COUNCIL OF
THE EUROPEAN UNION

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Subject:	COUNCIL RECOMMENDATION to Portugal with a view to bringing an end to the situation of an excessive government deficit

COUNCIL RECOMMENDATION

of

to Portugal

with a view to bringing an end to the situation of an excessive government deficit

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) in conjunction with Article 126(13) and Article 136 thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) According to Article 126(1) 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.

(3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken fully into account in all steps in the excessive deficit procedure (EDP). In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(4) The Council decided on 2 December 2009, in accordance with Article 126(6) of the Treaty, that an excessive deficit exists in Portugal.

(5) The Council agreed on 20 October 2009 that, provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest, that specificities of country situations should be taken into account, and that a number of countries need to consolidate before then.

(6) In accordance with Article 126(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1] (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances. In deciding whether special circumstances exist, "relevant factors" as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account. Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-offs and other temporary measures, of at least 0,5 % of GDP as a benchmark.

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

(7) Special circumstances, which are relevant for the greater flexibility in the application of the EDP introduced with the 2005 reform of the Stability and Growth Pact, are deemed to exist in the case of Portugal. In particular, the economy faces a severe economic downturn in 2009 in the sense of the Treaty and the Stability and Growth Pact in the framework of the global economic and financial crisis. For the years 2009 and 2010, the Commission services' autumn 2009 forecast foresees that annual GDP would contract by 2,9 % and grow by 0,3 % respectively. This will have a significant negative impact on the budgetary position in 2009 and 2010. The existence of special circumstances authorises the Council to allow the correction of the excessive deficit in a medium-term framework.

(8) The October 2009 EDP notification of the Portuguese authorities projects the government deficit to increase to 5,9 % in 2009, above the 3 % of GDP reference value, after a fiscal expansion as a response to the economic downturn and in line with the European Economic Recovery Plan. According to the Commission services' autumn 2009 forecast, the general government headline deficit will rise to 8 % of GDP in 2009 and 2010 and increase further to 8,7 % of GDP in 2011, based on the customary unchanged policy assumption. In 2010, despite the discontinuation of most of the measures of an extraordinary nature linked to the crisis in 2009, no improvement in the fiscal position is expected due to the continued weak economic environment, the working of automatic stabilisers and a marked growth in interest expenditure.

(9) Considering the special circumstances and the EERP framework, an average annual fiscal effort is recommended. The required fiscal effort should take into account all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia swaps and the expected change in age-related expenditure in the medium term. In calculating the average annual fiscal effort, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total fiscal effort needed to reach the nominal deficit target of 3 % by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

(10) Against this background, it is appropriate to consider a correction of the excessive deficit in a medium-term framework with a deadline for the correction of 2013. In particular, in view of the high general government deficit, gross debt and the related interest payments, and taking into account the current account position, a credible and sustainable adjustment path would require the Portuguese authorities to start consolidation in 2010 as envisaged, and ensure an average annual fiscal effort of 1¼ % of GDP; specify the measures that are necessary to achieve the correction of the excessive deficit by 2013 and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected. The budgetary consolidation should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus.

(11) General government gross debt has been above the 60 % of GDP reference value since 2005 and, according to the data notified by the Portuguese authorities in October 2009, is planned to stand at 74,5 % of GDP in 2009. According to the Commission services' autumn 2009 economic forecast, the general government debt-to-GDP ratio is projected to increase from 66,3 % in 2008 to 91,2 % in 2011. Rapid budgetary consolidation is therefore also necessary to contribute to bringing the government gross debt ratio on a declining path that approaches the 60 % of GDP reference value at a satisfactory pace. Moreover, the Portuguese authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value.

(12) In general, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy. Concerning the institutional aspects of public finances, important steps have been taken, or are due to enter into force, in particular in the area of public administration reform. A consolidation of public services networks in several sectors, including the reform of the health and pension systems are underway. Whilst the impact of these measures on the efficiency and effectiveness of public expenditure has not yet fully materialised, they have the potential to yield a more efficient use of public resources in several areas of the public sector. The overall efficiency and effectiveness of public spending could also benefit from further improvements in the governance of public finances, such as an improved medium-term budgetary planning and reinforced fiscal institutions. In this domain, the Portuguese authorities have put forward plans to develop performance-based budgeting, with a multi-annual budgetary framework and numerical budgetary rules, but implementation has not yet materialised.

(13) As regards the sustainability of public finances, while the long-term budgetary impact of ageing is lower than the average in the EU, as enacted pension reforms have helped to contain the projected increase in pension expenditure over the coming decades. In order to reduce the risk to the long-term sustainability of public finances as defined by the Commission Communication[1] on "Long-term sustainability of public finances for a recovering economy" and discussed by the ECOFIN Council[2] on 10 November 2009, Portugal should improve its structural primary balance in a durable manner by 5,5 % of GDP. Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of the Portuguese stability programme which will be prepared between 2010 and 2013 could usefully be devoted to this issue.

(14) In general, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances, which would benefit from strengthening the enforceable nature of its medium-term budgetary framework and from continuing to improve the monitoring of the budget execution throughout the year, as well as reinforcing the growth potential of the economy.

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1 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf

2 Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf

(15) In addition, in view of the importance of achieving its medium-term objective (MTO) to provide an adequate safety margin against cyclical downturns and to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Portugal should also ensure that budgetary consolidation towards the MTO is sustained after the excessive deficit is corrected.

HEREBY RECOMMENDS:

(1) Recognising that Portugal's budgetary position in 2009 resulted from measures amounting to 1½ % of GDP, which were also an appropriate response to the European Economic Recovery Plan, and the free play of automatic stabilisers, the Portuguese authorities should put an end to the present excessive deficit situation by 2013.

(2) The Portuguese authorities should bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in a medium-term framework. To this end, the Portuguese authorities should:

(a) implement the consolidation strategy envisaged in the January 2009 update of the Stability Programme;

(b) ensure an average annual fiscal effort of 1¼ % of GDP over the period 2010-2013, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus;

(c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

(3) In addition, the Portuguese authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value.

(4) To limit risks to the adjustment, Portugal would benefit from strengthening the enforceable nature of its medium-term budgetary framework as well as from continuing to improve the monitoring of the budget execution throughout the year.

(5) The Council establishes the deadline of 2 June 2010 for the Portuguese government to take effective action necessary to implement the consolidation envisaged in the January 2009 update of the Stability Programme and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

The Portuguese authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2010 and 2013.

Furthermore, the Council invites the Portuguese authorities to implement reforms with a view to raising potential GDP growth and reforms conducive to enhancing the quality of public finances, in particular the efficiency and effectiveness of public spending. The implementation of these recommendations would also facilitate a smooth adjustment of the economy in the light of the external imbalances.

This Recommendation is addressed to the Republic of Portugal.

Done at Brussels,

For the Council
The President