EUROPEAN
COMMISSION

Brussels, 22.5.2017
COM(2017) 521 final

Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Portugal

and delivering a Council opinion on the 2017 Stability Programme of Portugal

Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Portugal

and delivering a Council opinion on the 2017 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,[3]

Having regard to the resolutions of the European Parliament,[4]

Having regard to the conclusions of the European Council,

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 16 November 2016, the Commission adopted the Annual Growth Survey,[5] marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report,[6] 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. That

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2017) 521 final.
4 P8_ TA(2017)0038, P8_ TA(2017)0039, and P8_ TA(2017)0040.
5 COM(2016) 725 final.
6 COM(2016) 728 final.

Recommendation was endorsed by the European Council on 9-10 March 2017 and adopted by the Council on 21 March[7].

(2) 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 for the euro area which is reflected in recommendations 1 to 4 below.

(3) The 2017 country report for Portugal[8] was published on 22 February 2017. It assessed Portugal's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the recommendations adopted in previous years and Portugal's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 22 February 2017.[9] 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 high but decreasing unemployment and slow productivity growth. Potential growth lags behind its pre-crisis level, affected by persistent bottlenecks and rigidities in the product and labour markets, together with external imbalances. The current account balance shows some improvements, though additional effort is required for a more significant adjustment of net external liabilities. Following a significant adjustment in recent years, unit labour costs started increasing due to sluggish productivity growth and rising wages. Private debt is falling, and government debt has stabilised, in a context of remaining deleveraging needs. The stock of non-performing loans remains high and, together with low profitability and relatively thin capital buffers, they pose risks to banks' balance sheets. Labour market conditions have improved but youth and long-term unemployment, as well as the share of temporary employees, are still high.

(4) On 28 April 2017, Portugal submitted its 2017 National Reform Programme and its 2017 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time. Portugal's National Reform Programme includes commitments both for the short and medium term. In particular, it includes measures to improve the management of public finances and the business environment and to tackle corporate debt. It commits with ambitious reforms to modernise the public administration, increase social protection, upgrade the skill level of the labour force and improve governance in State-owned enterprises. It also covers the challenges identified in the 2017 country report and the Recommendation for the Euro Area, including the need to re-launch investment and ensure the sustainability of public finances. If fully implemented within the indicated timelines, these measures would help address Portugal's macroeconomic imbalances and country-specific recommendations. Based on the assessment of Portugal's policy commitments, the Commission confirms its previous assessment that at this stage no further steps are warranted in the framework of the Macroeconomic Imbalances Procedure. The implementation of the policy reform agenda will be followed closely by means of specific monitoring.

---

7 2017/C92/01.

8 SWD(2017) 87 final.

9 COM(2017) 90 final.

(5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,[10] where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.[11]

(6) Following the abrogation of the excessive deficit procedure, Portugal is in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2017 Stability Programme, Portugal plans to attain a headline deficit of 1.5% of GDP and 1.0% of GDP in 2017 and 2018, respectively, and a further improvement to a surplus of 0.4% of GDP in 2020. Those plans do not include the potential deficit-increasing impact of bank support measures.[12] The medium-term budgetary objective – a structural surplus of 0.25 % of GDP – is planned to be achieved by 2021. The Stability Programme projects the government debt-to-GDP ratio to reach 127.9% in 2017 and 124.2% in 2018, which would then be at 117.6% in 2020. The macroeconomic scenario underpinning these budgetary projections is plausible for 2017 but favourable for the following years. At the same time, the measures needed to support the planned deficit targets from 2017 onwards have not been sufficiently specified.

(7) On 12 July 2016, the Council recommended Portugal to achieve an annual fiscal adjustment of at least 0.6% of GDP towards the medium-term budgetary objective in 2017. Based on the Commission 2017 spring forecast, there is a risk of a significant deviation from that requirement in 2017.

(8) In 2018, in light of its fiscal situation and notably of its debt level, Portugal is expected to further adjust towards its medium-term budgetary objective of a structural surplus of 0.25 % of GDP. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure[13] which does not exceed 0.1%. It would correspond to a structural adjustment of at least 0.6% of GDP. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2018. Portugal is prima facie not forecast to comply with the transitional debt rule in 2017 and 2018. Overall, the Council is of the opinion that further measures will be needed as of 2017 to comply with the provisions of the Stability and Growth Pact. However, as foreseen in Regulation

---

10 Article 23 of 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.

11 COM(2014) 494 final.

12 Commission Decision of 10 March 2017 – SA.47178 – Portugal – Recapitalisation of Caixa Geral de Depósitos, S.A.

13 Net government expenditure is comprised of total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

(EC) No 1466/97, the assessment of the budgetary plans and outcomes should take account of the Member State's budgetary balance in light of the cyclical conditions. As recalled in the Commission Communication accompanying these country-specific recommendations, the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal to achieve a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Portugal's public finances. In that context, the Commission intends to make use of the applicable margin of appreciation in light of the cyclical situation of Portugal.

(9) A solid budgetary consolidation relies on the timely and strict implementation of the new budget framework law, reviewing and rationalising public spending and further improving revenue collection. Portugal has started a spending review exercise, mainly based on efficiency measures that involve the health and education ministries, state-owned enterprises and (centralised) public procurement and real estate management. However, this spending review falls short of a comprehensive approach since it only covers the central government and focuses on efficiency savings stemming from streamlining services. In the health sector, the government has adopted measures aimed at promoting disease prevention and public health policies. Moreover, several steps have been taken to make the health care sector more efficient and sustainable, for example via centralised procurement or greater use of generics. At the same time, while the hospital reform continues, budgetary planning and implementation in hospitals remains an important issue. Late payments (arrears) continue to increase, denoting weaknesses in accounting control mechanisms and managerial practices. Accurate and balanced budgeting, improved controls and effective enforcement of the commitment control law could help reduce arrears and improve efficiency and quality in this sector. High and rising ageing costs still pose a risk to fiscal sustainability. In the medium term, higher fiscal risks are expected to be related largely to the costs of financing pensions. Long-term fiscal risks in the country are assessed as low, largely thanks to pension reforms and assuming a no-policy change scenario and that there is a further reduction in the reliance of the pension system on budgetary transfers. The restructuring of state-owned enterprises to make them fiscally sustainable has not still been fully addressed. State-owned enterprises supervised by the Ministry of Finance's monitoring unit (UTAM) had a total indebtedness of EUR 32 billion in the second quarter of 2016. A framework with established targets to guarantee the financial sustainability of state-owned enterprises could help to decrease their dependence on State budget transfers and tackle the large debt stock.

(10) The Portuguese labour market continued to recover in 2016, with a steady improvement in labour market indicators and notably a decrease in the unemployment rate. A significant share of new jobs created are on open-ended contracts. However, the stock of temporary contracts remains stable at high levels. High labour market segmentation adversely affects workers' career prospects and incomes, in particular among the young. In January 2017, Portugal redesigned its employment support programme to promote hiring on open-ended contracts. However, its expected impact on reducing segmentation appears limited, as relatively few people are expected to be covered by the programme. Although recent labour market reforms improved incentives for job creation, some aspects of the legal framework may still discourage firms from hiring workers on open-ended contracts. In particular, employers face high and uncertain firing costs in case of individual dismissal of permanent workers. This is due in part to the possibility of a worker

being reinstated if the dismissal is deemed unfair, and to inefficiencies in legal proceedings.

(11) With the drop in unemployment since 2014, the absolute number of the long-term unemployed is also decreasing. However, more than half of unemployed people have been jobless for a year or more, and this share is not decreasing with the recovery. High levels of long-term and youth unemployment increase the risk that jobless people will disengage from the labour market, gradually losing their skills and employability, thus also weighing negatively on potential growth. Youth unemployment, while still sizeable, is declining owing to a range of measures taken in previous years, including through outreach measures in the context of the Youth Guarantee. This may partly explain why the share of young people neither in employment nor in education or training (NEET) is lower than the EU average. Portugal is also taking action to streamline active labour market policies and to address the issue of the youth unemployment. This includes the introduction of employment incentives (through social security rebates) in April 2017, targeted to the hiring of young and long-term unemployed on open-ended contracts. However, to ensure effective activation of the long-term unemployed, it is crucial that public employment services cooperate effectively with social services to better identify and address the needs of this group. An important step in this direction would be to create the announced one-stop shops for employment.

(12) By following the announced schedule, the government has increased the minimum wage for the third consecutive year in 2017. The last increase, above expected inflation and average productivity increases, is expected to make the minimum wage increasingly binding, as the share of employees covered already amounted to a fifth of the total in 2016. Minimum wage increases contribute to reducing high in-work poverty and may positively impact on aggregate demand. However, they may entail employment risks, notably for the low-skilled. These risks did not materialise in the current context of recovery, but remain a challenge. The government is monitoring the impact of minimum wage developments through quarterly reports, which are published and discussed with social partners.

(13) Portugal has made significant improvements in its school education outcomes, as shown by the most recent PISA results. However, the country remains among the OECD countries with the highest rates of grade repetition, which is proven to increase the risk of early school leaving and weighs significantly on education costs. The overall skills level of the labour force remains among the lowest in Europe and hampers the country's innovation potential and competitiveness. Moreover, digital skills remain a barrier for upgrading the labour force skills. About 22 % of people in the Portuguese labour force have no digital skills (mostly because they do not use the internet regularly), about double the EU average. The government has taken action to promote adult education, namely by establishing the 'Qualifica' centres and 'passport'. To ensure they are effective, it will be crucial that they provide quality opportunities for up-skilling and re-skilling workers, in line with labour market needs. The government has also taken a number of measures to support cooperation between higher education and the business sector, namely regarding their research outcomes and activities. However, the university structures would need to adapt in order to favour this cooperation.

(14) The large stock of corporate non-performing loans, low profitability, exposure to sovereign debt risks and weak capital buffers are putting pressure on the banking sector. The deterioration in the quality of assets, in particular in the corporate sector,

weighs on the banking sector's profitability. It is one of the factors, along with low capital buffers, that impede the productive allocation of credit and investment. The non-performing loan ratio remains high (20.1 % against 19.6 % at the end of 2015) and is still rising for some sectors of the economy, in particular firms active in the construction and real estate sectors. Some steps have been taken recently to address the large stock of non-performing loans. However, a comprehensive strategy is still needed to ensure a significant reduction of the impaired debt stock, including fostering the development of secondary markets in order to enable banks to sell parts of their distressed portfolios.

(15) Credit conditions have been gradually improving on the demand and the supply side but access to finance remains a major concern for SMEs. The percentage of Portuguese SMEs which did not manage to obtain the full amount of loans requested rose from 34 % to 42 %, against a falling EU average that reached 30 % in 2016. Innovative and competitive firms with strong growth potential would benefit from better access to capital. This would reduce their dependence on debt financing and improve their access to finance, thereby helping firms to scale-up and internationalise. The difference in the cost of capital between investments financed by debt and the ones financed through equity in 2016 was the fifth highest in the EU and well above the EU average. Although the changes to the tax regime have reduced incentives to debt financing, it is too early to see any impact on the relatively high debt bias in corporate taxation. In July 2016, the authorities launched the *Capitalizar* programme designed mainly to encourage private investment. The programme establishes new credit lines for SMEs, creates specialised funds that would participate in private investments and introduces changes to the tax regime to support investment. In parallel, the government has put in place another programme (*Programa Semente*) to provide finance to start-ups and small enterprises in their early stages (seed capital). The programme will help them to raise equity finance by offering tax reliefs, for at least 2 years, to individual investors who purchase new shares in such companies. Both programmes are expected to improve the financing of companies in Portugal, provided that they are swiftly and fully implemented.

(16) In January 2017, as part of a package of measures to tackle barriers in services markets,[14] the Commission provided guidance to all Member States on national reform needs for regulating professional services with high growth and jobs potential. The reform recommendations address a broad range of requirements based on a comparative analysis following the spirit and the work carried out in the mutual evaluation exercise with Member States in the last 3 years. Portugal has participated actively in this exercise. Portugal explains in its national action plan that, as major reforms and review of the regulated professions have been carried out since 2011, it does not expect major modifications in the coming years. The guidance offered by the Commission complements the European Semester evaluations by specifically addressing the requirements applicable to these professions. There are significant regulatory and administrative barriers in accessing service provision in several sectors. Reforms targeting construction and the most restrictive business services, including regulated professions, were agreed during the financial assistance programme, but have been either halted or reversed. The by-laws regulating certain professions are less ambitious than the framework law in terms of opening up these

[14] COM(2016) 820 final, COM(2016) 821 final, COM(2016) 822 final, COM(2016) 823 final, COM(2016) 824 final.

professions to competition. They also raise concerns as regards the direct or indirect effect of restricting competition in the market for professional services.

(17) Low levels of efficiency and transparency persist in the Portuguese public administration. Competition in public procurement remains limited. Despite progress, there are still shortcomings as regards the transparency and reliability of public procurement data and procedures. Transparency in concession contracts and public-private partnerships is still hindered by contracting authorities lacking the expertise needed to manage complex contracts. The use of direct awards in public procurement remains high. Administrative burden and the lack of homogeneous implementing practices across the country are delaying the reform of procedures. Despite some progress, there have been delays in simplifying local and central administrative procedures with little coordination between the various layers of the public administration. The Portuguese authorities have approved a new simplification programme, called SIMPLEX+. This contains a fairly ambitious package of measures for citizens and businesses. These measures are promising abd an early implementation of the SIMPLEX+ package needs to be ensured so that the programme can start having an effective impact. Most of the measures included in the package relevant to businesses are now starting to be implemented. The performance of the Portuguese justice system is still below the EU average. In Portugal, efficiency indicators for civil, commercial and tax litigation cases remain poor. This has a negative impact on business dynamics and attracting foreign direct investment. The efficiency of the tax and administrative courts remains challenging in terms of resolution rate, and proceedings are still too long. It still takes up to 40 months to conclude insolvency court proceedings, raising doubts about the efficiency of SIREVE frameworks.

(18) Portugal is making progress with increasing transparency and combating corruption in public administration, but there is no overarching strategy. Anti-corruption appears to have become a real priority for the national prosecution services and more efficient processes for case and resource management have been put in place. Yet, it remains to be seen whether these will be reflected by improvements in final conviction rates for high-level corruption and the application of penalties that provide stronger deterrents. On the preventive side, the corruption prevention plans set up in each public institution have so far been largely formalistic. They are not fully adapted to each organisation nor are they complemented by adequate monitoring.

(19) 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 2017 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 socioeconomic 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.

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

(21) 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

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

recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations 1 to 4 below,

HEREBY RECOMMENDS that Portugal take action in 2017 and 2018 to:

1. Ensure the durability of the correction of the excessive deficit. Pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which translates into a substantial fiscal effort for 2018. When taking policy action, consideration should be given to achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Portugal's public finances. Step up efforts to finalise a comprehensive expenditure review at all levels of public administration. Strengthen expenditure control, cost effectiveness and adequate budgeting, in particular in the health sector with a focus on the reduction of arrears in hospitals and ensure the sustainability of the pension system. To increase the financial sustainability of state-owned enterprises set sector-specific efficiency targets in time for the 2018 budget, improving state-owned enterprises' overall net income and decreasing the burden on the State budget.

2. Promote hiring on open-ended contracts, including by reviewing the legal framework. Ensure the effective activation of the long-term unemployed. Together with social partners, ensure that minimum wage developments do not harm employment of the low-skilled.

3. Step up efforts to clean up the balance sheets of credit institutions by implementing a comprehensive strategy addressing non-performing loans, including by enhancing the secondary market for bad assets. Improve the access to capital, in particular for start-ups and small and medium sized enterprises.

4. Implement a roadmap to further reduce the administrative burden and tackle regulatory barriers in construction and business services by end 2017. Increase the efficiency of insolvency and tax proceedings.

Done at Brussels,

For the Council
The President