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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2016 national reform programme of Portugal and delivering a Council opinion on the 2016 stability programme of Portugal

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2016) 342 final.

COUNCIL RECOMMENDATION

of …

on the 2016 National Reform Programme of Portugal

and delivering a Council opinion on the 2016 Stability Programme of Portugal

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 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[2], and in particular Article 6(1) 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,

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[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.

Having regard to the opinion of the Employment Committee,

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 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report, in which it identified Portugal as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. This Recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016[3]. As a country whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Portugal should ensure the full and timely implementation of the Recommendation.

[3] OJ C 96, 11.3.2016, p. 1.

(2) The 2016 country report for Portugal was published on 26 February 2016. It assessed Portugal's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and Portugal's progress towards its national Europe 2020 targets. It also included the in-depth review under Article 5 of Regulation (EU) No 1176/2011. On 8 March 2016, the Commission presented the results of the in-depth review. The Commission's analysis leads it to conclude that Portugal is experiencing excessive macroeconomic imbalances. In particular, the large stocks of net external liabilities, private and public debt and a high share of non-performing loans constitute vulnerabilities in a context of elevated unemployment. Policy gaps persist regarding product and services markets, corporate debt restructuring, fiscal issues and selected areas of the labour market.

(3) On 29 April 2016, Portugal submitted its 2016 National Reform Programme and its 2016 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time. Portugal's National Reform Programme shows sufficient ambition to tackle the excessive imbalances, outlines relevant measures to foster competitiveness and reduction of private debt and refers to the challenges in the 2016 country report and the euro area recommendations focusing on the need to re-launch investment and ensure the sustainability of public finances. If fully and swiftly implemented, these measures would help address Portugal's macroeconomic imbalances. Based on the assessment of Portugal's policy commitments, there is no need at this stage for a stepping-up of the macroeconomic imbalances procedure.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[4], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking effectiveness of the European Structural and Investment Funds to sound economic governance.

[4] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(5) [Portugal is currently in the corrective arm of the Stability and Growth Pact. It did not correct the excessive deficit by the 2015 deadline and did not deliver the fiscal effort recommended by the Council in 2015. In its 2016 Stability Programme, the Government plans to correct the excessive deficit and reach a headline deficit of 2,2 % of GDP in 2016. Once a durable correction of the excessive deficit has been achieved, Portugal will become subject to the preventive arm and to the transitional debt rule. The (recalculated[5]) structural balance is set to improve only by around 0,35 % of GDP per year, below the required 0,6 % of GDP, between 2016 and 2020, and the medium-term budgetary objective – a structural surplus of 0,25 % of GDP – is not expected to be achieved within the time horizon of the Programme. According to the Stability Programme, the government debt-to-GDP ratio is expected to fall to 124,8 % in 2016 and to continue declining to 110,3 % in 2020. The macroeconomic scenario underpinning these budgetary projections is rather optimistic. Moreover, the measures needed to support the planned deficit targets from 2017 onwards have not been sufficiently specified. Based on the Commission 2016 spring forecast, the general government deficit is projected to reach 2,7 % of GDP in 2016, below the Treaty reference value of 3 % of GDP, and 2,3 % of GDP in 2017. As the structural deficit is projected to slightly increase in 2016 and 2017, the fiscal effort is not in line with the requirements of the Stability and Growth Pact. Moreover, Portugal is not forecast to comply with the transitional debt rule in 2017. Based on its assessment of the Stability Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that there is a risk that Portugal will not comply with the provisions of the Stability and Growth Pact. Therefore further measures will be needed to ensure compliance in 2016 and 2017.

(6) Pursuant to Article 10(1) of Regulation (EC) No 1467/97, the Commission will regularly monitor the implementation of action taken by Portugal in response to the Council Recommendation of 21 June 2013 under Article 126(7) TFEU, the Commission will therefore recommend to the Council the appropriate steps to be taken in the framework of the excessive deficit procedure.**]**

5 The structural balance as recalculated by the Commission based on the information in the Stability Programme, following the commonly agreed methodology.

(7) Timely and stringent implementation of the reformed budget framework law, the commitment control law and further improvements in revenue collection and expenditure control may significantly contribute to achieving the required fiscal adjustment. Portugal faces the double challenge of achieving the long-term fiscal sustainability of the healthcare system while at the same time maintaining the level of access to healthcare by improving efficiency in the system. Although Portugal currently has one of the lowest shares of public expenditure in total health spending in the Union, the projected increase in public healthcare expenditure by 2,5 % of GDP by 2060 is the highest. In view of addressing the long-term sustainability challenges in the health sector, comprehensive measures aimed at promoting disease prevention and public health policies as well as ensuring primary healthcare provision at an early and less costly stage have not yet been taken. In the short term, accurate budget planning and implementation in hospitals to ensure clearance of arrears remains an important challenge. While the long-term sustainability of the pension system was addressed in the recent reforms, its short to medium sustainability challenges remain unaddressed. The public pension system is characterised by a high reliance on budget transfers and intergenerational inequalities. Execution delays and policy gaps are still hampering the fiscal sustainability of state-owned enterprises, in particular in the transport sector. Strengthening efficiency enhancing measures in their restructuring plans remains crucial to achieve fiscal savings.

(8) Considerable efforts have been made to curb tax evasion by further improving the efficiency of the tax administration. Measures are being taken to combat tax fraud, to improve information-sharing with financial institutions, and to strengthen the anti-money-laundering framework. Despite the progress made, there is still scope for strengthening tax compliance. Reforming the tax administration to make it more efficient would also help encourage investment.

(9) Overall wage developments have been moderate, consistent with high unemployment and the need to promote external rebalancing, and in line with productivity growth over the medium term. Collective bargaining at sectoral level has been supportive of this trend, though the characteristics of the collective bargaining system still limit the scope of firm-level adjustment. In a context of low inflation and high unemployment, the minimum wage was increased in January 2016 from EUR 505 to EUR 530 per month and is planned to be further gradually increased to EUR 600 per month in 2019 (paid 14 times per year). Portugal is in the middle of the EU ranking for minimum wages as a percentage of average wages, but among the countries with the highest minimum wage as a percentage of the median wage. This suggests that wage distribution in Portugal is very biased towards lower wages, and that further increases in the minimum wage might rapidly expand the proportion of workers covered, which in 2016 has reached almost a quarter of all employees. While this could help reduce the intensity of in-work poverty, it also results in an increased compression of the wage structure, putting upward pressure on overall wages. If not matched by productivity increases, this risks harming the employment and competitiveness outlook, especially for labour-intensive industries. It also risks reducing the incentive to invest in skills.

(10) The Portuguese labour market continued to recover in 2014 and 2015 and substantial efforts have been made to reform activation policies, modernise the public employment service and increase the outreach towards non-registered young people, though some implementation challenges persist. In view of the recent deterioration of the social situation, especially as regards the increasing level of child poverty, important measures have also been taken to reinforce social assistance, namely in the areas of the minimum income scheme, child benefits and low pensions. The impact of these measures in reducing the intensity of poverty needs to be assessed. Nevertheless, absorbing the large pool of long-term unemployed remains a challenge, negatively affecting economic growth and the social situation. There is room for further activation of the long-term unemployed, through targeted labour market policies and enhanced coordination among employment and social services. Although the recovery brought about many new jobs on permanent contracts, segmentation in the labour market remains significant. The proportion of fixed-term employees remains one of the highest in Europe, and the rate of transition from temporary to permanent contracts is low.

(11) High private-sector indebtedness remains a major area of vulnerability for the Portuguese economy and financing conditions for small and medium-sized businesses remain difficult. Some progress has been made on reducing the corporate debt overhang and allowing the private sector to deleverage, but Portugal's private sector is still one of the most highly indebted in the Union. This is a major impediment to investment and potential output growth. Non-financial corporations are adjusting their balance sheets, but to a lesser extent than households. High and rising levels of non-performing loans in the business sector are weighing on the balance sheets of both the non-financial and the financial sector and are a major obstacle to investment. Action has been taken at various levels to address corporate indebtedness, but results have been slow to come. The debt bias of corporate taxation remains high. In the past few years, the Government has tried to tackle this problem by introducing thin capitalisation rules and an allowance for corporate equity. However, in 2015, the difference in the cost of capital (before and after taxation) between debt and equity-funded investments remained one of the highest in the Union. Access to credit remains costly and difficult for businesses, in particular small and medium-sized enterprises and start-ups. Alternative sources of funding, such as private equity, venture capital, crowdfunding and business angels, remain marginal and seriously under-developed.

(12) Despite progress, regulatory barriers and weak institutional capacity are still hampering business growth, competitiveness and investment. The efficiency of Portugal's justice system remains low, particularly in dealing with tax litigation. Public procurement is largely transparent in Portugal. However, according to data of the dedicated online platform "BASE", contracting authorities in Portugal often use the direct award procedure, which over the 2013-2015 period constituted on average 87,3 % of all public contracts, representing 47 % of total amounts contracted. Transparency remains a challenge for concession contracts and public-private partnerships, particularly at local and regional level. The Ministry of Finance's taskforce for public-private partnerships (UTAP) oversees some public-private partnerships managed by the central administration, but concessions, regional and local public-private partnerships are not subject to its monitoring. The port sector reforms still suffer from delays in implementation and obstacles to the entry of new players. Registering a business has become easier, but licensing remains cumbersome, and complex administrative procedures are detrimental to investor confidence. Challenges still exist concerning procedures for access to the construction market, obtaining a construction permit and on effective implementation of streamlined environmental licensing rules. Regulatory barriers in some business services sectors prevent resources from being allocated efficiently, particularly regarding legal services. The by-laws governing professional bodies, in particular those concerning their statutes and internal rules, are restrictive and may hinder both natural and legal persons from gaining access to the relevant professions. This affects particularly legal professions, where, among other things, restrictions on advertising and multidisciplinary activities are prevalent.

(13) Portugal is underperforming in science-business cooperation and in the commercialisation of knowledge. The barriers to cooperation between universities and the business sector are high, due to both regulatory and bureaucratic obstacles and the lack of incentives for cooperation in the academic system. This is detrimental to the employability of graduates and to innovation. The launch of the new short-cycle higher technical courses (TeSPs) has provided new opportunities for cooperation between the polytechnics and regional economic actors, but university programmes remain outside the modernisation process.

(14) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Portugal's economic policy and published it in the 2016 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Portugal in previous years. 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 strengthen the EU's overall economic governance by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations (1) to (5) below.

(15) In the light of this assessment, the Council has examined the Stability Programme, and its opinion[6] is reflected in particular in recommendation (1) below.

(16) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (5) below,

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

HEREBY RECOMMENDS that Portugal take action in 2016 and 2017 to:

1. [Ensure a durable correction of the excessive deficit by 2016, reducing the general government deficit to 2,3 % of GDP in 2016, by taking the necessary structural measures and by using all windfall gains for deficit and debt reduction. This is consistent with an improvement in the structural balance of 0,25 % of GDP in 2016. Thereafter, achieve an annual fiscal adjustment of at least 0,6 % of GDP in 2017]. Conduct, by February 2017, a comprehensive expenditure review and strengthen expenditure control, cost effectiveness and adequate budgeting at all levels of public administration. Ensure the long-term sustainability of the health sector, without compromising access to primary healthcare. Reduce the reliance of the pension system on budgetary transfers. By the end of 2016, refocus ongoing restructuring plans of state-owned enterprises.

2. In consultation with social partners, ensure that the minimum wage is consistent with the objectives of promoting employment and competitiveness across sectors.

3. Ensure the effective activation of the long-term unemployed and improve the coordination between employment and social services. Strengthen incentives for firms to hire through permanent contracts.

4. Take measures, by October 2016, to facilitate the cleaning up of the balance sheets of credit institutions and address the high level of non-performing loans. Reduce the debt bias in corporate taxation and improve the access to finance for start-ups and small and medium-sized enterprises via the capital market.

5. Increase transparency and efficiency in public procurement as regards public-private partnerships and concessions. By the end of 2016, improve and accelerate administrative and licensing procedures, accelerate tax litigations and reduce regulatory barriers, especially in business services. Incentivise cooperation between universities and the business sector.

Done at Brussels,

For the Council
The President