. **[Q4-2012]**

7.8. Take the necessary actions to ensure the effective functioning of the Competition Authority financing model [Q4-2012]. Following the efforts made in order to guarantee the enlarged scope of action of the Competition Authority, report on the conditions for the proper execution of its mandate [Q4-2012].

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

#### *Public procurement*

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

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

#### *Business environment*

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

7.12. Following the plans presented at the sixth review, adopt measures to facilitate access to finance and to export markets for SMEs. A limited number of instruments should be sought, focusing primarily on SMEs, especially those in the most productive and innovative segments of the economy, while ensuring these initiatives will not pose significant fiscal risks. Progress will be reported by [Q4-2012].

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

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

### **Licensing environment**

#### **Objectives**

The government is launching a new comprehensive programme to tackle excessive licensing procedures, regulations and other administrative burdens in the economy. These explicit and implicit barriers represent a major obstacle for economic growth in Portugal. Companies face substantial costs and uncertainty which affect investment decisions, thus limiting job creation. Furthermore,

these barriers affect small and medium-sized enterprises in a disproportionate way because they have fewer resources to surpass these obstacles, deteriorating the competitive environment. Foreign investment is also affected disproportionately because national companies have information advantages. The various new initiatives laid out below cover all families of licenses and will have a substantial impact in the business environment. The reviews of the legal regimes of environment and territory planning and of industrial and commercial licencing aim at ensuring their mutual compatibility.

#### *Regulatory simplification*

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

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

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

#### *Environment and territory planning*

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

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

- vi. review the Legal Regime for Urbanism and Building (RJUE) , that should be aligned with, the new Industrial Licensing regime (measure 7.24 ii) **[Q1-2013]**.

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

- i. implement a Legal Regime of Land Registration (registo cadastral) **[Q4 2013]**;
- ii. create a diploma on Land Registration and Land Registration Experts **[Q4-2013]**;
- iii. review the cartography for plans regime **[Q4-2013]**, and the diploma on Cartography **[Q4-2013]**;
- iv. enforce the Council of Ministers Resolution 56/2012 by **Q4-2013**, to collect all land registration procedures, currently scattered in various departments.

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

#### *Industrial Licensing*

7.21. Implement the new Industrial Licensing regime by means of:

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

*Commercial licensing*

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

*Geology*

7.23. Reviewing the geological licensing regimes, including:

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

*Tourism*

7.24. Review the Licensing in Tourism regime:

- i. eliminate or transforming into a voluntary regime the mechanism of prior communication in the Regime for Urbanism and Building **[Q1-2013]**. Simplify the legal regime for touristic establishments **[Q4-2012]**;
- ii. expand the range of ex post control mechanisms in urban operations, significantly reducing administrative procedures and costs for developers **[Q4-2012]**;
- iii. simplified and transparent requirements on the classification of the several types of touristic establishments (number of stars) **[Q4-2012]**;
- iv. review of the sanction legislation on the touristic establishments regime as a way to fight informal touristic economy, giving more powers to ASAE (Authority for Economic and Food Safety). **[Q4-2012]**