DECISIONS

COUNCIL IMPLEMENTING DECISION

of 2 September 2011

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

(2011/541/EU)

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) Upon a request by Portugal, the Council granted it financial assistance (Implementing Decision 2011/344/EU [2]) in support of a strong economic and financial 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 Union.

(2) In line with Article 3(9) of 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 first review of the authorities' progress on the implementation of the agreed measures as of the effectiveness and economic and social impact of those measures.

(3) Under the Commission's current projections for nominal GDP growth (-0,7 % in 2011, 0,0 % in 2012, 2,5 % in 2013 and 3,9 % in 2014), the fiscal adjustment path is in line with the Council Recommendation to Portugal of 2 December 2009 with a view to bringing an end to the situation of an excessive government deficit, pursuant to Article 126(7) of the Treaty, and is consistent with a path for the debt-to-GDP ratio of 101,1 % in 2011, 106,2 % in 2012, 107,3 % in 2013 and 106,4 % in 2014. The debt-to-GDP ratio would therefore be stabilised in 2013 and be placed on a declining path thereafter, 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, in particular for possible bank recapitalisation and financing to state-owned enterprises ('SOEs') and differences between accrued and cash interest payments.

(4) The quarterly quantitative performance criterion on the general government cash balance for the first half of 2011 was met. However, recent data pointed to an opening gap between fiscal trends and the 2011 deficit targets. Expenditure overruns in the first half of the year, underperforming non-tax revenue, the reclassification of some operations led to a projected shortfall of about 1,1 % of GDP over the whole of 2011. The net costs related to the sale of Banco Português de Negócios ('BPN') would add another 0,2 % of GDP to the headline deficit. The authorities have reacted promptly. Budget execution has been tightened, a one-time surcharge on the personal income tax has been introduced, increases in the VAT rates of natural gas and electricity have been brought forward from 2012 and sales of concessions will be stepped up. The authorities should also seek to adopt other consolidation measures of a permanent nature and/or frontload other measures planned for next year. The ongoing process of a phased transfer of banks pension funds to the State social security system should exceptionally provide a buffer towards meeting the deficit target for 2011. The acquired assets of these pension funds should not be used in a way detrimental to long-term fiscal sustainability. The government should not count on further transfers of pension funds to meet the targets for the coming years. Progress is being made to strengthen public financial management through improved reporting and monitoring and reforming the budgetary framework, in line with the recommendations from the Commission services and IMF staff.

(5) Banks are working towards meeting the higher capital requirements as required by the programme. Existing legislation is being amended to strengthen the augmented solvency support facility. A balanced and orderly deleveraging of the banking sector remains

[1] OJ L 118, 12.5.2010, p. 1.
[2] OJ L 159, 17.6.2011, p. 88.

critical, while safeguarding adequate credit for dynamic sectors to spur growth. A buyer for BPN has been found although the deal still needs clearance from Union competition authorities. Progress has also been made to strengthen the supervisory and regulatory framework, including via technical assistance. Portuguese banks passed the July 2011 European Banking Authority ('EBA') stress tests with mixed results reinforcing the need to implement the programme reforms to strengthen the sector.

(6) Notwithstanding the relatively large first disbursement, the government's cash position remains under strain. This is explained by increasing financing needs from SOEs, a sharp increase in households' redemption of savings certificates, and persisting financial market stress.

(7) Progress in labour and product market reforms is essential to restore competitiveness and raise growth potential. In this respect, the special rights of the state in private companies were abolished ahead of schedule. The privatisation programme is being accelerated and broadened. A severe and urgent restructuring of SOEs is at the top of the government's agenda. Labour market reforms to align the protection and rights under fixed and open-ended contracts and to establish an employer-financed fund for paying out workers' severance entitlements are advancing. Progress is being made in preparation for a budget-neutral so-called fiscal devaluation, and authorities remain committed to take a major first step in this area with the 2012 Budget. Structural reforms should be implemented decisively and closely monitored.

(8) In light of these developments, Implementing Decision 2011/344/EU should be amended,

HAS ADOPTED THIS DECISION:

Article 1

Implementing Decision 2011/344/EU is amended as follows:

(1) Article 1(3) is replaced by the following:

'3. The Union financial assistance shall be made available by the Commission to Portugal in a maximum of 14 instalments. An instalment may be disbursed in one or several tranches. The maturities of the tranches under the first and second instalment may be longer than the maximum average maturity referred to in paragraph 1. In such cases, the maturities of further tranches shall be set so that the maximum average maturity referred to in paragraph 1 be achieved once all instalments have been disbursed.';

(2) Article 3(5) is amended as follows:

(a) points (a), (b) and (c) are replaced by the following:

'(a) Portugal shall implement fully the fiscal consolidation measures foreseen in the 2011 budget amounting to around EUR 9 billion and the additional consolidation measures that the government has announced since then. To offset adverse budgetary trends and emerging risks to the achievement of the 2011 deficit target, Portugal shall tighten budgetary execution, implement the already approved one-time surcharge in the context of the personal income tax in 2011, frontload from 2012 to 1 October 2011 the increase in the VAT rate for natural gas and electricity and step up sales of concessions. The government shall also endeavour to adopt other consolidation measures of a permanent nature and/or frontload other measures planned for 2012. The ongoing process of a phased transfer of banks pensions funds to the State social security system shall exceptionally provide a buffer towards reaching the 2011 fiscal deficit target. The acquired assets of these pension funds shall not be used in a way detrimental to long-term sustainability.

(b) Portugal shall adopt measures to reinforce public finance management. Portugal shall implement the measures foreseen in the new Budgetary Framework Law, including setting-up a medium-term budgetary framework, prepare a medium-term fiscal strategy and establish an independent Fiscal Council. The budgetary framework at local and regional levels shall be considerably strengthened, in particular by aligning the respective financing laws to the requirements of the Budgetary Framework Law. Portugal shall step up reporting and monitoring of public finances, in particular arrears; it shall set up a strategy for the settlement of arrears, and reinforce budgetary execution rules and procedures. Portugal shall start the systematic and regular analysis of fiscal risks as part of the budget process, including the risks stemming from Public Private Partnerships ("PPPs") and SOEs.

(c) Portugal shall continue strengthening labour market functioning, notably by taking measures to reform employment protection legislation, wage setting and active labour market policies.';

(b) point (e) is replaced by the following:

'(e) Portugal shall continue opening up the economy to competition. The government shall take the necessary measures to ensure that the Portuguese State or any public body do not conclude, in a shareholder capacity, shareholder agreements which may hinder the free movement of capital or influence the management control of companies. The new Privatisation Law shall also be respectful to the principles of free movement of capital and not grant or allow special rights to the State. A revision

of competition law shall be undertaken aiming at improving the speed and effectiveness of enforcement of competition rules.';

(c) the following points are added:

'(g) Portugal shall adopt measures to improve the efficiency and sustainability of SOEs at central, regional and local level. Portugal shall prepare a comprehensive SOEs strategy document reviewing the tariff structure and the service provision and a plan to tighten borrowing requirements as of 2012. Portugal shall implement ongoing plans to reduce operational costs by at least 15 % on average in central government SOEs outside the health sector and prepare an equivalent plan for regional and local government SOEs.

(h) Portugal shall implement the privatisation programme. In particular, public sector shares in EDP, REN and GALP, and, if market conditions permit, TAP, shall be sold in 2011. A strategic privatisation plan for Parpublica shall be prepared. The privatisation plan through 2013 shall also cover Aeroportos de Portugal, the freight branch of CP, Correios de Portugal and Caixa Seguros, as well as a number of smaller firms.';

(3) in Article 3(6), points (a) and (b) are replaced by the following:

'(a) The 2012 budget shall include a budget neutral recalibration of the tax system with a view to lowering labour costs and boosting competitiveness. The reform shall be developed in consultation with the Commission, the ECB and the IMF.

(b) The measures, defined in points (c) and (d), amounting to at least EUR 5,1 billion, shall be included in the 2012 Budget. Further measures, mostly on the expenditure side, shall be taken to fill any possible gap arising from budgetary developments in 2011. The government shall prepare an updated assessment of the budgetary situation and prospects in view of the discussion of the 2012 Budget with the Commission, the ECB and the IMF before its approval by the government.';

(4) Article 3(8) is amended as follows:

(a) points (a), (b) and (c) are replaced by the following:

'(a) Encourage banks to strengthen their collateral buffers and monitor the issuance of the government guaranteed bank bonds, which has been authorised up to EUR 35 billion in line with EU State aid rules;

(b) Follow closely the plans presented by the banks to reach a core Tier 1 ratio of 9 % by end-2011 and 10 % at the latest by end-2012. If the banks cannot reach the capital requirement thresholds on time, they might temporarily require public provision of equity for private banks through the established EUR 12 billion bank solvency support facility;

(c) Ensure a balanced an orderly deleveraging of the banking sector, which remains critical to eliminating funding imbalances on a permanent basis. Banks' funding plans target a reduction in the loan-to-deposit ratio to about 120 % and a reduction of the reliance on Eurosystem funding during the duration of the programme. The Bank of Portugal shall ask banks to revise their funding plans by end-September. These funding plans shall be reviewed quarterly, starting from the second programme review. The Bank of Portugal shall take appropriate action in case of deviations from the banks' funding plans;';

(b) point (e) is replaced by the following:

'(e) Ensure that the state-owned Caixa Geral de Depósitos (CGD) is streamlined to increase the capital base of its core banking arm as needed; the necessary resources to increase the capital base should come from within the group. Complete the sale of Banco Português de Negócios after clearance from the Commission in accordance with competition and State aid rules;'.

Article 2

This Decision is addressed to the Portuguese Republic.

Article 3

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

Done at Brussels, 2 September 2011.

For the Council
The President
M. DOWGIELEWICZ