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PROPOSAL

from:	The Commission
dated:	27 September 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 Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director to Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union.

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2012/0276 (NLE)

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(9) of Decision 2011/344/EU, the Commission, together with the IMF and in liaison with the ECB, has conducted the fifth 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.

2012/0276 (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(9) 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 fifth 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) The rebalancing of the Portuguese economy is taking place at a faster-than-expected pace. The second quarter of 2012 brought a substantial quarter-on-quarter real GDP contraction of 1.2 percent following a flat first quarter. For the year as a whole, the projected pace of the economic recession remains unchanged at -3 percent. The current account deficit is declining more rapidly than anticipated, falling to 3 percent of GDP in 2012 from nearly 10 percent just two years ago. This adjustment is taking place on the back of well-performing exports and a rapid fall in imports. Looking forward, economic activity will be affected by a diminishing stimulus from external demand and the impact of further budgetary consolidation. As a consequence, GDP growth has been revised downward by about 1 percentage point in both 2013 and 2014 to around -1 and +1 percent.

(3) In spite of a rigorous budget implementation on the expenditure side, data until July point to a budgetary gap of 2¼ percent of GDP in 2012 compared with the budget plans. While the faster-than-projected adjustment from domestic demand to exports is welcome, it impacts on budgetary execution in two ways. First, employment-intensive domestic sectors, such as construction, are affected most negatively and the resulting higher unemployment weighs on social security budgets. Second, the tax-intensity of production and consumption is falling, leading to noticeable revenue shortfalls. The growth composition effect on revenues is amplified by intra-category shifts away from higher-taxed items such as consumer durables towards lower-taxed items of daily consumption. Also, the weakness in direct taxation is amplified by negative bracket creep as falling incomes are taxed at lower rates and tax

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

revenues on profits shrink. By contrast, expenditure has overall developed according to plans, with higher-than-budgeted savings on compensations for employees. Although a number of one-off factors could reduce the gap to about ¾ percent of GDP in 2012, a large carry-over into 2013 and 2014 of about 1½ percent of GDP would remain, making the fiscal programme targets over 2012-2014 unattainable.

(4) In view of the large revenue shortfalls and the more subdued growth outlook, the deficit targets haven been adjusted to 5.0 percent of GDP in 2012, 4.5 percent in 2013 and 2.5 percent of GDP in 2014. As the fiscal gap is assessed to be essentially outside the control of the government a revision of the targets to accommodate part of the shortfall seems appropriate. Even under the revised targets significant consolidation efforts of 3 percent and 1¾ percent of GDP will be necessary in 2013 and 2014. In order to maintain the credibility of the Programme some degree of front-loading of the adjustment is warranted.

(5) A range of structural spending and revenue measures underpin the revised fiscal targets. Measures worth ¼ percent of GDP will be taken still in 2012 to reach the target of 5 percent of GDP. This includes, inter alia, spending freezes and a frontloading of some of the measures planned for next year. For 2013, consolidation measures amounting to 3 percent of GDP will be incorporated in the budget to achieve the target of 4.5 percent of GDP. These include a further decrease in the wage bill, a reduction in intermediate consumption, a cut in social transfers, a further rationalisation in the health sector, reduced spending on capital formation, as well as revenue increases achieved via a reform of the personal income tax simplifying the tax structure, broadening the base by eliminating some tax expenditures, increasing the average tax rate while improving progressivity, broadening the corporate income tax base by eliminating interest deductibility, rising excises taxes and changing property taxation. For 2014, a comprehensive expenditure review has been initiated with a view to identifying spending cuts (of EUR 4 billion over 2014-2015) to reach a budget deficit of 2.5 percent of GDP.

(6) Instruments to control government expenses are put in place. The new commitment control system is being implemented but full compliance needs to be ensured so as to avoid a further build-up of new arrears. Budgetary fragmentation will be reduced and costly inefficiencies are being tackled across a broad range. This includes containing losses of public sector enterprises, renegotiating public-private partnerships and pushing for further savings in the health care sector.

(7) Under the Commission's current projections for nominal GDP growth (-1.0 % in 2011, -2.7 % in 2012, 0.3 % in 2013 and 2.2 % in 2014) and the revised fiscal targets, the path for the debt-to-GDP ratio is expected as follows: 107.8 % in 2011, 119.1 % in 2012, 123.7 % in 2013 and 123.6 % in 2014. The debt-to-GDP ratio would therefore be stabilised at below 124 % and be placed on a declining path in 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.

(8) The liquidity and the solvency conditions of the banking system have improved since the fourth review, reflecting the ongoing deleveraging, the exceptional liquidity support provided by the Eurosystem, and a capital augmentation worth over EUR 7 billion. Banks presented their updated funding and capital plans (4th edition). Albeit slightly less optimistic on deposits growth, all banks foresee to meet the indicative loan to deposit target of 120% by 2014. Overall, the implementation of the Memorandum of Understanding on the financial sector part is proceeding in accordance with the envisaged objectives to preserve financial

stability. Some efforts are still needed in some banks to meet the end of the year 10% core tier 1 target of the Banco de Portugal.

(9) Progress in the implementation of reforms to raise competitiveness, employment and the growth potential is broadly satisfactory. The revised Labour Code entered into force in August 2012. Further important reforms in the area of severance payment and collective bargaining are planned by the end of September. The Government has recently adopted a number of Active Labour Market Policies aimed at improving the functioning of Public Employment Services, supporting employment creation, strengthening activation and offering more effective training opportunities. The judiciary reforms in the areas of civil procedure and court organisation, which will speed up civil and commercial litigation and unclog the court system, are progressing well. Steps have been taken to improve the framework for the recognition of professional qualifications with the adoption of amendments to the law transposing Directive 2005/36/EC of the European Parliament and the Council on the mutual recognition of Professional Qualifications and with the adoption by the government of a law proposal aimed at improving the functioning of highly regulated professions. Work on the implementation of the Services Directive has advanced at a steady pace as regards sector-specific legislation, with the adoption of the remaining necessary sector-specific legislative amendments expected by the end of the year. Further efforts in the implementation of the zero authorisation initiative and the set-up of the point of single contact foreseen by the Directive 2006/123/EC of 12 December 2006 on services in the internal market[2] are essential to reduce the administrative burden. In view of facilitating access to finance to Small and Medium Enterprises (SMEs), the Government is committed to adopt, if necessary, a number of additional initiatives, including mechanisms to strengthen the export orientation of SMEs.

(10) Building on the independent report on the main National Regulator Authorities (NRA), Portugal will prepare a framework law that protects the public interest and promotes market efficiency. The law shall guarantee the Regulator's independence and financial, administrative and management autonomy to exercise their responsibilities, in full compliance with EU law. The law shall also contribute towards the effectiveness of the competition authority in enforcing competition rules therefore supporting and complementing the effect of the recently adopted competition law.

(11) The fifth update of the Memorandum of Understanding includes a full section on promoting a business-friendly licensing environment which provides a more detailed calendar and specific milestones in the revision of some important legal regimes such as environment and territorial planning, industrial, commercial and tourism licensing,

HAS ADOPTED THIS DECISION:

Article 1

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

(1) paragraphs 3 and 4 are replaced by the following:

'3. The general government deficit shall not exceed 5.9 % of GDP in 2011, 5.0 % in 2012, 4.5% of GDP in 2013 and 2.5% of GDP in 2014 in line with the revised excessive deficit procedure requirements. For the calculation of this deficit, the possible budgetary costs of bank support

[2] OJ L 376, 27.12.2006, p. 36.

measures in the context of the Portuguese Government's financial sector strategy shall not be taken into account. Consolidation shall be achieved by means of high-quality permanent measures and minimising the impact of consolidation on vulnerable groups.'

'4. Portugal shall adopt the measures specified in paragraphs 5 to 8 before the end of the indicated year, with exact deadlines for the years 2011-2014 being specified in the Memorandum of Understanding. Portugal shall stand ready to take additional consolidation measures to reduce the deficit to below 3 % of GDP by 2014 in case of deviations from targets.'

(2) paragraphs 6 to 9 are replaced by the following:

'6. Portugal shall adopt the following measures during 2012, in line with specifications in the Memorandum of Understanding:

(a) The general government deficit shall not exceed 5.0% of GDP in 2012. Portugal shall continue to closely monitor fiscal developments and implement further policy adjustments to achieve the 2012 target. To this effect, Portugal shall freeze some of the 2012 budget appropriations for investment projects not yet initiated; increase stamp duties on high value properties; rise tax rates on investment income; frontload some of the 2013 budget measures affecting social benefits; implement additional measures generating savings in intermediate consumption and raising revenues from sales in order to secure the deficit target for 2012.

(b) Portugal shall aim at a reduction of expenditure in 2012 of at least EUR 6.8 billion including a reduction in public sector wages and employment; cuts in pensions; a comprehensive reorganisation of the central administration, eliminating redundancies and other inefficiencies; reducing transfers to state-owned enterprises; reorganising and reducing the number of municipalities and parishes; cuts in education and health; lower transfers to regional and local authorities; and reductions in capital expenditure and in other expenditure as set out in the Programme.

(c) On the revenue side, Portugal shall implement revenue measures of at least EUR 3 billion, including broadening VAT bases through reducing exemptions and rearranging the lists of goods and services subject to reduced, intermediate and higher rates; an increase in excise taxes; broadening the corporate and personal income tax bases by reducing tax deductions and special regimes; ensuring the convergence of personal income tax deductions applied to pensions and labour income; and changes in property taxation by substantially reducing exemptions. These measures shall be complemented by action to fight tax evasion, fraud and informality.

(d) Portugal shall continue adopting measures to reinforce public finance management. Portugal shall implement the measures provided for in the new Budgetary Framework Law, including setting up a medium-term budgetary framework. The local and regional budgetary frameworks shall be considerably strengthened, in particular by aligning the respective financing laws with the requirements of the Budgetary Framework Law. Portugal shall step up the reporting and monitoring of public finances and reinforce budgetary execution rules and procedures. The Portuguese Government shall apply the strategy for the validation and settlement of arrears and step up the implementation of the commitment control law to prevent the creation of new arrears. Portugal shall implement the new legal and institutional PPPs framework. No PPP shall be launched until the new framework is fully effective. Based on a study prepared by an international auditing firm, Portugal shall develop a detailed strategic plan, in full compliance with applicable EU law including Public Procurement law, in view of obtaining substantial fiscal gains, while minimising the debt burden and ensure sustainable reduction of government liabilities. Portugal shall adopt a law to regulate the creation and the functioning of state-owned enterprises (SOEs) at the central, regional and local levels.

(e) Portugal shall apply the new legislation to reorganise and significantly reduce the number of local government entities. These changes will come into effect by the beginning of the next local election cycle. In addition, Portugal shall deepen efforts to streamline the public sector by reducing entities and improving task sharing at all levels of government.

(f) Portugal shall deepen the reform of the revenue administration by reinforcing the links between the Autoridade Tributária e Aduaneira and the revenue collection units of the Social Security, reducing the number of municipal offices and addressing remaining bottlenecks in the tax appeal system.

(g) Portugal shall implement the financial arrangement with the Autonomous Region of Madeira.

(h) Portugal shall adopt measures to improve the efficiency and sustainability of SOEs at central, regional and local level. Portugal shall explore options for managing the heavy debt load of SOEs, including Parpública, and to ensure improved conditions for market financing. Portugal shall aim at reaching operational balance at sector level by the end of 2012.

(i) Portugal shall continue implementing the privatisation programme. The direct sale of Caixa Geral de Depositos (CGD) insurance arm Caixa Seguros is ongoing.

(j) The Portuguese Government shall submit draft legislation to the Portuguese Parliament to align severance payments with the Union average of 8-12 days per year of work and create a compensation fund for severance payments.

(k) 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. Measures shall be taken to address weaknesses in the current wage bargaining schemes, including legislation to redefine the criteria and modalities of the extension of collective agreements and to facilitate firm-level agreements. Until then, the collective agreements shall not be extended.

(l) 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.

(m) Portugal shall implement the measures set out in its action plans to improve the quality of secondary and vocational education and training.

(n) The functioning of the judicial system shall be improved by implementing the measures proposed under the Judicial Reform Map and by applying targeted measures to progressively eliminate the court backlog and to foster alternative dispute resolution.

(o) Portugal shall continue opening up the economy to competition. The Portuguese Government shall take the necessary measures to ensure that obstacles to free movement of capital will not be created by their action and in particular, that the Portuguese State or any public body does not conclude, in a shareholder capacity, agreements which may hinder the free movement of capital or influence the management control of companies. Functioning of Professional services shall be fostered by improving the recognition of framework on professional qualification and by eliminating unnecessary restrictions on regulated professions. In construction and real estate activities, Portugal shall make the requirements for cross border providers less burdensome and review obstacles to the establishment of services providers.

(p) The competition and regulatory framework shall be improved. Portugal shall reinforce the independence, autonomy and governance of the main national regulatory authorities; implement the Competition Law with a view to improving the speed and effectiveness of the enforcement of competition rules; and monitor the inflow of new cases and report on the functioning of the specialised court for competition, regulation and supervision.

(q) In the energy sector, Portugal shall take measures to facilitate entry, promote the establishment of the Iberian gas market and shall take further steps towards the full transposition of the Third EU Energy Package. To ensure the National Regulatory Authority's independence, autonomy and all powers foreseen in the Package, Portugal shall adopt the new regulators' bylaws as agreed in July 2012 with EC/ECB/IMF by the third quarter 2012**,** and ensure that they are effective before end of year in time for the liberalisation of the electricity and gas market. Portugal shall take measures to review the support and compensation schemes for the production of electricity. Portugal shall take measures to reduce excessive rents and eliminate the tariff debt ('défice tarifário') by 2020, focusing on compensation schemes for power guarantee, special regime (renewables - excluding those granted under tender mechanisms - and cogeneration), and the ordinary regime ('CMECs' and 'CAEs').

(r) In other network industries, in particular transport, telecommunications and postal services, Portugal shall adopt additional measures to promote competition and flexibility.

(s) Portugal shall adopt a number of measures in view of increasing the efficiency of the licensing schemes for territorial planning, industrial and commercial licensing and tourism. In addition the Portuguese government shall analyse and fast-track applications for the licensing of planned investment projects which are left unresolved or undecided for more than 12 months.

(t) Portugal shall prepare an action plan with measures to facilitate access to finance and to export markets for companies, in particular for SMEs.'

'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 4.5% of GDP in 2013. The 2013 budget shall include permanent consolidation measures of at least 3% of GDP aiming at a reduction of the general government deficit within the timeframe referred to in Article 3(3). The 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. The government shall use contingency measures in the course of 2013 in case of slippages given possible implementation risks.

(b) The budget shall include revenue measures such as a reform of the personal income tax simplifying the tax structure, broadening the base by eliminating some tax expenditures, increasing the average tax rate while improving progressivity; broadening the corporate income tax base, increasing investment income tax rate; higher excises taxes and changes in property taxation.

(c) On the expenditure side, the 2013 budget shall identify measures such as lowering expenditures in the central administration, education and health; streamlining public and private social transfers and subsidies; reducing transfers to local and regional authorities; reduction of the wage bill by decreasing permanent and temporary staff and reducing overtime pay; and lower operational and capital expenditures by SOEs.

(d) Portugal shall complete the elimination of the court backlog.

(e) Portugal shall improve the business environment by reducing administrative burden through the extension of simplification reforms (Points of Single Contact – PSC - and ‘Zero Authorisation’ projects) to all sectors of the economy. In particular, Portugal shall adapt the content and the information available at the PSC to ensure conformity with Directive 2006/123/EC of the European Parliament and the Council* and with Directive 2005/36/EC of the European Parliament and of the Council**. Portugal shall alleviate credit constraints of small and medium-sized enterprises, including through the implementation of Directive 2011/7/EU of the European Parliament and of the Council***.

(f) Portugal shall adapt the content and the information available at the Point of Single Contact (PSC) for the 44 amended regimes to ensure conformity with the Services Directive, shall adapt the content and information available at the PSC for the 13 regimes to ensure conformity with the Professional Qualifications Directive

(g) Portugal shall continue implementing its privatisation programme, which shall be expanded to include additional companies and assets to the ones identified in the Memorandum of Understanding for sale or concession in 2013.'

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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.

'8. The general government deficit shall not exceed 2.5% of GDP in 2014. To achieve this objective Portugal shall apply a thorough expenditure reducing plan worth about EUR 4 billion over 2014-2015. A comprehensive expenditure review to fully specify the additional sources of savings shall be carried out for the sixth review and measures shall be fully specified by February 2013. The fiscal consolidation plans for 2014-2015 shall be fully defined in the 2013 Stability Programme.'

'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 and monitor the outstanding government guaranteed bank bonds;

(b) ensure that banks reach the Programme target of the Core Tier 1 ratio of 10 % at the latest by the end of 2012;

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

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

(e) optimise the process for recovering the assets transferred from BPN to the three state-owned SPVs 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. Ensure timely disposition of the subsidiaries and the assets in the other two state-owned SPVs.

(f) based on the set of preliminary proposals to encourage the diversification of financing alternatives to the corporate sector presented, develop and evaluate the different options put forward with a view to set priorities. Assess the effectiveness of EU-compatible government-sponsored export credit insurance schemes with a view to take appropriate measures 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 by November 2012 and secondly by the approval of a supervisory notice on the specific periodic contributions by banks one month later; adopt the supervisory notices on recovery plans by the end of October 2012; adopt the regulation on resolution plans by the end of November 2012; and adopt the rules applicable to setting-up and operation of bridge banks in line with Union competition rules by the end of October 2012. Priority shall be given to the review of the recovery and subsequent resolution plans of the banks that are of systemic importance;

(h) establish a framework for financial institutions to engage in out-of-court debt restructuring for households and SMEs and implement an action plan to raise public awareness of the restructuring tools.'

(3) The following paragraph 10 is added:

'10. In order to ensure the smooth implementation of the Programme's conditionality, and to help to correct imbalances in a sustainable way, the Commission shall provide continued advice and guidance on fiscal, financial market and structural reforms. Within the framework of the assistance to be provided to Portugal, together with the IMF and in liaison with the ECB, it shall periodically review the effectiveness and economic and social impact of the agreed measures, and shall recommend necessary corrections with a view to enhancing growth and job creation, securing the necessary fiscal consolidation and minimising harmful social impacts, particularly on the most vulnerable parts of Portuguese society.'

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