

# European Semester

2012/2677(RSP) - 30/05/2012 - Follow-up document

**PURPOSE:** draft Recommendation for a COUNCIL RECOMMENDATION on Portugal's 2012 national reform programme and delivering a Council opinion on Portugal's stability programme for 2012-2016.

**BACKGROUND:** the European Commission has adopted a **package of recommendations for budgetary measures and economic reforms** to enhance financial stability, boost growth and create employment across the EU.

The recommendations are **country-specific**, taking account of the individual situation of each Member State. The Commission has also issued recommendations for the euro area as a whole. The country-specific recommendations put forward by the Commission give operational guidance for Member States while preparing their budgetary policies and for economic reforms that should be enacted over the coming twelve months to boost competitiveness and facilitate job creation.

The adoption of the recommendations marks the **concluding of the second phase of the European Semester** of economic policy coordination, which was launched with the Commission's [Annual Growth Survey](#) on 23 November 2011.

The basis for these recommendations is a thorough assessment of the implementation of those adopted in 2011, combined with a detailed analysis of the national reform programmes and stability or convergence programmes that Member States submitted by 30 April 2012. The analysis underpinning the recommendations is presented in 28 Commission staff working documents.

**CONTENT:** on 2 May 2012, **Portugal** submitted its stability programme covering the period 2012-2016 and on 7 May 2012, Portugal submitted its national reform programme.

**Economic adjustment programme:** on 17 May 2011, the Council adopted Implementing Decision 2011/344/EU to make available to Portugal medium-term financial assistance for a period of three years from 2011 to 2014 in accordance with Council Regulation (EU) No 407/2010 establishing a European financial stabilisation mechanism. The accompanying Memorandum of Understanding signed on the same day and its successive supplements lay down the economic policy conditions on the basis of which the financial assistance is disbursed.

**Progress and challenges:** Portugal has made good progress on a number of fronts (labour market, health care, housing, judiciary and the insolvency and regulatory framework including competition and privatisations), but significant challenges remain:

1. achieving the fiscal targets remains essential if the government is to regain full market access within the programme period;
2. the need for the government to focus on reforms that address Portugal's competitiveness challenges by adopting rapidly additional structural reforms in the labour and product markets with a view to reducing labour costs, increasing flexibility and lowering entry barriers. Perseverance and resolve on the part of the government will be required to overcome strong vested interests that stand in the way of reforms.

Overall, the Third Review of the Economic Adjustment Programme has concluded that Portugal's implementation of the conditionality set out in the Memorandum of Understanding remains on track:

in particular, the fiscal deficit target for 2011 (5.9% of GDP) has been overachieved by resorting to a transfer of banks' pension funds to the state amounting to 3½ per cent of GDP;

- banks are on track to meet the capital requirements under the Programme by the end of the year but capital positions have to improve further in 2012.

The decline of GDP in 2011 was less marked than forecast, as exports and consumption performed better than foreseen. According to the Commission spring forecast, **the outlook for 2012 has deteriorated and GDP is now projected to fall by 3.3 per cent**, i.e. three percentage points more than in the autumn forecast. Economic growth in 2013 will also be more limited than originally expected. While the external adjustment has so far been remarkably fast, with Portuguese exports gaining market shares outside the EU and imports falling considerably, its persistence is still uncertain. Given the large external debt Portugal has accumulated, very substantial further adjustment of a structural nature is required.

**Budget perspectives:** the budget for 2012 targets a **government deficit of 4.5% of GDP**. Medium-term fiscal consolidation plans presented in the stability programme are also consistent with the Economic Adjustment Programme's deficit headline targets and a deficit-to-GDP ratio of 3% of GDP is expected by 2013.

The 2012 budget includes **consolidation measures amounting to more than 5% of GDP**, which are made up of permanent structural measures. Two thirds of the measures are on the expenditure side and

include a significant cut of public sector wages and pensions, a reduction in the number of government employees by 2% (full-time equivalent) and a rationalisation of state-owned enterprises.

**On the revenue side**, the budget envisages a reduction in tax exemptions, an increase in the number of goods and services taxed at the standard VAT rate, higher personal income and corporate taxes, an increase in excise taxes and enhanced efforts to fight tax evasion and fraud. The deficit is expected to decrease further to **1.8% of GDP in 2014 and 1% of GDP in 2015**.

**The main risks** to the budgetary targets are mainly related to the state-owned enterprise sector and local and regional governments. In terms of the structural balance, the fiscal structural adjustment is expected to be over 7 percentage points of GDP in 2011-2012. The MTO of -0.5% of GDP adequately reflects the requirements of the Stability and Growth Pact. As regards public debt, it is expected to peak at 115.7% of GDP in 2013 and gradually decline thereafter.

**Recommendations proposed for Portugal for the period 2012-2013:** implement the measures as laid down in Implementing Decision 2011/344/EU and further specified in the Memorandum of Understanding of 17 May 2011 and its subsequent supplements.

These recommendations should be endorsed by the European Council on 28-29 June 2012 and formally adopted by the Council in July 2012.