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Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Portugal in response to the Council Recommendation of 21 June 2013

{SWD(2016) 240 final}

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(8) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 of the Treaty, Member States shall 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. The Stability and Growth Pact includes Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1], which was adopted in order to further the prompt correction of excessive general government deficits.

(3) The Council, acting upon a recommendation by the Commission, decided on 2 December 2009, 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 at the latest, in accordance with Article 126(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97[2]. Following the request by the Portuguese authorities for financial assistance from the European Union, the Member States whose currency is the euro and the International Monetary Fund (IMF), the Council granted Union financial assistance to Portugal[3]. The Memorandum of Understanding on Specific Economic Policy Conditionality (the "Memorandum of Understanding") between the Commission and the Portuguese authorities was signed on 17 May 2011. Since then, the Council has issued two new recommendations to Portugal (on 9 October 2012 and 21 June 2013) on the basis of Article 126(7) of the Treaty, which extended the deadline for correcting the excessive deficit to 2014 and 2015 respectively. In both recommendations, the Council considered that Portugal had taken effective action, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred.

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

[2] 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

[3] Council Implementing Decision N° 2011/344/EU of 30 May 2011 on granting Union financial assistance to Portugal, OJ L 159, 17.6.2011, p. 88.

(4) Specifically, in order to bring the headline government deficit below the 3% of GDP reference value by 2015 in a credible and sustainable manner, Portugal was recommended to: (a) 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 was deemed 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 May 2013 update of the economic outlook for Portugal; (b) implement measures amounting to 3.5% of GDP to confine the 2013 deficit to 5.5% of GDP, including 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; (c) building on the Public Expenditure Review (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 and 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; (d) adopt the necessary permanent consolidation measures to achieve the 2015 deficit target of 2.5% of GDP. Furthermore, Portugal was recommended to 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 and to continue efforts to limit contingent liabilities stemming from state-owned enterprises and public-private partnerships.

(5) The Commission services May 2013 update of the economic outlook for Portugal, which underpinned the Council Recommendation of 21 June 2013, projected that the Portuguese economy would contract by 2.3% in 2013 before growing by 0.6% and 1.5%, respectively, in the two subsequent years. Nominal GDP growth was forecast at -0.6% and 1.8% in 2013 and 2014, respectively, and at 2.7% in the following year.

(6) In its Recommendation of 21 June 2013, the Council established a deadline of 1 October 2013 for effective action to be taken in line with the provisions of Article 3(4) of Regulation (EC) No 1467/97. In line with Article 10(2)(a) of Regulation (EU) No 472/2013, Portugal was exempted from a separate reporting under the excessive deficit procedure and reported in the framework of its macroeconomic adjustment programme.

(7) Risks of non-compliance with the Council Recommendation of 21 June 2013 were highlighted in subsequent assessments. In July 2015, based on its assessment of the 2015 Stability Programme, the first after the exit from the economic adjustment programme, the Council concluded that there was a risk that Portugal would not comply with the provisions of the Stability and Growth Pact. Similarly, the Commission's Opinion on Portugal's Draft Budget Plan for 2015 concluded that Portugal was at risk of not complying with the rules of the Stability and Growth Pact. In particular, the Commission pointed to a risk to the timely correction of the excessive deficit by 2015. Moreover, the Commission also pointed to the shortfall in structural effort as compared to the recommendation, indicating the need for additional structural consolidation measures for 2015 to underpin a credible and sustainable correction of the excessive deficit.

(8) A new assessment of the action taken by Portugal to correct the excessive deficit by 2015 in response to the Council Recommendation of 21 June 2013, leads to the following conclusions:

– Following the notification of the 2015 general government deficit and its validation by the Commission (Eurostat), the 2015 deficit came out at 4.4% of GDP, above the Treaty reference value of 3.0% of GDP. The gap vis-a-vis the reference value was largely due to a financial sector support measure in the context of the resolution of Banif at the end of 2015, which had a negative impact of 1.4% of GDP on the government deficit. Taking that element together with one-off revenue items, the deficit net of one-off measures would still have been above the Treaty reference value.

– The cumulative improvement in the structural balance in the period from 2013 to 2015 is estimated at 1.1% of GDP, significantly below the 2.5% of GDP recommended by the Council. When adjusted for the effects of revised potential output growth and revenue windfalls or shortfalls compared to the baseline scenario underpinning the recommendation, the cumulative improvement is reduced markedly to -0.1% of GDP.

– The amount of measures implemented until June 2014 was in line with the targets under the macroeconomic adjustment programme. Thereafter, the amount of permanent consolidation measures underpinning the budgetary targets for 2014 was significantly reduced over time from 2.3% of GDP planned at the time of the 2014 budget to around 1.5% of GDP in the projection underlying the 2015 budget. Thus, the amount of measures taken falls clearly short of the recommendation to take at least 2.0% of GDP of additional measures in 2014. For 2015, the amount of permanent fiscal consolidation measures was further reduced to around 0.6% of GDP in the 2015 budget and the headline target was set at 2.7% of GDP. Thus, the planned structural consolidation measures were insufficient to achieve the recommended 2015 deficit target of 2.5% of GDP. The 2015 deficit outturn confirmed that the planned measures were insufficient.

– Overall, since June 2014 the improvement of the headline deficit has been driven by the economic recovery and reduced interest expenditure in a low-interest rate environment. Windfall gains were not used to accelerate the deficit reduction and the volume of structural consolidation measures was not sufficient to reach the targets.

– General government gross debt has broadly stabilised since the Council Recommendation of 21 June 2013reaching 129.2% of GDP at the end of 2013, 130.2% of GDP in 2014 and 129.0% of GDP in 2015 according to the Commission 2016 spring forecast.

– Fiscal-structural reforms have progressed in most areas albeit at differentiated pace. The Budget Framework Law was revised and strengthened but it is set to fully enter into force only in September 2018. Considerable efforts have been made to curb tax fraud and evasion and to reform the tax administration. The long-term sustainability of the pension system has been improved in recent years, while short and medium term challenges remain. Reform in the health care system with a view to ensure the sustainability of the National Health Service (NHS) are progressing at adequate pace. Public administration reforms to improve fiscal management at regional and local levels have been implemented over the past years as well as reforms to the public-private partnerships (PPPs) and state-owned enterprises (SOEs), particularly during the economic adjustment programme duration.

(9) This leads to the conclusion that the response of Portugal to the Council Recommendation of 21 June 2013 has been insufficient. Portugal did not put an end to its excessive deficit by 2015. The fiscal effort falls significantly short of what was recommended by the Council,

HAS ADOPTED THIS DECISION:

Article 1

Portugal has not taken effective action in response to the Council Recommendation of 21 June 2013.

Article 2

This Decision is addressed to the Portuguese Republic.

Done at Brussels,

For the Council
The President