COUNCIL OF
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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Portugal **COMMON GUIDELINES** **Consultation deadline for Croatia: 18.6.2013**

COUNCIL RECOMMENDATION

of

with a view to bringing an end to the situation of an excessive government deficit in Portugal

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the European Commission, Whereas:

(1) According to Article 126 of the Treaty Member States are to avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) On 2 December 2009, the Council decided, in accordance with Article 126(6) of the Treaty, that an excessive deficit existed in Portugal and issued a recommendation to correct the excessive deficit by 2013[1], in accordance with Article 126(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[2].

(4) On 15 June 2010, the Commission concluded that Portugal had taken effective action in compliance with the Council Recommendation of 2 December 2009 to bring its government deficit below the 3 % GDP Treaty reference value and considered that no additional step in the excessive deficit procedure (EDP) was therefore necessary at that time.

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[1] All documents related to the excessive deficit procedure of Portugal can be found at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/portugal_en.htm

[2] OJ L 209, 2.8.1997, p. 6.

(5) On 9 October 2012, the Council concluded, in accordance with Article 3(5) of Regulation (EC) No 1467/97, that effective action had been taken but that unexpected adverse economic events with major unfavourable consequences for government finances had occurred. The Council therefore adopted a revised Recommendation under Article 126(7) of the Treaty ("the Council Recommendation of 9 October 2012") and recommended Portugal to correct the excessive deficit by 2014. In order to bring the headline general government deficit below the 3 % GDP Treaty reference value by 2014, Portugal was recommended to deliver an improvement of the structural budget balance of 2,3 % of GDP in 2012, 1,6 % of GDP in 2013 and 1,3 % of GDP in 2014. The headline general government deficit targets consistent with the requested improvements of the structural budget balance were 5 % of GDP for 2012, 4,5 % of GDP for 2013 and 2,5 % of GDP for 2014.

(6) The Portuguese authorities were also recommended to implement the measures adopted in the 2012 Budget Law and its March supplement and to take additional measures worth 0,3 % of GDP. Portugal was recommended to adopt permanent consolidation measures of at least 3 % of GDP to be included in the 2013 budget, adopting additional measures in case of slippages, and to define measures worth 1¾ % of GDP in 2014 following a comprehensive Public Expenditure Review (PER). In addition, Portugal was invited to implement the requirements set out in the Council Implementing Decision 2011/344/EU of 17 May 2011 on granting Union financial assistance to Portugal[1]. The Council further invited Portugal to adapt the Budget Framework Law to incorporate the EU fiscal governance rules and to continue enhancing tranparency and control at all budgetary stages as well as to respect the medium-term budgetary framework.

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1 OJ L 159, 17.6.2011, p. 88.

(7) According to Article 3(5) of Regulation (EC) No 1467/97, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) of the Treaty, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of the original Council Recommendation. Under Article 3(5) of that Regulation the occurrence of unexpected adverse economic events with major unfavourable budgetary effects is to be assessed against the economic forecast underlying the original Council Recommendation.

(8) In accordance with Article 126(7) of the Treaty and Article 3 of Regulation (EC) No 1467/97, the Council is required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The Recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit the Council requests the achievement of annual budgetary targets which, on the basis of the forecast underpinning the Recommendation, are consistent with a minimum annual improvement in the structural balance, that is, the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0,5 % of GDP as a benchmark.

(9) In the forecast underpinning the Council Recommendation of 9 October 2012, real GDP was expected to contract by 3,0 % and 1,0 % in 2012 and 2013, respectively. Growth prospects have deteriorated markedly since then, after the last quarter of 2012 turned out significantly worse than expected for both economic activity and labour market developments leading to a real GDP contraction of 3,2 % in 2012. In view of the negative carry-over from 2012 and the deterioration in the growth outlook for Portugal's export markets, the Commission services May 2013 update of the economic outlook for Portugal revised real GDP growth downwards to -2,3 % in 2013.

(10) The general government deficit in 2012 reached 6,4 % of GDP, which is above the 5,0 % EDP target. The headline deficit was affected by a number of one-off operations which were not known at the time of the Council Recommendation of 2 December 2009. These operations include: a capital injection into the state-owned bank Caixa Geral de Depósitos' (CGD) (0,5 % of GDP); the re-routing through government of the conversion into equity of shareholder loans of Parpública to SAGESTAMO, two companies outside the general government perimeter (0,5 % of GDP); the impairments associated with the transfer of assets from Banco Português de Negócios (BPN) (0,1 % of GDP). In addition, following an advice by Eurostat the revenues from the sale of the operating concession for the major airports in Portugal was treated as equity withdrawal and hence not impacting the general government balance, contrary to what the Government had foreseen in the budget (0,7 % of GDP). Excluding the impact of these one-off factors from the headline balance, the general government deficit would have amounted to 4,7 % of GDP, below the target.

(11) Tight expenditure control compensated for the large macroeconomically-driven underperformance of revenues in the last quarter of the year. Expenditure savings were achieved mostly in the public wage bill, with the reduction in public employment proceeding ahead of plans, by reducing intermediate consumption and freezing budgetary appropriations for new investment projects. Regional and local budget execution also turned out better than expected. On the whole, Portugal adopted permanent consolidation measures amounting to nearly 6 % of GDP in 2012, above the amount of measures required by the Council Recommendation of 9 October 2012. According to the Commission services May 2013 update of the economic outlook for Portugal, the improvement in the structural balance in 2012 amounted to 2,4 % of GDP compared with the 2,3 % of GDP required by the Council Recommendation of 9 October 2012. Taking into account the revision in potential output growth since that Recommendation, the fiscal effort would have been at least 0,2 percentage points higher. In addition, the estimated change in the structural balance was affected by revenue shortfalls compared with the scenario underlying the Council Recommendation of 9 October 2012 when applying standard revenue elasticities. These shortfalls amounted to around 0,4 percentage points. Taking these effects into account, the adjusted change in the structural balance amounted to 3,0 % of GDP, thus well above the effort required under the Council Recommendation of 9 October 2012.

(12) For 2013, the Commission services May 2013 update of the economic outlook for Portugal projects the general government deficit to reach 5,5 % of GDP, compared with a target of 4,5 % of GDP in the Council Recommendation of 9 October 2012. Budgetary consolidation in 2013 needs to compensate for a large negative primary balance drift which reflects more subdued labour market and growth developments as well as the continued rebalancing towards a more export-driven but also less tax-intensive economy compared with the projections underlying the Council Recommendation of 9 October 2012. In addition, on 5 April 2013, the Constitutional Court ruled against various measures worth 0,8 % of GDP included in the 2013 budget, which needed to be compensated for. In particular, the ruling concerned the cut of the remaining bonus payment for public sector workers, the cut of 90 % of the bonus payment for pensioners and the introduction of a contribution on unemployment and sick leave benefits.

(13) The Commission services May 2013 update of the economic outlook for Portugal foresees a structural effort in 2013 of 0,6 % of GDP. This falls short of the 1,6 % of GDP effort recommended by the Council. However, correcting for the downward revision of potential output growth since the time of the Council Recommendation of 9 October 2012, the estimated structural effort in 2013 would be about 0,2 percentage points higher. In addition, the change in the structural balance is also severely affected by revenue shortfalls (namely, relative to GDP developments using standard revenue elasticities) which amount to around 0,5 percentage points. Overall, taking those factors into account, the estimated structural effort would be 1,3 % of GDP. The adjusted structural effort is thus somewhat below the effort required by the Council Recommendation of 9 October 2012.

(14) The budgetary adjustment in 2013 is underpinned by permanent consolidation measures with a net worth of 3,5 % of GDP, which comprise the measures included in the 2013 Budget Law, amended by a supplementary budget in end-May. These measures include the frontloading of expenditure reducing measures identified in the context of the public expenditure review as well as other measures to replace the budget ones that were ruled unconstitutional. The amount of consolidation measures goes beyond that foreseen at the time of the Council Recommendation of 9 October 2012. The measures include, inter alia, a restructuring of the personal income tax (PIT) and increases in excise duties and property taxation. On the expenditure side, the measures envisage a sizeable reduction in the public sector wage bill through optimising the allocation of resources and resizing the public sector workforce and a reduction in overtime payments and compensations; increased efficiency in the functioning of public administration; lower intermediate public consumption including savings on public-private partnerships (PPPs); further rationalisation efforts in the health sector and in state-owned enterprises (SOEs); and the transfer of Cohesion Fund resources from less mature projects to more advanced ones.

(15) In 2014, according to the Commission services May 2013 update of the economic outlook for Portugal the general government deficit is expected to fall to 4,0 % of GDP, compared with the 2,5 % of GDP target of the Council Recommendation of 9 October 2012. The deviation reflects the higher headline deficits in the previous years as well as a more muted economic recovery. The structural effort in 2014 is forecast to be 1,4 % of GDP, 0,1 percentage point above the required effort in the Council Recommendation of 9 October 2012. The evolution of potential output between the projections underlying the Council Recommendation of 9 October 2012 and the Commission services May 2013 update of the economic outlook for Portugal would add 0,1 percentage point to the estimated fiscal effort. In addition, adjusting for unexpected revenue shortfalls, the effort would increase to 1,8 % of GDP. The adjusted structural effort in 2014 would thus be well above the amount required by the Council Recommendation of 9 October 2012.

(16) Those projections are underpinned by discretionary measures worth at least 2,0 % of GDP. On the expenditure side, those measures will draw on the results of the PER which aims at streamlining and modernising the public administration, addressing redundancies across the public sector functions and entities, improving the sustainability of the pension system and achieving targeted cost savings in individual line ministries. In the course of April and early May 2013, the Government adopted a package of permanent expenditure-reducing measures with cumulative yields of EUR 4,7 billion (2,8 % of GDP) over the period 2013-2014. The Government has initiated a broad-based consultation with social and political partners with a view to fully defining and implementing these reforms. On the revenue side, the authorities foresee a comprehensive reform of the corporate income tax in 2014. The goal is to boost investment and growth by simplifying the corporate income tax system. Given the limited fiscal space, the reform should be revenue-neutral.

(17) Gross public debt rose from 108,3 % of GDP in 2011 to 123,6 % of GDP in 2012 and, according to the Commission services May 2013 update of the economic outlook for Portugal, is expected to peak at around 124,2 % in 2014, thus exceeding the Treaty reference value in all years. The upward shift in the projections for 2012 is mostly driven by the statistical treatment of the transfer of privatisation receipts from Parpública to the State as well as the effect of the lower GDP path and the revised deficit projections. The Government will put forward various measures to curb the increase in the debt ratio such as the sale of foreign assets of a social security fund and the completion of privatisation efforts. Albeit small, a primary surplus is already expected in 2014 reflecting the strength of fiscal consolidation and the more benign macroeconomic developments.

(18) Important steps have been taken to improve public financial management in Portugal. Portugal was also asked to continue improving transparency and control at all budgetary stages for all levels of government. In December 2012, the Budget Framework Law was amended to incorporate the principles of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (fiscal compact), signed on 2 March 2012 in Brussels, and Regulations (EU) No 1173/2011, (EU) No 1174/2011, (EU) No 1175/2011, (EU) No 1176/2011, (EU) No 1177/2011 and Directive 2011/85/EU (six-pack)[1]. An additional revision is foreseen by the end of 2013 to further enhance budgetary procedures and principles of budgetary management, accountability, transparency and simplification. In addition, draft Regional and Local Finance Laws were submitted to Parliament at the end of December 2012. The laws set improved coordination mechanisms between the central and the local and regional administrations, a multi-annual budgetary framework and tighter fiscal rules as well as applying the principles of the amended Budget Framework Law. Portugal has also strengthened efforts to limit contingent liabilities by engaging in a far-reaching renegotiation process for PPPs with significant savings already foreseen in 2013 and SOEs restructuring is progressing at good pace. SOEs at sectoral level reached operational balance by the end of 2012 and further efficiency gains are expected going forward. The authorities are exploring ways to manage the heavy debt load of SOEs. These reforms show an important commitment towards fiscal sustainability over the medium term.

[1] Regulation (EU) No 1173/2011 (OJ L 306, 23.11.2011, p.1), Regulation (EU) No 1174/2011 (OJ L 306, 23.11.2011, p.8), Regulation (EU) No 1175/2011 (OJ L 306, 23.11.2011, p.12), Regulation (EU) No 1176/2011 (OJ L 306, 23.11.2011, p.25), Regulation (EU) No 1177/2011 (OJ L 306, 23.11.2011, p.33), Directive 2011/85/EU (OJ L 306, 23.11.2011, p. 41).

(19) According to the Commission services May 2013 update of the economic outlook, Portugal will not meet the nominal budgetary targets established in the Council Recommendation of 9 October 2012. However, taking into account the changes in economic developments when compared with the macro-economic scenario underlying that Recommendation, it appears that Portugal has taken effective action that represents adequate progress towards correcting the excessive deficit in 2012 and 2013 within the limits specified in the Council Recommendation of 9 October 2012. In particular, Portugal has adopted sizeable consolidation measures amounting to nearly 6 % of GDP in 2012 and to 3½ % of GDP in 2013. The structural effort delivered in 2012, corrected for potential output growth and revenue shortfalls, was well above the required effort in the Council Recommendation of 9 October 2012. In 2013, the structural effort is expected to fall short of the required effort, primarily due to unfavourable economic developments as well as the timing of the Constitutional Court ruling well within the budgetary year, which made it difficult to find substituting measures of equal structural quality. In 2014, the structural effort is expected to be again above the required effort. Considering all these factors and in line with the flexibility provided by the Stability and Growth Pact, an additional year for the correction of the excessive deficit appears justified.

(20) Granting an additional year for the correction of the excessive deficit would require intermediate headline deficit targets of 5,5 % of GDP in 2013, 4,0 % of GDP in 2014 and 2,5 % of GDP in 2015, which, based on the Commission services May 2013 update of the economic outlook for Portugal, is consistent with an improvement of the structural fiscal balance of 0,6 % of GDP in 2013, 1,4 % of GDP in 2014 and 0,5 % of GDP in 2015, the last corresponding to the minimum improvement required by Article 5(1) of 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]. In parallel to the regular reviews of the economic and financial adjustment programme for Portugal as defined in Implementing Decision 2011/344/EU, monitoring of progress on implementation of its EDP commitments will be carried out at an interval of three months.

(21) Portugal fulfils the conditions for the extension of the deadline for correcting the excessive general government deficit as laid down in Article 3(5) of Regulation (EC) No 1467/97,

HAS ADOPTED THIS RECOMMENDATION:

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

(1) Portugal should put an end to the present excessive deficit situation by 2015.

(2) Portugal should bring the headline deficit to 5,5 % of GDP in 2013, 4,0 % of GDP in 2014 and 2,5 % of GDP in 2015, which is consistent with an improvement in the structural balance of 0,6 % of GDP in 2013, 1,4 % of GDP in 2014 and 0,5 % of GDP in 2015, based on the Commission services updated 2013 spring forecast.

(3) Portugal should implement measures amounting to 3½ % of GDP to confine the 2013 deficit to 5,5 % of GDP. These include the measures defined in the 2013 Budget Law and additional measures included in the Supplementary Budget, namely, reductions in the wage bill, increased efficiency in the functioning of public administration, lower public consumption and better use of Union funds.

(4) Portugal should, building on the PER, adopt permanent consolidation measures worth at least 2,0 % of GDP in view of attaining a headline deficit of 4,0 % of GDP in 2014. Portugal should aim at streamlining and modernising the public administration, addressing redundancies across the public sector functions and entities, improving the sustainability of the pension system and achieving targeted cost savings in individual line ministries.

(5) Portugal should adopt the necessary permanent consolidation measures to achieve the 2015 deficit target of 2,5 % of GDP.

(6) The Council establishes the deadline of 1 October 2013 for Portugal to take effective action and, in accordance with point (a) of Article 10(2) of 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[1], to report in detail the consolidation strategy that is envisaged to achieve the targets set out in recommendation (2).

Furthermore, Portugal should maintain reform momentum in public financial management by revising the Budget Framework Law by the end of 2013 to further enhance budgetary procedures and principles of budgetary management, accountability, transparency and simplification; to continue efforts to limit contingent liabilities stemming from SOEs and PPPs.

This Recommendation is addressed to the Portuguese Republic.

Done at Brussels,

For the Council
The President

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[1] OJ L 140, 27.5.2013, p. 1.