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May 20, 2011

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

May 17, 2011

[Country's Policy](#)

[Intentions Documents](#)

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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.

I. LETTER OF INTENT

Lisbon, May 17, 2011

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

1. Against the background of the structural challenges facing the Portuguese economy and contagion from the sovereign debt crisis in other euro area countries, financial conditions facing the Portuguese sovereign and banks have sharply worsened. To restore market confidence and to raise the potential of our economy to generate socially balanced growth and employment we are proposing a far-reaching reform programme, backed by substantial international financing to meet balance of payments needs.
2. Following up on already announced measures, we believe further comprehensive action is required on three fronts: (i) deep structural reforms to boost potential growth, create jobs, and improve competitiveness (including through a fiscal devaluation); (ii) a credible and balanced fiscal consolidation strategy, supported by structural fiscal measures and better fiscal control over PPPs and SOEs; and (iii) efforts to safeguard the financial sector against disorderly deleveraging through market-based mechanisms supported by back-up facilities. As our reform programme is implemented, priority will be given to protecting the most vulnerable groups.
3. To signal our strong commitment to implementing the ambitious reform programme, we request financing assistance from international partners. We estimate that the support needed for our external financing will be around €78 billion over the next three years. We therefore request that the Fund support our policy programme through an arrangement under the Extended Fund Facility in the amount of SDR 23,742 million (€26 billion) which could be drawn over a period of 36 months to cover the balance of payments needs. This arrangement, along with support of €52 billion from the European Financial Stability Mechanism and the European Financial Stability Facility will underpin confidence, support market access, and help ensure orderly adjustment and the restoration of sustainable growth. We will draw on these resources in parallel throughout the programme period, drawing on the EU/euro-area and IMF financing in a ratio of 2 to 1 following programme approval and after each review period (measured at the program exchange rate).
4. We are confident that the policies described in the attached Memorandum of Economic and Financial Policies (MEFP) are sufficient to achieve the objectives under the programme. Progress in the implementation of the policies under this programme will be monitored through

quarterly (and continuous) quantitative performance criteria (PCs) and indicative targets, prior actions, structural benchmarks, quarterly programme reviews, and consultation clauses. These are detailed in Tables 1 and 2. The attached Technical Memorandum of Understanding (TMU) contains definitions.

5. We stand ready to take additional measures that may be needed to meet the objectives of the economic programme and will maintain a close policy dialogue with the Fund, including to consult in advance of any necessary revisions to these policies. We are confident that resolute implementation of our economic programme will help our economy recover and bolster market sentiment. If fiscal consolidation proceeds faster than expected or if market conditions improve significantly during the programme period, we would refrain *pari passu* from drawing on the full EU/euro-area and IMF support.

6. This letter is copied to Messrs. Juncker, Matolcsy, Rehn, and Trichet.

Sincerely yours,

/s/

Fernando Teixeira dos Santos
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

May 17, 2011

A. Introduction and Macroeconomic Outlook

1. **The Portuguese economy faces considerable challenges.** Competitiveness indicators have suffered, economic growth has been anemic, and the current account deficit is at 10 percent of GDP. The global crisis exposed Portugal's weak fiscal and financial position with public debt at around 90 percent of GDP at end-2010 and private sector debt about 260 percent of GDP. Banks that financed this build-up in debt now have the highest loan-to-deposit ratio in Europe.
2. **To address these challenges we have embarked on a balanced and focused reform to correct external and internal imbalances and boost potential growth and employment.** Our strategy envisions bold and upfront structural reforms to improve competitiveness, an ambitious but credible pace of fiscal adjustment, and measures to ensure a stable and dynamic financial system. Large support from the international community will help reduce the social costs of adjustment. It will also allow us sufficient breathing space to establish a strong record of policy implementation before going back to markets.
3. **Growth is expected to recover only gradually over the next three years.** Output is expected to contract around 2 percent in 2011 and 2012 on account of needed fiscal consolidation, general confidence effects that led to the request for international financial support, and adjustments in the banking system. In addition, general market concerns for Euro area periphery countries are also likely to weigh on sentiment in the near term. Nevertheless, as markets regain confidence in the economy and structural reforms begin to deliver, activity is expected to start recovering in 2013 onwards.

B. Reducing Public Debt and Deficit

4. **Our fiscal targets are ambitious but realistic.** We will target a deficit of 5.9 percent of GDP in 2011, 4.5 percent of GDP in 2012 and—consistent with the Excessive Deficit Procedure deadline agreed with the EU—3 percent of GDP in 2013. This will stabilize public sector debt by 2013. This deficit path reflects an appropriate trade-off between the need to take decisive and frontloaded actions to restore market confidence while ensuring that the pace of adjustment does not take an excessive toll on growth and employment.
5. **Our program is fully specified and carefully balanced between expenditure and revenue measures.** The 2011 budget already entails a significant effort, with discretionary fiscal measures amounting to some 5.4 percent of GDP. The deficit target for 2011 takes into account that the recession is now expected to be deeper and that some SOEs have been reclassified and included in the general government. To reach our target for 2011, we will

compress some spending (0.3 percent of GDP) relative to the 2011 budget, particularly in subsidies to SOEs and health spending. Additionally, to reach the targets for 2012–13, we need to take measures of about 5 percent of GDP in 2012–13. These measures are fully specified in this MEFP at the outset. As to the policy mix, expenditure measures account for 3.5 percent of GDP and revenue measures for 1.4 percent of GDP. The priority given to expenditure measures is in line with the need to reduce the public sector’s large claim on resources. The fiscal adjustment will be supported by well-specified structural reforms.

6. **Our program entails cuts in expenditures:**

- Following the 5 percent average cut in public sector wages this year, wages and pensions will be frozen through 2013, except, in the case of pensions, for those in the lowest categories. In addition, a special contribution levied on pensions above €1,500 will be introduced in 2012 but will exempt those in the lowest categories. Through a policy of only partly replacing separating staff, we will reduce the number of civil servants at the central government by 1 percent in both 2012 and 2013. The rationalization of the public administration at local and regional governments will provide further reduction in costs, including a reduction in employment by 2 percent annually.
- Better means-testing procedures will protect lower income families while making savings in social security non-contributory benefits. Rationalization of curricula and creation of school clusters, without damaging access, will cut costs in education. In addition, savings will be made through curtailing transfers to local and regional governments, other public bodies and entities, and SOEs.
- Our strategy depends also on improving decisions regarding capital expenditures. We will suspend the implementation of all new PPPs and large infrastructure projects until a thorough feasibility assessment is completed. No public funds or guarantees will be provided for the construction of the New Airport in Lisbon, and the high speed train project to Porto will remain suspended for the duration of the program. In addition, stronger controls will be put in place to rationalize new capital expenditures. Finally, line ministries will be required to request a pre-authorization of the Ministry of Finance (MoF) before engaging in new capital expenditure contracts.
- We will streamline spending on defense, SOEs, regional, and local governments. We will (i) submit a draft law by end-2011 revising the Military Funding Law to impose expenditures ceilings and enforce a zero-new-spending commitments rule; and (ii) reduce defense personnel and compensation by at least 10 percent during 2011–2014. In addition to measures detailed below (¶23) we will reduce SOE fringe benefits by at least 5 percent per year over 2011-2014 and will align wage compensation policies to those of the general government.

7. On the revenue side, the focus is on increasing the share of consumption taxes and reducing tax privileges:

- The higher VAT, PIT, and CIT rates in the 2011 budget will remain in effect through 2013. The list of goods and services subject to reduced VAT rates will be revised in 2011. The recurrent property tax (IMI) will be enhanced by a reassessment of the property values starting in the second half of 2011 and by rate increases from 2012 which will help compensate for a reduction of property transfer tax (IMT). Excise taxes on vehicles and tobacco will be raised. Electricity taxation will be introduced from January 2012. The convergence of deduction treatment of wages and pensions for tax purposes will be concluded by end-2013.
- A comprehensive revision of tax exemptions will yield 0.5 percent of GDP. We will freeze all existing tax benefits and incentives, and roll back some of them. On personal income tax, we will set a global cap on health, education and housing allowances, differentiated according to tax bracket; and phase out the allowance on mortgage expenses and rents through legislation to be approved by end-2011. On corporate income tax, we will by end-2011 (i) eliminate exemptions—including those subject to the sunset clause of the Tax Benefit Code—and all reduced rates; (ii) limit the deduction of losses; and (iii) limit the carryover period to 3 years. The temporary exemption of the annual property tax will be considerably reduced by end-2011.

8. In choosing fiscal measures, we have taken care to protect vulnerable groups. The 5 percent cut in nominal public sector wages and the freezing of pensions in 2011 exempt those earning the lowest wages and pensions. The special contribution on pensions will be levied only above a monthly threshold of €1,500. The means-testing program is being enhanced by applying unified and consistent selection criteria throughout the transfers system. In the health sector, an exemption threshold will be introduced to protect the more vulnerable from the proposed “moderating fees” (for health care) increases and the reduction in exemptions. The exemption threshold based on the value of the property will be kept.

C. Streamlining the Public Sector

Public Financial Management (PFM)

9. The strategic focus of the budget will be sharpened. A fiscal strategy for the general government will be published by end-August 2011, and thereafter in April annually, specifying 4-year medium-term economic and fiscal forecasts. This will include supporting analysis and underlying assumptions and 4-year costings of new policy decisions (structural benchmark). Starting with the budget for 2012, budgets will be prepared within the context of the fiscal strategy and will report information to allow for an assessment of performance against this strategy. An independent fiscal council will be established by end-September 2011 to assess the government’s performance against the fiscal strategy.

10. **The budget process will be further integrated.** SOE, PPP, and social security decisions with fiscal implications will be integrated with the budget process to reduce fragmentation. Capital expenditure decisions will be taken in a medium-term context, with enhanced monitoring and control, through the implementation of a public investment information system, as announced in the 2011 budget. Top-down budgeting with indicative expenditure ceilings and a medium-term budget framework for the central government budget will be introduced in the 2012 Budget and will be put into full effect with the 2013 budget. A new budget framework law incorporating some of these reforms has been approved by Parliament and is awaiting Presidential assent. A proposal to revise the local and regional financial laws will be submitted to parliament by end-2011 in order to fully adapt them to the principles and rules of the new budgetary framework law. We stand ready to refine further the budget framework based on inputs from EC and IMF staff.

11. **Expenditure control will be strictly enforced and arrears will be monitored and reported regularly.** Standard definitions of arrears and commitments will be approved by May 2011 (prior action). Any changes to the budget execution procedures necessary to align with these definitions will be implemented by end-2011, aided by technical assistance from the EC and IMF. Until then, existing commitment control procedures will be enforced to prevent the creation of new arrears. We will conduct and publish by end-August 2011 (structural benchmark) a comprehensive survey of arrears as at end-June 2011 covering all general government entities, as well as SOEs classified outside the general government sector. Following the survey, arrears of general government, will be monitored and published monthly.

12. **Fiscal reporting will be strengthened.** Consolidated general government cash-based reports will be developed and initially reported to the EC and IMF, before moving to external publication by end-December 2011. We will adopt a standard double entry-based chart of accounts and accounting policies consistent with International Public Sector Accounting Standards by end-2012. We will prepare a comprehensive inventory of the existing tax expenditures (including all types of exemptions, deductions, and reduced rates), by type of tax, along with their costing estimates (prior action). Starting with the 2012 budget, we will enhance our annual tax expenditure reports following international standards so that they (a) cover central, regional, and local governments; (b) use a more comprehensive concept of tax expenditures; and (c) include the methodology used for estimating such expenditures.

13. **We will start publishing a comprehensive report on fiscal risks as part of the annual budget.** This will commence with the 2012 Budget and will be consistent with international best practices. The report will take into account risks, including those related to forecast expenditure and revenue, contingent liabilities, the debt composition, the banking system, all PPPs, all SOEs, and natural disasters.

Public-Private Partnerships (PPPs)

14. **We will undertake a comprehensive review of PPPs and concessions to reduce the government's financial exposure.** The PPPs have exposed the government to significant financial obligations, and exposed weaknesses in its capacity to effectively manage these arrangements. The review will comprise two parts:

- We will request technical assistance from the EC and the IMF to undertake an assessment by end-August 2011 of at least the 20 most significant PPP and concession contracts, including the major *Estradas de Portugal* PPPs. The technical assistance report will identify the key areas of concern and prepare the terms of reference for a more detailed study described below.
- Based on this assessment, we will recruit a top tier international accounting firm by end-December 2011 (structural benchmark) to complete a more detailed study of PPPs and concessions by end-March 2012. It will assess the scope to renegotiate any PPP or concession contracts to reduce financial obligations without expropriating investors. The review will identify and, where practicable, quantify major contingent liabilities and any amounts that may be payable by the government. All PPP and concession contracts will be made available for these reviews.

15. **We will substantially enhance the annual report on PPPs to strengthen reporting and approval mechanisms.** Starting with the July 2012 report, the annual reports will detail all future cash flows and include a discussion of the government's obligations on an ongoing basis. The legal and institutional framework for assessing and entering into PPP or concession agreements as well as monitoring its execution will also be reviewed and strengthened under the supervision of the MoF and in consultation with EC and IMF staff by end-2012. We will not enter into any new PPPs or concessions at the central or local government levels until at least the completion of these reviews and legal and institutional reforms.

State-Owned Enterprises (SOEs)

16. **The MoF's central role in the financial governance of SOEs will be enhanced to cut operating costs and streamline the sector.** We will prepare a comprehensive report on ten SOEs posing the largest potential fiscal risks to the state (prior action). We will expand the coverage of this report by end-July 2011 to include all large central government SOEs to (i) complete concrete plans to reduce their overall operating costs by at least 15 percent over 2009 levels; (ii) review tariff structures to reduce subsidization; and (iii) apply tighter debt ceilings for 2012 onwards. In consultation with EC and IMF staff, we will review the level of service provision of SOEs by end-September 2011 as an input into the budget. A report will be prepared by end-February 2012 (structural benchmark) that reviews the operations and finances of SOEs at all levels of government. It will also include a systematic assessment of

SOEs' future financial prospects, the potential exposure of the government, and scope for orderly privatization. We will not create any additional SOEs at the central or local government levels at least until the completion of these reviews and will prepare a plan by end-2011 to strengthen governance of SOEs.

Privatization

17. **We plan to accelerate our privatization program.** The existing plan, elaborated through 2013, covers transport (Aeroporos de Portugal, TAP, and freight branch of CP), energy (GALP, EDP, and REN), communications (Correios de Portugal), and insurance (Caixa Seguros), as well as a number of smaller firms. The plan targets front-loaded proceeds of about €5 billion through the end of the program, with only partial divestment envisaged for all large firms. However, we are committed to go even further, by pursuing a rapid full divestment of public sector shares in EDP and REN, and are hopeful that market conditions will permit sale of these two companies, as well as of TAP, by the end of the 2011. We will identify, by the time of the second review, two additional large enterprises for privatization by end-2012. An updated privatization plan will be prepared by end-March 2012.

Health Sector

18. **A comprehensive reform will improve efficiency and effectiveness in the health care system.** Amongst other reforms, moderating fees will be increased by September 2011, indexed to inflation by end-2011, and exemptions will be substantially reduced by September 2011. In order to protect the more vulnerable, means-testing mechanisms will be put in place.

Revenue Administration

19. **The revenue administration will be modernised.** The domestic tax administration, customs administration, and the information technology service will be unified. We will complete a study by end-September 2011 to assess the feasibility of the new structure taking over the collection function of the social security administration. The structure, to be designed in consultation with EC and IMF staff, will be organized around core business functions and complemented by a taxpayer segmentation approach, mainly through the adoption of a Large Taxpayer Unit. The design of the new structure will be completed by end-2011 and fully implemented by end-2012. The structure will streamline local branches, closing down at least 20 percent of local offices in both 2012 and 2013.

20. **A revenue administration strategic plan for 2012-14 will be prepared by end-October 2011.** This will include concrete actions to combat tax fraud and evasion. We will also prepare a report by end-September 2011 assessing the current state of our tax information systems, and propose the next steps to strengthen the information technology function. We will submit to Parliament by end- 2011 a law to reinforce the auditing and enforcement powers of the central revenue administration to exercise control over the whole territory of Portugal, including currently exempt tax regimes. The law will also give to the central tax

administration the exclusive power to issue interpretative rulings on taxes with national scope, in order to ensure its uniform application.

21. **The operational capacity of the revenue administration will be strengthened.** The audit workforce will be increased to 30 percent of total employees of the tax administration by the end of 2012, mostly through reallocation of staff in the public sector and within the tax administration, and adopting a clear risk management approach for taxpayer selection. We will enhance third-party information to support audit.

22. **We will facilitate an orderly and efficient resolution of tax cases.** Tax tribunals will be specialized in large cases and will be assisted by independent tax specialists similar to the pool used for tax arbitration by end-January 2012. A temporary task force of judges will be established to clear cases worth above €1 million by end-2012 (prior action). The new tax arbitration law will be implemented by end-July 2011. We will include the application of above-market interest charges on the outstanding debt over the entire court proceeding, and impose a special statutory interest on non-compliance with a tax court decision. We will conduct a review of audit performance by end-September 2011 incorporating qualitative indicators in the current quantitative model. An integrated information system between the revenue administration and the tax tribunals will be adopted by end-2011.

Public Administration and its Perimeter

23. **The structure of public administration will be streamlined.** A second phase of the public administration restructuring program (PRACE 2007) will be implemented for central government by end-2011. A similar program for local governments will be launched by April 2012. The objective will be to improve efficiency, and reduce the size of public administration across all levels. We will reduce the number of central government employees by at least 1 percent a year over the duration of the program, with at least 2 percent reduction at the local level, through a policy of only partly replacing separating staff, while at the same time increasing mobility across the administration. As part of these reforms, we will reduce management positions and administrative units by at least 15 percent (on average, over end-2010 levels) by end-2011 for central government and end-June 2012 for local governments, and reduce the number of local branches of line ministries.

24. **The creation of new public and quasi-public entities will be controlled more strictly and the existing number entities will be streamlined.** In conjunction with the SOE review, a comprehensive survey of public and quasi-public entities, including associations, foundations and other bodies, across all levels of government will be published by end-2011. Based on this survey, the administration responsible for public entities will decide to close or maintain them. A new set of public administration laws regulating the creation of SOEs, foundations, associations, and similar bodies at the central and local levels will be adopted by July 2012. We will move immediately to make any legal changes required to enhance monitoring, reduce operating costs and temporarily stop the creation of any new public or quasi-public bodies (including SOEs) at the local level.

25. **We will work with the regional government to bring about similar changes at their level of government.** These efforts will cover preventing creation of SOEs, PPPs, concessions, and any other quasi public entities. We will work to reduce management positions and administrative units by at least 15 percent and put in place a new set of public administration framework laws. We will also work with regional governments to reduce the number of their employees by at least 2 percent a year over the duration of the program.

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

D. Protecting the Financial System amidst Deleveraging

27. **While the Portuguese banking system has weathered the crisis well so far, bank liquidity remains under pressure.** 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. Banks will be encouraged to take actions to strengthen their collateral buffers. Subject to approval under EC competition rules, the authorities are committed to facilitating the issuance of government guaranteed bank bonds in an amount of up to €35 billion, including the existing package of support measures.

28. **We see a balanced and orderly deleveraging of the banking sector as critical to eliminating its funding imbalances on a permanent basis.** The process should take place in an orderly manner within the Eurosystem framework and consistent with the IMF/EU adjustment program, taking into account the need to reduce reliance on Eurosystem funding and to continue to support the more productive sectors of the domestic economy, not least SMEs. The BdP and the ECB, in consultation with EC and IMF staff, will include clear periodic target leverage ratios and will ask banks to devise by end-June 2011 institution-specific medium-term funding plans to achieve a stable market-based funding position. To smooth the deleveraging process, we will encourage private investors to maintain their exposure. Quarterly reviews will be conducted in consultation with EC and IMF staff, and will examine the feasibility of individual banks' plans and their implications for leverage ratios, as well as the impact on credit aggregates and the economy as a whole, and the BdP will then request adjustments in the plans as needed.

29. **To bolster the resilience of the banking sector, we are asking banks to further strengthen their capital buffer, while augmenting the bank solvency support mechanism.** The BdP had already required banks to raise their core Tier 1 capital level to 8 percent and significant progress has been achieved in reaching this level. However, the environment has

become more challenging lately, and to further enhance confidence in the solvency of the banking system, the BdP will now direct all banking groups subject to supervision in Portugal to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent at the latest by end-2012 (prior action) and maintain it thereafter. If needed, using its Pillar 2 powers, the BdP will also require some banks, based on their specific risk profile, to reach these higher capital levels on an accelerated schedule, taking into account the indications of the solvency assessment framework described in paragraph 31. Banks will be required to present plans to the BdP by end-June 2011 on how they intend to reach the new capital requirements through market solutions. However, in the event that they cannot reach the targets on time, ensuring higher capital standards may temporarily require public provision of equity for the private banks. We are thus augmenting the bank solvency support facility in line with EU state aid rules. Taking into account the overall resources available to us, including the EU-IMF financing, we will have adequate funds to provide €12 billion to the facility. This will be done in a way that preserves the control of the management of the banks by their non-state owners during a first phase and allow them the option of buying back the government's stake. The banks benefitting from equity injections will be subjected to specific management rules and restrictions, and to a restructuring process in line with EU competition and state aid requirements, that will provide the incentive to give priority to market-based solutions.

30. **We will streamline the state-owned CGD group to increase the capital base of its core banking arm as needed.** With 23 percent of the system's assets, this bank plays a central role in the financial system and we realize that its balance sheet should be optimized. The CGD bank is expected to raise its capital to the new required levels from internal group resources and improve the group's governance. This will include a more ambitious schedule towards the already announced sale of the insurance arm of the group, a program for the gradual disposal of all non-core subsidiaries, and, if needed, a reduction of activities abroad.

31. **The BdP is further intensifying its monitoring of the banking sector.** It is stepping-up its solvency and deleveraging assessment framework for the system as a whole and for each of the eight largest banks, and will seek an evaluation of the enhanced assessment framework by end-September 2011 (structural benchmark) by a joint team of experts from the EC, the ECB and the IMF. By end-June 2011, the BdP will also design a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment (structural benchmark). This program will be part of a capacity building technical cooperation project put in place with the support of the EC, the ECB, and the IMF that will bring together Portuguese supervisors, cooperating central banks and/or supervisory agencies, external auditors and other experts as needed. The BdP will provide quarterly updates of banks' potential capital needs going forward and check that their deleveraging process remains on track and properly balanced. Whenever the assessment framework will indicate that a bank's core Tier 1 ratio might fall under 6 percent under a stress scenario over the course of the program, the BdP, using its Pillar 2 powers, will ask it to take measures to strengthen its capital base.

32. **The BdP has kept a watchful eye on the banking sector and will continue to strengthen banking regulation and supervision.** The efficacy of the supervisory function is being permanently improved. This has included the reorganization of the function into three more focused departments last year and the setting-up of an interdepartmental committee for the purpose of financial stability monitoring and macro-prudential supervision. An internal bank evaluation system is currently being developed and is being fine-tuned. Disclosure on non-performing loans will be improved by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments by end-September 2011 (structural benchmark). Still more focus will be put on on-site inspections and verification of data accuracy with technical assistance from the IMF, in the context of the data verification exercise for the new solvency assessment framework. New resources will be allocated for the recruitment of additional specialist banking supervisors. Close coordination will be maintained with home and host country supervisors, within the EU framework for cross-border banking supervision and with relevant non-EU host supervisors of branches and subsidiaries of Portuguese banks.

33. **We are stepping-up our efforts to bring closure to the case of Banco Português de Negócios (BPN).** Following the unsuccessful privatization of the bank in 2010, and taking into account the recent deterioration of economic conditions, we are now launching a process to sell the bank on an accelerated schedule and without a minimum price. To this end, we will submit a new plan to the EC for approval under competition rules. Our target is to find a buyer by end-July 2011 at the latest. To facilitate the sale, the 3 existing special purpose vehicles holding its non-performing and non-core assets have been separated from BPN, and more assets could be transferred into these vehicles as part of the negotiations with prospective buyers. BPN is also undertaking additional cost-cutting measures to increase its attractiveness to investors. Once a solution has been found, CGD's state-guaranteed claims on BPN and all related special purpose vehicles will be taken over by the state according to a timetable to be defined at that time.

34. **We will strengthen the early intervention and resolution framework.** This will allow timely and effective intervention and resolution in line with EU developments and international sound practices. Legislation concerning credit institutions will be amended, in consultation with EC, ECB, and IMF staff, by end-November 2011 (structural benchmark) to, inter alia, impose early reporting obligations based on clear triggers and penalties; empower the BdP with remedial measures to promote implementation of a recovery plan; and require credit institutions with systemic risks to prepare contingency resolution plans subject to regular review. The amendments will also introduce a resolution regime for distressed credit institutions as a going concern under official control to promote financial stability and protect depositors. There will be clear triggers for its initiation, and restructuring tools for the resolution authorities shall include (i) recapitalization without shareholder pre-emptive rights in accordance with the relevant EU framework; (ii) transfer of assets and liabilities to other credit institutions; and (iii) a bridge bank.

35. **We will strengthen the legislation on the Deposit Guarantee Fund (FGD) and on the Guarantee Fund for Mutual Agricultural Credit Institutions (FGCAM).** This will be

done in consultation with EC, ECB and IMF staff, by end-2011 (structural benchmark). These funds' functions will be re-examined to strengthen protection of guaranteed depositors. These funds should retain the ability to fund the resolution of distressed credit institutions and in particular the transfer of guaranteed deposits to another credit institution but not to recapitalize them. Such financial assistance shall be capped at the amount of guaranteed deposits that would have to be paid out in liquidation. This should be permissible only if it does not prejudice the ability of these funds to perform their primary function. Further, the Insolvency Law will be amended by end-November 2011 to provide that guaranteed depositors and/or the funds (directly or through subrogation) will be granted a priority ranking over unsecured creditors in the credit institution's insolvent estate.

36. **The legal framework will be refined to facilitate orderly and efficient corporate and household debt restructurings.** The Insolvency Law will be amended to better support effective rescue of viable firms (end-November 2011 structural benchmark), with technical assistance from the IMF, to, inter alia, introduce fast track court approval procedures for restructuring plans. General principles on voluntary out of court restructuring in line with international best practices will be issued by end-September 2011. We will also take the necessary actions to authorize the tax and social security administrations to use a wider range of restructuring tools based on clear criteria and review the tax law to identify impediments to debt restructuring. The amendments to the Insolvency Law will also include improvements of personal insolvency procedures to better support rehabilitation of financially responsible individuals. Finally, we will launch a campaign to raise awareness of the restructuring tools available for early rescue of viable firms through, e.g., training and new information means.

37. **The government will intensify the monitoring of the corporate and household sectors, and prepare contingency plans for a large debt overhang in these sectors.** Starting quarterly, reports on corporate and household sectors will be prepared, to include an assessment of their funding pressures and debt refinancing activity. An assessment of the guarantees programs currently place and an evaluation of market-based financing alternatives will also be performed. Finally, a task force will be constituted to prepare contingency plans to efficiently deal with the challenges posed by corporate and household sectors indebtedness. These enhanced monitoring actions will put be in place by end-September 2011 in consultation with EC, IMF, and ECB staff.

E. Enhancing Competitiveness through Structural Reforms

Labor markets

38. **Reforms will focus on creating new jobs, not least for the young.** We must address the fundamental problems that impede the efficient transition of workers across occupations, firms and sectors and create socially unfair privileges. To this end, in consultation with our social partners, we will adopt the following measures:

- **Reform employment protection legislation to foster flexibility and improve equity.** We will align severance payments for open-ended and fixed-term hires, submit legislation by end-July 2011 (structural benchmark) reducing severance payments for all new contracts to 10 days per year of tenure, with an additional 10 days financed out of employers' financed fund, and present a proposal to revise severance payment entitlements for current employees in line with the reform for new hires by end-2011, without reducing accrued-to-date entitlements. As a further step, by end-March 2012, we will prepare a proposal to align the level of severance payments to the EU average, while at the same time amending the dismissal fund in a way that allows the portability of worker's entitlement to severance pay. We will prepare by end-December 2011 a proposal aimed at introducing adjustments to the cases for fair individual dismissals.
- **Revise the unemployment insurance system to change incentives, increase employment, and strengthen social safety nets.** We will reduce the maximum duration of unemployment insurance benefits to no more than 18 months, and cap unemployment benefits at 2.5 times the social support index and introduce a declining profile of benefits after six months of unemployment (a reduction of at least 10 percent in benefits), without reducing accrued-to-date entitlements. To extend social safety nets, we will reduce the necessary contributory period to access unemployment insurance from 15 to 12 months, and present a proposal to extend eligibility for clearly-defined categories of self-employed. Training opportunities will be strengthened, especially for the low-skilled.
- **Ensure that labor costs support job creation and competitiveness.** Over the program period, any increase in the minimum wage will take place only if justified by economic conditions and agreed in the context of regular program reviews.
- **Define clear criteria for the extension of collective agreements,** including the representativeness of the negotiating organizations and the implications of the extension for the competitive position of non-affiliated firms. To promote wage adjustments in line with productivity at the firm level we will (i) allow works councils to negotiate mobility conditions and working time arrangements; (ii) reduce the threshold below which works councils or other workers organizations cannot conclude firm-level agreements to 250 employees per firm; and (iii) include in sectoral collective agreements conditions under which works councils can independently conclude firm-level agreements.

Fiscal devaluation

39. **A critical goal of our program is to boost competitiveness.** This will involve a major reduction in employer's social security contributions. This measure will be fully calibrated by the time of the first review (end-July 2011, structural benchmark). The offsetting measures

needed to ensure fiscal neutrality may include changing the structure and rates of VAT, additional permanent expenditure cuts, and raising other taxes that would not have an adverse effect on competitiveness. In calibrating this measure, we will take measures to: (i) mitigate the social impact of higher consumption taxes; (ii) ensure that changes to social security contributions are compensated by allocating equivalent revenues in order not to jeopardize the sustainability of the pension system; and (iii) ensure that tax changes are passed through to lower prices. While the proposal might be implemented in two steps, the bold first step will be implemented in the context of the 2012 budget. A structural benchmark for October 2011 will be set at the time of the first review.

Competition Framework

40. **To rebalance growth toward the tradable sector, we need to foster competition in the non-tradable sector.** State involvement in private sector activities will be reduced, and the independence of sectoral regulators reinforced. We will eliminate “golden shares” and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state (structural benchmark, end-July 2011).

41. **We will take bold steps to address excessive profits and reduce the scope for rent-seeking behavior.**

- In electricity, we will review the efficiency of support schemes for co-generation and renewables, assessing their rationale, levels, and other relevant design elements, including options for reducing the implicit production subsidy (structural benchmark, end-December 2011). We will reassess legacy support measures associated with the production of electricity under the ordinary regime, and, where possible, revise downwards the guaranteed compensation mechanism (CMEC) paid to producers and the remaining long-term power-purchase agreements (PPAs).
- In telecommunications, we will facilitate the entry in the market of new players auctioning new radio frequencies for broadband wireless access and lowering mobile termination rates, alleviate restrictions on mobility of consumers and ensure that the provision on universal service designation and the incumbent’s concession contract are non-discriminatory.

- We will review and reduce the number of regulated professions (by end-September 2011 for professions not regulated by Parliament and by end-March 2012 for all others); eliminate the restriction on the use of advertising in regulated professions (end-September 2011); improve the recognition framework on professional qualifications, ease the requirements related to the establishment of foreign service providers in Portugal; and reduce the number of requirements to which cross-border service providers are subject (end-December 2011).
- We will (i) submit to Parliament a law revising the Competition Law, clearly separating rules on competition enforcement procedures and penal procedures, and (ii) establish a new Court on Competition Matters and introduce greater specialization of judicial functions (structural benchmark).

42. **We commit to a number of additional measures to enhance the flexibility and productive capacity of the economy.** In particular, we will undertake a comprehensive reform of the housing market which aims at facilitating labor mobility and reducing incentives for private sector over-borrowing. We also commit to tackle low educational attainment and improve the quality of secondary and vocational education, and continue reducing the administrative burden for firms in all sectors and facilitate access to export markets by end-March 2012. The joint EC-ECB Memorandum of Understanding further specifies these and other structural policies recommended in the MEFP.

Judicial Reforms

43. **Immediate priority will be given to improve the efficiency of the judicial process.** The current tedious judicial process coupled with a severe backlog of cases impede effective market functioning across a number of sectors. We are committed to implement the announced Judicial Reform Map without delay and take additional steps to make the judicial system efficient and effective.

44. **We aim to resolve the backlog of cases in the courts within 24 months.** An audit of the backlog cases including debt enforcement, insolvency, and tax and labor cases will be completed by end-June 2011. Based on this audit, additional measures will be developed by end-September 2011 to expedite the resolution of the backlog, including (i) establishing separate Chambers or Teams involving all agencies solely for resolving the backlog; (ii) restructuring court record-keeping to take cases off the books; (iii) merging similar small debt enforcement cases; (iv) strengthening and enforcing existing regulations allowing dormant cases to be removed from the court register; (v) imposing additional costs and penalties against non-cooperative debtors in enforcement cases; and (vi) assigning special court managers to allow judges to focus on the cases.

45. **The court system will be restructured to improve management efficiency.** Thirty-nine court units, with added management support for each unit, will be established by end-

2012. This restructuring will be entirely financed through expenditure savings and gains of efficiency and is part of the rationalization effort, in order to improve efficiency in the management of infrastructure and public services. We will develop a roadmap for this reform, identifying key quarterly milestones by end-September 2011. A new internal management system will be implemented for two county courts (including Lisbon) by end-2011. The new Courts on Competition Matters and Intellectual Property Rights will become operational by end-January 2012; and we will assess the need for separate Chambers within the Commercial Courts with specialized judges for insolvency cases by end-2011. A new personnel management plan will be developed to support judicial specialization and mobility of court officials by end-2011.

46. **We will further improve the efficiency of civil case processing in the courts.** The new experimental civil procedure regime which has been applied to seven courts will be extended to four courts by end-September 2011. A report will be prepared by end-2011 on whether such regime should be applied to all courts. Finally, we will review the Code of Civil Procedure and prepare a proposal by end-2011 (structural benchmark) addressing the key areas for refinement, including (i) consolidating legislation for all enforcement cases before the court, (ii) giving judges the power to expedite cases, (iii) reducing administrative burdens on judges, and (iv) enforcing statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases.

47. **A more sustainable and transparent budget for the judiciary is crucial to the success of the judicial reform.** We will standardize the court fees and introduce special court fees for certain cases and procedures by end-September 2011. The Ministry of Justice will develop and publish an annual plan on the allocation of resources based on court by court performance data. A workload/staffing assessment will be completed for the six pilot courts under the Judicial Reform Map and the specialized courts by end-March 2012. In addition, quarterly reports on recovery rates, duration and costs of corporate insolvency and tax cases will be published starting from the third quarter of 2011.

48. **Alternative dispute resolution (ADR) needs to be strengthened to better facilitate out-of-court settlement.** We will adopt the Law on Arbitration by end-September 2011. We will take all necessary legal, administrative, and other steps to make arbitration for debt enforcement cases fully operational by end-February 2012 to facilitate resolution of backlog cases and out-of-court settlement (structural benchmark). The Justices for Peace regime will be optimized by increasing its capacity to handle small claim cases by end-March 2012. To bolster the ADR regime, we will adopt measures to give priority to the ADR enforcement cases in the courts by end-2011.

F. Program Matters

49. **In the context of the arrangement, the BdP will undergo a safeguards assessment in accordance with the IMF safeguards policy.** In this regard, and to facilitate a timely

completion of the assessment, the authorities have provided the information requested for the assessment to commence, and have also authorized the external auditors to provide information to and hold discussions with IMF staff. A memorandum of understanding between the government and the BdP will establish a clear framework on the modalities for the repayment of IMF financing and the servicing of interest payments and other charges. As part of these arrangements, Fund disbursements will be deposited into the government's account at the BdP pending their use.

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

	Performance Criteria (unless indicated otherwise)			Indicative Targets			
	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
1. Floor on the consolidated General Government cash balance (cumulative) 1/	-5.4	-6.7	-10.3	-1.7	-3.8	-5.9	-7.6
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 2/	...	0	0	0	0	0	0
3. Ceiling on the overall stock of General Government debt	175.9	175.9	175.9	189.4	189.4	189.4	189.4
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government 3/	0	0	0	0	0	0	0

1/ Corresponds to an overall deficit of the General Government of €10,042 million on ESA 95 basis. Cumulative from January 1, 2011 for 2011, and cumulative from January 1, 2012 for 2012.

2/ Applies on a continuous basis from September 15, 2011 onwards. Insufficient information for application in June.

3/ Applies on a continuous basis from June 15, 2011 onwards.

Table 2. Portugal: Structural Conditionality	
Measure	Status / Timing
Prior Actions	
1 Direct all banking groups subject to supervision in Portugal to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent by end-2012 and maintain it thereafter, with banks required to present by end-June 2011 plans on how they intend to comply with these requirements.	Met
2 Prepare a comprehensive report on 10 SOEs posing the largest potential fiscal risks to the state. The report would cover (i) concrete plans, per enterprise, for reducing its operational costs, consistent with an average cut of at least 15 percent in the sector over 2009 levels; (ii) a planned revision of the tariffs.	Met
3 Prepare a comprehensive inventory of the existing tax expenditures (including all types of exemptions, deductions, and reduced rates), by type of tax, along with their costing estimates.	Met
4 Approve a standard definition of arrears and commitments	Met
5 Establish a temporary task force of judges to clear tax cases worth above €1 million	Met
Structural Benchmarks	
A. Strengthen financial stability and enhance banking sector monitoring:	
6 Design a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment.	End-Jun. 2011
7 Seek evaluation of the enhanced solvency and deleveraging assessment framework by a joint team of experts from the EC, the ECB and the IMF.	End-Sep. 2011
8 Improve disclosure on non-performing loans by adding a new ratio aligned with international practices to the current ratio that covers only overdue loan payments.	End-Sep. 2011
9 Amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF to strengthen the early intervention framework and introduce a regime for restructuring of banks as a going concern under official control.	End-Nov. 2011
10 Amend the Insolvency Law to better facilitate effective rescue of viable firms and support rehabilitation of financially responsible individuals.	End-Nov. 2011
11 Amend the relevant legislation to strengthen deposit insurance framework by authorizing bank resolution financing and introducing depositor preference.	End-Dec. 2011
B. Enhance competitiveness:	
12 Eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state.	End-Jul. 2011
13 Submit to Parliament a law, already agreed with social partners, to align and reduce severance payments on all new contracts (fixed term and open-ended).	End-Jul. 2011
14 Finalize calibration of fiscal reform to reduce unit labor costs via deficit-neutral reduction in labor taxes.	End-Jul. 2011
15 Submit to Parliament legislation revising the Competition Law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonized with the European Union competition legal framework.	End-Dec. 2011
16 Review the efficiency of support schemes for co-generation and renewables and propose possible options for reducing the implicit subsidy.	End-Dec. 2011
17 Review the Code of Civil Procedure and prepare a proposal addressing the key areas for refinement.	End-Dec. 2011
18 Take all necessary legal, administrative, and other steps to make arbitration for debt enforcement cases fully operational.	End-Feb. 2012
C. Strengthen public financial management and reduce fiscal risks:	
19 Publish a fiscal strategy document for the general government which will specify 4-year medium-term economic and fiscal forecasts, supporting analysis and underlying assumptions, and 4-year costings of new policy decisions.	End-Aug. 2011
20 Conduct and publish the results of a survey of arrears of general government entities and SOEs for all categories of expenditure as at end-June 2011.	End-Aug. 2011
21 Based on assessment from EU/IMF technical assistance on the budgetary implications of main PPP programs, recruit a top tier international accounting firm to complete a more detailed study of PPPs and identify areas for deeper analysis by an international consulting firm.	End-Dec. 2011
22 Prepare a report on SOEs based on forecast financial statements assessing their financial prospects, potential government exposure, and scope for orderly privatization.	End-Feb. 2012

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

May 17, 2011

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

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 MTU, 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 includes:
 - The Central Government. This includes:
 - The entities covered under the State Budget, as defined in the current Budget Framework Law, Law No. 91/2001 of August 20, amended by Law 48/2004 of August 24, 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), including Caixa Geral de Aposentações (CGA) and National Health Service (NHS) entities, and other entities belonging

to the budgetary Central Government classified by the National Statistical Authority (INE) as part of the Central Government.

- Other entities 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 Authority (INE) as part of the Central Government.
- State-owned enterprises (SOE) which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as part of the Central Government (ISOE).
- Regional and Local Governments (*Administrações Regionais and Locais*), including 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.
- Social Security Funds comprising all funds that are established in the general social security system.

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

The General Government, as measured for purposes of Program monitoring in 2011, shall not include entities nor operations that are re-classified into General Government during the remainder of 2011.

5. **Supporting material:**

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

expenditure items. Data will also include detailed information on called guarantees and PPP-related revenues and expenditures.

- Data on domestic and foreign debt redemptions, new domestic and foreign debt issuance, change in the domestic and foreign cash balances of the Central Government at the BdP and other financial institutions, and all other sources of financing including capital transactions, and arrears of the General Government will be provided to the EC, the ECB, and the IMF by the DGO in the MoF within seven weeks after the closing of each month.
- BdP will provide to the EC, the ECB, and the IMF detailed monthly data on the financing of the General Government, as defined in ESA95, within seven weeks after the closing of each month.

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

G. 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. 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.

- **The cash balance of the State Budget.** The cash balance of the State Budget will be measured from above the line, based on budget revenues (recurrent revenue plus non-recurrent revenue, including EU revenues, minus tax refunds) minus budget expenditures of the State Budget as published monthly on the official website of the DGO of the MoF, and in line with the corresponding line items established in the State Budget. Budget expenditures will exclude amortization payments but include salaries and other payments to staff and pensions; grants to Social Security Funds, medical care and social protection; operational and other expenditure, interest payments; cash payments for military equipment procurement; EU expenses, and called guarantees (excluding those related to the banking sector support and restructuring strategy) where the Central Government makes payments on behalf of entities that are not part of the General Government.
- **The cash balance of the Regional and Local Governments, Social Security Funds and 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 MoF will make this specification available by end-May 2011. The reporting by Local Government will be phased as set out in paragraph 8 below.

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

Other provisions

7. For the purpose of the program, the expenditure of the central government that is monitored excludes payments related to bank support, when carried out under the program's banking sector and restructuring strategy. Transactions that are excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchases of troubled assets. 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. Production of the consolidated General Government budget execution report for internal, EC, ECB, and IMF monitoring will begin in July 2011. The reports will be published externally from end-December 2011. The larger municipalities (defined as those with a population of 100,000 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, 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 quarterly 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.**

- Data on cash balances of the State Government, SEO 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 MoF will submit by end-July and end-January, 2012 a full reconciliation of the cumulative monthly cash deficit up to, respectively, end-March and end-September with the corresponding cumulative accrual deficits determined by the INE in accordance with ESA 95 rules. 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.

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

10. **Definition.** For the purpose of the Program, domestic arrears are defined as invoices 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 in the supplier contract, arrears are defined as invoices that have remained unpaid for 90 days or more after the date of the invoice. Data on arrears will be provided within six weeks after the end of each month. The continuous target of non-accumulation of domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the beginning of the month. Furthermore, in line with quantitative targets to be established at the time of the first review, the existing stock of arrears will be settled or otherwise reduced. This also includes arrears that are being accumulated by the NHS and SOE, which are, otherwise, to a degree excluded from the General Government under ESA95 and ESA95 Manual on Government Deficit and Debt rules classification.

11. Commitment is defined as an explicit or implicit agreement 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.

12. **Supporting material.** Starting in September 2011, the MoF will provide consistent data on monthly expenditure arrears of the General Government, as defined above. Data will be provided within seven weeks after the end of each month and will include total arrears classified by the different constituent sectors of the General Government sub-sector as defined in paragraph 4.

I. 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 ceiling on the stock of General Government debt will exclude debt arising from payments for bank restructuring, when carried out under the Program's banking sector support and restructuring strategy. This includes loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by the central government to support banks, including the issuance of guarantees or provision of liquidity will be immediately reported to the EC, ECB and IMF.

14. **Adjusters.** For 2011, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock at end-December 2010 general government debt of EUR160.47 billion.

15. **Supporting material.** Quarterly data on the total stock of General Government debt as defined in paragraph 13 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.

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

16. **Definition.** For the purposes of the Program, an external debt payments arrear will be defined as a payment on debt to non-residents contracted or guaranteed by the General Government, which has not been made within seven days after falling due (taking into account any applicable contractual grace period). The performance criterion will apply on a continuous basis throughout the Program period.

17. **Supporting material.** The stock of external debt payment arrears of the General Government will be provided by the MoF with a lag of not more than seven days after the test date.

K. Bank Solvency Support Facility

18. EUR 1 billion will be provided in cash and be made available in a separate dedicated account to be set up at the Bank of Portugal by end-June 2011. The remainder of the EUR 12 billion foreseen for the bank support fund will be deposited into the dedicated account consistent with the need for bank capital determined by Program reviews.

L. 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.
20. Concerning the Central Administration, and Regional and Local Administrations owned companies not classified by INE within the General Government, the MoF will provide by end-September 2011 data on the 2010 financial statements reported under the Simplified Business Information framework, to be reported by end-June 2011.

II. LETTER OF INTENT

Lisbon, May 13, 2011

Mr Jean-Claude Juncker
President
Eurogroup

Mr György Matolcsy
President
Council of the European Union (ECOFIN)

Mr Olli Rehn
Commissioner
European Commission

Mr Jean-Claude Trichet
President
European Central Bank

Dear Sir:

1. Against the background of the structural challenges facing the Portuguese economy and contagion from the sovereign debt crisis in other euro area countries, financial conditions facing the Portuguese sovereign and banks have sharply worsened. To restore market confidence and to raise the potential of our economy to generate socially balanced growth and employment we are proposing a far-reaching reform programme, backed by substantial international financing to meet balance of payments needs.

2. Following up on already announced measures, we believe further comprehensive action is required on three fronts: (i) deep structural reforms to boost potential growth, create jobs, and improve competitiveness (including through fiscal devaluation); (ii) a credible and balanced fiscal consolidation strategy, supported by structural fiscal measures and better fiscal control over PPPs and SOEs; and (iii) efforts to safeguard the financial sector against disorderly deleveraging through market-based mechanisms supported by back-up facilities. As our reform programme is implemented, priority will be given to protecting the most vulnerable groups.

3. To signal our strong commitment to implementing the ambitious reform programme, we request financing assistance from international partners. We estimate that the support needed for our external financing will be around €78 billion over the next three years. We therefore request support from the European Financial Stability Mechanism and the European Financial

Stability Facility which could be drawn over a period of 36 months. The overall total of this support will be €52 billion. We are also sending a parallel request for financial assistance to the IMF for a total amount of €26 billion (SDR 23.7 billion). This arrangement will underpin confidence, support market access and help ensure orderly adjustment and the restoration of sustainable growth. We will draw on these resources in parallel throughout the program period, drawing on the EU/euro-area and IMF financing in a ratio of 2 to 1 following programme approval and for each review period (measured at the programme exchange rate).

4. We are confident that the policies described in the attached Memorandum of Economic and Financial Policies (MEFP) are sufficient to achieve the objectives under the programme. An annexed Memorandum of Understanding (MoU) specifies detailed economic policy measures that will be used as benchmarks for assessing policy performance in the context of the quarterly reviews, in coordination with the IMF and the European Commission, under the financial assistance programme. The reviews will assess progress in the programme's implementation and permit understandings on any additional measures that may be needed to achieve its objectives.

5. In particular, progress in the implementation of the policies under this programme will be monitored through quarterly (and continuous) quantitative performance criteria (PCs) and indicative targets, prior actions, structural benchmarks, quarterly programme reviews, and any consultation clauses (these are detailed in Tables 1 and 2; the attached Technical Memorandum of Understanding (TMU) contains definitions), and through the detailed and specific economic policy criteria in the MoU.

6. The conditionality under the programme provides substantial comfort that the programme will be delivered and that the support will be repaid. We will ensure that the financial assistance in the context of the EFSM and EFSF to be provided to Portugal will be subject to the loan terms and conditions that will protect the EU, the euro-area and EU Member States' financial and legal interests in a non discriminatory way as compared to the assistance provided by the euro-area and the EU to other Member States.

7. The Portuguese Government and Banco de Portugal believe that the policies set forth in the attached MoU are adequate to achieve the objectives of our economic programme. We, nonetheless, stand ready to take additional measures that may be needed to meet the objectives set. We will maintain a close policy dialogue and will consult with the European Commission, the ECB and the IMF prior to the adoption of any such measures and in advance of any necessary revisions to the policies included in the MEFP and the MoU. All available information requested by the European Commission, the ECB and the IMF to assess implementation of the programme will be provided.

8. We are confident that resolute implementation of our economic programme will help our economy recover and bolster market sentiment. If fiscal consolidation proceeds faster than

expected or if market conditions improve significantly during the programme period, we would refrain *pari passu* from drawing on the financing assistance.

9. This letter is copied to Mr. Strauss-Kahn.

Sincerely yours,

/s/

Fernando Teixeira dos Santos
Minister of State and Finance

/s/

Carlos da Silva Costa
Governor of Banco de Portugal

Attachment: 1. Memorandum of Economic and Financial Policy Conditionality (MEFPC);

ATTACHMENT I: PORTUGAL—MEMORANDUM OF UNDERSTANDING ON SPECIFIC ECONOMIC POLICY CONDITIONALITY

May 17, 2011

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

The Council Implementing Decision specifies that the first disbursement of financial assistance from the EFSM shall be released subject to the entry into force of this Memorandum of Understanding on specific economic policy conditionality (MoU) and of the Loan Agreement. Before the signature of this MoU, Portugal has completed the prior actions set out in the Memorandum of Economic and Financial Policies (MEFP) and which are also included in this MoU.

The Decision also makes the release of further instalments conditional on a positive conclusion of the reviews of conditionality that will take place throughout the three-year duration of the programme. These reviews will assess progress made with respect to the policy criteria in the Council Implementing Decision and specified in the MEFP and in this MoU, as well as Council Recommendations in the context of the Excessive Deficit Procedure. The first quarterly review will be carried out in the third quarter of 2011 and will assess compliance with the conditions to be met by end-July. The following reviews taking place in any given quarter will assess compliance with the conditions to be met by the end of the previous quarter.

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

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

1. Fiscal policy

Objectives

Reduce the Government deficit to below EUR 10,068 million (equivalent to 5.9% of GDP based on current projections) in 2011, EUR 7,645 million (4.5% of GDP) in 2012 and EUR 5,224 million (3.0% of GDP) in 2013 by means of high-quality permanent measures and minimizing the impact of consolidation on vulnerable groups; bring the government debt-to-GDP ratio on a downward path as of 2013; maintain fiscal consolidation over the medium term up to a balanced budgetary position, notably by containing expenditure growth; support competitiveness by means of a budget-neutral adjustment of the tax structure.

Fiscal policy in 2011

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

1.2. Over the remainder of the year, the government will rigorously implement the Budget Law for 2011 and the additional fiscal consolidation measures introduced before May 2011. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). **[Q3 and Q4-2011]**

Fiscal policy in 2012

1.3. On the basis of a proposal developed by the time of the first review **[end-July 2011]**,² the 2012 Budget will include a budget neutral recalibration of the tax system with a view to lower labour costs and boost competitiveness **[October 2011]**.

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

1.5. Throughout the year, the government will rigorously implement the Budget Law for 2012. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). **[Q1, Q2, Q3 and Q4-2012]**

1.6. The following measures will be carried out with the 2012 Budget Law **[Q4-2011]**, unless otherwise specified:

Expenditure

1.7. Improve the working of the central administration by eliminating redundancies, increasing efficiency, reducing and eliminating services that do not represent a cost-effective use of public money. This should yield annual savings worth at least EUR 500 million.

² Structural benchmark in the Memorandum of Economic and Financial Policies.

Detailed plans will be presented by the Portuguese authorities and will be assessed **by Q1-2012**; the budgetary impacts will spread to 2014. To this end, the government will:

- i. reduce the number of services while maintaining quality of provision;
- ii. create a single tax office and promoting services' sharing between different parts of the general government;
- iii. reorganise local governments and the provision of central administration services at local level;
- iv. regularly assess the value for money of the various public services that are part of the government sector as defined for national accounts purposes;
- v. promote mobility of staff in central, regional and local administrations;
- vi. reduce transfers from the State to public bodies and other entities;
- vii. revise compensation schemes and fringe benefits in public bodies and entities that independently set their own remuneration schemes;
- viii. reduce subsidies to private producers of goods and services.

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

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

- i. Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 1% per year in the staff of central administration and 2% in local and regional administration. [**Q3-2011**]
- ii. Freeze wages in the government sector in nominal terms in 2012 and 2013 and constrain promotions.
- iii. Reduce the overall budgetary cost of health benefits schemes for government employees schemes (ADSE, ADM and SAD) lowering the employer's contribution and adjusting the scope of health benefits, with savings of EUR 100 million in 2012.

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

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

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

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

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

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

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

- i. sustaining an average permanent reduction in operating costs by at least 15%;
- ii. tightening compensation schemes and fringe benefits;
- iii. rationalisation of investment plans for the medium term;
- iv. increase their revenues from market activities.

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

Revenue

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

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

- i. abolishing all reduced corporate income tax rates;
- ii. limiting the deductions of losses in previous years according to taxable matter and reducing the carry-forward period to three years;
- iii. reducing tax allowances and revoking subjective tax exemptions;
- iv. curbing tax benefits, namely those subject to the sunset clause of the Tax Benefit Code, and strengthening company car taxation rules;
- v. proposing amendments to the regional finance law to limit the reduction of corporate income tax in autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

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

- i. capping the maximum deductible tax allowances according to tax bracket with lower caps applied to higher incomes and a zero cap for the highest income brackets;
- ii. applying separate caps on individual categories by (a) introducing a cap on health expenses; (b) eliminating the deductibility of mortgage principal and phasing out the deductibility of rents and of mortgage interest payments for owner-occupied

housing; eliminate interest income deductibility for new mortgages (c) reducing the items eligible for tax deductions and revising the taxation of income in kind;

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

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

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

1.23. Raise VAT revenues to achieve a yield of at least EUR 410 million for a full year by:

- i. reducing VAT exemptions;
- ii. moving categories of goods and services from the reduced and intermediate VAT tax rates to higher ones;
- iii. proposing amendments to the regional finance law to limit the reduction of VAT in the autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

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

- i. raising car sales tax and cutting car tax exemptions;
- ii. raising taxes on tobacco products;
- iii. indexing excise taxes to core inflation;
- iv. introducing electricity excise taxes in compliance with EU Directive 2003/96.

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

Fiscal policy in 2013

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

1.27. Throughout the year, the government will rigorously implement the Budget Law for 2013. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). **[Q1, Q2, Q3 and Q4-2013]**

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

Expenditure

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

- i. central administration functioning: EUR 500 million. Detailed plans will be presented and assessed before Q3-2012;
- ii. education and school network rationalization: EUR 175 million;
- iii. wage bill: annual decreases of 1% per year in headcounts of central administration and 2% in local and regional administrations;
- iv. health benefits schemes for government employees: EUR 100 million.
- v. health sector: EUR 375 million;
- vi. transfers to local and regional authorities: EUR 175 million;
- vii. costs in other public bodies and entities, and in SOEs: EUR 175 million;
- viii. capital expenditure: EUR 350 million;
- ix. maintain the suspension of pension indexation rules except for the lowest pensions in 2013.

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

Revenue

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

- i. corporate tax bases and reduce tax benefits and tax deductions: EUR 150 million;
- ii. personal income tax benefits and tax deductions: EUR 175 million;
- iii. taxation of all types of cash social transfers and convergence of personal income tax deductions for pensions and labour income: EUR 150 million;
- iv. excise taxes: EUR 150 million.

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

Fiscal policy in 2014

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

1.34. Throughout the year, the Government will rigorously implement the Budget Law for 2014. Progress will be assessed against the (cumulative) quarterly deficit ceilings in the

Memorandum of Economic and Financial Policies (MEFP), including the Technical Memorandum of Understanding (TMU). [Q1 and Q2-2014]

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

2. Financial sector regulation and supervision

Objectives

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

Maintaining liquidity in the banking sector

2.1. Subject to approval under EU competition rules, the authorities are committed to facilitate the issuance of government guaranteed bank bonds for an amount of up to EUR 35 billion, including the existing package of support measures.

Deleveraging in the banking sector

2.2. Banco de Portugal (BdP) and the ECB, in consultation with the European Commission (EC) and the IMF, will include clear periodic target leverage ratios and will ask banks to devise by **end-June 2011** institution-specific medium-term funding plans to achieve a stable market-based funding position. To smooth the deleveraging process, the authorities will encourage private investors to maintain their exposure. Quarterly reviews will be conducted in consultation with the EC and the IMF, and will examine the feasibility of individual banks' plans and their implications for leverage ratios, as well as the impact on credit aggregates and the economy as a whole, and the BdP will then request adjustments in the plans as needed.

Capital buffers

2.3. BdP will direct all banking groups supervised by BdP to reach a core Tier 1 capital ratio of 9 percent by **end-2011** and 10 percent at the latest by **end-2012** and maintain it thereafter.³ If needed, using its Pillar 2 powers, the BdP will also require some banks, based on their specific risk profile, to reach these higher capital levels on an accelerated schedule, taking into account the indications of the solvency assessment framework described below. Banks will be required to present plans to BdP by **end-June 2011** on how they intend to reach the new capital requirements through market solutions.

³ Prior action in the Memorandum of Economic and Financial Policies.

2.4. In the event that banks cannot reach the new capital requirements on time, ensuring higher capital standards might temporarily require public provision of equity for the private banks. To that effect, the authorities will augment the bank solvency support facility, in line with EU state aid rules, with resources of up to EUR 12 billion provided under the programme. The facility will be designed in a way that preserves the control of the management of the banks by their non-state owners during an initial phase and allows them the option of buying back the government's stake. The banks benefitting from equity injections will be subjected to specific management rules and restrictions, and to a restructuring process in line with EU competition and state aid requirements, that will provide the incentive to give priority to market-based solutions.

Caixa Geral de Depósitos (CGD)

2.5. The state-owned CGD group will be streamlined to increase the capital base of its core banking arm as needed. The CGD bank is expected to raise its capital to the new required level from internal group resources, and improve the group's governance. This will include a more ambitious schedule toward the already announced sale of the insurance arm of the group, a program for the gradual disposal of all non-core subsidiaries, and, if needed a reduction of activities abroad.

Monitoring of bank solvency and liquidity

2.6. The BdP is stepping up its solvency and deleveraging assessment framework for the system as a whole and for each of the eight largest banks, and will seek an evaluation of the enhanced assessment framework by **end-September 2011** by a joint team of experts from the EC, the ECB and the IMF.⁴

2.7. By **end-June 2011**, the BdP will also design a program of special on-site inspections to validate the data on assets that banks provide as inputs to the solvency assessment. This program will be part of a capacity building technical cooperation project put in place with the support of the EC, the ECB, and the IMF that will bring together Portuguese supervisors, cooperating central banks and/or supervisory agencies, external auditors and other experts as needed.⁵

2.8. The BdP will provide quarterly updates of banks' potential capital needs going forward and check that their deleveraging process remains on track and properly balanced. Whenever the assessment framework will indicate that a bank's core Tier 1 ratio might fall under 6 percent under a stress scenario over the course of the program, the BdP, using its Pillar 2 powers, will ask it to take measures to strengthen its capital base.

Banking regulation and supervision

2.9. BdP will ensure by **end-September 2011** that the disclosure of non-performing loans will be improved by adding a new ratio aligned with international practices to the current

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

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

ratio that covers only overdue loan payments.⁶ BdP will intensify on-site inspections and verification of data accuracy with technical assistance from the IMF, in the context of the data verification exercise for the new solvency assessment framework. BdP will allocate new resources to the recruitment of additional specialist banking supervisors. Close coordination will be maintained between home and host country supervisors within the EU framework for cross-border banking supervision and with relevant non-EU host supervisors of branches and subsidiaries of Portuguese banks.

Banco Português de Negócios

2.10. The authorities are launching a process to sell Banco Português de Negócios (BPN) on an accelerated schedule and without a minimum price. To this end, a new plan is submitted to the EC for approval under competition rules. The target is to find a buyer **by end-July 2011** at the latest.

2.11. To facilitate the sale, the three existing special purpose vehicles holding its non-performing and non-core assets have been separated from BPN, and more assets could be transferred into these vehicles as part of the negotiations with prospective buyers. BPN is also launching another program of more ambitious cost cutting measures with a view to increase its attractiveness to investors

2.12. Once a solution has been found, CGD's state guaranteed claims on BPN and all related special purpose vehicles will be taken over by the state according to a timetable to be defined at that time.

Bank resolution framework

2.13. The authorities will amend legislation concerning credit institutions in consultation with the EC, the ECB and the IMF by **end-November 2011** to, inter alia, impose early reporting obligations based on clear triggers and penalties. BdP will be authorised to take remedial measures to promote implementation of a recovery plan. Credit institutions with systemic risks will be required to prepare contingency resolution plans) subject to regular review.⁷

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

⁶ Structural benchmark in the Memorandum of Economic and Financial Policies.

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

The Deposit Guarantee Fund

2.15. The authorities will strengthen the legislation on the Deposit Guarantee Fund (FGD) and on the Guarantee Fund for Mutual Agricultural Credit Institutions (FGCAM), in consultation with EC, the ECB and the IMF, **by end-2011**.⁸ These funds' functions will be re-examined to strengthen protection of guaranteed depositors. These funds should however retain the ability to fund the resolution of distressed credit institutions and in particular the transfer of guaranteed deposits to another credit institution but not to recapitalise them. Such financial assistance shall be capped at the amount of guaranteed deposits that would have to be paid out in liquidation. This should be permissible only if it does not prejudice their ability to perform their primary function.

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

Corporate and household debt restructuring framework

2.17. To better facilitate effective rescue of viable firms, the Insolvency Law will be amended by **end-November 2011** with technical assistance from the IMF, to, inter alia, introduce fast track court approval procedures for restructuring plans.⁹

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

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

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

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

Monitoring of corporate and household indebtedness

2.22. The authorities will prepare quarterly reports on corporate and household sectors including an assessment of their funding pressures and debt refinancing activities. The authorities will assess guarantee programmes currently in place and evaluate market-based financing alternatives. A task force will be constituted to prepare contingency plans to efficiently deal with the challenges posed by high corporate and household sectors

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

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

indebtedness. These enhanced monitoring actions will put be in place by **end-September 2011** in consultation with the EC, the IMF and the ECB.

3. Fiscal-structural measures

Objectives

Improve the efficiency of the public administration by eliminating redundancies, simplifying procedures and reorganising services; regulate the creation and functioning of all public entities (e.g. enterprises, foundations, associations); streamline the budgetary process through the newly approved legal framework, including by adapting accordingly the local and regional financial legal frameworks; strengthen risk management, accountability, reporting and monitoring.

Public Financial Management framework

To strengthen the public financial management framework the Government will take the following measures:

Reporting

- 3.1. Approve a standard definition of arrears and commitments.¹⁰ **[Q2-2011]**
- 3.2. Conduct and publish a comprehensive survey of arrears by **end-August 2011** covering all categories of expenditure payables as at the end of June 2011. All general government entities and SOEs classified outside the general government will be covered by this survey.¹¹
- 3.3. Enhance the existing monthly reporting on budgetary execution on a cash basis for the general government, including on a consolidated basis. The monthly reporting perimeter currently includes the State, Other public bodies and entities, Social Security, regional and local governments and it will be progressively expanded to include all SOEs and PPPs reclassified within the general government and local governments. **[Q3-2011]**
- 3.4. The existing annual report on tax expenditures will be improved, starting with the 2012 budget, in line with international best practices. The report will cover central, regional and local administrations. Technical assistance may be provided if necessary. **[Q3-2011]** A comprehensive inventory of the existing tax expenditures, by type of tax, along with their policy costs estimates will be prepared by **Q2-2011**.¹²
- 3.5. Develop intra-annual targets, and corrective measures in case of deviation from targets, for **[Q3-2011]**:

¹⁰ Prior action in the Memorandum of Economic and Financial Policies.

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

¹² Prior action in the Memorandum of Economic and Financial Policies.

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

3.6. Implement any changes to the budget execution rules and procedures necessary to align with the standard definition of arrears and commitments. Meanwhile, existing commitment control procedures will be enforced for all types of expenditure across the general government. Technical assistance may be provided if necessary. **[Q4-2011]**

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

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

3.9. Publish information on: number of general government staff on a quarterly basis (no later than 30 days after the end of the quarter); Stock and flows over the relevant period per Ministry or employment entity (i.e. new hiring, retirement flows, and exit to other government service, private sector or unemployment); average wage, allowances and bonuses. **[Q1-2012]**

Monitoring

3.10. Approve a standard definition of contingent liabilities. **[Q2-2011]**

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

Budgetary framework

3.12. Publish a fiscal strategy document for the general government by **end-August 2011** and annually thereafter in April for the Stability Programme. The document will specify 4-year medium-term economic and fiscal forecasts and 4-year costs of new policy decisions. Budgets will include a reconciliation of revisions to the 4 year fiscal forecasts attributable to policy decisions and parameter revisions e.g. policy decisions, changes in the macroeconomic environment.¹³

3.13. Ensure full implementation of the Budgetary Framework Law adopting the necessary legal changes, including to the regional and local finance laws: **[Q3-2011]**

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

- i. The general government perimeter will cover the State, Other public bodies and entities, Social Security, SOEs and PPPs reclassified within the general government and local and regional administrations.
- ii. Define in detail the proposed characteristics of the medium-term budgetary framework, including medium-term fiscal strategy, decision-making and prioritisation process, carry over rules, commitment controls; and appropriate contingency reserves and related access rules. **[Q3-2011]**

3.14. A proposal to revise the local and regional finance laws will be submitted to Parliament in order to fully adapt the local and regional financing framework to the principles and rules adopted by the recently revised Budgetary Framework Law, namely in what concerns (i) the inclusion of all relevant public entities in the perimeter of local and regional government; (ii) the multi-annual framework with expenditure, budget balance and indebtedness rules, and programme budgeting; and (iii) the interaction with the function of the Fiscal Council. **[Q4-2011]**

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

3.16. Adopt the Statutes of the Fiscal Council, based on the working group report of 6 April 2011. The Council will be operational in time for the 2012 budget. **[Q3-2011]**

Public Private Partnerships

The Government will:

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

3.18. Perform with the technical assistance from EC and the IMF, an initial assessment of at least the 20 most significant PPP contracts, including the major *Estradas de Portugal* PPPs, covering a wide range of sectors. **[end-August 2011]**

3.19. The Government will recruit a top tier international accounting firm to undertake a more detailed study of PPPs in consultation with INE and the Ministry of Finance.¹⁴ The review will identify and, where practicable, quantify major contingent liabilities and any related amounts that may be payable by the Government. It will assess the probability of any payments by Government in relation to the contingent liabilities and quantify such amounts. The study, to be completed by **end-March 2012**, will assess the feasibility to renegotiate any PPP or concession contract to reduce the Government financial obligations. All PPPs and concession contracts will be available for these reviews. **[Q4-2011]**

3.20. Put in place a strengthened legal and institutional framework, within the Ministry of Finance, for assessing fiscal risks *ex-ante* of engaging into PPP, concessions and other public

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

investments, as well as for monitoring their execution. The Court of Auditors must be informed of this ex-ante risk assessment. Technical assistance may be provided if necessary. **[Q1-2012]**

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

State-owned enterprises¹⁵

3.22. Report on concrete plans to reduce the overall operating costs of central government 10 State-owned enterprises (SOEs) posing the largest potential fiscal risks to the State by at least 15% over the 2009 levels and on a planned review of the tariff structure.¹⁶

3.23. Prepare a comprehensive assessment of the tariff structure of State-owned enterprises (SOEs) to reduce the degree of subsidisation. For the central government SOEs, the assessment will be done by **end-July 2011**, for local and regional government SOEs by **end-September 2011**. Review the level of service provisions of all SOEs. **[Q3-2011]**

3.24. Review ongoing plans to reduce operational costs by the end of 2011 by at least 15% on average compared with 2009, proposing company specific cuts that are consistent with a realistic economic and financial assessment. For the central government SOEs, the review will be carried out by **end-July 2011**, for local and regional government SOEs by **end-September 2011**.

3.25. Apply tighter debt ceilings to SOEs from 2012 onwards. For the central government SOEs, the plans will be announced by **end-July 2011**, for local and regional government SOEs by **end-September 2011**.

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

3.27. Prepare a report reviewing the operations and finances of SOEs at central, regional and local government levels. The report will assess these companies' business financial prospects, the potential exposure of the government and scope for orderly privatisation. The Government will adopt the necessary legal changes to fulfill this requirement. Technical assistance will be provided.¹⁷ **[Q1-2012]**

¹⁵ State-owned enterprises comprise those pertaining to central, local and regional administration.

¹⁶ Prior action in the Memorandum of Economic and Financial Policies.

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

3.28. No additional SOEs at central government level will be created until this review is completed. Given the financial impact of these decisions, the Government will submit to Parliament a draft law so that this limitation will also be applicable to local authorities. The Government will promote the initiatives needed so that the same objective is achieved by the regions. [Q1-2012]

3.29. The Government will submit to Parliament a draft law to regulate the creation and the functioning of SOEs at the central and local levels. The law will enhance the monitoring powers of the central administration over all SOEs. In addition, the timing and content of financial and operational reporting will be defined. The decisions adopted at central level to improve the efficiency of the enterprises while reducing their financial burden will be implemented at all SOEs, taking into account their specificities. The Government will promote the initiatives needed so that the same objective is achieved by the regions. [Q1-2012]

3.30. The annual SOEs report prepared by the MoF **in July 2011** will include a comprehensive fiscal risk report detailing and analyzing all liabilities (explicit and implicit) of SOEs.

Privatisation

3.31. The Government will accelerate its privatisation programme. The existing plan, elaborated through 2013, covers transport (Aeroportos de Portugal, TAP, and freight branch of CP), energy (GALP, EDP, and REN), communications (Correios de Portugal), and insurance (Caixa Seguros), as well as a number of smaller firms. The plan targets front-loaded proceeds of about €5.5 billion through the end of the program, with only partial divestment envisaged for all large firms. The Government commits to go even further, by pursuing a rapid full divestment of public sector shares in EDP and REN, and is hopeful that market conditions will permit sale of these two companies, as well as of TAP, by the **end of 2011**. The Government will identify, by the time of the **second review**, two additional large enterprises for privatisation by end-2012. An updated privatisation plan will be prepared by **March 2012**.

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

Revenue administration

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

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

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

- ii. Reducing the number of municipal offices by at least 20% per year in 2012 and 2013; **[Q4-2012 and Q4-2013]**
- iii. Increase in the resources devoted to auditing in the tax administration to at least 30% of the total staff, mostly through reallocations of staff within the tax administration and other parts of the public administration. The threshold should be attained by **Q4-2012**.

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

- i. Reviewing the assessment of audit performance based on both qualitative and quantitative indicators; **[Q3-2011]**
- ii. Applying interest charges on the outstanding debt over the whole appeal period using an interest rate above market levels. Impose a special statutory interest on non-compliance with a tax court decision; **[Q3-2011]**
- iii. Implement the new tax arbitration law by **Q3-2011**;
- iv. Establishing an integrated IT system between the revenue administration and the tax courts; **[Q4-2011]**
- v. Setting up a temporary task force of judges by **Q2-2011**¹⁸ to clear cases worth above EUR 1 million by **Q4-2012**.

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

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

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

Public administration

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

Central, regional and local administration

3.39. Reduce management positions and administrative units by at least 15% in the central administration. **[Q4-2011]**

¹⁸

Prior action in the Memorandum of Economic and Financial Policies.

3.40. In view of improving the efficiency of the central administration and rationalising the use of resources, implement a second phase of the public administration restructuring programme (PRACE 2007). [Q4-2011]

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

3.42. In conjunction with the review of SOEs (see above), prepare a detailed cost/benefit analysis of all public and quasi-public entities, including foundations, associations and other bodies, across all levels of government. [Q4-2011] Based on the results of this analysis, the administration (central, regional or local) responsible for the public entity will decide to close or to maintain it in respect of the law (see below). [Q2-2012]

3.43. Regulate by law the creation and the functioning of foundations, associations, and similar bodies by the central and local administration. This law, which will also facilitate the closure of existing entities when warranted, will be prepared in coordination with a similar framework to be defined for SOEs. The law will define the monitoring and reporting mechanisms and evaluation performance. In addition, the Government will promote the initiatives needed [Q4-2011] so that the same objective is achieved by the regions.

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

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

Shared services

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

- i. Fully implement the strategy of shared services in the area of financial (GeRFIP) and human resources (GeRHup). [Q2-2012]
- ii. Rationalise the use of IT resources within the central administration by implementing shared services and reducing the number of IT entities in individual Ministries or other public entities. [Q4-2012]

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

Human resources

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

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

Health care system

Objectives

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

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

Financing

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

- i. a substantial revision of existing exemption categories, including stricter means-testing in cooperation with Minister of labour and social affairs; **[by September-2011]**
- ii. increase of moderating fees in certain services while ensuring that primary care moderating fees are lower than those for outpatient specialist care visits and lower than emergency visits; **[by September-2011]**
- iii. legislate automatic indexation to inflation of NHS moderating fees. **[Q4-2011]**

3.51. Cut substantially (by two thirds overall) tax allowances for healthcare, including private insurance. **[Q3-2011]**

3.52. To achieve a self sustainable model for health-benefits schemes for civil servants, the overall budgetary cost of existing schemes – ADSE, ADM (Armed Forces) and SAD (Police Services) - will be reduced by 30% in 2012 and a further 20% in 2013, at all levels of general government. Further reductions at a similar pace will follow in the subsequent years towards having them self-financed by 2016. The budgetary costs of these schemes will be reduced by lowering the employer's contribution and adjusting the scope of health benefits. **[Q4-2011]**

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

Pricing and reimbursement of pharmaceuticals

3.54. Set the maximum price of the first generic introduced in the market to 60% of the branded product with similar active substance. **[Q3-2011]**

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

Prescription and monitoring of prescription

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

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

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

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

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

Pharmacies sector

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

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

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

Centralised purchasing and procurement

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

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

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

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

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

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

Primary care services

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

- i. increasing the number of USF (*Unidades de Saúde Familiares*) units contracting with regional authorities (ARSs) using a mix of salary and performance-related payments as currently the case. Make sure that the new system leads to reduction in costs and more effective provision; **[Q3-2011]**
- ii. set-up a mechanism to guarantee the presence of family doctors in needed areas to induce a more even distribution of family doctors across the country. **[Q4-2011]**

Hospital services

3.71. Set out a binding and ambitious timetable to clear all arrears (accounts payable to domestic suppliers past due date by 90 days) and introduce standardised commitment control procedures for all entities to prevent the re-emergence of arrears. **[Q3-2011]**

3.72. Provide detailed description of measures aimed at achieving a reduction of EUR 200 million in the operational costs of hospitals in 2012 (EUR 100 million in 2012 in addition to savings of over EUR 100 million already in 2011), including reduction in the number of

management staff, as a result of concentration and rationalisation in state hospitals and health centres. **[Q3-2011]**

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

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

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

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

3.77. Continue with the reorganisation and rationalisation of the hospital network through specialisation and concentration of hospital and emergency services and joint management (building on the Decree-Law 30/2011) joint operation of hospitals. These improvements will deliver additional cuts in operating costs by at least 5 per cent in 2013. A detailed action plan is published by 30 November 2012 and its implementation is finalised by the first quarter 2013. **[Q2-2012]**

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

3.79. Annually update the inventory of all practising doctors by specialty, age, region, health centre and hospital, public and private sector so as to be able to identify practising, professional and licensed physicians and current and future staff needs by the above categories. **[Q3-2011]**

3.80. Prepare regular annual reports, the first to be published by the end of March 2012, presenting plans for the allocation of human resources in the period up to 2014. The Report specifies plans to reallocate qualified and support staff within the NHS. **[Q3-2011]**

3.81. Introduce rules to increase mobility of healthcare staff (including doctors) within and across health regions. Adopt for all staff (including doctors) flexible time arrangements, with a view of reducing by at least 10% spending on overtime compensation in 2012 and another 10% in 2013. Implement a stricter control of working hours and activities of staff in the hospital. **[Q1-2012]**

Cross services

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

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

4. Labour market and education

Labour market

Objectives

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

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

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

Unemployment benefits

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

- i. reducing the maximum duration of unemployment insurance benefits to no more than 18 months. The reform will not concern those currently unemployed and will not reduce accrued-to-date rights of employees;
- ii. capping unemployment benefits at 2.5 times the social support index (IAS) and introducing a declining profile of benefits over the unemployment spell after six months of unemployment (a reduction of at least 10% in the benefit amount). The reform will concern those becoming unemployed after the reform;
- iii. reducing the necessary contributory period to access unemployment insurance from 15 to 12 months;
- iv. presenting a proposal for extending eligibility to unemployment insurance to clearly-defined categories of self-employed workers providing their services to a single firm on a regular basis. The proposal will take into account the risks of possible abuses and will contain an assessment of the fiscal impact of

extending benefits under several scenarios concerning eligibility criteria (namely the involuntary character of unemployment) and requirements for increased social security contributions for firms making use of these arrangements.

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

Employment protection legislation

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

4.4. Severance payments.

- i. The Government will submit **by end-July 2011** legislation to Parliament to implement a reform in the severance payments for new hires in line with the March 2011 Tripartite Agreement.¹⁹ Severance payments of open-ended contracts will be aligned with those of fixed-term contracts. The reform will re-design the system for severance payment entitlements as follows:
 - total severance payments for new open-ended contracts will be reduced from 30 to 10 days per year of tenure (with 10 additional days to be paid by an employers' financed fund) with a cap of 12 months and elimination of the 3 months of pay irrespective of tenure;
 - total severance payments for fixed-term contracts will be reduced from 36 to 10 days per year of tenure for contracts shorter than 6 months and from 24 to 10 days for longer contracts (with 10 additional days to be paid by an employers' financed fund);
 - implementation of the fund agreed in the March Tripartite Agreement to partly finance the cost of dismissals for new hires.
- ii. By **Q4-2011**, the Government will present a proposal to align severance payment entitlements for current employees in line with the reform for new hires, (taking into account the revised link between entitlement and seniority and the cap to total entitlements) without reducing accrued-to-date entitlements. This plan will lead to draft legislation to be submitted to Parliament by [**Q1-2012**].
- iii. By **Q1-2012**, the Government will prepare a proposal aiming at:
 - aligning the level of severance payments to that prevailing on average in the EU;
 - allowing the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers by means of the creation of notional individual accounts.

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

¹⁹ Structural benchmark in the Memorandum of Economic and Financial Policies.

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

- i. Individual dismissals linked to unsuitability of the worker should become possible even without the introduction of new technologies or other changes to the workplace (art. 373-380, 385 Labour Code). Inter alia, a new reason can be added regarding situations where the worker has agreed with the employer specific delivery objectives and does not fulfil them, for reasons deriving exclusively from the workers' responsibility;
- ii. Individual dismissals linked to the extinction of work positions should not necessarily follow a pre-defined seniority order if more than one worker is assigned to identical functions (art. 368 Labour Code). The predefined seniority order is not necessary provided that the employer establishes a relevant and non-discriminatory alternative criteria (in line with what already happens in the case of collective dismissals);
- iii. Individual dismissals for the above reasons should not be subject to the obligation to attempt a transfer for a possible suitable position (art. 368, 375 Labour Code). As a rule, whenever there are work positions available that match the qualifications of the worker, dismissals should be avoided.

Working time arrangements

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

- i. The Government will prepare an assessment regarding the use made of increased flexibility elements by the social partners associated with the 2009 Labour Code revision and prepare an action plan to promote the use of flexible working time arrangements, including on modalities for permitting the adoption of "bank of hours" working arrangement by mutual agreement of employers and employees negotiated at plant level. **[Q4-2011]**
- ii. Draft legislation will be submitted to Parliament by **Q1-2012** on the following aspects:
 - implementation of the commitments agreed in the March Tripartite Agreement regarding working time arrangements and short-time working schemes in cases of industrial crisis, by easing the requirements employers have to fulfill to introduce and renew these measures;
 - revision of the minimum additional pay for overtime established in the Labour Code: (i) reduction to maximum 50% (from current 50% for the first overtime hour worked, 75% for additional hours, 100% for overtime during holydays); (ii) elimination of the compensatory time off equal to

25% of overtime hours worked. These norms can be revised, upwards or downwards, by collective agreement.

Wage setting and competitiveness

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

- i. commit that, over the programme period, any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of the programme review;
- ii. define clear criteria to be followed for the extension of collective agreements and commit to them. The representativeness of the negotiating organisations and the implications of the extension for the competitive position of non-affiliated firms will have to be among these criteria. The representativeness of negotiating organisations will be assessed on the basis of both quantitative and qualitative indicators. To that purpose, the Government will charge the national statistical authority to do a survey to collect data on the representativeness of social partners on both sides of industry. Draft legislation defining criteria for extension and modalities for their implementation will be prepared by **Q2-2012**;
- iii. prepare an independent review by **Q2-2012** on:
 - how the tripartite concertation on wages can be reinvigorated with the view to define norms for overall wage developments that take into account the evolution of the competitive position of the economy and a system for monitoring compliance with such norms;
 - the desirability of shortening the survival (*sobrevigência*) of contracts that are expired but not renewed (art 501 of the Labour Code).

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

- i. implement the commitments in the Tripartite Agreement of March 2011 concerning the "organised decentralisation", notably concerning: (i) the possibility for works councils to negotiate functional and geographical mobility conditions and working time arrangements; (ii) the creation of a Labour Relations Centre supporting social dialogue with improved information and providing technical assistance to parties involved in negotiations; (iii) the lowering of the firm size threshold above which works councils can conclude firm-level agreements to 250 employees. Action for the implementation of these measures will have to be taken **by Q4-2011**;
- ii. promote the inclusion in sectoral collective agreements of conditions under which works councils can conclude firm-level agreements without the delegation of unions. An action plan will have to be produced **by Q4-2011**.

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

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

Active labour market policies

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

- i. a report on the effectiveness of current activation policies and other ALMPs in tackling long-term unemployment, improving the employability of the young and disadvantaged categories, and easing labour market mismatch;
- ii. an action plan for possible improvements and further action on activation policies and other ALMPs, including the role of Public Employment Services.

Education and training

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

- i. Set up an analysis, monitoring, assessment and reporting system in order to accurately evaluate the results and impacts of education and training policies, notably plans already implemented (notably concerning cost saving measures, vocational education and training and policies to improve school results and contain early school leaving). **[Q4-2011]**
- ii. Present an action plan to improve the quality of secondary education services including via: (i) the generalization of trust agreements between the Government and public schools, establishing wide autonomy, a simple formula-based funding framework comprising performance evolution criteria, and accountability; (ii) a simple result-oriented financing framework for professional and private schools in association agreements based on fixed per-class funding plus incentives linked to performance criteria; (iv) a reinforced supervisory role of the General Inspectorate. **[Q1-2012]**
- iii. Present an action plan aimed at (i) ensuring the quality, attractiveness and labour market relevance of vocational education and training through partnerships with companies or other stakeholders; (ii) enhancing career guidance mechanisms for prospective students in vocational educational training. **[Q1-2012]**

5. Goods and services markets

Energy markets

Objectives

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

Liberalisation of electricity and gas markets

5.1. Regulated electricity tariffs will be phased out **by January 1, 2013** at the latest. Present a roadmap for the phasing out following a stepwise approach by **end-July 2011**. The provisions will specify:

- i. The timeline and criteria to liberalise the remaining regulated segments, such as pre-determined conditions relating to the degree of effective competition in the relevant market;
- ii. The methods to ensure that during the phasing-out period market prices and regulated tariffs will not diverge significantly and to avoid cross-subsidisation between consumers segments;
- iii. The definition of vulnerable consumers and the mechanism to protect them.

5.2. Transpose the Third EU Energy Package by the **end of June 2011**. This will ensure the National Regulator Authority's independence and all powers foreseen in the package.

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

5.4. Regulated gas tariffs are to be phased out by **January 1, 2013** at the latest.

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

Additional costs associated with electricity production under the ordinary regime

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

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

5.7. Review the efficiency of support schemes for co-generation and propose possible options for adjusting downward the feed-in tariff used in co-generation (reduce the implicit subsidy).²⁰ **[Q4-2011]**

5.8. Review in a report the efficiency of support schemes for renewables, covering their rationale, their levels, and other relevant design elements.²¹ **[Q4-2011]**

5.9. For existing contracts in renewables, assess in a report the possibility of agreeing a renegotiation of the contracts in view of a lower feed-in tariff.²² **[Q4-2011]**

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

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

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

Energy policy instruments and taxation

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

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

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

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

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

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

Telecommunications and postal services

Objectives

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

Telecommunications:

The Government will:

5.16. Ensure more effective competition in the sector by implementing the new Directive on EU electronic communications regulatory framework (“Better Regulation Directive”), which will (among others) enhance independence of the National Regulator Authority. [Q2-2011]

5.17. Facilitate market-entry by auctioning ‘new’ radio frequencies (i.e. auction of spectrum) for broadband wireless access [Q3-2011] and lowering mobile termination rates [Q3-2011].

5.18. Ensure that the provision on universal service designation and the incumbent’s concession contract are non-discriminatory: re-negotiate the concession contract with the undertaking currently providing the universal service and launch a new tender for designation of universal service providers. [Q3-2011]

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

Postal services

The Government will:

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

5.21. Eliminate VAT exemption for products within the universal service [Q3-2011]

Transport

Objectives

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

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

Strategic Plan for Transport:

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

- i. An in-depth analysis of the transport system including an assessment of existing capacity, forecast demand, and projected traffic flows;
- ii. Measures to integrate rail, port and air transport services into the overall logistic and transport system, notably by improving competition in these transport modes;
- iii. Measures to facilitate entry for low-cost airline companies, making use of the existing infrastructure;
- iv. A set of priorities for investment with an estimate of the financial needs and the foreseen sources of financing as well as of energy savings.

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

Railways sector

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

- i. Strengthen the rail regulator independence and competences including by strengthening its administrative capacity in terms of decision and execution powers and staffing;
- ii. Ensure full independence of the state-owned railway operator CP from the State;
- iii. Balance the infrastructure manager's revenues and expenditures on the basis of a multi-annual contract with the infrastructure manager of a duration of at least three years and concrete commitments on State finance and performance;
- iv. Carry-out a rationalisation of the network and effective incentives for the infrastructure manager to reduce its costs, whereby the regulatory body will be given a monitoring role;
- v. Revise the existing Public Service Obligations (PSOs) on rail passenger transport, including the legal basis and administrative capacity for stepwise introduction of competitive tendering for PSOs;
- vi. Revise the infrastructure charging scheme to introduce a performance scheme, permitting operators to introduce yield management of tickets, in particular to raise ticket prices;
- vii. Privatisise the freight branch of the state-owned rail operator and some suburban lines.

Ports [Q4-2011]

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

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

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

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

Other services sector**Objectives**

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

Sector-specific legislation of Services

5.28. Adopt the remaining necessary amendments to the sector specific legislation to fully implement the Services Directive, easing the requirements related to establishment and reducing the number of requirements to which cross-border providers are subject. Amendments will be presented to the Parliament [Q3-2011] and adopted by [Q4-2011].

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

Professional qualifications

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

Regulated professions

5.31. Eliminate restrictions to the use of commercial communication (advertising) in regulated professions, as required by the Services Directive [Q3-2011].

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

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

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

Administrative burden

5.35. Continue the simplification reform effort by:

- i. making the Points of Single Contact (PSC) more user-friendly and responsive to SMEs needs, extending on-line procedures to all sectors covered by the Services Directive [Q4-2011] and adapt the content and information available at the PSC to the new legislation to be adopted [Q1-2012];
- ii. making fully operational the “Zero authorisation” project that abolish authorisations/licensing and substitute them with a declaration to the PSC for the wholesale and retail sector and restaurants and bars [Q4-2011]. The project shall include all levels of administration, including all municipalities [Q2-2012];
- iii. extending PSC to services not covered by the Services Directive [Q1-2013];
- iv. extending the Zero authorisation project to other sectors of the economy [Q1-2013].

6. Housing market**Objectives**

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

Rental market

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

Administrative procedures for renovation

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

Property taxation

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

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

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

7. Framework conditions

Judicial system

Objectives

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

The Government will:

Court backlog

7.1. Intensify implementation of proposed measures under the Judicial Reform Map. Conduct an audit of the backlog cases in order to better target measures [**end-June 2011**]. Eliminate court backlogs by **Q2-2013**.

7.2. Based on the audit, better target existing measures and assess the need for additional measures to expedite the resolution of the backlog [**Q2-2011**]. Additional measures to be considered include, among others: (i) establishing separate Chambers or Teams (solely) directed towards resolving the backlog, (ii) restructuring court record-keeping so that cases can be taken off the books; (iii) merging similar small debt enforcement cases; (iv) strengthening and enforcing existing regulations allowing dormant cases to be removed from the court register; (v) imposing additional costs and penalties against non-cooperative debtors in enforcement cases; (vi) introducing a staggered court fee structure for extended litigation prompted by litigating parties without manifest cause; and (vii) assigning special court managers to manage the court agenda/hearings allowing judges to focus on the cases.

Management of courts

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

7.4. Adopt new court management methods for two county courts, including Lisbon. [**Q4-2011**]

7.5. Develop a personnel management plan that permits judicial specialisation and mobility of court officials. [**Q4-2011**]

Alternative dispute resolution for out-of-court settlement

7.6. The Government will present a Law on Arbitration by **end-September 2011** and make arbitration for debt enforcement cases fully operational by **end-February 2012** to facilitate resolution of backlog cases and out of court settlement.²³

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

7.8. Adopt measures to give priority to alternative dispute resolution enforcement cases in the courts. **[Q4-2011]**

Civil cases in the courts

7.9. Extend the new experimental civil procedure regime to 4 courts. **[Q3-2011]**

7.10. Assess in a report whether the experimental civil procedure regime will be applied to all courts. **[Q4-2011]**

7.11. Make specialised courts on Competition and on Intellectual Property Rights fully operational. **[Q1-2012]**

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

7.13. The Government will review the Code of Civil Procedure and prepare a proposal **by end-2011** addressing the key areas for refinement, including (i) consolidating legislation for all enforcement cases before the court, (ii) giving judges the power to expedite cases, (iii) reducing administrative burdens on judges, and (iv) enforcing statutory deadlines for court processes and in particular injunction procedures and debt enforcement and insolvency cases.²⁴

7.14. Adopt specific measures for an orderly and efficient resolution of outstanding tax cases including (also covered under revenue administration):

- i. taking necessary steps to implement the Tax Arbitration Law (to enable an effective out of court resolution of tax claims); **[Q3-2011]**
- ii. assessing measures to expedite the resolution of tax cases such as: i) creating a special procedure for high value cases; ii) establishing criteria for prioritizing; iii) extending statutory interests for the entire the court proceeding; iv) imposing a special statutory interest payment on late compliance with a tax court decision. **[Q4-2011]**

²³ Structural benchmark in the Memorandum of Economic and Financial Policies.

²⁴ Structural benchmark in the Memorandum of Economic and Financial Policies.

Budget and allocation of resources

7.15. Standardize court fees and introduce special court fees for certain categories of cases and procedures with the aim of boosting revenue and disincentivizing spurious civil litigation. [Q3-2011]

7.16. Develop an annual workplan on the allocation of resources based on court by court performance data, which will be published annually on the internet.

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

7.18. Publish quarterly reports on recovery rates, duration and costs of corporate insolvency and tax cases, publishing the first report by Q3-2011.

Competition, public procurement and business environment

Objectives

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

Competition and sectoral regulators

7.19. The Government will eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state (end-July 2011).²⁵

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

- i. Establish a specialised court in the context of the reforms of the judicial system [Q1-2012].
- ii. Propose a revision of the competition law, making it as autonomous as possible from the Administrative Law and the Penal Procedural Law and more harmonized with the European Union competition legal framework, in particular:²⁶ [Q4-2011]
 - simplify the law, separating clearly the rules on competition enforcement procedures from the rules on penal procedures with a view to ensure effective enforcement of competition law;

²⁵ Structural benchmark in the Memorandum of Economic and Financial Policies.

²⁶ Structural benchmark in the Memorandum of Economic and Financial Policies.

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

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

7.21. Ensure that the national regulator authorities (NRA) have the necessary independence and resources to exercise their responsibilities. **[Q1-2012]** In order to achieve this:

- i. provide an independent report (by internationally recognised specialists) on the responsibilities, resources and characteristics determining the level of independence of the main NRAs. The report will benchmark nomination practices, responsibilities, independence and resources of each NRA with respect to best international practice. It will also cover scope of operation of sectoral regulators, their powers of intervention, as well as the mechanisms of coordination with the Competition Authority. **[Q4-2011]**
- ii. based on the report, present a proposal to implement the best international practices identified to reinforce the independence of regulators where necessary, and in full compliance with EU law. **[Q4-2011]**

Public procurement

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

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

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

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

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

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

7.27. Ensure ex-ante auditing/checks on public procurement by the appropriate national bodies (most notably the Portuguese Court of Auditors) as a tool to prevent and counteract the practice of illegal award of additional works/services and increase transparency. **[Q3-2011]**

7.28. Upgrade the national Public Procurement Portal (Base) based on Resolution n° 17/2010 of the National Parliament in order to improve transparency of award procedures **[Q4-2011]**

7.29. Modify Art. 42 (7) (8) (9) of the Public Procurement Code, which sets out a requirement for investment in R&D projects on all public contracts worth more than EUR 25 million, to ensure full compliance with the Public Procurement directives, in particular by: i) eliminating the condition for the R&D project to be carried out in national territory; ii) requiring the R&D investments to be directly relevant for the performance of the contract; and iii) ensuring that all amounts to be spent on R&D projects are linked and justified by the subject-matter of the contract. **[Q4-2011]**

Business environment

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

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

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

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