



Exma. Senhora
Chefe do Gabinete de Sua Excelência a
Presidente da Assembleia da República
Dra. Noémia Pizarro

SUA REFERÊNCIA	SUA COMUNICAÇÃO DE	NOSSA REFERÊNCIA	DATA
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ASSUNTO: RESPOSTA AO REQUERIMENTO N.º 110/XII/3.ª

Encarrega-me a Secretária de Estado dos Assuntos Parlamentares e da Igualdade de enviar cópia do ofício n.º 2676, datado de 20 de junho de 2014, do Gabinete do Senhor Primeiro-Ministro, sobre o assunto supra mencionado.

Com os melhores cumprimentos,

A Chefe do Gabinete

Marina Resende



Exma. Senhora
Dra. Marina Resende
Chefe do Gabinete de S. Exa. a
Secretária de Estado dos Assuntos
Parlamentares e da Igualdade

Gabinete da Secretária de Estado dos
Assuntos Parlamentares e da Igualdade
Entrada n.º 2793
Data: 20-06-2014

S/Refª: 2587/SEAPI - 06.06.2014

ASSUNTO: Resposta ao Requerimento n.º 110/XII/3.ª de 06 de junho de 2014

Luca Marina,

Na sequência do ofício supra identificado e em resposta ao Requerimento n.º 110/XII/3.ª de 06 de junho de 2014, do Senhor Deputado Alberto Martins, do Partido Socialista, encarregame S. Exa. o Primeiro-Ministro de transmitir o seguinte:

A carta de intenções enviada ao Fundo Monetário Internacional a 26 de maio de 2014 foi publicada no Portal do Governo e enviada para a Assembleia da República a 12 de junho de 2014.

Com os melhores cumprimentos, *am. j. r.*

O Chefe do Gabinete

Francisco R. de Menezes

(Francisco Ribeiro de Menezes)

Anexo: carta de Intenções

Portugal: Letter of Intent

Lisbon, May 26, 2014

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

Dear Ms. Lagarde:

1. This Letter describes the progress made in recent months toward the objectives laid out in our program supported by the Extended Arrangement. It also updates previous letters and MEFPs and highlights the policy steps to be taken in the months ahead, as well as our medium-term reform plans going beyond the program which concludes with this review.

2. Strong program implementation in the face of often challenging circumstances allowed us to put the Portuguese economy on a sustainable growth path. We have undertaken a large fiscal adjustment under the program and we have recently made further progress toward the program objectives, with the end-March 2014 deficit and debt performance criteria met by a comfortable margin, in the context of prudent expenditure control and sustained revenue performance. We have continued to work on boosting the competitiveness of the Portuguese economy and have addressed vulnerabilities in the financial sector as they emerged. This, together with improved market sentiment and economic recovery in the euro area, allowed Portugal to return to growth, post a current account surplus for the first time in decades, and tap international bond markets at lengthening maturities and favorable yields.

3. Nevertheless, key challenges remain and further efforts are needed beyond the program period to secure durable market access, sustain the growth momentum, complete our ambitious fiscal consolidation plan in line with our European Union commitments, and vigilantly monitor the resilience of the financial system in the context of the ongoing deleveraging and rebalancing of the economy. Our reform and policy plans to address these challenges and successfully anchor the objectives set under the program are presented below.

MACROECONOMIC OUTLOOK

4. *Recent developments and outlook.* With economic sentiment at its long-term average, the economic expansion is set to continue, supported by improvements in domestic demand and exports. The unemployment rate is also expected to decline in line with the macro outlook. However, reflecting both recent developments and still-large slack in the economy, inflation will remain subdued in 2014. As in the last review, risks to the baseline are related to the negative effects of private sector deleveraging and of envisaged fiscal consolidation on growth.

5. *External adjustment.* The current account improvement is expected to slow down as domestic demand accelerates. A surplus of about 1 percent is expected for this year, underpinned by continued export growth that reflects market share gains amid strong external demand from both EU and non-EU trading partners. However, weaker-than-expected external demand remains the main downside risk to external adjustment. More importantly, notwithstanding reforms already implemented, continued competitiveness gains will be needed to sustain robust export growth over the medium term.

FISCAL POLICY

6. *2014 Budget Execution.* We remain committed to achieving our 2014 deficit target of 4 percent of GDP—consistent with a structural primary adjustment of about 0.7 percent of GDP. We are monitoring closely budget implementation by line ministries, through monthly reporting to the Council of Ministers, with a special focus on the Public Expenditure Review measures in the budget, as well as finalizing remaining legislation necessary to implement the 2014 budget, including on survivors' pensions and online gambling. In order to make further progress towards the targeted reduction in the size of the public sector workforce, we have extended the term of the ongoing mutual agreements schemes for teachers and we plan to launch other schemes aimed at reducing overemployment in specific sub-sectors in the fall. Nevertheless, the expected yields of the measures on mutual agreements and the requalification schemes have been revised downward due to delays, with the saving targets included in the 2014 budget from these programs now extended to 2015. These together with previously identified pressures arising from lower social security revenues and higher transfers to state-owned hospitals are expected to be offset by the positive 2013 carryover and improved macroeconomic outlook. Moreover, any budgetary implications potentially arising from the ongoing SOE debt management operation, pending further clarity on the implications of ESA2010, will not affect our structural fiscal effort. Should any risks to the execution of the budget materialize, we remain committed to implement compensatory measures of equivalent size and quality to meet the agreed deficit targets.

7. *Medium-term fiscal consolidation.* We will advance our fiscal consolidation efforts in 2015, with a targeted deficit of 2.5 percent of GDP, through the measures identified in the context of the 11th and 12th reviews and as reflected in the 2014 Fiscal Strategy Document. These include savings from (i) further re-organization and streamlining of state-owned enterprises (114); (ii) further expenditure cuts across line ministries, including via increased savings from the health sector through agreements to cap annual public expenditure on pharmaceuticals or through the introduction of a tax claw-back on pharmaceutical industries as our efforts to reduce SOE hospitals' structural imbalances advance; (iii) the rationalization of ICT-related costs in public administration; (iv) additional reductions in public employment which will be attained mainly by attrition, non-renewal of some contracts in areas with over-employment, and the distribution of savings from the requalification scheme between 2014 and 2015; (v) savings from the reduction in contracted studies, consulting and other projects as well as some small revenue items; (vi) reorganization of the provision of public services at local level through the *Aproximar* program; and (vii) excise duties. Moreover, further fiscal consolidation of about ½ percent of GDP will be needed in the outer years

to keep public debt on a downward trajectory, in compliance with the requirements of the Stability and Growth Pact. The 2014 Fiscal Strategy Document, presented last April, provides detailed spending ceilings by line ministries and underlying adjustment measures consistent with our EU budgetary commitments.

8. *Reform of pensions and public administration.* We also intend to complement these additional consolidation measures with other permanent measures aimed at gradually replacing some of the transitory measures introduced under the program and currently in place, so as to ensure the sustainability of the fiscal adjustment. To this purpose, we are advancing our work on the following measures on pensions and wage bill, largely building on the General Public Administration Labor Law which was approved by end-March and taking into consideration recent rulings by the Constitutional Court:

- *Pension measures.* New comprehensive measures as part of the ongoing pension reform shall be undertaken, aimed at further improving the sustainability of the pension system. To fully replace the transitory measure on pensions and fairly distribute the necessary adjustment across pensioners and employed labor force in the private and public sector as well as the society at large, we will (i) introduce a sustainability contribution on pensions respecting progressivity principles; (ii) increase employees' social contributions by 0.2 percentage point; and (iii) raise the standard VAT rate by 0.25 percentage point, with the resulting revenue allocated to the pension system. Moreover, the Pension Reform Committee has developed measures further linking annual pension indexation to demographic and economic criteria as presented in our 2014 Fiscal Strategy Document, and we will discuss these policies with social partners.
- *Supplements and Wage Scale Reforms.* Building on the principles identified in the General Public Administration Labor Law, we have recently conducted a comprehensive review of wage supplements, aimed at standardizing and rationalizing existing supplements by key categories. We will submit a draft law to eliminate supplements during leave days to Parliament by end-June. In parallel, we will finalize a broader reform proposal aimed at rationalizing and unifying wage supplements in the public administration, with a view to its implementation starting in 2015. These and other budgetary savings identified for 2015 (117) will enable us to start reinstating the transitory reductions in wages, with the aim of fully phasing them out over a five year period, provided this is consistent with our wage bill and budgetary targets. Moreover, we are advancing our comprehensive review of public sector remunerations and careers so as to integrate them into the existing single wage scale for public employees. We expect to finalize the reform in the second half of 2014.

The replacement of any transitional measures will remain consistent with our budgetary commitments under the European Treaty on Stability, Coordination, and Governance.

9. *Debt Path.* Gross debt reached 129 percent of GDP in 2013, broadly in line with our preliminary estimate at the time of the 11th review, supported by the improved fiscal cash balance and upward revision in nominal GDP. In 2014, under the programmed fiscal path and as a result of the ongoing debt management operations in SOEs, notably in the transport sector (114), Maastricht

debt, on an ESA95 basis, is expected to stabilize at around 130 percent of GDP and to gradually start to decline in 2015. This is expected to be consistent with a debt-to-GDP ratio of less than 128 percent on an ESA2010 basis, according to our preliminary estimates of the impact of the introduction of the new rules as of end-September 2014, given the offsetting effects of reclassification and nominal GDP recalculation. The debt projections hinge on continued fiscal consolidation in line with our EU budgetary commitments, further use of our cash deposits, as well as the ongoing reallocation of the Social Security portfolio from foreign assets to government securities. Given the ongoing buildup of Central Government cash balances, net debt on an ESA95 basis is projected at around 122 percent of GDP by end-2014.

LIMITING FISCAL RISKS

10. *Public Financial Management (PFM)*. We remain committed to continue our public financial management (PFM) agenda in the post-program period. The Fiscal Transparency Evaluation (FTE) will assist us in better defining our priorities, which along with ongoing reforms will be crystallized in a revised Budget Framework Law (BFL). A pillar of the ongoing PFM reform agenda will remain the enforcement of the commitment control law (CCL) to prevent any new accumulation of domestic arrears, particularly in the health sector.

- *Budget Framework*. We aim at completing the revision of the BFL by the end of this year. On the basis of the report of the technical group charged with revising the BFL, we will present a first draft of the revised law by September and continue consultations with key stakeholders. The key elements of the legislation will include the streamlining of the budget appropriation structure, strengthening of accountability relations, and broadening of the focus and analysis of fiscal risks. In the meantime, we have amended the BFL to fully transpose the Fiscal Compact provisions.
- *Expenditure Control and Arrears*. We remain committed to stop any accumulation of new domestic arrears. In addition to the steps taken since the beginning of the program, we have recently established a dedicated unit within the Ministry of Finance in charge of analyzing expenditure arrears for the entire public sector. We have also finalized targeted programs for publicly owned hospitals with structural financial imbalances and allocated additional budgetary funds to close their operational deficits and fully fund their investment needs, starting in May. Accordingly, should any new imbalances emerge during the year, additional resources will immediately be provided (up to €300 million in 2014) so that hospitals can fully comply with the Commitment Control Law. As regards the railroad company Comboios de Portugal (CP), a new debt management strategy has been launched, which will aim at improving the company's funding model and halt any further accumulation of arrears (114).
- *Fiscal Transparency*. We remain committed to undertake and publish a Fiscal Transparency Evaluation (FTE), with support from IMF experts, by the end of June. This evaluation will assess the transparency of our PFM system against the principles set by the newly revised IMF Fiscal Transparency Code. The FTE will assist us in taking stock of the reform achievements under the program and fine-tuning our priorities going forward, including the BFL revision, with a focus not only on entities included under the general government but also on the broader public

sector with a view to enhance further the disclosure, reporting, and management of the underlying fiscal risks so as to avoid past unpleasant surprises that contributed to the deterioration of public debt dynamics.

11. *Revenue Administration.* With the reforms under the program already starting to bear fruits in terms of revenue collection and performance, we remain determined to push the agenda forward and making further progress in curbing tax evasion in support of our medium-term fiscal objectives. On the back of the hiring process of approximately 1000 new tax auditors and a successful e-invoicing reform implemented, our tax administration reform agenda in the post-program period will involve: (i) strengthening its strategy for tax compliance; and (ii) improving its relationship with the taxpayers. The first objective will be achieved through enhancing capacity in our Compliance Risk Management Unit, created last November, by continuing: (i) phasing in of a modern compliance risk model; (ii) improving PIT compliance management through pilot projects, including the current projects on the High Net Wealth Individuals and Self-employed Professionals; and (iii) augmenting control of the monthly PIT withholding information. The second objective will be reached by establishing by end-2014 a dedicated Taxpayer Services Department, unifying most services related to taxpayers.

12. *Anti-money laundering (AML).* After the program period, we remain committed further to strengthen our AML legal and regulatory framework to tackle more effectively money laundering. For that our multidisciplinary working group will conclude a national AML/CFT risk assessment, proposing any necessary amendment to bring our AML/CFT regime in line with the revised AML/CFT standard adopted by the Financial Action Task Force (FATF/GAFI). In this context, on the basis of recommendations made by IMF technical assistance, we are committed to implement the identified reforms by end-2014, in order to strengthen the exchange of information system between the AML authorities and other competent authorities, such as the Tax and Customs Authority.

13. *Public-Private Partnerships (PPPs).* Beyond the savings already obtained with the PPPs renegotiation, we will continue taking steps to achieve a fiscally responsible PPP model. We remain committed to finalize our major renegotiation of road contract PPPs with all concessionaires and lending banks, including with the European Investment Bank, generating additional structural savings of more than €2.5 billion over the life cycle of these concessions. We will also finalize the revision of the regulatory framework for the road and rail sectors, reducing operation, maintenance, and major repair requirements, in line with EU standards and with the objective of minimizing fiscal risks. Moreover, with a negotiation team appointed last February, the renegotiation of the Security Integrated System (SIRESP) PPP contract will proceed as envisaged, with the objective of generating further permanent savings starting in 2014 via a reduction on its internal rate of return and full network scope improvement and optimization. Furthermore, the Ministry of Finance PPP unit will continue to work towards enhancing fiscal transparency, improving reporting on PPPs, expanding its field of action to other sectors, namely health and security, in coordination with the relevant line ministries, and closely monitoring and advising the PPP renegotiation process in the autonomous region of Madeira.

14. *State-Owned Enterprises.* The consolidated operational balance of transport SOEs has substantially improved under the program, thanks to formal cost-reduction objectives for loss-making firms that we intend to retain going forward. The selection process to staff the dedicated Technical Unit (UTAM) is ongoing – the Unit will be operational by end-June 2014. Moreover, we have recently taken further steps to strengthen the financial sustainability of selected SOEs:

- *Debt management operation.* As legacy debt burdens continue to weigh on the financial results of SOEs, mainly in the transport sector, we have recently launched a new comprehensive debt management strategy to restore their financial sustainability and stop any accumulation of arrears (¶17). As a first step, we have started servicing their financial debt at residual maturity and any operational losses that some of these companies may still have, but that will have to be corrected. Subsequently and according to the ESA2010 rules coming into effect in September, it is expected that some of the SOEs, including CP, will be reclassified within the general government perimeter (¶16). The new reclassified companies will be subject to the strategy currently in place for the SOEs already within the general government perimeter which includes their recapitalization in line with EU rules. Operational and financial restructuring will help pave the way for successful tendering of concessions already planned or considered.
- *REFER/EP Merger.* In addition, the merger of REFER and EP that will be concluded this year is expected to generate significant operational efficiency gains.

15. *Privatization.* Under the program, we have exceeded our initial privatization targets and we are further considering expanding the privatization program to include additional assets for sale or concessions. The sale of the insurance arm of state-owned CGD is expected to be closed by May, with the proceeds contributing towards CGD's CET1 capital. TAP's financial results improved significantly in 2013, including in its Brazilian subsidiary, and we will evaluate the opportunity to re-launch the privatization process in the course of this year. The launch of the privatization process of CP Carga in the second half of the year is subject to a satisfactory appraisal of the firm, following the agreement with REFER regarding the transfer of its terminals and the approval of the rail investment plan. We will sell the remaining 11 percent of the shares in REN through a market offer, which is expected to be done by end-June 2014. Binding offers for the sale of the waste management company, EGF, are now expected by end-July 2014. The restructuring of transport SOEs in Lisbon and Porto is ongoing (¶14). Following the consultation process, we now expect to launch the four concessions by end-June 2014.

16. *Regional and Local Governments.* In the post-program period, we will remain committed to fiscal discipline at local and regional government level which has improved considerably over the program period, including through implementation of the new Regional Finance Law (RFL) and Local Finance Law (LFL). Accordingly, we are (i) fostering close coordination between the central and subnational governments through the recently created Council of Territorial Partnership and the Coordination Council; (ii) finalizing the program for local governments' arrears settlement (PAEL), with only ten requests by municipalities pending approval; and (iii) expecting to submit to Parliament a draft law by end-June on the Municipality Support Fund (FAM) for financially distressed municipalities, whose proposals for rules and procedures have just been finalized by a group of

experts. We will also finalize our strategy for the reorganization of the provision of public services at local level (*Aproximar*) and continue to closely monitor Madeira's program with the State (PAEF), including its PPP renegotiation process.

SAFEGUARDING FINANCIAL STABILITY

17. *Bank Supervision.* Banks' capital buffers remain commensurate with the still challenging operating environment. In line with past credit impairment reviews, and in anticipation of the ECB's Comprehensive Assessment, the BdP continues to monitor the adequacy of banks' impairment levels, with a particular focus on companies with credit at risk. While we will continue to encourage banks to seek private solutions, should new capital needs arise in the context of the Comprehensive Assessment process, we remain committed to providing further support to viable banks with resources from the Bank Solvency Support Facility (BSSF), if needed. Any public support will remain subject to strict conditionality, in line with EU State-aid rules, aimed at avoiding subsidizing private shareholders and preventing migration of private liabilities to the public sector balance sheet, while ensuring adequate lending to the real economy.

18. *Funding and Liquidity Conditions.* Deposits have remained stable in an environment of gradually decreasing remuneration rates, while banks continue to expand their access to financial markets funding and gradually reduce the reliance on Eurosystem liquidity. Nevertheless, non-standard measures by the European Central Bank (ECB) to restore the proper transmission of monetary policy continue to play a pivotal role in easing liquidity pressures and absorbing remaining funding constraints, while strengthened collateral buffers provide an important shield against potential adverse shocks. In parallel, we continue discussions with our European partners on further initiatives to support funding conditions, including potential mechanisms to securitize banks' high quality mortgage and SME credit.

19. *Corporate Debt Restructuring.* We are finalizing our strategic plan, in technical consultation with the BdP and with EC, ECB, and IMF staff, aimed at addressing the corporate debt overhang, with a particular focus on economically viable SMEs. The strategic plan envisages: (i) an enhanced framework for debt restructuring that can support the reallocation of capital towards productive sectors in the economy, notably tradable sectors; (ii) a body with enough power to move the corporate debt restructuring process forward, facilitating more standardized out-of-court workouts for SMEs and inter-creditor agreements in the debt restructuring of larger firms; and (iii) close monitoring of financial stability implications through the assessment of the impact of restructuring the corporate debt overhang on banks' balance sheets. The strategic plan, to be completed by end-May 2014, will also include clearly defined milestones and deadlines, to be discussed with EC, ECB and IMF staff.

20. *Deferred tax assets.* We are assessing the feasibility and implications of a possible amendment of the treatment of deferred tax assets (DTA) in the corporate sector. In doing so, we will carefully weigh the benefits of such an amendment for financial stability against the program's objective of ensuring fiscal sustainability, while providing proper incentives for accelerated balance sheet clean-up.

21. *Development Financial Institution (DFI).* We continue to seek ways to address market failures and improve access to financing, especially for viable SMEs. To this end, the DFI will more efficiently manage financial instruments funded by EU structural funds and other government-supported funding instruments. The DFI will be incorporated as a financial company supervised by the BdP. The DFI will impose no additional burden on or risks to public finances or sovereign credit and adhere to safeguards of supervision, public control and transparency. The Decree-Law and by-laws will ensure that the DFI will: (i) not invest in debt issued or guaranteed by the public sector including non-financial state-owned enterprises outside the general government perimeter, and regional and local authorities, nor lend or issue guarantees to that sector; (ii) not take deposits or other repayable funds from the public; (iii) not engage in direct lending, limiting its lending activities to on-lending through commercial banks; (iv) solely source its long-term financing from multilateral financial institutions or national promotional institutions; and (v) manage EU structural and investment funds in accordance with EU regulations and the Partnership Agreement. The business model will be finalized in technical consultation with the staff of the EC, ECB and IMF. The DFI will operate in line with EU State-Aid rules.

22. *Central Credit Registry.* We remain committed to enhancements to the Central Credit Registry that will reduce information asymmetries by granting financial institutions access to companies' historical information and corporate balance sheets. We have adjusted the scope of the proposed legislation which will allow to fast-track improvements to the legal framework. The final draft of the proposed Decree-law will now be submitted for approval to the Council of Ministers by end-June, after consultation with the main stakeholders. Implementation of these changes is still expected to take place during the second half of 2014.

23. *BPN Special Purpose Vehicles (SPVs).* The gradual recovery of the assets from Banco Português de Negócios (BPN), held by three state-owned SPVs, continues. Business plans for two service providers for the management of Parvalorem's loan portfolio have been agreed. CGD's state-guaranteed claim will be gradually settled in cash, according to the schedule previously agreed with the EC, ECB, and IMF staff. Any net recoveries realized on the assets will also be applied toward the settlement of CGD's claims.

BOOSTING COMPETITIVENESS, GROWTH, AND EMPLOYMENT,

24. *Reform strategy.* The ultimate objective of our structural reform agenda has been to enhance competitiveness and improve the business environment, so as to engineer a sustainable rebalancing of the economy toward high productivity-growth tradable sectors and boost medium-term growth and job creation. Most reforms initiated at the beginning of the program are drawing to a close or will be completed in the next few months. Product and labor market reforms have been designed to alleviate nominal rigidities, facilitate adjustment, and foster a reallocation of resources toward the tradable sector in the context of a monetary union. Important measures were also taken to reduce red tape and raise the efficiency of the judicial system. While reforms are starting to bear fruit, the economy remains vulnerable. The requirements of a monetary union are such that a more flexible economy is paramount to reduce susceptibility to shocks and foster higher sustainable growth and employment. In light of this, the government is committed to sustain its reform effort, focusing both

on the effective impact of the reforms already implemented—including via systematic and independent evaluation of outcomes—and identifying and tackling remaining policy distortions. Priority areas to be addressed in the post-program era are laid out in a medium-term reform strategy document, [The Road to Growth, A medium-term reform strategy for Portugal](#).

25. *Competition/Regulation.* The reform of the competition and regulation frameworks—which is aimed at strengthening competition, ensuring a level-playing field for business activity, and establishing a regulatory environment that protects the public interest and promotes market efficiency—is close to completion. The final adoption of the bylaws of the National Regulatory Authorities (NRAs) is expected to take place shortly; and with a few additional weeks necessary to make the NRAs fully operational, the reform should be fully in force by September 2014. Looking ahead, we will ensure that the competition authorities and national regulatory authorities remain independent and benefit from financial, administrative and management autonomy, including by taking into account their potential growing resource needs over the medium term. We will also continue to promote the adoption of best international regulatory practices. With the expected gains from these reforms potentially large, the government will rely increasingly on these authorities and their recommendations to strengthen the competitive environment in the economy.

26. *Sectoral reforms.* In keeping with the progress made under the program we will continue to enhance competition and take steps to reduce end-user costs in a number of sectors in network industries.

- *Energy.* While the Portuguese government has already taken significant measures to alleviate pressures on the electricity tariff deficit, elimination of the related debt by 2020 will still require price increases above inflation. In light of this, we will strive to identify further policy options to better share the burden of adjustment among all stakeholders, including by tackling any remaining excess rents in the sector. Following the identification by the government of the problem of distortion on the system services market and highlighted in the reports of the relevant regulators, we are implementing measures in line with these reports to prevent the risk of overcompensation in the adjustment calculations (*revisibilidade*) of the CMEC scheme. The government is keen on taking steps to reduce energy prices. Accordingly, we have prepared a number of measures that will deliver cost reductions to be reflected in end-user electricity prices (for the lowest income earners), bottled and natural gas, and fuel. Most of these measures will be implemented in the next few months. The exceptional energy levy introduced in 2014 will also be maintained next year. We will continue to ensure that is not passed through to end-users.
- *Transport.* The reform agenda in the transport sector will remain geared toward reducing costs for exporters and making the economy more competitive. Building on our recently-adopted long-term strategic transport infrastructure plan, infrastructure investment projects will be prioritized taking into account their impact on competitiveness and the budget constraint. In the rail sector, we will continue to prepare the privatization of the freight branch of the state-owned rail operator, by implementing measures to ensure operational balance by 2015, by assessing the investment plan on rail to fully enhance the economic value of the company, and by

completing the company terminals' unbundling. In the ports sector, we will continue to implement our reform plan according to the chronogram that was recently made public. In this context, we have launched a renegotiation of existing concession contracts). The objective is to foster efficiency and price reduction. Looking ahead, we will also revise incentives for port operators by adopting a new performance-based model for future concessions and encourage entry of new operators.

27. *Labor Market Institutions.* Significant steps have been taken over the past few years to make the labor market more dynamic and efficient—including reforming Employment Protection Legislation, streamlining unemployment benefits and reforming the wage-setting mechanism. However, notwithstanding the recent decline, unemployment remains high, particularly for youth and the long-term unemployed. The labor market is also segmented, with a large proportion of new employment contracts extended on short-term basis—although flows have improved recently. In addition, a more flexible labor market is critical to enhance the economy's resilience to shocks, particularly in the context of the monetary union. Against this backdrop, we see scope to extend the progress made in recent years in a number of directions. First, continued efforts to adapt employment protection would help support labor demand and reduce unemployment at a faster pace. Second, we will encourage wage developments consistent with productivity, including by making collective bargaining more dynamic and fostering decentralization of wage bargaining. The government's immediate priority in this area will be to: (i) adjust the current criterion for the extension of collective agreements—taking into account the representativeness of micro-, small-, and medium-sized enterprises in the various sectors and maintaining the aim of the previous reform under the program; (ii) shorten the survival periods of collective agreements; (iii) introduce mutually agreed temporary suspension clauses for enterprises facing economic difficulties; and (iv) extend the suspension of the previous collective agreements with payments of extra hours above the code, in line with the rules of the state budget for 2014. In setting the minimum wage, we will take into account developments in employment and productivity and consult with social partners. Finally, the government intends to continue to strengthen activation policies, with significant expected pay offs when vacancies pick up.

28. *Services.* Reforms in the services sector aim at eliminating entry barriers and increase competition. Significant progress is being made in amending sector-specific legislations to align them with the Services Directive, with 67 out of 70 diplomas already approved by the Government. Following the publication last year of the new legal framework aimed at improving the functioning of the regulated professions, 18 professional bodies' statutes are being amended. We expect all bylaws to be submitted to Parliament for final approval by the end of the summer. These new legislations eliminate unjustified restrictions to activity and further improve the conditions for mobility of professionals in line with the EU Directives in the area of free movement of professionals.

29. *Business environment.* Tackling excessive licensing procedures, regulations and other administrative burdens—which are impeding the establishment, operation, and expansion of firms—will remain a government priority. The roadmap for regulatory simplification under preparation will serve as a guide in the months ahead. We will also continue to make progress toward making the

Point of Single Contact—an e-government portal which allows administrative procedures to be conducted online—fully operational. Building on the successful reforms already implemented in the program, we will continue making progress toward an effective and efficient judicial system.

30. On the basis of the strength of the policies outlined in this letter, and in light of our performance under the program, we request the completion of the twelfth and final review under the Extended Arrangement. This would complete the disbursements of international assistance under the arrangement.

31. We remain confident that the policies described in this letter and previous letters and MEFPs are adequate to achieve the objectives under the program supported by the Extended Arrangement. We intend to maintain a close dialogue with the Fund and will consult with it semi-annually under Post-Program Monitoring consistent with standard Fund policies.

32. This letter is copied to Messrs. Dijsselbloem, Rehn, and Draghi.

Sincerely yours,



Paulo Portas
Deputy Prime Minister



Maria Luís Albuquerque
Minister of State and Finance



Carlos da Silva Costa
Governor of the Banco de Portugal