



**COUNCIL OF
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Subject: COUNCIL IMPLEMENTING DECISION on granting Union financial assistance to Portugal

COUNCIL IMPLEMENTING DECISION

of

on granting Union financial assistance to Portugal

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 mechanism¹, and in particular Article 3(2) thereof,

Having regard to the proposal from the European Commission,

¹ OJ L 118, 12.5.2010, p. 1.

Whereas:

- (1) Portugal has recently come under increasing pressure in financial markets, creating rising concerns about the sustainability of its public finances. Indeed, the current crisis has had a dramatic impact also on public finances, which ultimately led to a sharp increase in sovereign spreads. Amidst consecutive downgradings by credit rating agencies of Portuguese bonds, the country became unable to refinance itself at rates compatible with long-term fiscal sustainability. In parallel, the banking sector, which is heavily dependent on external financing, particularly within the euro area, was increasingly cut off from market funding.
- (2) In view of this severe economic and financial disturbance caused by exceptional circumstances beyond the control of the government, Portugal officially requested financial assistance from the European Union, the Member States whose currency is the euro, and the International Monetary Fund ("IMF") on 7 April 2011 with a view to supporting a policy programme to restore confidence and enable the return of the economy to sustainable growth, and to safeguarding financial stability in Portugal, the euro area and the Union. On 3 May 2011, an agreement was reached between the Government and the joint Commission/IMF/ECB mission in respect of a comprehensive three-year policy programme for the period up to mid-2014, to be laid down in a Memorandum of Economic and Financial Policies ("MEFP") and a Memorandum of Understanding on Specific Economic Policy Conditionality ("MoU") This policy programme was supported by the two largest opposition parties.

- (3) This draft economic and financial adjustment programme ("the Programme") submitted by Portugal to the Commission and the Council aims at restoring confidence in the sovereign and in the banking sector and supporting growth and employment. It foresees comprehensive action on three fronts. First, deep and frontloaded structural reforms to boost potential growth, create jobs, and improve competitiveness (including through fiscal devaluation). In particular, the Programme contains reforms of the labour market, the judicial system, network industries, and housing and services sectors, with a view to strengthening the economy's growth potential, improving competitiveness and facilitating economic adjustment. Second, a credible and balanced fiscal consolidation strategy, supported by structural fiscal measures and better fiscal control over Public-Private-Partnerships ("PPPs") and State-Owned Enterprises ("SOEs"), aiming at putting the gross public debt-to-GDP ratio on a firm downward path in the medium term. The authorities are committed to reducing the deficit to 3 % of GDP by 2013. Third, a financial sector strategy based on recapitalisation and deleveraging, with efforts to safeguard the financial sector against disorderly deleveraging through market-based mechanisms supported by back-up facilities.

- (4) Under the Commission's current projections for nominal GDP growth (-1,2 % in 2011, -0,5 % in 2012, 2,5 % in 2013 and 3,9 % in 2014), the fiscal targets are consistent with a path for the debt-to-GDP ratio of 101,7 % in 2011, 107,4 % in 2012, 108,6 % in 2013 and 107,6 % 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, which are projected to increase the debt-to-GDP ratio by 1¾ percentage points ("pps") of GDP in 2011 and by ¾ pps per year between 2012 and 2014. These include sizeable acquisitions of financial assets, notably for possible bank recapitalisation and financing to SOEs amounting to ½ % of GDP per year between 2011 and 2014. On the other hand, privatisation proceeds totalling around 3 % of GDP up to the year 2013 will support debt reduction efforts.

- (5) The assessment by the Commission, in liaison with the European Central Bank ("ECB") and together with the IMF, is that Portugal needs financing of a total amount of EUR 78 billion (78 000 million) over the period from June 2011 to mid 2014.

Notwithstanding the significant fiscal adjustment, the financing gap for the sovereign may amount to EUR 63 billion over the period of the Programme. This assumes no access to the medium- and long-term debt market until the first half of 2013. Portugal is assumed to be able to roll-over part of its existing stock of short-term debt, while the programme also provides for a financing buffer in case of unexpected deviations from the Commission's baseline financing scenario. Portugal is encouraged to maintain and adjust its financial market operations, seeking to develop market access and confidence. The financial sector strategy contained in the programme to restore confidence in the Portuguese banking system on a sustainable basis requires banking groups to bring their core tier 1 capital ratio to 9 % by the end of 2011 and to 10 % by the end of 2012 and to maintain it thereafter. The programme contains a banking support scheme of up to EUR 12 billion to provide the necessary capital in case market solutions cannot be found. Actual funding needs may, however, be substantially lower, in particular if market conditions improve significantly and no severe unexpected banking losses materialise during the period of the Programme.

- (6) The Programme would be financed through contributions from external sources. The Union's assistance to Portugal would reach up to EUR 52 billion under the European Financial Stabilisation Mechanism ("EFSM") established by Regulation (EU) No 407/2010 and from contributions from the European Financial Stability Facility. In addition, Portugal has requested a loan of SDR 23,742 billion (equivalent to EUR 26 billion at the exchange rate of 5 May 2011) from the IMF under an Extended Fund Facility. The support from the EFSM needs to be supplied on terms and conditions similar to those of the IMF. The Union financial assistance should be managed by the Commission.
- (7) The Council should review on a regular basis the economic policies implemented by Portugal.
- (8) The specific economic policy conditions agreed with Portugal should be laid down in a Memorandum of Understanding on Specific Economic Policy Conditionality (the "Memorandum of Understanding"). The detailed financial terms should be laid down in a Loan Facility Agreement.
- (9) The Commission, in liaison with the ECB, should verify at regular intervals that the economic policy conditions attached to the assistance are fulfilled, through missions and regular reporting by the Portuguese authorities.

- (10) Throughout the implementation of the Programme, the Commission should provide additional policy advice and technical assistance in specific areas.
- (11) The operations which the Union financial assistance helps to finance must be compatible with Union policies and comply with Union legislation. Interventions in support of financial institutions must be carried out in accordance with Union rules on competition.
- (12) The assistance should be provided with a view to supporting the successful implementation of the Programme,

HAS ADOPTED THIS DECISION:

Article 1

1. The Union shall make available to Portugal a loan amounting to a maximum of EUR 26 billion, with a maximum average maturity of 7,5 years.
2. The financial assistance shall be made available during three years starting from the first day after the entry into force of this Decision.
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 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.
4. The first instalment shall be released subject to the entry into force of the Loan Facility Agreement and the Memorandum of Understanding. Any subsequent loan releases shall be conditional upon a favourable review by the Commission, in consultation with the ECB, of Portugal's compliance with the general economic policy conditions as defined by this Decision and the Memorandum of Understanding.
5. Portugal shall pay the cost of funding of the Union for each tranche plus a margin of 215 basis points, which results in conditions similar to those of the IMF support.

6. In addition, the costs referred to in Article 7 of Regulation (EU) No 407/2010 shall be charged to Portugal.
7. If required in order to finance the loan, the prudent use of interest rate swaps with counterparties of the highest credit quality and advanced borrowing shall be permitted.
8. The Commission shall decide on the size and release of further instalments.
The Commission shall decide on the size of the tranches.

Article 2

1. The assistance shall be managed by the Commission in a manner consistent with Portugal's undertakings.
2. The Commission, in consultation with the ECB, shall agree with the Portuguese authorities the specific economic policy conditions attached to the financial assistance as set out in Article 3. Those conditions shall be laid down in a Memorandum of Understanding to be signed by the Commission and the Portuguese authorities consistent with the undertakings referred to in paragraph 1. The detailed financial terms shall be laid down in a Loan Facility Agreement to be concluded with the Commission.

3. The Commission, in liaison with the ECB, shall verify at regular intervals (at least quarterly) that the economic policy conditions attached to the assistance are fulfilled, and report to the Economic and Financial Committee before disbursement of each instalment. To this end, the Portuguese authorities shall cooperate in full with the Commission and the ECB, and shall place all the necessary information at their disposal. The Commission shall keep the Economic and Financial Committee informed of possible refinancing of the borrowings, or changes to the financial conditions.
4. Portugal shall adopt and implement additional consolidation measures to ensure macro-financial stability, in case such measures will be necessary during the programme of assistance. The Portuguese authorities shall consult the Commission and the ECB in advance of the adoption of any such additional measures.

Article 3

1. The draft economic and financial adjustment programme (the "Programme") prepared by the Portuguese authorities is hereby approved.

2. The disbursement of each instalment after the first one shall be made on the basis of a satisfactory implementation of the Programme and, more particularly, the specific economic policy conditions laid down in the Memorandum of Understanding. These shall include, inter alia, the measures provided for in paragraphs 4 to 8 of this Article.
3. The general government deficit shall not exceed EUR 10 068 million (equivalent to 5,9 % of GDP based on current projections) in 2011, EUR 7 645 million (4,5 % of GDP) in 2012 and EUR 5 224 million (3,0 % of GDP) in 2013, in line with the excessive deficit procedure ("EDP") requirements. For the calculation of this deficit, the possible budgetary costs of bank support measures in the context of the government's financial sector strategy shall not be taken into account. Consolidation shall be achieved by means of high-quality permanent measures and minimising the impact on vulnerable groups.
4. Portugal shall adopt the measures specified in paragraphs 5 to 8 before the end of the indicated year, with exact deadlines for the years 2011-2014 being specified in the Memorandum of Understanding. Portugal shall stand ready to take additional consolidation measures to reduce the deficit to below 3 % of GDP by 2013 in case of deviations from targets.

5. Portugal shall adopt the following measures before the end of 2011, in line with specifications in the Memorandum of Understanding:
- (a) Portugal shall implement fully the fiscal consolidation measures foreseen in the 2011 budget amounting to around EUR 9 billion and additional measures introduced before May 2011 worth more than EUR 400 million. These measures aim at a reduction of the general government deficit within the timeframe referred to in paragraph 3. The revenue measures foreseen in the 2011 budget, worth EUR 3,4 billion, shall be complemented by an increase in social contributions via stricter inspection and compulsory contribution of trainees. In addition to the expenditure measures foreseen in the 2011 budget, additional measures including savings in the health sector, lower subsidies for State-Owned Enterprises ("SOEs"), and reductions in social transfers shall be implemented.
 - (b) Portugal shall adopt measures reinforcing a credible budgetary strategy and strengthening the budgetary framework. Portugal shall fully implement the measures foreseen in the new Budgetary Framework Law, including setting up a medium-term budgetary framework, prepare a thorough fiscal strategy analysis and establish an independent Fiscal Council. The local and regional financing frameworks shall be aligned to the new Budgetary Framework Law. Portugal shall step up reporting and monitoring of public finances, including, in particular, of arrears. 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 adopt the first batch of measures aimed at strengthening labour market functioning by limiting severance payments and making working time arrangements more flexible.
 - (d) In the energy sector, Portugal shall take measures to facilitate entry, promote the establishment of the Iberian gas market and review the support and compensation schemes for the production of electricity. For other network industries, in particular transport, telecommunications and postal services, Portugal shall adopt additional measures to promote competition and flexibility.
 - (e) Portugal shall take urgently action to foster competition and the economy's adjustment capacity. This includes the abolition of special rights of the State in companies, a revision of competition law to make it more effective, lighter requirements for establishment and cross-border provision in services sectors.
 - (f) Portugal shall improve practices and rules for public procurement contributing to a more competitive business environment and to more efficient public spending.
6. Portugal shall adopt the following measures during 2012, in line with specifications in the Memorandum of Understanding:
- (a) The 2012 budget shall include a budget neutral recalibration of the tax system with a view to lowering labour costs and boosting competitiveness.

- (b) The budget for 2012 shall include fiscal consolidation measures amounting to at least EUR 5,1 billion and aiming at a reduction of the general government deficit within the timeframe referred to in Article 3(3).
- (c) The budget shall provide for a reduction of expenditure in 2012 of at least EUR 3,5 billion including: a comprehensive reorganisation of the central administration eliminating duplicities and other inefficiencies; cuts in education and health; lower transfers to regional and local authorities; a reduction in public sector employment; adjustments in pensions; and reductions in capital expenditure and in other expenditure as set out in the Programme.
- (d) On the revenue side, the budget shall include revenue measures totalling around EUR 1,5 billion in a full year including, inter alia: broadening the corporate and personal income tax bases by reducing tax deductions and special regimes; ensuring the convergence of personal income tax deductions applied to pensions and labour income; changes in property taxation by substantially reducing exemptions; broadening VAT bases by reducing exemptions and rearranging the lists of goods and services subject to reduced, intermediate and higher rates; and, an increase in excises. These measures shall be complemented by action to fight tax evasion, fraud and informality.

- (e) Portugal shall put in place a strengthened legal and institutional framework for assessing fiscal risks prior to engaging in a PPP contract. Similarly, Portugal shall adopt a law to regulate the creation and the functioning of SOEs at the central, regional and local levels. Portugal shall not engage in any new PPP contract or create an SOE until the reviews and the new legal structure are in place.
- (f) Local government administration in Portugal has currently 308 municipalities and 4 259 parishes. Portugal shall develop a consolidation plan to reorganise and significantly reduce the number of such entities. These changes will come into effect by the beginning of the next local election cycle.
- (g) Portugal shall modernise the revenue administration by creating a single entity, reducing the number of municipal offices and addressing remaining bottlenecks in the tax appeal system.
- (h) Portugal shall introduce legislation to reform the unemployment insurance system, including a reduction of the maximum duration of unemployment insurance benefits to 18 months, a cap on unemployment benefits to 2,5 times the social support index, a reduction in benefits over the unemployment spell, a reduction of the minimum contributory period, and an extension to certain categories of self-employed. Active labour market policies shall be strengthened after a review of current practices and an agreed action plan.
- (i) The system of severance payments shall be brought in line with practices in other EU Member States, based on the specification in the Memorandum of Understanding.
- (j) Regulations on overtime pay shall be eased and increased flexibility of working time arrangements introduced in line with the Memorandum of Understanding.

- (k) Portugal shall promote wage developments consistent with the objectives of fostering job creation and improving firms' competitiveness with a view to correcting macroeconomic imbalances. Any increase in minimum wages will take place only if justified by economic and labour market developments. Measures shall be taken to address weaknesses in the current wage bargaining schemes, including legislation to redefine the criteria and modalities of the extension of collective agreements and to facilitate firm-level agreements.
- (l) An action plan shall be prepared to improve the quality of secondary and vocational education.
- (m) The functioning of the judicial system shall be improved by implementing the measures proposed under the Judicial Reform Map and by conducting and auditing of the backlog cases in order to target measures to eliminate court backlog and foster alternative dispute settlements.
- (n) The competition framework shall be improved by reinforcing the independence and resources of the national regulator authorities. Professional services shall be liberalised by improving the professional qualification framework and by eliminating restrictions on regulated professions.
- (o) Regulated tariffs in electricity and gas retail markets shall be eliminated.

7. Portugal shall adopt the following measures during 2013, in line with specifications in the Memorandum of Understanding:
- (a) The 2013 budget shall include fiscal consolidation measures amounting to at least EUR 3,2 billion aiming at a reduction of the general government deficit within the timeframe referred to in Article 3(3). In particular, on the expenditure side the budget shall provide for a reduction in expenditure in 2013 of at least EUR 2,5 billion, including: reducing expenditures in the central administration, education and health; transfers to local and regional authorities; reducing the number of employees in the public sector; and, lowering costs by SOEs.
 - (b) The budget shall include revenue measures including notably further broadening of corporate and personal income tax bases, higher excises taxes and changes in property taxation, yielding close to EUR 0,8 billion of additional revenue. Portugal shall improve the business environment by reducing administrative burden through the extension to all sectors of the economy of simplification reforms (Points of Single Contact and Zero authorisation projects) and by alleviating SME's credit constraints including with the implementation of Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions².
 - (c) Portugal shall complete the elimination of the court backlog.

² OJ L 48, 23.2.2011, p. 1.

8. With a view to restoring confidence in the financial sector, Portugal shall adequately recapitalise and orderly deleverage its banking sector and bring closure to the Banco Português de Negócios case. In that regard, Portugal shall develop and agree with the Commission, the ECB and the IMF a strategy for the future structure and functioning of the Portuguese banking groups so that financial stability is preserved. In particular, and in line with exact deadlines for the years 2011-2014 being specified in the Memorandum of Understanding, Portugal shall:
- (a) amend legislation in order to facilitate the issuance of government guaranteed bank bonds for an appropriate amount in accordance with the Memorandum of Understanding;
 - (b) adopt the necessary regulatory requirements by end-May 2011 regarding increases in minimum core tier 1 capital adequacy ratio to 9 % by end-2011 and 10 % by end-2012 (to be maintained thereafter);
 - (c) ensure that banks by end-June 2011 devise institution-specific medium-term funding plans to achieve a stable market-based funding position in line with periodic target leverage ratios established by the Bank of Portugal and the ECB. The feasibility of these funding plans and their implications for leverage ratios will be examined by the Bank of Portugal and the ECB, in consultation with the Commission and the IMF staff on quarterly basis.

- (d) indicate clear periodic target leverage ratios for banks and step up the solvency and deleveraging assessment framework during 2011;
- (e) ensure that the state-owned Caixa Geral de Depositos will be streamlined to increase the capital base of its core banking arm as needed and launch a process to sell Banco Português de Negócios on an accelerated schedule. To this end, Portugal shall submit a new plan to the Commission for approval under State aid control rules;
- (f) amend by end-2011 legislation concerning early intervention and resolution of banks as well as legislation concerning the Deposit Guarantee Fund and the Guarantee Fund for Mutual Agricultural Credit Institutions, with a view to protecting depositors and facilitate restructuring. In particular, these funds should retain the ability to fund the resolution of distressed credit institutions, but not to recapitalise them. Such funding shall be capped at the amount of guaranteed deposits that would have to be paid out in liquidation and be permissible only if it does not prejudice the ability of these funds to perform their primary function;
- (g) amend by end-November 2011 the Insolvency Law to provide that guaranteed depositors and/or the funds (directly or through subrogation) will be granted a priority ranking over unsecured creditors in the credit institution's insolvent estate and to better support effective rescue of viable firms;
- (h) undertake to encourage private investors to maintain their overall exposures on a voluntary basis.

9. In order to ensure the smooth implementation of the Programme's conditionality, and to help to correct imbalances in a sustainable way, the Commission shall provide continued advice and guidance on fiscal, financial market and structural reforms. Within the framework of the assistance to be provided to Portugal, together with the IMF and in liaison with the ECB, it shall periodically review the effectiveness and economic and social impact of the agreed measures, and shall recommend necessary corrections with a view to enhancing growth and job creation, securing the necessary fiscal consolidation and minimising harmful social impacts, particularly regarding the most vulnerable members of Portuguese society.

Article 4

Portugal shall open a special account with the Bank of Portugal for the management of the Union financial assistance.

Article 5

This Decision is addressed to Portugal.

Article 6

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

Done at Brussels,

For the Council

The President
