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2013/0362 (NLE)

Proposal for a

COUNCIL IMPLEMENTING DECISION

amending Implementing Decision 2011/344/EU on granting Union financial assistance to Portugal

{SWD(2013) 435 final}

EXPLANATORY MEMORANDUM

Upon a request by Portugal, the Council granted financial assistance to Portugal on 17 May 2011 (Council Implementing Decision 2011/344/EU) in support of a strong economic and reform programme aiming at restoring confidence, enabling the return of the economy to sustainable growth, and safeguarding financial stability in Portugal, the euro area and the EU.

In line with Article 3(10) of Decision 2011/344/EU, the Commission, together with the IMF and in liaison with the ECB, has conducted the eigth and ninth reviews to assess the progress on the implementation of the agreed measures as well as their effectiveness and economic and social impact.

Taking into account the recent economic, fiscal and financial developments and policy actions, the Commission considers that some changes to the economic policy conditions underpinning the assistance are necessary to secure the programme's objectives, as explained in the recitals of the proposed amendments to the Council Implementing Decision.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism[1], and in particular Article 3(2) thereof,

Having regard to the proposal from the European Commission,

Whereas:

(1) In line with Article 3(10) of Council Implementing Decision 2011/344/EU, the Commission, together with the International Monetary Fund (IMF) and in liaison with the European Central Bank (ECB), has conducted, between 16 September and 3 October 2013 the combined eight and ninth reviews of the authorities' progress on the implementation of the agreed measures.

(2) Quarterly real GDP growth returned into positive territory in the second quarter of this year and short-term indicators also point to a progressive bottoming out of the recession. Real GDP is expected to contract by 1.8 percent this year and to grow by 0.8 percent and 1.5 percent in 2014 and 2015, respectively. Tensions in the labour market are expected to ease somewhat. Still, the unemployment rate is expected to peak at 17.7 percent next year before starting to decrease progressively. Uncertainties with regard to the macroeconomic outlook are high as the sustainability of the projected recovery in 2014 and 2015 is contingent on positive trade and financial market developments, which remain fragile.

(3) Up to August 2013 the government cash deficit recorded an improvement of 0.6 percentage points of GDP (net of extraordinary factors) compared with the same period of last year. Solid tax revenue performance and tight execution of most expenditure items are supporting the budgetary execution. However, some deviations have been identified with respect to the fiscal outlook of the 7th review. These include shortfalls related to the reprogramming of EU funds and the postponement of the sale of a port concession (one-offs) and other factors, such as the higher than expected contribution to the EU budget, the underperformance of some non-tax revenues, the transfer to Greece of dividends from Greek bonds holdings in Banco de Portugal's investment portfolio, the lower than expected social contributions to the public employees' pension scheme and overruns in the wage bill and intermediate consumption. After the use of the provisional budget allocations (0.3 percent of GDP), the net effect of the deviations is estimated to increase the 2013 deficit by 0.5 percent of GDP.

1 OJ L 118, 12.5.2010, p. 1.

In addition, a capital injection into BANIF amounting to 0.4 percent of GDP also increased the budget gap although this operation shall not be considered for programme purposes.

(4) The government is taking corrective measures to ensure attainment of the 5.5 percent of GDP programme deficit target, notably through the reduction of available funds for investment and tighter control on the intermediate consumption of line ministries (0.1 percent of GDP). In addition, the government announced a one-off tax-and-social-security-contributions debt recovery scheme, which is expected to recover revenues of about 0.4 percent of GDP and is accompanied by increased sanctions for criminal tax offenders.

(5) The updated fiscal projections show for 2013 a fiscal effort, measured by the improvement in the structural balance, of 0.5 percent of GDP, slightly below the 0.6 percent of GDP envisaged at the 7th Review. The projected underperformance is mainly explained by delays in the implementation of the initially planned consolidation package and its partial replacement by one-offs while unexpected pressures have weighed on the budget reserves. The implementation delays are due to several constraints, such as the political crisis in July and the subsequent government reshuffle; the challenge of responding to the Constitutional Court opinion of 29 August deeming some provisions of the draft law for a new requalification system unconstitutional and the technical difficulties in implementing certain measures, notably the redesigned social security contributions from unemployment and sickness benefits above a minimum level, following the ruling of the Constitutional Court of 5 April.

(6) The government has reaffirmed its commitment to the deficit target of 4 percent of GDP in 2014. In this respect, the government has adopted consolidation measures amounting to about 2.3 percent of GDP, which also cover for part of the slippages in 2013 that will carry over into 2014. The consolidation measures are to a large extent included in the draft Budget Law, whilst some measures are implemented through specific legislation. The measures are primarily of a permanent nature and rest predominantly on expenditure savings. Overall, the cumulative value of the consolidation package necessary to achieve the envisaged fiscal adjustment has not changed with respect to the 7th review – approximately EUR 4.7 billion of permanent saving measures over 2013-2014, or 2.8 percent of GDP. However, part of the consolidation effort is now back loaded to 2014 as a result of the aforementioned implementation delays in 2013.

(7) Most of the consolidation in 2014, about 1.8 percent of GDP, should be drawn from the public expenditure review (PER), which was carried out over the past year with the objective of increasing equity and efficiency in the provision of social transfers and public services. The main impact of the PER measures will be along three main axes: (1) limiting outlays in the public sector wage bill, by reducing the public-sector work force while shifting its composition towards higher-skilled employees, aligning the public sector work rules with those of the private sector and making the remuneration policy more transparent and merit-based; (2) pension reform and (3) sectoral expenditure cuts across line ministries and programmes.

(8) To compensate for the negative carryover from the 2013 budgetary execution and achieve the 4 percent of GDP deficit target, the PER package is to be complemented by other permanent measures aiming at further improving the efficiency and equity of the current tax and benefit structure (worth 0.4 percent of GDP). Moreover, a number of one-off measures worth 0.2 percent of GDP will be implemented, more than offsetting the costs arising from the one-off upfront payments related to the introduction of a mutual agreement redundancy scheme in the public sector.

(9) The debt-to-GDP ratio is expected to peak at 127.8 percent in 2013 and to decline thereafter. The upward revision with respect to the 7th review is explained by the correction of the 2012 debt data, which is now slightly higher, and the non-realisation of some short-term debt-reducing operations. In particular, the Social Security Stabilisation Fund is now expected to increase its holdings of Portuguese Government Bonds more gradually and privatisation receipts will mostly remain in Parpublica until the new ESA 2010 enters into force and the status of the company is defined. Moreover, the Treasury cash balance at the end of the year is estimated to be higher than previously assumed (by about EUR 2 billion).

(10) The budgetary adjustment process is flanked by a range of fiscal structural measures to enhance control over government expenditure and improve revenue collection. In particular, a comprehensive reform is bringing the budgetary framework, including at central, regional and local government levels, in line with best practices in public finance management. The new commitment control system is showing results but implementation needs to be monitored closely to ensure that commitments are covered by available funding. Reforms in the public administration continue with a view to modernising and rationalising public sector employment and entities. Progress in the reform agenda of the revenue administration is enhancing monitoring and strengthening revenue compliance. The renegotiation of Public-Private-Partnerships has made good progress and significant savings are projected for 2013 and beyond. State-owned enterprises reached operational balance on average by the end of 2012 and additional reforms are foreseen to avoid a renewed deterioration of their results. Reforms in the health care sector are producing significant savings and implementation is continuing broadly in line with targets.

(11) The banks' capital ratios increased substantially in the past year allowing them to meet the EBA regulatory capital buffers as well as the 10 percent Core Tier 1 programme target. This capital buffer remains adequate across the board when using the new Capital Requirements Directive (CRD) IV rules for evaluating the banks' own funds. These new capital rules will apply from January 2014 onwards. Banco de Portugal is currently developing a transition approach to introduce CRD IV. The indicative loan-to-deposit target of 120 percent by 2014 is likely to be met, with some banks already below this threshold. Efforts to diversify the sources of funding for the corporate sector are being strengthened. Building on the recent external audit of the existing government-sponsored credit lines and on a set of policy recommendations, the authorities submitted a plan with measures aimed at improving the performance and governance of these instruments. The crisis management toolkit including a bank resolution fund, early intervention powers and a recapitalisation law is being finalised.

(12) Further progress has been made in implementing growth and competitiveness-enhancing structural reforms. A new reduction of severance payments entered into force on 1st October and two compensation funds have been established with the purpose of a partial financing of severance payments. Additional steps have been taken to strengthen Active Labour Market Policies. Additional measures have been adopted in the area of education, in which progress is overall satisfactory.

(13) The implementation of the Services Directive aiming at reducing barriers to entry and boost competition and economic activity by facilitating access for new entrants to the market in the different economic regimes is proceeding at a good pace and its transposition is now close to completion. The framework law for improving the functioning of the regulated professions involving a professional body was adopted and the revision of the statutes of the eighteen professions concerned is the next step to complete this reform. The Framework Law to set the main principles of the functioning of the most important National Regulator Authorities (NRA), including their endowment with strong independence and autonomy

entered already into force and the bylaws of the various sectoral regulators are to be adopted soon. Implementation of the measures to reduce the electricity tariff debt has been delayed, though the government has recently presented a new tax to partially deal with this matter. Some legal provisions aimed at easing licensing procedures and other administrative burdens have been adopted such as the proposal of the New Base Law for Soil, Spatial Planning and Urbanism.

(14) Further progress is still necessary to make the transport sector more sustainable and open to competition. There has been some improvement in the financial position of the rail infrastructure manager, but significant additional effort is needed to bring it to operational balance by 2015.The reforms in ports need to be stepped up.

(15) Some additional measures have been adopted to improve the liquidity conditions of the business sector, in particular Small and Medium Enterprises (SME).

Reforms of the judicial system are close to completion. Progress has been achieved in reducing backlog cases and landmark reforms such as the geographical reorganisation of the court districts and the reform of the Code of Civil Procedure have been or are on the way of being completed. Continued improvement of the functioning of the judicial system, which is essential for the proper and fair functioning of the economy, through: (i) ensuring effective and timely enforcement of contracts and competition rules; (ii) increasing efficiency by restructuring the court system, and adopting new court management models; (iii) further reducing slowness of the system of courts cases (including tax court cases) is nevertheless necessary,

HAS ADOPTED THIS DECISION:

Article 1

In Article 3 of Implementing Decision 2011/344/EU, paragraphs 7 to 9 are replaced by the following:

‘7. Portugal shall adopt the following measures during 2013, in line with specifications in the Memorandum of Understanding:

(a) The general government deficit shall not exceed 5.5 percent of GDP in 2013. For the calculation of this deficit, the possible budgetary costs of bank support measures in the context of the Government's financial sector strategy shall not be taken into account. The consolidation measures included in the 2013 budget and supplementary budget shall be implemented rigorously throughout the rest of the year. In addition, should further slippages arise in budgetary execution, the government shall implement additional corrective measures;

(b) Portugal shall continue implementing its privatisation programme;

(c) Portugal shall complete the implementation of the strategy of shared services in public administration;

(d) Portugal shall continue the reorganisation and rationalisation of the hospital network through specialisation, concentration and downsizing of hospital services, joint management and joint operation of hospitals. Portugal shall ensure the implementation of the multiyear action plan for hospital reorganisation;

(e) Following the adoption of the amendments to the New Urban Lease Act Law 6/2006 and the Decree Law which simplifies the administrative procedure for renovation, Portugal shall undertake a comprehensive review of the functioning of the housing market;

(f) Portugal shall develop a nationwide land registration system to allow a more equal distribution of benefits and costs in the execution of urban planning;

(g) Portugal shall devise and implement alternative reform options of the labour market with similar effect to those that were declared unconstitutional by the Constitutional Court ruling of 26 September 2013;

(h) Portugal shall promote wage developments consistent with the objectives of fostering job creation and improving firms' competitiveness with a view to correcting macroeconomic imbalances. Over the Programme period, any increase in minimum wages shall take place only if justified by economic and labour market developments;

(i) Portugal shall continue to improve the effectiveness of its active labour market policies in line with the results of the assessment report and the action plan to improve the functioning of the public employment services;

(j) Portugal shall continue to implement the measures set out in its action plans to improve the quality of secondary and vocational education and training, in particular the government shall present plans to make the funding framework of schools more effective and the professional schools of reference shall be established;

(k) Portugal shall complete the adoption of the outstanding sectorial amendments necessary to fully implement the Services Directive;

(l) Portugal shall submit to Parliament the professional bodies' amended statutes;

(m) Portugal shall approve the corresponding amendments to the bylaws of the National Regulatory Authorities;

(n) Portugal shall publish quarterly reports on recovery rates; duration and costs of corporate insolvency cases; duration and cost of tax cases and on the clearance rate of enforcement court cases;

(o) Portugal shall improve the business environment by completing pending reforms on the reduction of administrative burden [fully operational Point of Single Contact (PSC) and 'Zero Authorisation' projects] and by carrying out further simplification of existing licensing procedures, regulations and other administrative burdens in the economy which are a major obstacle for the development of economic activities;

(p) Portugal shall complete the reform of the ports' governance system, including the overhaul of port operation concessions;

(q) Portugal shall implement the measures enhancing the functioning of the postal and telecommunications sectors;

(r) Portugal shall implement the measures enhancing the functioning of the transport system;

(s) Portugal shall implement the measures eliminating the energy tariff debt;

(t) Portugal shall ensure that the new legal and institutional PPP framework is applied and the PPP road contracts continue to be renegotiated in line with the strategic plan presented by the government and with the regulatory framework revision, in order to obtain substantial fiscal gains, particularly in 2013;

(u) Portugal shall continue to focus on measures to combat tax fraud and evasion and strengthen taxpayers' compliance.'

'8. Portugal shall adopt the following measures during 2014, in line with specifications in the Memorandum of Understanding:

(a) The general government deficit shall not exceed 4 percent of GDP in 2014. For the calculation of this deficit, the possible budgetary costs of bank support measures in the context of the Government's financial sector strategy shall not be taken into account. To achieve this objective Portugal shall deliver consolidation measures worth 2.3 percent of GDP, primarily through the 2014 Budget Law. Measures shall be mainly of permanent nature and titlted towards the expenditure savings side;

(b) The consolidation package shall build on the expenditure-reducing measures that were prepared in the framework of the public expenditure review (PER). Overall, the amount of these measures shall add up to 1.8 percent of GDP in 2014 and shall include (1) limiting outlays on the public wage bill by reducing the size of the public-sector work force while changing its composition towards higher-skilled employees, notably through a requalification programme and a voluntary redundancy scheme; further convergence of public and private sector work rules (including the increase in working hours and reduction in holiday entitlements) and the introduction of a single wage scale as well as the streamlining of wage supplements. Beneficiaries' contributions to the special health insurance schemes shall be increased and thereby contribute to enhance the equity and efficiency of public spending; (2) reforms of the pension system by an increase in the statutory retirement age *via* changes to the sustainability factor; an alignment of the rules for pension benefit calculations between the civil servants' pension regime (CGA) and the general pension system, while protecting benefits below minimum thresholds; and streamlining survivors' pensions of both CGA and the general pension regime, in particular in cases where these accumulate with other pensions; (3) savings in intermediate consumption and expenditure programmes across line ministries. In view of political and legal risks, some of the measures may be partly or fully replaced by others of equivalent size and quality;

(c) The PER package shall be completed with other permanent revenue measures aiming at further improving the efficiency and equity of the current tax and benefit structure (worth 0.4 percent of GDP). In particular, the corporate tax rate on expenses related to company cars shall be increased and environmental and health- related taxation shall be improved by changing the taxation of passenger diesel cars and by increasing excises on tobacco and on alcoholic beverages. Fiscal exemptions in property taxation for pension funds and real estate funds shall be eliminated. The caps to the social security contributions of members of statutory bodies shall be removed. A special levy on the energy sector shall be imposed curbing excessive rents from the energy sector. Part of the income generated by this levy shall be used to reduce the tariff debt. Online gambling licences shall be sold with a view to the regularisation of this market and this activity shall also be taxed. A special fee on media spectrum shall be introduced and the levy on financial institutions shall be increased. Moreover, a number of one-off measures shall be implemented, more than offsetting the costs arising from the one-off upfront payments related to the introduction of the mutual agreement redundancy scheme in the public sector. These include the transfer of the CTT health fund to the government sector, the sale of a port and silos concessions as well as special dividends from the sale of excessive oil reserves from a public company;

(d) Portugal shall present a report with the objectives (i) to identify overlaps of services and jurisdictions and other sources of inefficiencies between the central and the local levels of government; and (ii) to reorganise the network of decentralised services of ministries mainly through the citizens' shops network and other approaches, encompassing more efficient geographical areas and intensifying the use of shared services and digital government;

(e) Portugal shall continue the reorganisation and rationalisation of the hospital network through specialisation, concentration and downsizing of hospital services, joint management and joint operation of hospitals. Portugal shall ensure the implementation of the multiyear action plan for hospital reorganisation;

(f) Portugal shall implement the plan to create an independent gas and electricity logistics operator company;

(g) Portugal shall implement the measures enhancing the functioning of the transport system;

(h) Portugal shall assess the impact of the optional VAT cash accounting regime;

(i) Portugal shall carry out an inventory and an analysis of the costs of regulations that are likely to have a higher impact on economic activity.'

'9. With a view to restoring confidence in the financial sector, Portugal shall aim to maintain an adequate level of capital in its banking sector and ensure an orderly deleveraging process in compliance with the deadlines set in the Memorandum of Understanding. In that regard, Portugal shall implement the strategy for the Portuguese banking sector agreed with the Commission, the ECB and the IMF so that financial stability is preserved. In particular, Portugal shall:

(a) monitor the banks' transition to the new capital rules as laid down in the Capital Requirements Directive IV package (CRD IV) and ensure that capital buffers remain commensurate with the challenging operating environment;

(b) advise banks to strengthen their collateral buffers on a sustainable basis;

(c) ensure a balanced and orderly deleveraging of the banking sector, which remains critical in permanently eliminating funding imbalances and reducing the reliance on Eurosystem funding in the medium-term. Banks funding and capital plans shall be reviewed quarterly;

(d) encourage the diversification of financing alternatives for the corporate sector and in particular the SMEs through an array of measures aiming at improving their access to the capital markets;

(e) continue to streamline the state-owned CGD group;

(f) outsource the management of the BPN credits currently held by Parvalorem to the firms selected through the bidding process with a mandate to gradually recover the assets. The Portuguese Government shall ensure timely disposal of the subsidiaries and the assets in the other two state-owned special purpose vehicles;

(g) on the basis of the presented proposals to encourage the diversification of financing alternatives to the corporate sector, develop and implement solutions that provide financing alternatives to traditional bank credit for the corporate sector. The Portuguese Government shall assess the scope for improving the performance and governance of the existing government-sponsored credit lines building on the results of the recent external audit and the submitted roadmap;

(h) analyse banks' recovery plans and issue guidelines to the system on recovery plans and prepare resolution plans on the basis of the reports submitted by the banks. Submit to Parliament the necessary amendments to the recapitalization law reflecting the recent Communication from the European Commission on the application of the state-aid rules to support measures in favour of banks in the context of the financial crisis;

(i) implement the framework for financial institutions to engage in out-of-court debt restructuring for households, smoothen the application for restructuring of corporate debt and implement an action plan to raise public awareness of the restructuring tools;

(j) prepare quarterly reports on the implementation of the new restructuring tools. On the basis of the recently conducted survey explore alternatives to increase the successful recovery of companies adhering to the PER (the Special Revitalization Procedure for companies in serious financial distress) and the SIREVE (the Companies' Recovery System through Extrajudicial Agreements for companies in difficult economic situation or imminent or actual insolvency).'

Article 2

This Decision is addressed to Portugal.

Article 3

This Decision shall be published in the *Official Journal of the European Union.*

Done at Brussels,

For the Council
The President