COUNCIL OF THE EUROPEAN UNION

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from:	The General Secretariat
to:	Permanent Representatives Committee/Council
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on Portugal’s 2014 national reform programme and delivering a Council opinion on Portugal’s 2014 stability programme

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2014) 423 final.

COUNCIL RECOMMENDATION

of

on the National Reform Programme 2014 of Portugal
and delivering a Council opinion on the Stability Programme of Portugal, 2014

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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[1] OJ L 209, 2.8.1997, p. 1.

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee, Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which focuses on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a Recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, it adopted a decision on guidelines for the employment policies of the Member States[2], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Member States' Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 strategy and to implementing the country-specific recommendations.

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[2] Maintained for 2014 by Council Decision 2014/322/EU of 6 May 2014 on guidelines for the employment policies of the Member States for 2014 (OJ L 165, 4.6.2014, p. 49).

(4) Portugal was subject to a macroeconomic adjustment programme until 17 May 2014 in line with Article 1(2) of Council Implementing Decision 2011/344/EU[3], which provided that the financial assistance would be made available for three years. On 23 April 2014, the Council decided[4] to extend the availability of the financial assistance by six weeks, to allow for a comprehensive and thorough assessment of compliance with the programme conditionality and an orderly disbursement of the last loan tranche. Under Article 12 of Regulation (EU) No 472/2013 of the European Parliament and of the Council[5] Portugal was thus exempt from the monitoring and assessment of the European Semester for economic policy coordination for the duration of the programme. Having exited the programme, Portugal should now be fully re-integrated into the European Semester framework.

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey, marking the start of the 2014 European Semester for economic policy coordination. Also, on 13 November 2013, the Commission, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council[6]**,** adopted the Alert Mechanism Report.

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3 Council Implementing Decision 2011/344/EU of 30 May 2011 on granting Union financial assistance to Portugal (OJ L 159, 17.06.2011, p. 88).

4 Council Implementing Decision 2014/234/EU of 23 April 2014 amending Implementing Decision 2011/344/EU of 30 May 2011 on granting Union financial assistance to Portugal (OJ L 125, 26.4.2014, p. 75).

5 Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (OJ L 140, 27.05.2013, p. 1).

6 Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) Pursuant to Regulation (EU) No 472/2013, Portugal was exempted from the obligation to submit its National Reform Programme and its Stability Programme for the duration of the macroeconomic adjustment programme. Nevertheless, it submitted an updated Fiscal Strategy Document on 30 April 2014 (*Documento de Estratégia Orçamental*) and a letter from the Government providing an update on developments on the Europe 2020 targets. On 17 May 2014, the Government presented its ongoing reform programme and new initiatives towards sustainable growth in a document entitled "The Road to Growth, a medium-term reform strategy for Portugal".

(8) The objective of the budgetary strategy outlined in the 2014 Fiscal Strategy Document is to correct the excessive deficit by 2015 in a sustainable manner and reach the medium-term objective by 2017. The strategy plans to bring the government deficit to 4,0 % of GDP in 2014 and to lower it further to 2,5 % of GDP in 2015, in line with the targets set in the Excessive Deficit Procedure Recommendation of 21 June 2013 and re-confirmed by the 12th review of the macroeconomic adjustment programme. However, on 30 May 2014 the Constitutional Court annulled consolidation measures estimated to impact the budgetary results in 2014 by around 0,4 % of GDP, with possible follow-on effects in 2015. In order to achieve the agreed targets, the Government will have to introduce replacement measures of equivalent size. There are, however, two rulings of the Constitutional Court still pending which prevents a complete quantification of the measures to be taken. In view of the limited time available, the Government may need to resort to measures of a less growth-friendly nature, particularly on the revenue side. Beyond 2015, the strategy confirms the aim of achieving the medium-term objective by 2017 by way of delivering a structural effort of 0,5 % of GDP in 2016 and achieving a structural deficit of 0,5 % in 2017. According to the strategy, general government gross debt will peak at around 130,2 % of GDP in 2014 and will gradually start declining as from 2015. The macroeconomic scenario underlying the budgetary projections of the strategy is in line with the Commission spring forecast and was analysed by the Public Finance Council. Following the constitutional court ruling the fiscal strategy in 2014 will have to be revised in order to achieve the deficit target of 4 % of GDP. Nevertheless, downside risks to the target remain, in particular due to legal uncertainties and the statistical impact of operations aimed at a more efficient management of the debt overhang of some state-owned enterprises.

The 2015 budgetary adjustment is underpinned by fiscal consolidation measures amounting to 0,8 % of GDP which is considered to be sufficient to achieve the target of 2,5 % of GDP. Based on the assessment of the Governments' fiscal strategy and the Commission forecast, pursuant to Regulation (EC) No 1466/97, the Council is of the opinion that the strategy's targets are consistent with the requirements of the Stability and Growth Pact.

(9) Fiscal consolidation needs to be underpinned by further reforms of the system of public financial management. In particular, despite progress made under the macroeconomic adjustment programme, the comprehensive reform of the Budget Framework Law needs to be completed and further efforts are necessary to strictly ensure expenditure control by enforcing the commitment control law and to prevent the further accumulation of public sector arrears. Continued restructuring of state-owned enterprises, ensuring their financial sustainability and tightly controlling pension and healthcare expenditure will be crucial. On the revenue side, there is scope for making the tax system more growth-friendly and further fostering tax compliance.

(10) Portugal faces challenges relating to unemployment which, notwithstanding the recent decline, remains very high, particularly for young people. The unemployment rate stood at 16,4 % in 2013 and youth unemployment at 38,1 %, substantially above the EU average, as was the percentage of young people not in education, employment, or training. Portugal's traditionally high employment rate among 20-64 years old, has declined markedly since the start of the economic crisis, from 73,1 % in 2008 to 65,6 % in 2013. As regards youth unemployment, in line with the objectives of a youth guarantee, the main challenges include weak outreach to non-registered young people, and a need to better align education and training with labour market needs. Under the macroeconomic adjustment programme, Portugal has implemented a wide range of labour market reforms aimed at easing overly restrictive employment protection legislation, making wage-setting mechanisms more flexible and improving the functioning of the public employment services and activation policies. Challenges remain, however, in particular the need to tackle labour market segmentation and improve the responsiveness of wages to the economic conditions. An independent evaluation of the effects of the recent reforms in the employment protection system would help to assess, in particular, their impact on job creation, precariousness, overall labour costs and on the number of court appeals against dismissals and their outcome. Despite efforts to alleviate the negative social impact, the necessary economic adjustment following the crisis has had negative repercussions in terms of poverty.

(11) Portugal has made significant progress in reforming its education system by means of several measures to fight early school leaving, and improve tertiary attainment rate and labour market matching. However, the full implementation and efficient use of funding remain crucial. In particular, further work is necessary to reduce skills mismatches, including by increasing the quality and attractiveness of vocational education and training, including dual vocational education and training, fostering employers' involvement in helping to design programmes and providing adequate in job trainings and apprenticeships. There is also a need to effectively implement career guidance and counselling services for secondary and tertiary students in line with labour market needs and skills anticipation, and strengthen links with the business sector.

(12) Portugal has taken significant steps under the macroeconomic adjustment programme to improve the capital base of the banking sector and to strengthen its supervision and resolution framework. However, important challenges remain and need to be carefully monitored and managed; these include the profitability of the Portuguese banks. Data for the first quarter of 2014 show that some of the assisted banks registered positive results. Asset quality is still a major problem, with impairment levels remaining high at about 6 % of total gross loans and non-performing loans at elevated levels (10,6 %), in particular in the corporate segment (over 16 %) according to the data available at end 2013. Portugal has adopted a number of measures to facilitate lending to viable companies, but financing conditions remain difficult, particularly for SMEs, and the range of financing alternatives for the corporate sector, other than bank-based finance, remains limited. Freshly granted loans to SMEs fell by 4,8 % in 2013 as compared with 2012. The average interest rates on new loans to Portuguese firms have come down somewhat since early 2013, but remain significantly above the euro area average. Given the high corporate debt overhang and the need for a further deleveraging of the banking sector, banks' ability to extend credit to viable firms at reasonable cost remains constrained.

(13) With a view to ensuring the efficiency and sustainability of the energy sector and lowering the energy cost for the economy, two packages of measures have been enacted under the macroeconomic adjustment programme. Rents in the energy sector must, however, be further reduced and the high and rising tariff debt tackled. To this end, Portugal has recently announced a third package of measures, including the extension to 2015 of the 2014 special levy on the energy operators. In addition, improving cross-border integration of the energy networks and speeding up implementation of the electricity and gas interconnection projects remain outstanding issues and necessitate robust follow-up in view of ending the isolation of the Iberian peninsula from the EU energy market. In the transport sector, progress has been made under the programme, in particular in enhancing the competitive position of the Portuguese ports, drawing up a comprehensive long-term transport plan, after weaknesses and gaps had been addressed, and improving the regulatory framework. However, further measures remain necessary to effectively implement the comprehensive long-term transport plan and the reform action plan for ports. Steps are also needed to ensure the independence and capacity of the transport regulator, and the financial sustainability of the state-owned enterprises in the sector and enhance efficiency and competition in rail transport.

(14) A landmark reform has been implemented in the urban lease market with a view to making the housing market more dynamic including by better balancing rights and obligations of landlords and tenants, introducing more flexibility in the choice of contract duration, and incentivising renovation works. More work is still required to comprehensively evaluate the impact of this reform on the basis of data on key drivers of the market and on the shadow economy in the Portuguese rental market. Portugal has made substantial progress in enhancing its business environment, in particular by fostering better framework conditions, promoting entrepreneurial culture and improving insolvency proceedings for firms in distress. Attention should now be shifted to implementation. The simplification of administrative and licensing procedures has made progress but a number of measures still require completion. Further efforts are necessary to remove obstacles to competition in the services sector, in particular by adopting sectoral amendments, and in professional services, by adopting legislation on the remaining professional bodies. As regards regulation and competition**,** follow-up measures are necessary to ensure the independence and autonomy of the national sectoral regulators and the Competition Authority. Significant delays still affect payments by public authorities.

(15) Good progress has been made under the macroeconomic adjustment programme in rationalising and modernising the public administration in terms of employment, remuneration policy, working conditions, organisational efficiency and quality of services. However, some of the envisaged reform measures still need to be completed and transparency improved. Despite significant progress made to improve the efficiency of the judicial system, further improvements are called for in particular in terms of the length of proceedings, the clearance rate, the number of pending cases, and the monitoring and evaluation process.

(16) The Commission's analysis leads it to conclude that the successful implementation of the macroeconomic adjustment programme was instrumental in managing economic and financial risks and reducing imbalances. Portugal has adopted a wide range of challenging structural reforms under the programme, which are starting to bear fruit in terms of enhanced competitiveness and resuming economic growth, but more work is needed to assess the reforms' impact on the functioning of the economy. Continued monitoring of all implemented reforms is therefore essential to assess whether they contribute to boosting competitiveness, output and employment growth.

(17) Since after the end of the macroeconomic adjustment programme, which will be legally concluded on 28 June 2014, Portugal will be fully re-integrated in the European Semester exercise, the Commission, on this basis has assessed the documents submitted by Portugal. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Portugal but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the Union by providing EU-level input for future national decisions. Its recommendations for Portugal under the European Semester are reflected in recommendations (1) to (8) below.

(18) In the light of this assessment, the Council has examined the Government's fiscal strategy, and its opinion[7] is reflected in particular in recommendation (1) below. These recommendations were prepared in the wake of the conclusion of the macroeconomic adjustment programme and therefore build on that programme's achievements to secure its lasting implementation.

(19) In the context of the European Semester, the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On this basis, the Council has issued specific recommendations addressed to the Member States whose currency is the euro[8*]. As a country whose currency is the euro, Portugal should also ensure the full and timely implementation of these recommendations,

HEREBY RECOMMENDS that Portugal take action within the period 2014-2015 to:

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[7] Under Article 5(2) of Council Regulation (EC) No 1466/97.

[8] OJ C…

[*] OJ: Please insert reference for doc. st 10676/14.

1. Implement the necessary fiscal consolidation measures for 2014 so as to achieve the fiscal targets and prevent the accumulation of new arrears. For the year 2015, implement a revised budgetary strategy in order to bring the deficit to 2,5 % of GDP, in line with the target set in the Excessive Deficit Procedure Recommendation, while achieving the required structural adjustment. Replace consolidation measures which the Constitutional Court considers unconstitutional by measures of similar size and quality as soon as possible. The correction of the excessive deficit should be done in a sustainable and growth-friendly manner, limiting recourse to one-off/temporary measures. After the correction of the excessive deficit, pursue the planned annual structural adjustment towards the medium-term objective, in line with the requirement of an annual structural adjustment of at least 0,5 % of GDP, more in good times, and ensure that the debt rule is met in order to put the high general debt ratio on a sustainable path. Prioritise expenditure-based fiscal consolidation and increase further the efficiency and quality of public expenditure. Maintain tight control of expenditure in central, regional and local administration. Continue the restructuring of the state-owned enterprises. Develop by the end of 2014 new comprehensive measures as part of the ongoing pension reform, aimed at improving the medium-term sustainability of the pension system. Control healthcare expenditure growth and proceed with the hospital reform. Review the tax system and make it more growth-friendly. Continue to improve tax compliance and fight tax evasion by increasing the efficiency of the tax administration. Strengthen the system of public financial management by swiftly finalising and implementing the comprehensive reform of the Budgetary Framework Law by the end of 2014. Ensure strict compliance with the Commitment Control Law. Effectively implement single wage and supplements' scales in the public sector from 2015 onwards.

2. Maintain minimum wage developments consistent with the objectives of promoting employment and competitiveness. Ensure a wage setting system that promotes the alignment of wages and productivity at sectoral and/or firm level. Explore, in consultation with the social partners and in accordance with national practice, the possibility of mutually agreed firm-level temporary suspension of collective agreements. By September 2014, present proposals on mutually agreed firm-level temporary suspension of collective agreements and on a revision of the survival of collective agreements.

3. Present, by March 2015, an independent evaluation of the recent reforms in the employment protection system, together with an action plan for possible further reforms to tackle labour market segmentation. Pursue the ongoing reform of active labour market policies and Public Employment Services aimed at increasing employment and labour participation rates, specifically by improving job counselling/job search assistance and activation/sanction systems with a view to reducing long-term unemployment and integrating those furthest away from the labour market. Address the high youth unemployment, in particular by effective skills anticipation and outreach to non-registered young people, in line with the objectives of a youth guarantee. Ensure adequate coverage of social assistance, including the minimum income scheme, while ensuring effective activation of benefit recipients.

4. Improve the quality and labour-market relevance of the education system in order to reduce early school leaving and address low educational performance rates. Ensure efficient public expenditure in education and reduce skills mismatches, including by increasing the quality and attractiveness of vocational education and training and fostering cooperation with the business sector. Enhance cooperation between public research and business and foster knowledge transfer.

5. Monitor banks' liquidity position and potential capital shortfalls, including by on-site thematic inspections and stress-testing. Assess the banks' recovery plans and introduce improvements to the evaluation process where necessary. Implement a comprehensive strategy to reduce the corporate debt overhang and reinforce efforts to widen the range of financing alternatives, including for early stages of business developments, by enhancing the efficiency of the debt restructuring tools (particularly PER and SIREVE) for viable companies, introducing incentives for banks and debtors to engage in restructuring processes at an early stage and improving the availability of financing via the capital market. Ensure that the identified measures support the reallocation of financing towards the productive sectors of the economy, including to viable SMEs, while avoiding risks to public finances and financial stability. Implement, by end September 2014, an early warning system mainly with supervisory purposes, to identify firms, including SMEs, with a high probability of default due to an excessive level of indebtedness, and which can, indirectly, promote early corporate debt restructuring.

6. Implement the second and third packages of measures in the energy sector aimed at reducing energy costs for the economy, while eliminating the electricity tariff debt by 2020, and closely monitor implementation. Improve the cross-border integration of the energy networks and speed up implementation of the electricity and gas interconnection projects. Implement the comprehensive long-term transport plan and the "chronogram" setting out the ports sector reforms. Complete the transports concessions for the metropolitan areas of Lisbon and Oporto. Ensure that the renegotiations of the existing port concessions and the new authorisation schemes are performance-oriented and in line with internal market principles, in particular procurement rules. Ensure that the national regulatory authority for transport (AMT) is fully independent and operational by the end of September 2014. Ensure the financial sustainability of the state-owned enterprises in the transport sector. Strengthen efficiency and competition in the railways sector, by implementing the plan for the competitiveness of CP Carga, after the transfer of the freight terminals while ensuring the management independence of the state-owned infrastructure manager and railway undertakings.

7. Further improve the evaluation of the housing market, including by setting up, by the end of 2014, a more systematic monitoring and reporting framework and issue a comprehensive report on the shadow economy in that market. Continue efforts to carry out further inventories of regulatory burdens with a view to including, by March 2015, sectors not yet covered. Adopt and implement, by the end of September 2014, the outstanding licensing decrees and sectoral amendments. Remove, by the end of September 2014, remaining restrictions in the professional services sector and enact the professional bodies' amended by-laws which have not yet been adopted under the macroeconomic adjustment programme. Eliminate payment delays by the public sector. Ensure adequate resources of the national regulators and competition authority.

8. Continue to rationalise and modernise central, regional and local public administration. Implement the reforms to enhance the efficiency of the judicial system and increase transparency. Step up efforts to evaluate the implementation of reforms undertaken under the macroeconomic adjustment programme as well as planned and future reforms. In particular, insert mandatory systematic ex ante and ex post assessments in the legislative process. Set up a functionally independent central evaluation unit at government level, which assesses and reports every six months on the implementation of these reforms, including consistency with the ex ante impact assessment, with corrective action if needed.

Done at Brussels,

For the Council
The President