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PROPOSAL

from:	Commission
dated:	6 December 2012
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Subject:	Proposal for a COUNCIL IMPLEMENTING DECISION amending Implementing Decision 2011/344/EU on granting Union financial assistance to Portugal

Delegations will find attached a proposal from the Commission, submitted under a covering letter from Mr Jordi AYET PUIGARNAU, Director to Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union.

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Proposal for a

COUNCIL IMPLEMENTING DECISION

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

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 sixth review 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.

2012/0352 (NLE)

Proposal for a

COUNCIL IMPLEMENTING DECISION

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

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 the sixth review of the authorities' progress on the implementation of the agreed measures as well as of the effectiveness and economic and social impact of the agreed measures.

(2) After a strong decline of 3% in 2012 in real terms, economic activity is expected to gradually recover starting from the second half of 2013 with quarterly growth rates returning to positive territory. Looking forward, the economic recovery is expected to gather pace in 2014 despite some headwinds from domestic consumption. Risks to the macroeconomic outlook are tilted to the downside. In particular, a stronger-than-expected deterioration of the economic climate in some euro area countries would have spill-over effects on Portugal.

(3) The 5% of GDP budget deficit target for 2012 remains valid, even though there are some risks. While the budgetary execution on the expenditure side remains under control, revenues until October continue to fall short of already downward revised targets. Additional saving measures worth around 0.3% of GDP are being implemented to meet the deficit target, but there are some uncertainties with regard to their final yield. Finally, the statistical authorities are still assessing whether the sale of the airport concession (ANA), estimated at 0.7% of GDP, can be treated as a deficit-reducing operation.

(4) The 2013 budget law, which was adopted on 27 November, includes discretionary measures of more than 3% of GDP to achieve the deficit target of 4½% of GDP in 2013. On the expenditure side, the budget envisages a sizeable reduction in the public sector wage bill through lower employment coupled with a reduction in overtime payments and other compensations. Rationalisation efforts in the health sector, State Owned Enterprises (SOEs), Public-Private-Partnerships (PPPs) will be deepened, while social spending will be further

[1] OJ L 118, 12.5.2010, p. 1.

streamlined. On the revenue side, the budget foresees a comprehensive reform of the Personal Income Tax (PIT) that will reduce the number of brackets and increase the average tax rate in line with European standards, while preserving progressivity and curbing tax benefits. In addition, a surcharge of 3.5% is imposed on the part of taxable income above the minimum wage and a solidarity surcharge of 2.5% on the income of the top tax bracket and of 5% on income above EUR 250 000. Corporate tax revenues are increased by means of limiting the deductibility of interest costs, reducing the threshold for applying the highest rate on profits and changing the methodology for special prepayment to companies under group taxation, among others. The budget also includes changes in indirect taxation, notably an increase in excise taxes on tobacco, alcohol and natural gas, a broadening of the base of property taxation after revaluation of properties and the creation of a financial transaction tax. In addition, social contributions will rise as they will be also charged on supplementary payments for public employees and on unemployment benefits.

(5) Taking into account the measures in the budget, revenue increases will contribute by 80 % to the fiscal adjustment in 2013 while the remaining 20% will come from expenditure reductions (after considering the effect of the reinstatement of the 13th salary in the public sector and 1.1 monthly pensions, following the decision of the Constitutional Court). In view of the risks associated with the strongly revenue-based adjustment, the authorities are preparing contingency measures amounting to 0.5% of GDP which will be activated if risks materialise. The measures will mainly consist of expenditure savings, notably further reductions in payroll costs, and will be further specified in early 2013 in time for the seventh review.

(6) The budgetary adjustment process is underpinned by a range of structural measures to enhance control over government expenditure and improve revenue collection. In particular, a comprehensive reform of the budgetary framework is foreseen to bring it in line with best practices in budgetary procedures and management. The new commitment control system is starting to show results but implementation needs to be monitored closely to ensure that commitments are in line with funding. Reforms in the public administration, which have already produced significant savings, will continue. Key reforms to restructure the revenue administration are close to completion and the authorities are enhancing monitoring and strengthening revenue compliance. The renegotiation of PPPs has started and significant savings are projected for 2013 and beyond. State-owned enterprises are expected to reach operational balance on average by the end of the year. Reforms in the health care sector are producing significant savings and implementation is continuing broadly in line with targets.

(7) A comprehensive expenditure review has been initiated with the objective to enhance the efficiency and equity of public services, while generating spending savings of about EUR 4 billion or 2.5% of GDP. The exercise aims at reducing redundancies across the public sector functions and entities, and reallocating resources toward growth-friendly spending areas. The identification, quantification and timetable of implementation of the measures should be specified by February 2013. The 2013 Stability Programme will provide further information on the medium-term fiscal consolidation plan.

(8) Under the Commission's current projections for nominal GDP growth (-1.0 % in 2011, -2.3% in 2012, 0.3% in 2013 and 2% in 2014) and the fiscal targets of 5% of GDP in 2012, 4½% in 2013 and 2½% in 2014, the debt-to-GDP ratio is expected to develop as follows: 108.1% in 2011, 120% in 2012, 122.2% in 2013 and 122.3% in 2014. The debt-to-GDP ratio would level off from 2012 onwards and be placed on a downward path after 2014, assuming further progress in the reduction of the deficit. Debt dynamics are affected by several below-the-line operations, including sizeable acquisitions of financial assets, notably for possible

bank recapitalisation and financing to state-owned enterprises and differences between accrued and cash interest payments.

(9) The capital augmentation exercise amounting to EUR 8.2 billion is nearly completed and will allow the participant banks to meet the EBA regulatory capital buffers as well as the end-of-year 10% Core Tier 1 program target. The indicative loan-to-deposit target of 120% by 2014 will likely be met with some banks already below the threshold at this stage. Efforts to diversify the sources of funding for the corporate sector are being strengthened. The legal acts on bank resolution including recovery plans, bridge banks and a resolution fund are being finalised.

(10) Further progress has been made in implementing growth and competitiveness enhancing structural reforms. In addition to strengthening active labour market policies, the authorities are committed to reducing severance payments to promote labour market flexibility and job creation. The implementation of the action plans on secondary school and vocational training is overall progressing as scheduled.

(11) The transposition 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 good pace. Licensing procedures and other administrative burdens are also being simplified in different economic sectors such as environment and territorial planning, agriculture and rural development, industry, or geology. A 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, is under preparation.

(12) Reforms of the judicial system continue to advance according to the agreed schedule. Further progress has been achieved on the reduction of backlog cases and broader reforms such as the geographical reorganisation of the court districts and the reform of the Code of Civil Procedure.

(13) Each measure required by this Decision is instrumental in re-establishing a sound economic and financial situation in Portugal and to restoring its capacity to finance itself on the markets,

HAS ADOPTED THIS DECISION:

Article 1

Article 3 of Implementing Decision 2011/344/EU is amended as follows:

(1) paragraph 7 is 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 4½% of GDP in 2013. The 2013 budget shall include permanent consolidation measures of at least 3% of GDP aiming at reducing the general government deficit within the timeframe referred to in paragraph 3. The Portuguese Government shall explore ways to increase the weight of expediture reduction in the overall consolidation package for 2013 in order to ensure a medium-term growth-friendly fiscal adjustment tilted towards the expenditure side. Given budgetary execution risks the Portuguese Government shall prepare contingency measures of 0.5% of GDP by early 2013 which should be activated in case of a materilasation of such risks;

(b) the 2013 budget shall include revenue-raising measures, notably a reform of the personal income tax that simplifies the tax structure, a broadening of the tax base through the elimination of some tax benefits and increases of the average tax rate, while preserving progressivity; a broadening of the corporate income tax base; an increase in the investment income tax rate; an increase in excise taxes and changes in recurrent property taxation;

(c) the 2013 budget shall include expenditure-saving measures, notably a rationalisation of public administration, education, health care and social benefits; a reduction of the wage bill by decreasing permanent and temporary staff and reducing overtime pay; a streamlining of public and private social transfers and subsidies; a reduction in transfers to local and regional authorities; and a lowering of operational and capital expenditures by SOEs;

(d) Portugal shall continue implementing its privatisation programme;

(e) Portugal shall develop common revenue forecasting guidelines for subnational governments;

(f) Portugal shall deepen the use of shared services in public administration;

(g) Portugal shall reduce the number of local branches of line ministries (e.g. tax, social security, justice) by merging them in citizens' shops and developing further the e-administration over the duration of the programme;

(h) 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. Finalise the implementation of the action plan by the end of 2013;

(i) With the support of internationally-reputed experts and 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;

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

(k) Portugal shall make fully operational the management tool to analyse, monitor and assess the results and impacts of education and training policies and shall establish the professional schools of reference;

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

(m) Portugal shall implement targeted measures to achieve steady reduction of the backlogged enforcement cases in view of resolving the backlog of court cases;

(n) Portugal shall adopt the Framework Law on the main National Regulator Authorities in order to guarantee their full independence and financial, administrative and management autonomy;

(o) Portugal shall improve the business environment by completing pending reforms on the reduction of administrative burden [Point of Single Contact (PSC) foreseen by the Services Directive 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 port work legislation and the ports' governance system, including the overhaul of port operation concessions;

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

(r) Portugal shall implement the measures eliminating the energy tariff debt and fully transpose the Third EU Energy Package.'

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* OJ L 376, 27.12.2006, p. 36.

** OJ L 255, 30.9.2005, p. 1.

*** OJ L 48, 23.2.2011, p. 1.

(2) paragraph 9 is replaced by the following:

'9. With a view to restoring confidence in the financial sector, Portugal shall adequately recapitalise its banking sector and ensure an orderly deleveraging process. 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) advise banks to strengthen their collateral buffers on a sustainable basis;

(b) ensure a balanced and orderly deleveraging of the banking sector, which remains critical in permanently eliminating funding imbalances. Banks' funding plans aim at reducing the loan-to-deposit ratio to an indicative value of approximately 120% in 2014 and reducing the reliance on Eurosystem funding in the medium-term. Those funding plans shall be reviewed quarterly;

(c) 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 and export credit insurance;

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

(e) optimise the process for recovering the assets transferred from BPN to the three state-owned special purpose vehicles through the outsourcing to a professional third party of the management of the assets, with a mandate to gradually recover the assets over time. The Portuguese Government shall select the party managing the credits through a competitive bidding process and include adequate incentives to maximise the recoveries and minimise operational costs into the mandate. The Portuguese Government shall ensure timely disposal of the subsidiaries and the assets in the other two state-owned special purpose vehicles;

(f) on the basis of the set of preliminary proposals to encourage the diversification of financing alternatives to the corporate sector presented, develop and implement solutions that provide financing alternatives to traditional bank credit for the corporate sector. The Portuguese Government shall assess the effectiveness of government-sponsored export credit insurance schemes with a view to taking appropriate measures compatible with EU law to promote exports;

(g) ensure the initial and periodical funding arrangements for the Resolution Fund in two steps, first by the approval of a decree-law on the banks' contributions to the Resolution Fund, and secondly by the approval of a supervisory notice on the specific periodic contributions by banks; adopt the supervisory notices on the resolution plans. The implementation of the recovery and resolution plans of the banks shall give priority to those that are of systemic importance;

(h) 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;

(i) submit to Parliament amendments to the legal framework governing access to public capital to allow the State, under strict circumstances and in accordance with state aid rules, to exercise control over an institution and to perform mandatory recapitalisations.'

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