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Reforming the Legal and Institutional Framework for the  
Enforcement of Civil and Commercial Claims in Portugal

by Sebastiaan Pompe and Wolfgang Bergthaler

I N T E R N A T I O N A L M O N E T A R Y F U N D

**IMF Working Paper**

Legal Department

**Reforming the Legal and Institutional Framework for the Enforcement of Civil and Commercial Claims in Portugal**

**Prepared by Sebastiaan Pompe and Wolfgang Bergthaler**

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***Abstract***

This paper discusses the recent major reforms in the area of civil and commercial claims enforcement undertaken by the Portuguese authorities in the context of the IMF/EU-supported adjustment program. The economic literature has long recognized that slow claims enforcement affects economic growth, foreign direct investment, credit and labor markets, and firm size. The Portuguese authorities together with IMF/EU staff deployed a novel approach that has focused on incentives tackling weaknesses in the enforcement process with the aim of increasing the efficiency and effectiveness of claims enforcement and resolving court backlogs. The paper finds impressive quantifiable changes affecting, in particular, court backlog reduction, court processing speed, and private debt recovery. The economic literature suggests that this will impact positively on the payment culture and overall growth, even if such impact cannot be determined at this stage.

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## 1. INTRODUCTION

1. **This paper analyzes the recent major reforms that the Portuguese authorities have undertaken in the area of civil and commercial claims enforcement, in the context of the International Monetary Fund (IMF)/European Union (EU) supported adjustment program.**<sup>1</sup> The economic literature has long recognized that slow claims

enforcement may affect not only economic growth but also foreign direct investment (FDI), credit and labor markets, and firm size. The Portuguese authorities, assisted by IMF, European Commission (EC), and European Central Bank (ECB) staff, designed a novel approach to tackling weaknesses in claims enforcement—namely, an approach focusing on incentives. These incentives aim to increase the effectiveness and efficiency of the judicial system for the enforcement of civil and commercial claims, thereby changing behavior.<sup>2</sup>

2. **The paper is structured as follows.** The paper first discusses the recent literature, which ties weaknesses in claims enforcement to slow growth, and then describes their impact in terms of data on the Portuguese economy. Second, it explains the diagnostic undertaken by the Portuguese authorities in the context of the IMF/EU adjustment program. Third, it describes the specific steps the Portuguese authorities undertook to implement the measures. Fourth, it concludes with key lessons.

### A. Economic Relevance

3. **The economic literature has long recognized the importance of a predictable and efficient system of property rights and effective enforcement of civil and commercial claims for economic growth.** Traditionally, the significance of this relationship has been defined in terms of a country's ability and cost to access international capital markets, which translates into FDI. Recent developments in the economic literature, however, point at a more direct relationship between the speed of legal enforcement and economic growth. The literature suggests that slow legal enforcement—in addition to affecting FDI—is also a factor in shaping economic structures and can create structural barriers to growth. Studies<sup>3</sup> point at the way slow enforcement of claims restricts firm size, reduces access to credit, affects firm capital structures and liquidity (with a spin-off to employment), and increases unemployment through liquidity-triggered insolvencies. These factors contribute to a structural productivity gap of affected economies, resulting in a structural growth deficit.

4. **The system of claims enforcement has acquired a special importance in the context of the global financial crisis.** As set out more specifically below, not only gave the

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<sup>2</sup> Recent Banco de Portugal research supports the view that it does not suffice to change the regulatory framework; instead, it is critical to shape the way it is applied. See, for example, Pinheiro-Alves and Tavares (2013, 22 and following).

<sup>3</sup> See the studies cited in paragraph 5.

crisis legal enforcement a forward-looking role supporting recovery and sustaining growth in the future but also challenges to enforcement of civil and commercial claims resulted in accumulated public expenditure burdens to the state, such as the workload impact and personnel pressures of the ever-increasing backlogs, the structural operational deficits, the litigation-induced impaired tax revenue, and the large stock of paid-for-but-unenforced enforcement cases. All of these made reforming claims enforcement not solely a matter for future recovery and growth but also a critical element for resolving the crisis itself.

5. **Specifically, the Portuguese legal system has been identified as an important factor to explain the country's growth performance, but there are other indicators such as unemployment.** Various factors, including excessive public spending, caused Portugal to trail the EU members' average from the late 1990s and the first decade of the 21st century. Yet, the comparative low figures of investment, both foreign and domestic, tell their own story:

- **Impact on FDI.** Inward FDI is positively correlated with the quality of legal institutions (Bénassy-Quéré and others, 2007). There are questions on whether FDI in Portugal (as well as in other countries in the region) played the role it could in boosting the performance of the economy (IMF, 2011a).<sup>4</sup> The FDI attracted by Portugal trailed that of other EU countries, including Spain and France. While there were many factors to explain this, including relatively high labor costs and an inflexible labor market, the slow enforcement of civil and commercial claims was a significant contributing factor.<sup>5</sup>
- **Impact on credit markets.** Weak contract enforcement raises the cost of borrowing and shortens loan maturities (Bae and Goyal, 2009; Laeven and Majnoni, 2003), with a detrimental impact on investment, the depth of mortgage markets, and GDP (Bianco and others, 2002; Laeven and Majnoni, 2003; Djankov and others, 2008). Portugal is a traditional case in point, with a shallow mortgage market. This changed after 2002 with the introduction of the euro, when the mortgage market increased sharply (Warnock and Warnock, 2008). The global financial crisis further exposed the continued weaknesses in legal enforcement, which was an important factor in the comparatively sharp contraction of the market.
- **Impact on firm size and export competing firms.** The literature also finds a positive correlation between the quality of the judicial system and firm size (Kumar and others, 2001; Beck and others, 2006). Various factors can keep firms small, including restrictive labor regulations and administrative permits. In this regard, Portugal has been cited as a typical example (Braguinsky and others, 2011; *The Economist*, 2012). However, the literature also points to a strong rapport between firm size and slow, costly dispute settlement (Giacomelli and Menon, 2012;

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<sup>4</sup> The Portuguese situation was compounded by issues of sectoral allocation as well as over-investment in the non-tradable sector.

<sup>5</sup> See European Commission 2014, notably Chapter V.2. In a survey of 238 foreign and 18 domestic firms, Castro and Buckley (2001) firmly identified the legal system and bureaucracy as the main obstacle to doing business in Portugal and the key factor to reduced investment, ahead of 14 other indicators, including the tax system, labor skills, market size, etc. See also Pinheiro-Alves and Tavares (2013).

Garcia-Posada and Mora-Sanguinetti, 2012). There is evidence that a weak legal environment reduces external competitiveness of export-competing firms by raising their transactions costs (IMF, 2015).

- **Impact on debt restructuring and insolvency.** Inefficient, nonspecialized, and inexperienced courts impact timely debt resolution and impede rapid reallocation of resources to more productive sectors within an economy. Out-of-court debt restructuring schemes do not yield cost-effective and rapid results without being backstopped by a functioning and robust insolvency regime and institutional framework (i.e., courts and insolvency practitioners). Such delayed debt resolution negatively affects bank lending, with negative feedback loops to growth and economic recovery.<sup>6</sup>
- **Impact on labor market.** Inefficient labor courts can have detrimental effects on job reallocation, which in turn impacts productivity and capital intensity. A number of publications define inefficiency in terms of speed (Gianfreda and Vallanti, 2013a, 2013b). Other publications qualify efficiency in terms of a steady pro-worker orientation of courts, which it finds creates labor-market rigidities that result in job destruction even if individual workers might win in court (Fraisie, Kramarz, and Prost, 2011). This may be the case in Portugal, where courts tend to side with individual workers at the expense of overall employment, backed up by a constitutional and legislative framework very protective of labor.<sup>7</sup>
- **Impact on weak enforcement reinforces vulnerabilities.** Weak enforcement leads to late (or nonexistent) payments, which triggers liquidity issues, bumps up insolvency, and increases unemployment. Pervasive late payments are closely linked to a weak enforcement system (Intrum Justitia, 2013). This is particularly relevant for Portugal, which is among the worst performers on consumer, corporate, and public sector payment.<sup>8</sup>

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<sup>6</sup> Bergthaler and others (2015); Aiyar and others (2015). This paper will not further discuss Portugal's reform efforts in debt restructuring and insolvency. See IMF (2015).

<sup>7</sup> Portuguese courts have been consistently recognized to have a favorable inclination towards workers; see Braguinsky, Branstetter, and Regateiro (2011). The Portuguese Constitutional Court on four occasions declared unconstitutional laws (or sections thereof) sitting at the heart of the IMF/EU-supported economic adjustment program and all related to labor protection. This included sections of the 2013 state budget, which scrapped holidays bonuses for public workers and pensioners, as well as cuts in unemployment and health benefits (April 2013); a law limiting holiday and Christmas pay on grounds that because it only applies to the public sector, it is inequitable (July 2013); a law permitting the state to fire public sector workers (August 2013); a law for private sector layoffs on grounds of discriminatory conditions (September 2013); and a law that converged state and public pensions on the ground that it violated the reasonable expectation of workers to a fixed pension payment (December 2013).

<sup>8</sup> Out of 32 countries reviewed on the duration of payment in days, Portugal scored second worst on payment by consumers (after Italy), fourth worst on payment by businesses (after Turkey, Italy, and Cyprus), and fourth worst on payment by public bodies (after Italy, Greece, and Spain). *European Payment Index 2013* [http://intrum.crmplatform.nl/documents/IJ\\_EPI\\_2013\\_UK\\_SEC.pdf](http://intrum.crmplatform.nl/documents/IJ_EPI_2013_UK_SEC.pdf). See also European Commission (2014).

- **Impact on entrepreneurship and innovation.** Ardagna and Lusardi (2008) establish a link between entrepreneurship rates and the efficiency of the judiciary. Berkowitz and others (2006) find that stronger contract-enforcement institutions are positively correlated with more complex exports and less sophisticated imports. Finally, there is evidence that a weak legal framework leads to “fidelity management” (i.e., management is hired based on family connections rather than on merit) firms, which leads to poor overall economic performance IMF (2015).

## B. Background for Reforms

6. **Having lost market access in early 2011 in the wake of the global financial crisis, which had become the euro area crisis, the Portuguese authorities requested financial assistance from the IMF and the euro-area through the European Financial Stability Facility (EFSF) in support of their economic reform program.** The IMF supported the program with a three-year extended arrangement.<sup>9</sup> A number of the structural measures that Portugal committed to implement under the IMF-supported program were related to reforming the claims enforcement system (see Box 1).<sup>10</sup>

### Box 1. Key Measures under the IMF-Supported Program<sup>1</sup>

Key measures undertaken by Portuguese authorities under the IMF extended arrangement included the following.

- **Civil procedure reform:** Comprehensively reform the Code of Civil Procedure (CCP) with a proposal completed (December 2011) and submission to Parliament of the draft bill (November 2012).<sup>2</sup>
- **Institutional reform:** Comprehensively reform the judicial organization (November 2012).<sup>3</sup> Standardize court fees and introduce special court fees for certain cases by end-September 2011.
- **Backlog:** Audit backlogged court cases (June 2011) and eliminate the backlog of enforcement cases (June 2013). Establish an interagency task force by end-November 2011 to set quarterly targets for closing enforcement cases and prepare quarterly reports on implementation status.
- **Enforcement agents:** Reorganize the profession of enforcement agents with a new oversight body and a new fee structure (both end-June 2013).

The Portuguese authorities met all these measures on time.

<sup>1</sup> See IMF (2011b, 2011c, 2011d, 2012a, 2012b, 2012c, 2013a, 2013b, 2013c, 2014a, and 2014b).

<sup>2</sup> Both measures were structural benchmarks. According to the IMF’s Guidelines on Conditionality (IMF, 2013d), “[a] measure may be established as a structural benchmark where it cannot be specified in terms that may be objectively monitored or where its non-implementation would not, by itself, warrant an interruption of purchases or disbursements under an arrangement. Structural benchmarks are intended to serve as clear markers in the assessment of progress in the implementation of critical structural reforms in the context of a program review.”

<sup>3</sup> Structural benchmark.

<sup>9</sup> To the extent economists have judged the issue of claims enforcement to be macro-critical, the IMF has been involved in the area of claims enforcement since the Asian crisis and more recently in Greece, Kosovo, Ukraine in a program context, and Italy in the surveillance context (see, Esposito, Lanau, and Pompe, 2014).

<sup>10</sup> There were about 52 actions in the broader financial sector and insolvency area with the objective of reducing transactions costs. According to a survey conducted by IMF staff, the reforms were perceived to be positive (IMF, 2015).



7. **The Portuguese authorities came to the issue of judicial reform well prepared, with detailed information on their system, and willingness to consider changes.** The authorities had been aware of the crisis building up in the justice sector for some time. At various times prior to the crisis, the authorities had undertaken initiatives to turn around the situation in the courts.<sup>11</sup> However, these initiatives did not translate into meaningful reform.<sup>12</sup> What matters, though, is that even as the economic crisis was affecting the country in 2009–2010, the authorities were well informed on the issue of judicial reform. Also, having explored various reform approaches over the previous decades, the authorities recognized the need for more structural adjustment. This was an important backdrop to the reforms that were undertaken and helps to explain their ambit and impact.

8. **The Portuguese judicial system had (and continues to have) a number of commendable features that are of broader structural importance.** Two key features stand out: (1) a very efficient system for the administrative processing of payment orders (*injunção*), and (2) an outstanding electronic data infrastructure for the judiciary.

- **Payment orders.** Payment orders<sup>13</sup> cover a large majority of small and mid-sized civil and commercial claims. Also, the majority of such claims generally are uncontested by the debtor. A speedy processing of such claims is important to an economy and helps shape a country's payment culture. In view of the high volume of such claims, payment orders can also be very burdensome to a legal system—and costly to the taxpayer. The tendency in Europe, therefore, is to shift to a very summary processing of such claims, with some countries having moved to an entirely automated process.<sup>14</sup> In 2000, Portugal introduced an automated system, which bypasses the regular courts. This makes the country a front-runner in the efficient processing of payment orders. However, the challenge in Portugal, as it turned out, is that while the processing of payment orders was efficient, the enforcement of these payment orders failed due to inadequate institutional and professional infrastructure. This does not deny that there also were significant in-court inefficiencies and delays, but such inefficiencies principally affected contentious civil and tax disputes. On

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<sup>11</sup> This includes statutory changes starting as early as 1993, the privatization of the enforcement agents in 2003, the Action Plan to Relieve the Courts (*Plano de Ação para o Descongestionamento dos Tribunais* 2006–2008), and the Working Group to Speed up the Detection and Settlement of Enforcement Procedures (*Grupo Dinamizador da Detecção e Liquidação de Processos de Execução*). Also, in 2009, the government established a commission to review the Code of Civil Procedure to improve efficient case processing.

<sup>12</sup> Some of the reform measures ended up contributing to the slow enforcement process, such as the privatization of the enforcement agents in 2003.

<sup>13</sup> Payment orders can cover a broad category of civil and commercial claims.

<sup>14</sup> Examples of summary proceedings are the *injunction de payer* in France, the *Mahnverfahren* in Austria and Germany, and the so-called *EPU* in Poland. Some countries, such as France, still require a judge in person and the requirement to submit supporting evidence. Other countries, such as Austria or Germany, are fully automated and do not require submission of evidence.

payment orders, which constitute the vast majority of civil claims, the in-court process was very efficient.

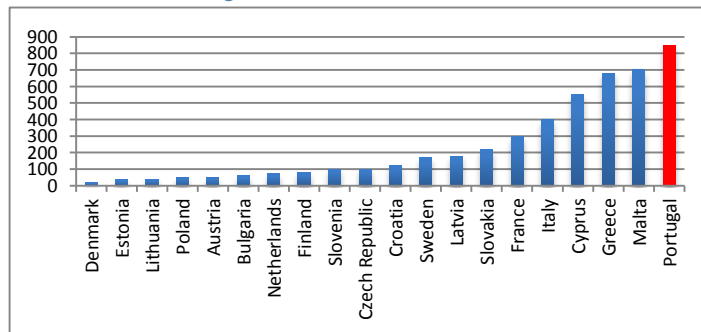
- **Data infrastructure (CITIUS).** The system encompasses key elements of the civil courts<sup>15</sup> and processing of the enforcement cases. It is a partially interactive system, permitting usage of relevant professions (such as enforcement agents), e-filing, and so forth. Also the system generates data to fairly granular levels, allowing for detailed understanding of the status and operations of the courts. Consequently, and unlike in many other countries in Europe, Portugal is very advanced for the large majority of courts and cases; they can realize cross-cutting and detailed analyses of the justice system's performances. This system developed rapidly, and from 2012 it allowed the enforcement agents to connect with their IT infrastructure. This significantly enhanced the efficiency of the enforcement process and at the same time strengthened transparency and accountability.

### C. National Data and International Comparison

#### International Comparison

9. **International reports show that the enforcement of civil and commercial claims in Portugal is slow.** For instance, the European Scoreboard 2014 (which is based on 2010 figures, see Figure 1) gives Portugal the worst score of all EU countries in the enforcement of civil and commercial claims generally.

Figure 1. EU Scoreboard 2015: Time (in Days) Needed to Resolve All Litigious and Non-Litigious Civil, Commercial, and Administrative Cases

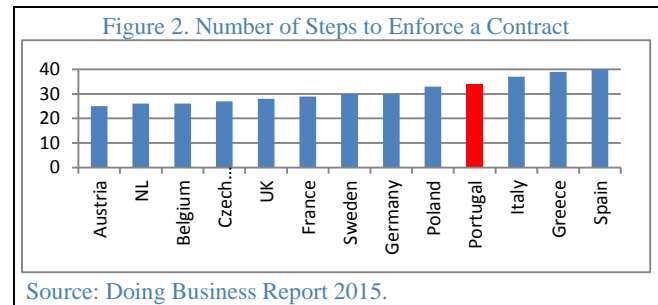


Source: Council of Europe (CEPEJ) data for 2012.

<sup>15</sup> The system does not, however, cover the administrative and tax courts.

10. **For regular civil and commercial cases that end up in Portuguese courts, the procedure is not very fast or efficient** (see Figure 2).

<sup>16</sup> Thus, compared with many other countries in the euro area, Portuguese law has a relatively large number of steps to enforce a contract.



11. **The Portuguese enforcement system has bottlenecks at specific stages of the process, with other elements working fairly well.**<sup>17</sup> An important bottleneck in Portugal sits in the enforcement stage. In-court delays are important but not as severe. This explains why, in the EU Scoreboard, for example, Portugal scores very badly in the overall resolution of civil and commercial disputes (Figure 1), but ranks in the mid-range on resolution of litigation (16th out of 22 countries).<sup>18</sup>

12. **The weak performance of Portugal’s enforcement system is reflected in the impact on its payment culture.** For instance, the European Payment Index shows that Portugal ranks among the worst performers on consumer, corporate, and public sector payment.<sup>19</sup>

<sup>16</sup> The overall figures on the resolution of litigation in Portugal include both in-court litigation and the very efficient computer-based payment order procedure (the *injunção* discussed above). The latter offsets the slow in-court process of the former.

<sup>17</sup> This helps explain why Portugal scores comparatively well in some international reports. One example is the *Doing Business Report 2015*. In the section on “Enforcement of Contracts,” Portugal has a higher ranking than that of a number of other EU countries, including the United Kingdom and the Netherlands. In fact, Portuguese law requires more procedural steps to enforce a contract than do the United Kingdom and the Netherlands, and the process takes longer in Portugal, yet it also is significantly cheaper. Cost is one of the variables counted in the *Doing Business Report*, and this impacts on the overall country score. [www.doingbusiness.org/data/exploretopics/enforcing-contracts](http://www.doingbusiness.org/data/exploretopics/enforcing-contracts). Disclaimer: As pointed out in an independent evaluation of the *Doing Business Report* (see [www.worldbank.org/ieg/doingbusiness](http://www.worldbank.org/ieg/doingbusiness)), care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business constraints, and a small number of informants, which tend to overstate the indicators’ coverage and explanatory power.

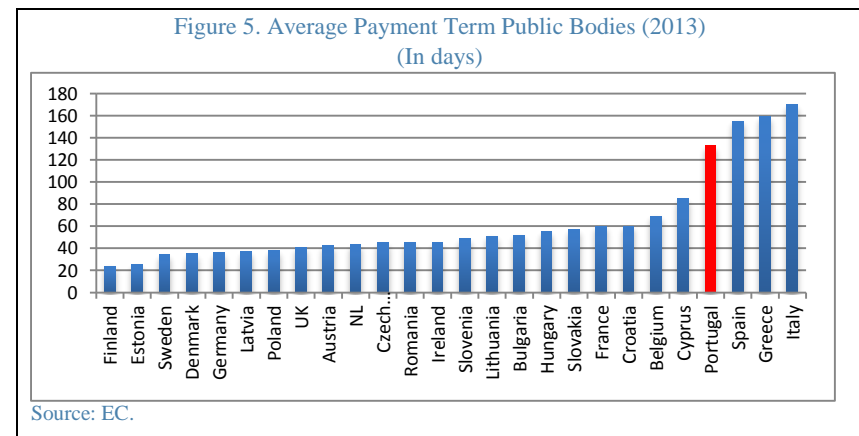
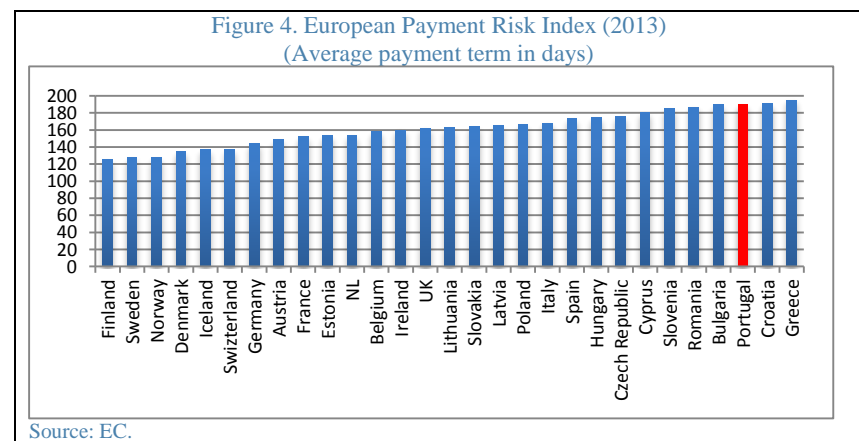
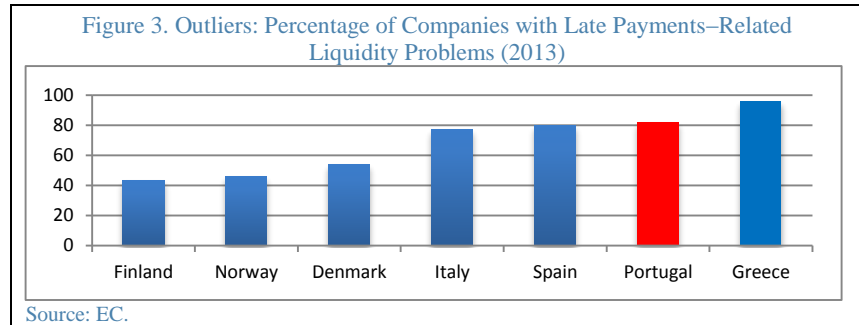
<sup>18</sup> Scoreboard and CEPEJ data are skewed by the fact that Portugal retains cases on the court register during the enforcement process, when a number of other EU countries do not (such as France, the Netherlands, or the United Kingdom). This also reflects the fact that courts in Portugal retain a role in enforcement, which is absent in some other EU countries. As a result of this system, Portugal will likely always have a longer processing time for cases than some other EU countries, regardless of how efficient it becomes. That said, it must be recognized that some countries with in-court and/or state-administered enforcement procedures (such as Germany, Austria, and Sweden), clearly are more efficient in processing enforcement cases. Data and market assessments also show that Portugal’s legal enforcement challenges are more than a bookkeeping issue and have real market impact. Moreover, they have gradually worsened with time, as is recognized by consecutive Portuguese administrations.

<sup>19</sup> Out of 32 countries reviewed on the duration of payment in days, Portugal scored second worst on payment by consumers (after Italy), fourth worst on payment by businesses (after Turkey, Italy, and Cyprus), and fourth

13. **This weak payment culture affects firm liquidity.**

Compared with other countries, a large percentage of Portuguese firms face liquidity challenges directly attributed to late payments (see Figures 3 and 4).

This is the second highest in the larger EU region (after Greece). The Portuguese market is dominated by small and microenterprises (SMEs). These SMEs are particularly vulnerable to liquidity constraints arising out of late payments—which then often trigger company closures and insolvency. The prevailing late payment practice in Portugal has an accelerator effect on unemployment. Portugal is listed as the third highest payment risk country within the larger European region. Similarly, the lobby group 30max, which seeks country compliance with the EU Late Payments Directive, lists Portugal as the fourth worst performer of 26 countries in the payment term of public bodies, with a marked difference from other countries<sup>20</sup> (see Figure 5).

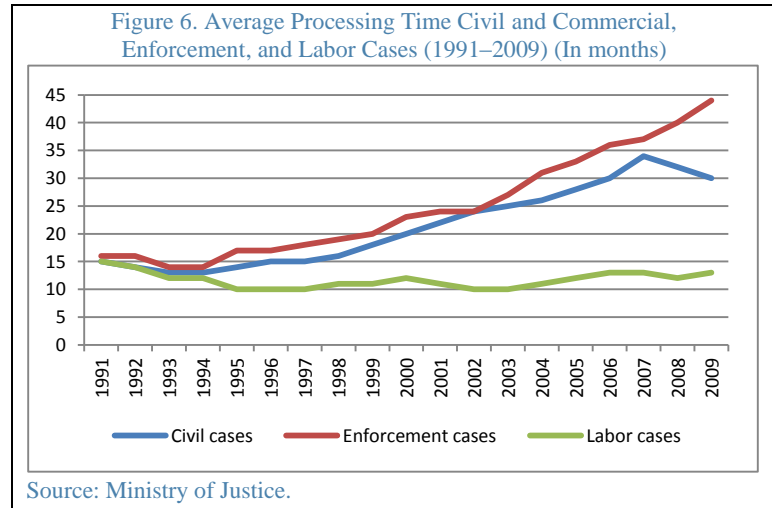


worst on payment by public bodies (after Italy, Greece, and Spain). *European Payment Index 2013*  
[http://intrum.crmplatform.nl/documents/IJ\\_EPI\\_2013\\_UK\\_SEC.pdf](http://intrum.crmplatform.nl/documents/IJ_EPI_2013_UK_SEC.pdf).

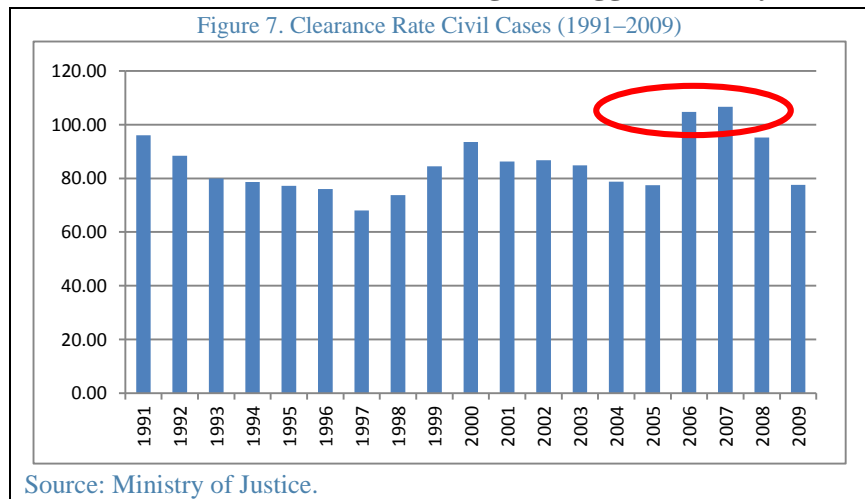
<sup>20</sup> 30max: Map of Debtors. <http://www.30max.eu/map-of-debtors/>.

## National Data

14. **A closer look at Portuguese national data reveals two general features in particular (see Figure 6)<sup>21</sup>:** (1) progressively worsening delays overall in the processing of civil and commercial cases over the years and (2) such delays more pronounced in some procedures. The average duration of the in-court process (litigation) of civil and commercial disputes more than doubled between 1991 and 2009 (from 600 days to 1,300 days). The duration of the post-court enforcement process of civil and commercial cases tripled between 1991 and 2009 (from 15 months to 45 months). The duration of the in-court process (litigation) of specialist disputes remained static and sometimes improved. This notably applies to labor cases (the duration of labor cases declined from 15 months to 13 months).<sup>22</sup>



15. **Also, between 1991 and 2009 the civil courts in Portugal struggled and, by and large, failed to manage the workload (see Figure 7).** As a result, courts resolved steadily fewer cases than entered newly into the courts (clearance rate<sup>23</sup>), except only for two years. A negative clearance rate (below 100 percent) means that cases are left undecided and thus accumulate.

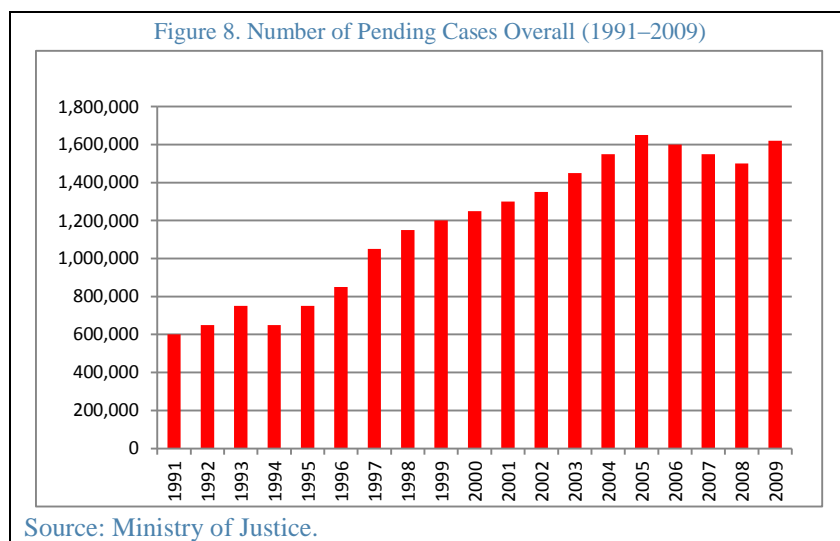


<sup>21</sup> Because the IMF-supported program focuses on the enforcement of civil and commercial claims, the data reviewed here will be limited to those cases.

<sup>22</sup> The core issue with labor disputes in Portugal seems to be the steady siding of the courts with workers, rather than the duration of the court process. See Braguinsky, Branstetter, and Regateiro (2011). The economic literature suggests that pro-worker orientation of courts leads to job destruction. See, for example, Fraise, Kramarz, and Prost (2011).

<sup>23</sup> Clearance rate is the relationship between the new cases and completed cases within a period, in percentage.

16. **Consequently, the number of pending cases in Portugal steadily increased, from 600,000 in 1991 to more than 1.6 million in 2009** (see Figure 8). This figure includes all cases, including the in-court civil, commercial, criminal, and labor cases, and the post-court enforcement cases.

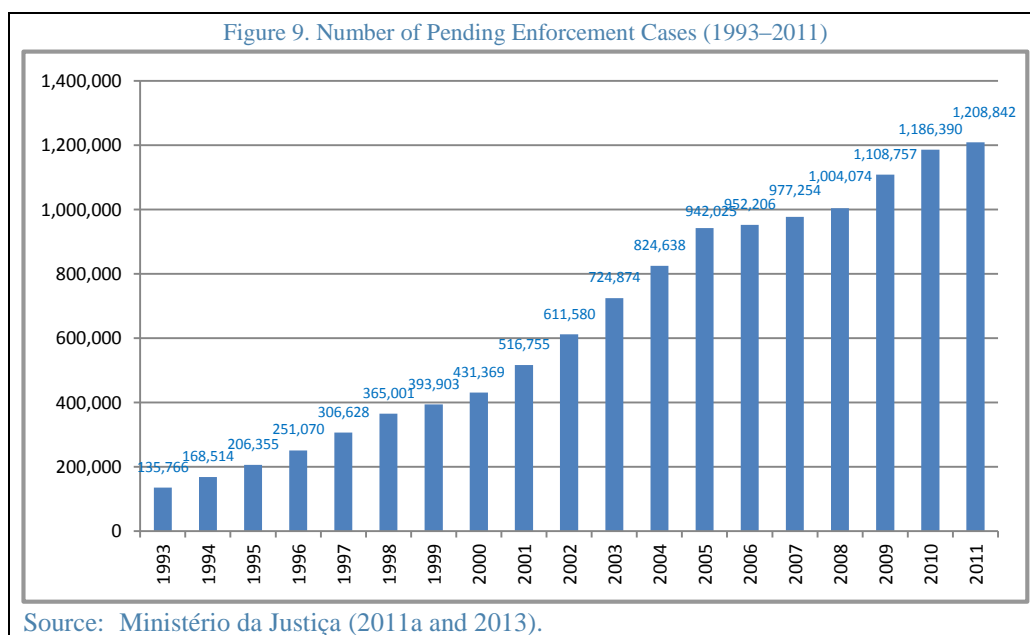


17. **This increase in pending cases resulted from inefficiencies within the courts and notably in the enforcement regime.** It did not result from changes in the inflow of cases, which between 1995 and 2009 remained fairly static in a range between 600,000 and 700,000 cases annually.

### Enforcement Cases

18. **In the course of the Portuguese enforcement process, a typically judicially awarded title (such as a judgement) or other titles (such as a payment order or a notarial deed) are forcefully executed against the debtor by the enforcement agent under court supervision.** It should be emphasized that the title (such as a judgment) alone would not force the debtor to repay the debt unless s/he pays voluntarily.

19. **Of the total number of pending cases in the Portuguese justice system, enforcement cases are by far the most significant component.** The number of pending enforcement cases at the onset of the crisis was in excess of 1.2 million. This number caps the unrelenting year-after-year increase of pending cases over a period of 18 years (see Figure 9).



20. **As a result of the very large number of pending enforcement cases, the duration of the enforcement itself took longer.** The average duration of completion of enforcement cases increased significantly from 15 months (1991) to 45 months (2009).<sup>24</sup> What is further notable is that a large number of cases took more than five years to enforce (see Table 1). Also, the figures clearly point to an increasing trend in these cases in recent years.

Table 1. Enforcement Cases Taking More than Five Years to Complete

2007	21%
2008	26%
2009	29%
2010	28%

Source: Ministry of Justice, Director General for Justice Policy (DGJP).

21. **Furthermore, a sizable number of enforcement cases show indications of being dormant (see Table 2).** At the onset of the crisis, more than 36 percent of the enforcement cases had not shown any activity for 12 months or more.<sup>25</sup> As these cases remain pending in the courts' books and physically stored in the steadily expanding court archives, intermittent court action is required to tackle them. Inactive cases therefore constitute a burden on court administration, posing a severe challenge to the court system.

Table 2. Enforcement Cases Showing No Activity (April 2011)

1 year	26%
2 years	6%
3+ years	4%

Source: Ministry of Justice, DGJP.

22. **All civil and commercial legal procedures must be enforced.** Therefore, delays in the enforcement process affect the speed and effectiveness of the legal process as a whole. Whether such procedures bypass the courts—for instance, through the *injunção* process—or go through the full adversarial process in the courts, in the end this process must get translated into hard action: debtors must be notified, payment must be affected, and, if it is not, bank accounts must be garnished, assets must be seized and liquidated; in the worst case, properties must be foreclosed with evictions and auctions. Unless the debtor cooperates, this is how the legal process delivers. Therefore, delays in the enforcement process translate in delays on the overall legal enforcement process.

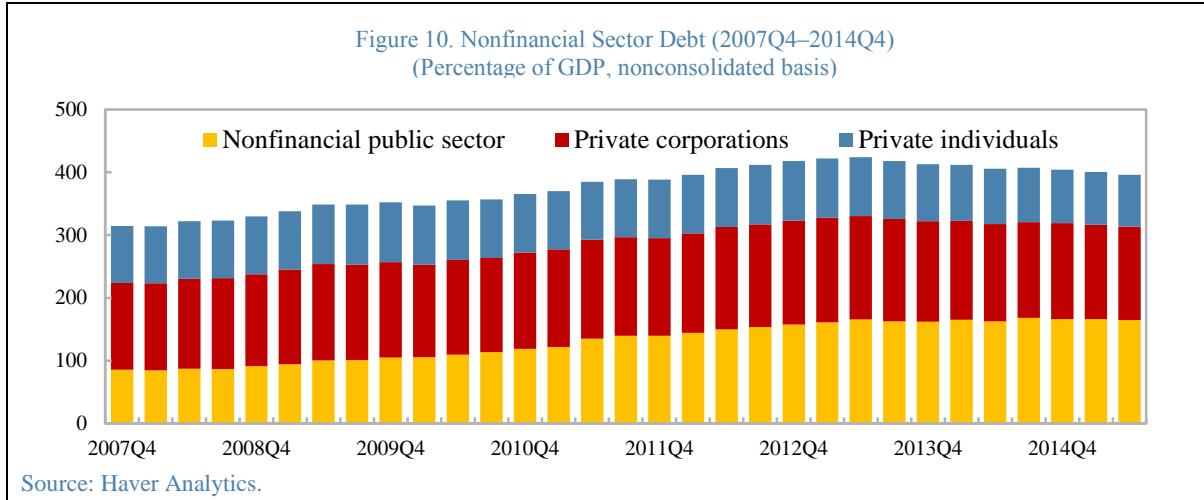
## 2. DIAGNOSIS OF PROBLEMS AND THE REFORM APPROACH

### A. The Incentive Approach

23. **The new feature of the global financial crisis, exemplified by Portugal, has been the volume and significance of household debt, which raises many sensitive issues including social ones (see Figure 10).** Even as the IMF had extensive experience in other forms of debt restructuring—notably corporate, banking, and sovereign—there are no international best practices and established processes for household debt resolution (Hagan, 2014).

<sup>24</sup> It should be noted that the numbers include cases with periodic payments.

<sup>25</sup> Ministério da Justiça (2011b, 35). These are unofficial figures.



24. **The Portuguese authorities, assisted by IMF, EC, and ECB staff, developed a novel approach to reforming the justice sector in the context of the financial adjustment program for Portugal.** In their diagnosis of the bottlenecks in the legal enforcement process, the IMF staff focused on the enforcement of civil and commercial claims rather than the legal system as a whole. The diagnostic focused on the incentives that underpinned the behavior of the key actors, such as the market (litigants), the institutions, and the legal professions (the enforcement agents). This approach recognized that the slow enforcement process cannot be explained solely by inadequacies in the statutory framework (which is what a legal approach would typically focus on); the inefficiency might equally relate to how that framework is applied and how institutions and professions are organized and managed. Accordingly, the diagnosis proposed to focus on changes to the incentives underpinning the behavior of key actors in the enforcement of civil and commercial claims; by doing this, the efficiency and effectiveness of the enforcement of such claims could be enhanced.<sup>26</sup>

### B. Market Incentives

25. **In their diagnostic, the IMF staff identified a number of incentives that explain why the market (in other words, litigants) brings cases to court and that contribute to the slowing down of the process.** These incentives include the following: financial incentives, time incentives, legal incentives, and administrative incentives.

<sup>26</sup> This approach was subject to a number of limitations. The most important was that the reforms had to be budget-neutral at best and indeed preferably led to reduced public expenditure. In reality, the Portuguese Ministry of Justice, which administered the court budget, had been running a structural deficit for a number of years reaching almost €240 million at the onset of the crisis. The Ministry of Justice managed to balance its books between 2011 and 2013. This was a major achievement, taking place in the background of and in parallel to the key legal reforms. Also, the budget cuts affected these reforms, since the ministry could offer nothing in terms of material benefits to the judiciary to secure its buy-in to the reforms. This does not suggest that the budget rebalancing originated entirely from the judicial budget. The Ministry of Justice jurisdiction extended to other areas, such as the prison services—for example, some prisons that were sitting on prime real estate near the coast were sold off. Even so, the courts did suffer significant cuts in budget and facilities.



## Financial Incentives

26. **The Portuguese enforcement system has a number of financial incentives that have a dual effect on the market.** First, the system encourages the market to bring cases to court (in contrast to, for instance, out-of-court settlement). Second, there are financial incentives to go slowly once in court.

- **Low court fees boost litigation.**<sup>27</sup> Court fees in Portugal were generally low for corporate litigants. It has been recognized that low court fees incentivize litigation, since there is no, or very little, downside to filing a case in court, as there is little or no cost to parties. Court fees were low also for corporate litigants who might be insured for legal costs and can transfer litigation costs to the market. As a result, the Portuguese taxpayers effectively subsidized corporate litigation, because it is the state that provides for the necessary infrastructure for the judiciary.
- **No costs imposed for a losing party boosts litigation.** The inefficiency of the enforcement procedure meant that the losing party, especially when the enforcement was not successful, did not pay litigation costs (such as lawyer fees). Consequently, litigation for debtors is a zero-sum game in which they cannot lose: even in the worst-case scenario, they had delayed payment with no added penalty. The system failed to weed out trivial and spurious filings, which was the cornerstone of the weak payment culture that marked Portugal.

27. **Suspension of statutory interest causes delays.** Portuguese courts suspended statutory interest for cases beyond three years.<sup>28</sup> This suspension notably applied in tax litigation and was a major incentive for litigants to prolong litigation in corporate disputes involving high-value tax claims. Statutory interest almost universally applies to monetary debts. It aims to offset value depreciation resulting from inflation. Statutory interest also disincentivizes debtors to unnecessarily prolong litigation with the sole objective to erode debt value. Further, because statutory interest rates exceed average inflation rates (particularly these days), this incentivizes expedited settlement. The suspension of statutory interest, as happened in Portugal, effectively transforms a tax debt into an interest-free loan. In such a situation, the longer a case sits in court, the more profitable it becomes to a company.

## Time Incentives

28. **The Portuguese enforcement system before the crisis had a number of features that obstructed an efficient case process, both in court and in the enforcement.** The

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<sup>27</sup> Of course access to justice must continue to be granted.

<sup>28</sup> The reason for suspending statutory interest in Portugal was that statutory interest in principle applies both ways (both for the tax payer and the state) and the Portuguese Tax Office was thus exposed to increased payment should the court decide against it. The court suspension of statutory interest therefore aimed to protect the tax authorities—and taxpayers. Because statutory interest also accommodates a risk factor, some countries (such as the United States) impose different interest rates on the state and market litigants, but this was deemed hard to implement in Portugal.

delays could be driven by parties or by the court, or were simply inherent in the way the system operated. Slow procedures attract debtors aiming to defer payment and who were served by clogging up the system further. Slow enforcement regimes tend to attract litigants intent on making these slower still.

- **Party-driven delays:** The Portuguese pre-reform civil procedure gave parties certain rights that helped delay the case process. In day-to-day practice, the distinction between parties legitimately using their rights or abusing them could be very fine. For instance, under the procedure before the reforms, parties could apply for deferment of a case. In theory such a request could be denied by the court, but in practice that was never done. Courts adhered to the old concept that in civil disputes, parties should determine the nature of the dispute and the pace of the trial. Consequently, deferments were granted as a matter of routine and became a major cause for court delays. Another example was the right of parties to call witnesses. In law and in practice such right was unrestricted in Portugal, which allowed uncooperative debtors to call for large numbers of witnesses to testify with the purpose of delaying the case. Parties calling for as many as 20 witnesses was not uncommon.
- **Court-driven delays:** The pre-reform Portuguese Civil Procedure Code gave the court a fairly interventionist role. At various points, the case process depended on court intervention, such as the mandatory written summary by the court of the main issues in dispute and lengthy decisions. In practice these summaries developed into detailed and complex documents, which in turn invited delays. The written summary thus became a major bottleneck in the case process. As to court decisions, the judiciary prized academic excellence over practicality, and court decisions could easily develop into academic treatises of dozens of pages even in small claims cases—with attendant delays.
- **System-driven delays:** Pre-reform Portuguese procedural rules and court practices were inefficient because of statutory complexities and court practices. For instance, a court decision constituted an enforceable document in its own right, but a new enforcement procedure was required to enforce it, with some enforcement actions (e.g., seizure of bank accounts) requiring the intervention of the court many times.

### **Legal Incentives**

29. **A significant contributing factor to increased litigation lies in how Portuguese courts perceive their role.** Portuguese courts tend to approach each case on its merits, with limited regard to precedent or overall impact. This case-by-case approach does not encourage consistency and certainty. The absence of such market certainty incentivizes litigation and even gaming behavior. Parties bring cases to court without regard to precedent decisions, in the hope the court will give them a favorable hearing based on their specific facts.

30. **It is difficult to fully quantify the volume of litigation that would not have been filed with greater certainty in court decision making.** The Portuguese authorities defined

this as the bandwidth of speculative filings—that is, cases filed against pervasive doctrine and precedent. While these figures cannot be extrapolated, Portuguese court behavior is said to artificially increase litigation by about one-third in this category of cases—to the detriment of certainty in the market. However, once the ground rules were changed to restrict the case-by-case approach of the courts, the number of cases filed with the court has decreased, as shown by the resolution of high-value tax cases (i.e., cases in excess of € 1 Million, discussed in greater detail later). These changes sped up the court process and resulted in a drop in case filings by about one-third, as reported by stakeholders.

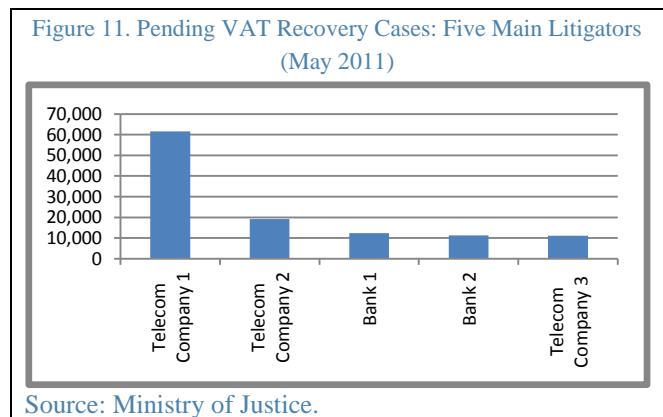
### Administrative Incentives

31. **Finally, the Portuguese enforcement system invited litigation for situations where litigation was not properly warranted.** Courts operated effectively like an administrative clearing house.

- **VAT bad debt recover regime.**

One example of administrative incentives causing delays was the VAT recovery system connected to bad debts in force until the end of 2012. Under the old rules, VAT levied in connection with unpaid goods and services' supplies subject to tax could only be recovered on the basis of a court decision

certifying that the underlying credit could not be recovered. Although some special rules applicable to credits of a smaller amount would make the regime more flexible, a VAT deduction was dependent on a mandatory court certification, upon an enforcement procedure determining that the amounts in debt could not be collected. Moreover, under the Law No. 23/96 of July 26, 1996, governing the so-called public essential services, the statute of limitation governing such claims was limited to 6 months, a short deadline which was considered as, on the one hand, hard to reconcile with most providers' legal practices and capabilities and inconsistent with a legal culture that privileges alternative dispute resolution to judicial litigation. Thus, by virtue of a combination of VAT rules and the and law of public essential services, as they stood before 2013, this regime resulted in a significant increase in volume of cases filed in civil courts which, in light of laws in force by then, instrumentalized civil courts just for purposes of recovering VAT. This was found to bear a major impact on the inflow of cases and workload of courts. Thus, the Portuguese telecommunications industry was said to file 5,000 cases on a weekly basis solely for the purposes of VAT recovery, and the top litigating firms had about 100,000 cases in the system, principally for VAT recovery for very small claims (see Figure 11).



- **Destitute debtors.** The Portuguese enforcement regime has no mechanism to weed out claims against destitute debtors, which are said to comprise up to 40 percent of all claims, as reported by the chamber of solicitors. This means that on an annual basis up to 200,000 cases cannot be enforced, which is costly to the judicial system.

### C. Institutional Incentives

32. **The IMF staff diagnostic also identified features of the then Portuguese system that incentivized or facilitated slow processing of cases by courts.** As noted above, these features showed that the slow case process was in part caused by the institutions themselves. Furthermore, some of the deeper reasons for these institutional delays rested less with judges or court staff individually and more with how the judiciary as a whole was set up and managed. Process and institutional incentives contributed to the slow processing of cases.

#### Process Incentives

33. **The pre-reform Portuguese Code of Civil Procedure (CCP) was not oriented toward servicing modern society or market needs, where speed is as important as justice.** It was an antiquated, heavy-handed, and complicated procedure. One particular feature was the use of a three-judge panel as a default setting for many cases.

#### Institutional Framework Incentives

34. **A key deficiency in the Portuguese pre-crisis judiciary was the absence of drivers for performance delivery, both in the structure of the courts and the way these were managed:**

- **System fragmentation.** The Portuguese court system at the onset of the crisis consisted of a comparatively large number of small courts with relatively high autonomy.<sup>29</sup> The system was wide-flung and fragmented, which led to a number of structural, and often chronic, inefficiencies (see Table 3).

Table 3. The Fragmented Portuguese Court System

	Population	Number of 1 <sup>st</sup> Inst. Courts	Number of 1 <sup>st</sup> Inst. Courts per 100,000 Inhabitants
Austria	8 million	154	1.9
Portugal	10.7 million	231	2
Italy	59.6 million	1231	2
France	62.1 million	774	1.2
Poland	38.1 million	365	1
Netherlands	16.7 million	19	0.1

Source: CEPEJ Report 2010–2012 data.

<sup>29</sup> The autonomy was in part boosted by local government co-financing courts in their district. This also complicated the consolidation under the proposed reforms, which created tensions between the central and local governments.

- **Weak resource allocation.** The system did not allow for a timely identification of bottlenecks or a corresponding allocation of resources to address them. There was no proper system of workload assessment. Additionally, statutory restrictions applied to transferring judges and staff between courts. Consequently, the wide-flung Portuguese courts tended to develop imbalances, with some courts chronically overworked and others having hardly any cases. Also, overworked and underutilized courts would be sitting very close to each other, depending on jurisdiction boundaries. These situations were allowed to persist, as central management lacked instruments to structurally identify bottlenecks and to address them through personnel allocations or other means.
- **Weak specialization.** The fragmented court system resulted in an assembly of generalist judges who were expected to handle all types of cases. For the majority of standard civil claims, this system was not an issue. However, for cases requiring specialist expertise, such as insolvency, finance/banking, or even high-value taxation (in the administrative courts), the system evidently was problematic in terms of both the quality of decisions and the speed of issuing decisions. Moreover, the absence of specialization resulted in major delays for those cases requiring specialty knowledge.
- **Weak routine-development.** The fragmented court system did not permit the development of operational routines that could alleviate workload and enhance consistency of decisions.<sup>30</sup>
- **Weak performance accountability.** The Portuguese judiciary had no instruments to define its service delivery. The main reason judges and courts were slow in processing cases is that the system lacked established performance standards and a management system that could hold judges and courts to such standards. In particular, the judicial system in Portugal lacked (1) a well-defined system or clear and reliable standards to measure workload (and assign resources accordingly), (2) a system or established standards of performance targets and ways to ensure their compliance, and (3) an adequate central planning and management system.<sup>31</sup>

**35. The absence of this infrastructure of performance indicators made the Portuguese judicial system largely dependent on individual courts and judges. While**

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<sup>30</sup> An often quoted example is 30-page court decisions, of high academic quality, for a small claims case. These routines could take the form of court-developed guidelines and standard or template decisions. Such routines provide an important support for courts to speed up the case process, create greater consistency in decisions, and enhance market certainty.

<sup>31</sup> Management of the Portuguese courts was fragmented both at the center and in devolved levels. At the center, management was divided between a Judicial Council (with limited management expertise, a large and hence

dereliction of duty was punishable under Portuguese law, the speed of case processing among courts and judges was wide ranging. Basically, there were no measures in place to stop courts from going slow, or to even define a slow process.

36. **This issue may also be illustrated by the administrative and tax courts.** These courts operate under their own management structure and were not fully integrated in the data systems, which the other courts had in place. Also, these courts lacked a system of effective performance indicators. One of the most salient examples was that tax cases were processed on a first-come-first-served basis and assigned to judges regardless of experience and seniority. It therefore could happen that a junior judge would be assigned a high-value corporate tax case and would have to face teams of highly experienced and specialized lawyers. These factors contributed to the slow processing, notably, of high-value tax cases in the pre-crisis era.

### Judiciary Incentives

37. **Finally, professional incentives were not geared toward speed and efficiency.** Judicial careers were determined on the basis of legal skills, which were evidenced in the judges' decisions. The system incentivized junior judges to write expansive decisions, and because junior judges were assigned to the smaller cases coming into the system, the system fostered a culture of judges writing long and time-consuming academic decisions on small claims cases. As a result, the system was geared toward long processing time, with little regard to legitimate society and market needs and expectations.<sup>32</sup>

#### D. Professional Incentives

38. **The final actors identified in the diagnostic were legal professions, particularly enforcement agents.** Enforcement agents are the key players in the enforcement process. Because enforcement was the weakest link in the Portuguese judicial system, the role and performance of enforcement agents merited close attention.

39. **Portugal has a system of private enforcement agents, comparable to the systems in France or the United Kingdom.** However, the organizational structure of enforcement agents was weak, making it difficult to maintain professional standards and opening the door for poor performance. Furthermore, the fee structure gave enforcement agents no incentive to push forward the enforcement process.

40. **Enforcement agents in Portugal are not a uniform profession.** The function of enforcement agents may be performed by enforcement agents, who can be lawyers,

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weak composition, and inadequate support) and a Ministry of Justice that was constitutionally restricted in its operations. Separate Judicial Councils existed for the General Courts, Administrative Courts, and Prosecution. Court management at local levels was shared between the Court Chief Judge and the Chief Prosecutor. The Court Clerk was not under direct jurisdiction of the Court President, and operated under his own distinct Council of Court Clerks.

<sup>32</sup> This refers to contentious disputes and does not extend to the very efficient payment order system (*injunção*) discussed earlier.

solicitors, or, in some circumstances, bailiffs, leading to segmented supervision. In addition, there are bailiffs (the only profession charged with enforcement pre-2003) responsible for enforcing small claims and tax claims that remained with the jurisdiction of enforcement agents after their privatization in 2003.

41. **A similar point can be made related to the tax administration.** Before the reforms, it is said that the tax authorities lost about 70 percent of their cases due to weak case management, inadequate legal representation, or lack of specialization.

### Financial Incentives

42. **Enforcement agents in Portugal received the upfront fee as remuneration even without taking any action.** In a typical private enforcement regimes, the fee structure consists of three parts: a base statutory fee, cost reimbursement, and a performance fee. The way that fees are construed and imposed generally aims at incentivizing performance in two ways: first by restricting the statutory fee and cost reimbursement, and second by back-loading the fee and making it dependent on recovery. The performance fee is the most significant share of the income of enforcement agents in countries such as France or the Netherlands. However, the Portuguese system did not make a clear difference between various fees, with a significant portion being front-loaded.

43. **Enforcement agents also did not have a time limit for enforcement.** This also contributed to extended periods for enforcement cases.

44. **The fee structure, in combination with the poor oversight, invited enforcement agents to take on cases, cash in on the prepayment, and then not to take action.** As a result, by May 2011, several enforcement agents had amassed large numbers of cases that were not going anywhere (see Table 4).<sup>33</sup> Also, transfer of cases to other enforcement agents was difficult, since the fees had already been paid. The new enforcement agent would have to work for free or for a much reduced fee. Consequently, the fee system was a major factor in blocking up the enforcement process as a whole.

Table 4. Accumulation of Cases with Enforcement Agents (May 2011)

Enforcement Agent 1	28,601 pending cases
Enforcement Agent 2	22,343 pending cases
Enforcement Agent 3	13,257 pending cases
Enforcement Agent 4	12,968 pending cases
Enforcement Agent 5	11,832 pending cases

Source: Ministry of Justice.

### Professional Structure Incentives

45. **The problems of enforcement agents taking on cases without enforcing them—and, more generally, not proceeding with efficient enforcement—were also tied to the absence of adequate oversight.** The Portuguese regime of private enforcement agents had

<sup>33</sup> Of all pending enforcement cases, 14 percent were held by just 11 enforcement agents (May 2011 figures). While some enforcement agents accumulated an inordinate number of cases, the issue of inactivity or failure to aggressively pursue a case was pervasive and affected even enforcement agents with much fewer cases, as the overall statistics show.

been introduced in 2003 without proper professional standards and adequate oversight. The absence of sanctions, or even an authority to impose sanctions, further invited errant behavior. Unlike in a few countries with a private enforcement regime (e.g., the United Kingdom or the Netherlands), courts in Portugal retained an oversight role in the enforcement process. Also, for a number of interventions the enforcement agent had to seek authorization from the court. The interaction between the enforcement agent and the court could be problematic, because the enforcement agent sometimes had to wait a long time (in terms of months) for the court to issue a clearance for its proposed enforcement action. The court role in the enforcement process clearly was a cause for delays. Moreover, it was hard for creditors to figure out whether inaction was due to the enforcement agent or the court; consequently, the two-pronged enforcement process in Portugal resulted in significant delays in the enforcement process.

### 3. IMPLEMENTATION OF THE REFORMS: STEPS IDENTIFIED

46. **The authorities tackled the inefficiency in the legal enforcement regime through a comprehensive reform strategy.** The strategy—which formed part of the authorities’ adjustment program—was supported by the IMF/EU financial assistance. The strategy had two components: backward-looking and forward-looking.

- **Backward-looking.** The backward-looking component addressed the immediate problem facing the system: the very large number of pending cases. The reform strategy tackled the issue head-on through a coordinated and targeted backlog reduction program.
- **Forward-looking.** The forward-looking component involved structural reform measures aimed at making the legal enforcement system more efficient and responsive to general market and society needs.

47. **The latter measures were designed to overhaul the system for civil and commercial claim enforcement, which this paper cannot fully cover.** They cut deep into some of the organic legislation of the country, including the CCP, statutes on the judicial organization, statutes and rules on the legal professions, the financial and budgetary underpinnings of the system, and the tax rules.<sup>34</sup>

#### A. Backward-Looking Measures: The Backlog Reduction Program

48. **The Portuguese authorities tackled the very large number of pending cases head-on through a series of measures designed to achieve two purposes (see Box 2).** First, a targeted review was conducted, with the view to close all pending cases on a quarterly basis. Second, measures were developed to prevent a buildup of cases going forward. The backward- and forward-looking measures are intricately connected and complement each other in achieving the objectives of an efficient and effective judicial

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<sup>34</sup> It should be noted that the authorities also reformed the criminal and administrative procedures codes.



process. These backward-looking measures, though, did not intend to tackle the broader structural issues in the judiciary.

- First, the authorities set up a special task force composed of members of the High Council of the Judiciary, the Chamber of Solicitors, and several departments of the Ministry of Justice to review all pending enforcement cases on a case-by-case basis and to develop measures to close dormant and unenforceable cases. Specifically, the task force set quarterly targets to review all 1.2 million enforcement cases that were pending as of May 2011 (i.e., the IMF Executive Board approval of the IMF extended arrangement).
- Second, the authorities enacted a Decree Law No. 4 of 2013, which enabled the expedient closure of enforcement court cases that had been pending and inactive for an excessive period of time because of the inexistence of assets.
- Third, a range of legal measures was enacted, aiming to reduce the inflow of new enforcement court cases. This included increased court fees for certain types of claims and for repeat litigators to disincentivize frivolous litigation. Also, VAT rules for unrecoverable claims were changed: the new system no longer requires mandatory intervention of a court in the determination-certification of a bad debt for VAT purposes, with the aim to reduce the number of cases filed in court merely for VAT recovery.

### **Box 2. Court Backlog Resolution: Results**

As a result of these measures, the backlog of enforcement cases was effectively resolved by the time the adjustment program expired in June 2014.

- More than 500,000 pending enforcement cases were closed (45 percent of all pending enforcement cases as of May 2011).
- The clearance rate increased to 158 percent (2014), making Portugal the top-performing country in Europe. From the point the reforms kicked in (Q4/2012), the clearance consistently exceeded 100 percent.
- The inflow of enforcement cases halved from 450,792 (2008) to 206,981 (2014).

### **B. Forward-Looking Measures: Structural Reforms**

49. **The forward-looking structural reform measures adopted by the Portuguese authorities covered a wide range and are of considerable complexity.** While the review of all measures is beyond the scope of this paper, it is important to look at their underlying drivers. As noted before, the Portuguese authorities did not approach the reforms as a

technical exercise; rather, they designed the reform with the objective to change the underlying incentives affecting the behavior of the institutions, the professions, and the market. Consequently, what might seem a disparate set of reforms from a formalistic point of view is actually a coherent reform policy from a behavioral and economic perspective. This paper proposes to consider the reforms in that light.

### C. Market Incentives

50. **The market incentives encompass measures that affect the behavior of market players (litigants).** The essence of these incentives is to transfer litigation costs from the taxpayer to the market (i.e., private litigants) while continuing to ensure access to justice consistent with Article 6 of the European Convention of Human Rights. These litigation costs can be direct (e.g., court fees, interest rates, and lawyer's fees), indirect (duration, effort), or subsidiary (mandatory filing for certain procedures/VAT). A selective increase in court fees serves a number of objectives, as follows:

- Discourage ferocious litigation, or litigation solely filed to delay paying debts. Increased court fees (all while upholding the principle of access to justice) make litigation a conscious choice for litigants. This therefore tends to reduce case inflow, notably of ill-founded litigation, and enhances payment culture.
- Transfer litigation costs of the civil and administrative process from the taxpayer to the market— specifically, to those market actors best able to carry such costs (e.g., high-value or high-volume litigators). A selective application of the system reduces, even abolishes, taxpayer subsidy for high-value litigation.
- Develop a more equitable system, which allows for cross-subsidization and thus can benefit economically weaker sections of the market.
- In 2015, a pretrial triage mechanism for enforcement cases (PEPEX) came into effect. The mechanism is a cheap and expedited procedure which enables creditors to verify whether debtors have assets, and on that basis, whether it makes sense to pursue enforcement or to terminate the procedure.<sup>35</sup> The procedure applies to claim up to €10,000. This captures the larger share of the market of enforcement claims,

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<sup>35</sup> The so-called PEPEX law (Order 233/2014), came into force in November 2014. The market took some time to get accustomed to this new procedure, but once it did, usage jumped exponentially. Five hundred PEPEX cases were filed in January 2015; since then, about 11,794 PEPEX cases have been filed. The net result of PEPEX is that it keeps cases out of court, in that creditors can verify whether debtors have assets at all and then decide whether it makes sense to start legal procedures.

including notably the large majority of telecommunications and utility bills. Even if the procedure only came into effect in 2015, the data trend suggests that by December 2015 up to 60 percent of the enforcement cases will be weeded out through the PEPEX system (see Table 5).<sup>36</sup>

	Total number of enforcement cases filed	PEPEX cases	Percentage
Q1	50 506	10 470	20.73
Q2	52 614	19 085	36.27
Q3	50 000*	28 294	56.59
Q4	50 000*	30 000*	60.00*
Total	203 120	87 849	43.25

\* Projected by the Chamber of Solicitors (December 2015).

Source: Ministry of Justice (DGPJ) and Chamber of Solicitors.

## Financial Incentives

51. **The authorities radically shifted incentives for the market by introducing a new court fee system, which included the following features:**

- **Simple system.** A uniform, clear, and simple-to-administer system applicable to all cases (replacing the previous different parallel regimes).
- **Increase in court fees.** A selective increase of court fees specifically targeting those litigants who make the most use of the system, who are most able to bear the costs, and who can transport them to their products or services (bulk litigants, high-value cases).
- **Appeal.** An increase of court fees with appeals (replacing the old system, which made appeals cheaper).
- **Interest.** In tax court cases, change statutory interest beyond the three-year which applied previously.

## Administrative Incentives

52. **An important alleviation of administrative pressures included the abolition of the requirement of a court order certifying nonpayment for VAT recovery.** Henceforth, VAT for unpaid bills could be recovered without going through a court of law first—which helped taxpayers and took a heavy administrative load off the shoulders of the courts. The new system implemented is IT-based and encourages cross-inputs from debtors and creditors.

<sup>36</sup> Of this number, the share where the creditor decided to pursue the claim following the PEPEX process ranged from 8 percent to 12 percent on a quarterly basis. This means that 88 percent to 92 percent of the enforcement cases were weeded out of the system.

As a result, it does not simply shift the administrative the burden to the tax authorities and yet assists in the control of undue deductions for input VAT.

#### D. Institutional Incentives

53. **Two key initiatives involved comprehensive reforms of two core areas of the Portuguese legal system—namely, the CCP and the judicial organization.** These reforms were the most significant in over almost a century.

##### Time and Process Incentives

54. **The new CCP significantly streamlines and simplifies processes for civil and commercial litigation.** The CCP that became effective on September 1, 2013, was drafted by a national committee representing lawyers, professors, and judges, with the assistance of international expertise. The CCP speeds up court processes by:

- **Organization.** Providing a process program (i.e., a schedule) at the beginning of each process.
- **Simplification.** Reducing the administrative burdens; for instance, (1) Article 85 now provides that no separate enforcement action is necessary to enforce an enforceable court decision and (2) periodic payments no longer continue on court registers until paid in full.
- **Certainty.** Increasing safeguards and certainty by e.g., making private documents (such as promissory notes) no longer enforceable titles.
- **Automaticity.** For instance, Article 849 of the CCP provides that if no assets are found in an enforcement procedure and neither the creditor nor the debtor indicates assets within 10 days, the process terminates within three months.
- **Empowering.** Empowering judges to set time frames for their decisions and giving them the right to dismiss parties' submissions that aim at delaying the court process.
- **Single judge.** It also provides for civil and enforcement trials by a single judge rather than a panel of three judges.

##### Institutional Framework Incentives

55. **The streamlined reorganized court organization network became effective on September 1, 2014** (see Box 3 and Figure 13). The heart of this reform was to introduce performance accountability into the judiciary. The system was based on national performance targets, measured in terms of turnover of cases, aggregated from targets of local courts and individual judges. The system included tight compliance methods (and incentives) on both a quarterly and an annual basis. While the new system is nuanced and refined—for example,

the judges themselves generate the performance targets—it will completely alter the work of courts and individual judges, who must henceforth report on, and account for, their performance.

56. **The new organization also increased specialization for judges and flexibility in the use of resources.** The new organization enables more specialized courts and judges in *comarcas*, which justify the use of labor, commercial, or criminal benches. Rather than having separate courts, such specialized units operate as benches of the same court.<sup>37</sup> Those excess judges who could not be allocated to the new court organization are available to fill in vacancies from illness or leave.

57. **One element of this reform involved a rationalization in terms of work units/numbers** (see Figure 12). The authorities proceeded with closing courts, recognizing that the system may be over-equipped.<sup>38</sup>

58. **The main thrust of the reforms targeted the operating and management structures of the judiciary.** On the operating structure, the reforms moved the system from the old static (formation-based) model toward a performance-based model, with performance targets, means (and incentives) to achieve such targets, and performance accountability based on turnover.

59. **This operating structure calls for management that permits that performance targets are centrally set, performance is tracked, adequate means are allocated, and compliance is secured.** It calls for a forward-leaning management format with strong central guidance. With regard to the operating structure, the following three elements stand out:

- **Allocation of resources.** The reforms changed the former system, in which each court was an independent management unit with the near impossibility to shift resources between courts, into a more fluid organization, which permitted the allocation of resources as the need arose. Notably, the 234 courts were restructured into 23 districts, with the possibility to move judges and staff in courts within the district, as needed. Also a free-flowing pool of judges was established to be assigned where needed.<sup>39</sup>
- **Performance targets.** Further, the reform set out that performance targets are set for each court (constituted in consultation between the court and central authority), with a quarterly assessments on whether targets are being met.

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<sup>37</sup> In 2012, the authorities established separate courts for intellectual property and competition law. The establishment of such courts runs counter to having an integrated court system, which reduces flexibility while increasing specialization.

<sup>38</sup> The court network was streamlined by closing underutilized courts (i.e., courts with less than 250 cases annually, so about 54 courts). This was not the main thrust of the reforms; the number of closed courts remained modest, certainly compared with the situations in other European countries.

<sup>39</sup> The number of court districts (*comarca*) has been significantly reduced to 23 across the country and aligned with the administrative districts (concentration).

- **Incentives.** The law envisages a system of incentives, presumably budgetary, for courts that exceed their performance targets.

60. **In terms of the way these operating elements affected the management structure, key features include the following:**

- **Fewer but more powerful courts.** At the local level, the reforms changed the system from a large number of relatively powerless work units (i.e., with very limited management autonomy) to a small number of powerful work units. Thus, under the old regime, the only way to keep the many courts in check was to minimize their autonomous management powers. The new regime, with the small number of work units, made it possible (and indeed required) that these courts also acquire significant autonomy in the way they managed their business. Consequently, management powers in the local courts were centralized,<sup>40</sup> as the courts acquired significant powers to develop the annual work plans, the attendant budgets, and personnel requirements, and, finally, to verify compliance on a quarterly basis and at the end of the financial year.
- **Professional managers.** These major powers also imposed the need for high management standards at the courts. Consequently, the new law imposed more stringent selection criteria for the new senior managers (i.e., court presidents), including management training and experience.
- **Strong central management.** The reforms introduced a strong central management of the judiciary, which set overall strategic objectives on a three-year cycle (including performance targets), and then translated these into annual performance targets. The local work units must report to this central management entity.

61. **With respect to tax disputes, the authorities established special task forces of senior and experienced judges to decide high-value tax cases.** By focusing on those cases of most value, speeding these cases up could increase revenue and establish legal certainty more rapidly. Interestingly, as the market understood that tax cases were settled more expediently and, presumably, more competently than before, the number of filings of high-value tax disputes dropped markedly. With respect to tax cases, between January 2011 and March 2013, the number of pending cases was reduced from 1016 to 713, which represents a reduction in terms of pending procedural value of more than €1 billion (Lobo and others, 2013).

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<sup>40</sup>Also, in the lower courts, the controls of the central managers were enhanced (notably vis-à-vis the court administrators who traditionally had had high levels of autonomy).

Figure 12. Judicial Organization before 2013

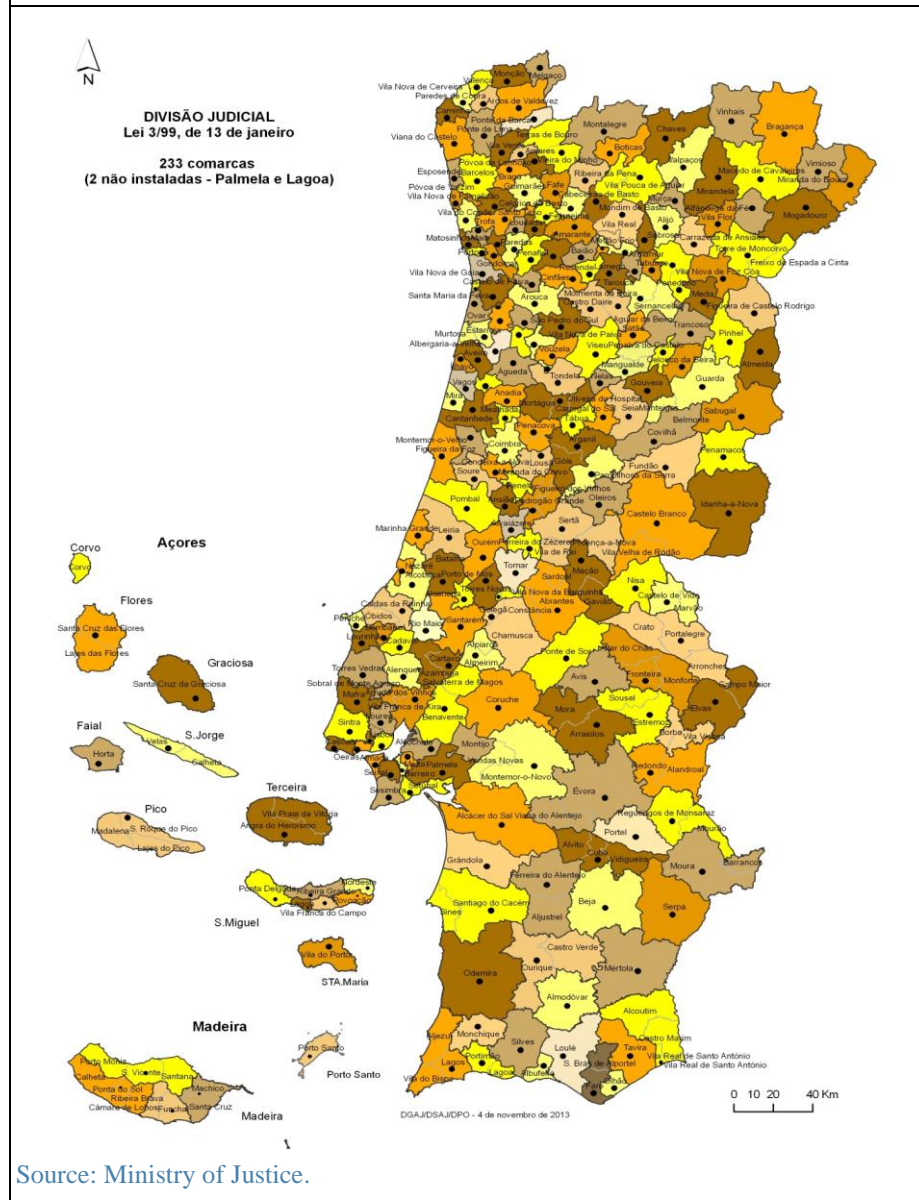
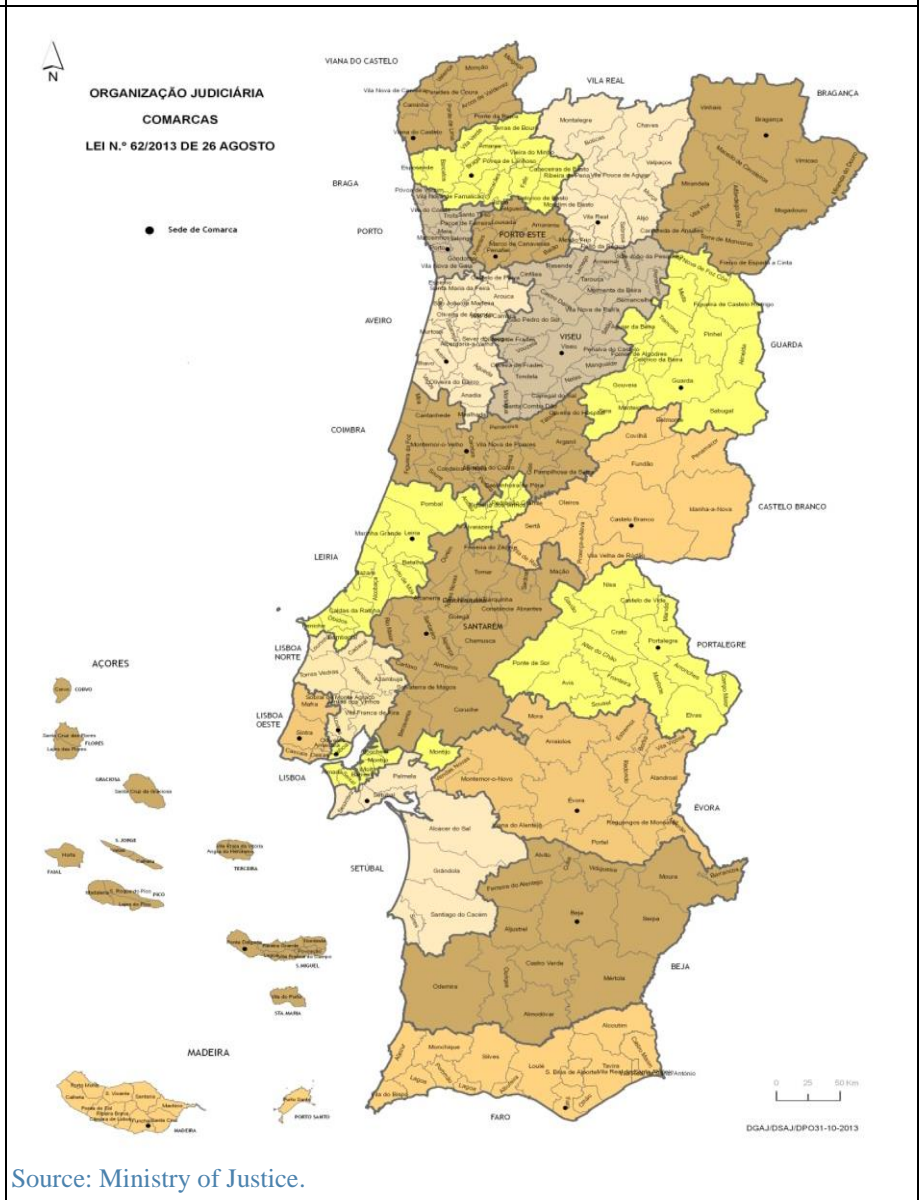


Figure 13. Judicial Organization after 2013



### Box 3. Institutional Changes: Results

There are a number of results that the institutional reforms efforts yielded:

- **Court districts.** The number of court districts was reduced from 234 to 23.
- **Inflow management** (*enforcement cases clearance rate*). In the period preceding the reforms, the courts were never able to clear the inflow of cases. From January 2013 the situation turned around completely. In all months since January 2013, the system processed and cleared more cases than came in.
- **Processing speed** (*enforcement cases disposition time*<sup>1</sup>). In the period preceding the reforms, courts always took, on average, more than 1,500 days to complete a case (except for two months in 2008). From January 2013, in all months, the cases were completed within 1,500 days, with several months sitting in the 500-to-1,000-days range.

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<sup>1</sup> Disposition time compares the number of resolved cases during the observed period and the number of unresolved cases at the end of the observed period. Then, 365 is divided by the number of resolved cases, divided by the number of unresolved cases at the end, so as to be able to express it in number of days. The ratio measures how quickly the judicial system (of the court) turns over received cases—that is, how long it takes for a type of case to be resolved.

### E. Professional Incentives

62. **The Portuguese authorities, in close cooperation with the Chamber of Solicitors, implemented a wholesale reform in the organization of the enforcement of civil claims.** The reforms changed the incentives for enforcement agents to pursue claims and maximize recovery by (1) linking revenue to recovery through a performance fee structure, (2) increasing their powers, and (3) strengthening disciplinary supervision and oversight while reducing bureaucratic interference. These reforms were accompanied by significant efforts on the part of the Chamber of Solicitors to clean up some of the more excesses of the old system.<sup>41</sup>

#### Financial Incentives

63. **A new fee structure was introduced, which aimed at incentivizing performance in two ways:** by restricting the upfront statutory fee and back-loading the fees, and by making them dependent on recovery. For instance, the performance fee is the most significant share of the income of enforcement agents in countries such as France or the Netherlands.

64. **The new procedure—being easy, inexpensive, and effective—should have a positive long-term impact on the market.** The reduction of risk and transaction costs for

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<sup>41</sup> This included resolving the many pending cases with dysfunctional enforcement agents. Because these agents had been paid, and no more payment was forthcoming under the old regime, there was no incentive for another agent to take on these cases, whether to secure enforcement or to close them. The Chamber of Solicitors played an important role in resolving this issue.



enforcement—plus attendant charges, such as insurance—must be expected to increase access to credit and market trust. Also, reducing enforcement costs brings down the break-even point (where recovery costs exceed claim value), which particularly benefits the SMEs that dominate the Portuguese market. While the procedure currently is most used by banks, it clearly also benefits small entrepreneurs.

65. **Another benefit is that the garnishment system significantly simplifies processing by banks** (see Box 4). In 2013, the Banco de Portugal (in cooperation with the Ministries of Justice and Finance) established an IT-based system that encompasses all bank accounts in Portugal and that is accessible to enforcement agents. For the first time, it is possible to know whether a particular debtor indeed has funds that the enforcement agent may garnish.

### Professional Incentives

66. **The new CCP enables enforcement agents to perform more functions independent from the courts.** The number of enforceable titles has been reduced, thus limiting the practice that disputes were litigated in enforcement proceedings. A new electronic and centralized system for garnishments was put in place. It enables enforcement agents to quickly seize money in debtors' bank accounts against which creditors have an enforceable title. In about 12 months, €0.3 billion could be recovered via this new system.

### Supervisory Incentives

67. **The authorities established a new framework to supervise and monitor enforcement agents through a new independent agency, the Commission for the Follow-up of Court Assistants (CAAJ)** to succeed the previous agency, the Organization for Efficiency of Justice (CPEE). The CAAJ also supervises the insolvency administrators, called judicial administrators. This agency enables the modern and effective supervision and monitoring of enforcement agents.

68. **With respect to the tax administration, the authorities reorganized the litigation department of the tax administration. Within a short period, the win-lose ratio improved from 30-70 to 50-50.** The litigation department was more specialized and focused on the important cases.

#### Box 4. Enforcement: Results

The measures taken by the Portuguese authorities have had a significant impact on enforcement effectiveness, as can be exemplified by the new system of garnishment of bank accounts. From the point it came into effect (September 2013) over 15 months:

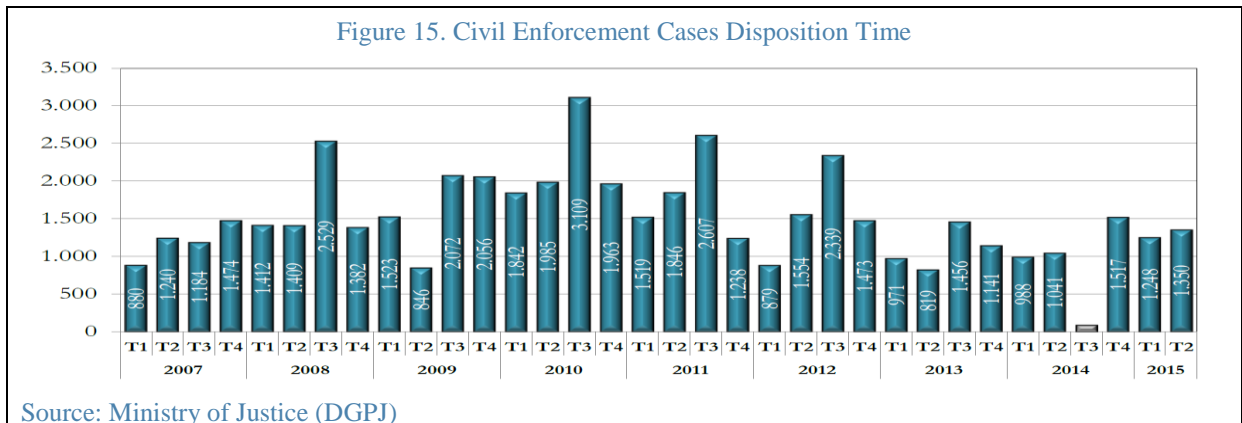
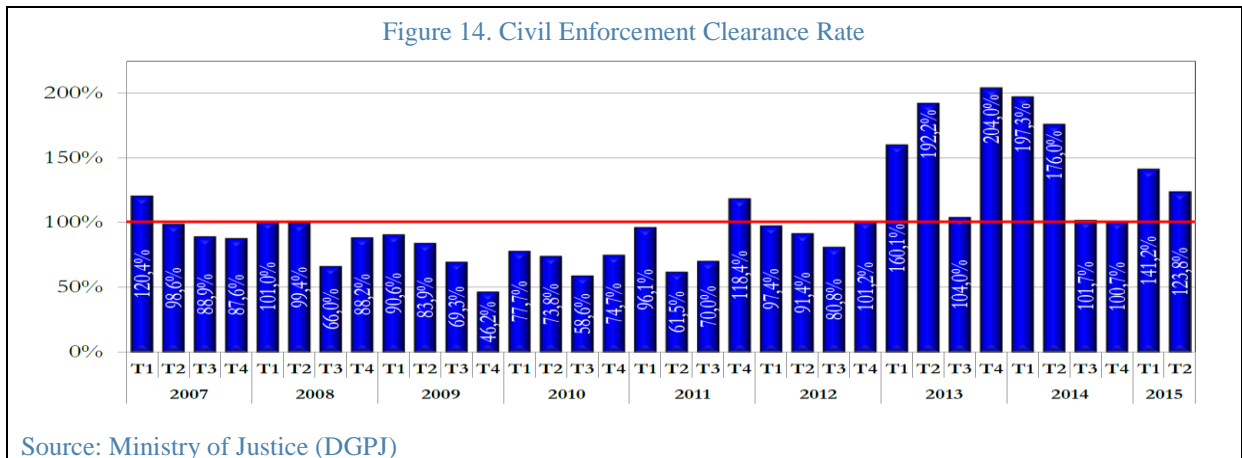
- 1.7 million garnishment applications were filed;
- 125,000 actual seizures were effected;
- €337 million were recovered (0.2 percent of GDP).<sup>1</sup>

<sup>1</sup> This marks a very sharp difference from the previous regime, during which recovery between 2003 and 2013 totaled only €20 million.

#### 4. CONCLUSIONS AND KEY LESSONS

69. **In the experience of the IMF staff, the justice sector reforms undertaken by the Portuguese authorities may be among the most successful reforms undertaken in this sector.** This paper is a first step toward a better understanding of the elements of this success.

70. **The IMF/EU-supported program played a role in helping the authorities realize these reforms.**<sup>42</sup> The hard data illustrations in this paper give ample evidence of the impact of the reforms under the IMF/EU-supported program lasting from May 2011 to June 2014. A further illustration can be found in recently published consolidated data on court performance in Portugal, which show how the program turned around court performance. The first graph (Figure 14) shows how the clearance rate became steadily positive—above 100 percent (i.e., more cases decided than came in)—after the program measures took effect. The second graph (Figure 15) shows how the disposition time (i.e., the time it took to complete a case) dropped significantly as the program measures took effect.<sup>43</sup>



<sup>42</sup> This is recognized in Portugal. See, for instance, Correia and Videira (2015). The IMF role was also acknowledged by the contribution of the Portuguese Association of Enforcement Agents at the IMF Roundtable on Effective Claims Enforcement, Neto (2015).

<sup>43</sup> Ministry of Justice of Portugal/DGPJ, Destaque Estatístico Trimestral Boletim 21 (November 2015).

71. **There is no doubt that the reforms efforts of claims enforcement was a Portuguese achievement, in which the following factors played a key role:**

- **Comprehensive strategy.** The authorities approached the reform of the system for claims enforcement comprehensively. The measures affected many different areas—from the process issues to organizational issues, to professional issues—but were always targeted interventions rather than wholesale operations. The authorities also sequenced the measures appropriately.
- **Preparation.** All legislative initiatives preceded intensive stakeholder consultation and then followed the approach of starting with an action plan, and then a concept note, before moving to a first or second draft and final adoption/enactment of the measure. An example is the rollout of the CCP in September 2013, which was well planned (templates, IT system) and executed by the Ministry of Justice.
- **Capacity.** The authorities had excellent capacity to design and implement reforms in the area of claims enforcement. They also reached out to international experts whenever they faced novel or challenging issues, as exemplified by the April 2012 workshop that brought together international experts and key stakeholders.
- **Cooperation among stakeholders.** Judicial reform is a challenging area: the judiciary is nominally independent but depends on the Ministry of Justice to fund it (such as clerks, staff) and the municipalities to provide the infrastructure (such as buildings). The enforcement agents are independent professionals, albeit supervised by a quasi-governmental agency. This scattered field of responsibilities requires delicate processes and intensive stakeholder consultations, which the authorities achieved impressively. For instance, the cooperation in the task force to tackle the backlog was exemplary among the ministry officials, judges, enforcement agents, and court staff, who worked through all pending enforcement cases (about 1.2 million cases) in a matter of months, with a view to categorize them for resolution.
- **Ownership.** The authorities at all times owned the substance and the process of the reform steps. While the steps were embedded into the larger economic adjustment program supported by the IMF/EU, the authorities fully owned the substance of the measure and its sequencing.
- **Expertise.** While the authorities had excellent domestic expertise, they did not shy away from international expertise and cross-country experience. To the extent international best practices (e.g., the Council of Europe recommendations and guidelines on enforcement) were not available, the authorities turned to international experts and cross-country experience (e.g., fee structure for enforcement agents, reform of the CCP, reform of the court organization) to receive inspiration and solve difficult problems.
- **Data.** Diagnosing a problem is possible only if accurate and reliable data are available. As mentioned before, the superb data systems in place enabled an adequate

diagnosis and also facilitated adjustments if the envisaged measures did not achieve the desired outcomes.

72. **This is not to say that the reforms came about without compromises.** Institutional reform processes in this sector affect society at large as well as a broad set of important stakeholders. These always necessitate compromises, and the outcomes sometimes necessarily are less than what had been originally envisioned. Portugal is no exception. The ongoing supervision of the enforcement process by the courts, the reduction of the number of courts, and the workload measurement are examples of issues that might have been pushed further but on which realistic compromises were necessary.

73. **Not all reforms went as planned.** The authorities have had to face some major challenges—some unexpected and some that persisted. Among the numerous challenges, three in particular merit mention.

- **First, the IT changes triggered by the reforms created significant problems.** While the rollout of the CCP in 2013 went very smoothly and was a model of good and timely planning, the implementation of the new judicial organization faced a number of IT issues. Despite authorities' massive investment of time and effort, including the transfer of all cases from the old courts to the new courts, the system change was not smooth. The technical problems resulted in a temporary system standstill that has continued for extended periods. However, due to continued persistence on the authorities' side, these issues have been largely overcome.
- **Second, the oversight of enforcement agents requires further strengthening.** Even while significant progress has been made in this domain, the system of reporting and inspection should ideally be comprehensive. Instead, reporting and inspection is skeletal, with a tapering off in recent years. Country experience shows that unless the system has full coverage, there will be slippage, whose impact is felt on the quality and effectiveness of the enforcement system as a whole.
- **Third, in a recent survey conducted by IMF staff on the impact of structural reforms, entrepreneurs cited the insolvency and debt restructuring frameworks as an area where more government action is needed IMF (2015).** Accordingly, the debt enforcement reform efforts need to be sustained and the short term gains need to develop a long term effect that stakeholders can notice. As commented previously, some of the reforms have only been introduced recently and others may take a while to bear fruit.

74. **It cannot be said that the system is perfect now—if ever such a thing exists in judicial reform which is always seeking improvement.** The reforms have shown impressive progress in the short- to medium-term, yet other reforms will deliver only in the longer run. Some of the key reforms, such as the new management structure for the judiciary and the workload-based performance of the courts, have yet to come into full effect, and failure to push these through may significantly weaken the reforms as a whole. The legal-institutional side of the reform process is still at an early stage and calls for a sustained

engagement of the authorities at both policy and operational levels. For instance, the administrative and tax courts continue to operate outside of the new judicial organization and IT system and should be integrated expeditiously (Barros, 2015).

75. **It is too early to fully assess the broader economic impact of the reforms.** There are positive indicators, such as the reduction of the backlogs, the increase in processing time, and the much greater efficiency in recovery through the bank garnishment process—all of which reasonably must be expected to increase payment culture, reduce transaction costs, and therefore support growth. Similarly, greater efficiency in the resolution of high-value tax cases has reduced the number of disputes filed in court and indirectly boosted tax revenue. However, the impact on deleveraging remains limited, including, notably, that of corporate debt.

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