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Commission assesses the updated Portuguese stability programme (2001-2004)

The European Commission has [today] adopted a recommendation to the Council of Ministers on the updated Stability Programme of Portugal (2001-2004). The programme projects average annual output growth of 3¼ % over the period 2001-2004 which appears feasible. The programme projects an improvement in the general government balance from a deficit of 1.5 % of GDP in 2000 to a balanced position in 2004. Over the same period, the debt ratio is expected to fall to 48.1 % of GDP. The Commission concludes that the medium-term budgetary targets in the updated programme are broadly in line with the Stability and Growth Pact. However, as the government balance is projected to reach the required minimum position only from 2002, a faster decline in the deficit ratio would be advisable with a view to increasing the necessary safety margin. More ambitious deficit targets would also be desirable for stabilisation purposes and in order to accelerate the reduction in the debt ratio to accommodate the expected budgetary impact of population ageing. The budgetary consolidation over the programme period is based on roughly equal contributions from both the revenue and the expenditure side. Although revenue increases are expected to stem from a broadening of the tax base and higher efficiency in tax collection, with tax rates being cut, the continued reliance on revenue increases is not fully in keeping with the recommendations of the Broad Economic Policy Guidelines. On the basis of the Commission's Recommendation, the Council is expected to adopt a formal Opinion on the updated Portuguese programme on [12 March 2001].

The Commission recommendation is adopted on the initiative of Pedro Solbes, EU Commissioner responsible for economic and monetary affairs, who commenting on the programme said: *"The Commission's assessment of the stability programmes for the Member States is an important element in the multilateral surveillance process. Given the continuous improving of economic policy co-ordination in the Union, the Commission will put increasing emphasis in its analysis on the degree of ambition with which member states plan to conduct their economic policies in the short and medium term. An assessment of how member states plan to tackle budgetary consolidation and implement structural reforms, on the appropriateness of the policy-mix given the current economic cycle, or on how to deal with sustainability issues like the consequences of ageing population are among the issues in our analysis."*

The Commission's main conclusions on the Portuguese programme are the following:

- The programme projects the general government balance to improve from a deficit of 1.5 % of GDP in 2000 to a balanced position in 2004. Over the same period, the debt ratio is expected to fall to 48.1 % of GDP. The Commission concludes that the medium-term budgetary targets in the updated programme are broadly in line with the Stability and Growth Pact. However, as the government balance is projected to reach the required minimum position only from 2002, a faster decline in the deficit ratio would be advisable with a view to increasing the necessary safety margin. More ambitious deficit targets would also be desirable for stabilisation purposes and in order to accelerate the reduction in the debt ratio to accommodate the expected budgetary impact of population ageing.
- The macroeconomic scenario underlying the updated Portuguese stability programme assumes annual average growth of 3¼ % over the period 2001-2004. Such a growth rate seems attainable for a catching-up country like Portugal. However, due also to an expansionary policy mix, domestic demand in Portugal has been very buoyant in recent years. This has led to a large external imbalance, the correction of which is necessary for a return to more dynamic growth. This requires, in addition to budgetary restraint to curb domestic demand, improvements in price-competitiveness through wage moderation and a strengthening of policies aimed at fostering productivity growth.
- In 2000, a deficit of 1.5 per cent of GDP was achieved with the help of the proceeds from the sale of UMTS licences, which were not initially budgeted and amounted to 0.4 per cent of GDP. As a result, the underlying budgetary position net of UMTS proceeds has hardly changed from 1999 to 2000 which appears inappropriate in the current conditions of excess demand. Overruns in current primary expenditure and lower than estimated revenues from mineral oil taxes were only partially offset by lower than projected capital expenditure and higher than budgeted tax revenues in some areas (income taxes, VAT). Consequently, budgetary developments in 2000 were not fully in line with the 2000 Broad Economic Policy Guidelines which recommended strict adherence to the budgetary target through tight expenditure restraint. Overruns in current primary expenditure, especially in the health sector and the government wage bill, have been a feature of budgetary implementation also in earlier years.
- In 2001, abstracting from UMTS proceeds, the projected improvement in the government balance amounts to 0.8 per cent of GDP, implying an adequate tightening of the budgetary stance. However, achieving the target calls for a reinforcement of budgetary procedures, in particular as far as the control of current expenditure is concerned. Notwithstanding increased efforts in this regard by the Portuguese authorities in the framework of the envisaged Public Finance Consolidation Programme, attaining the planned cut in current primary expenditure of ½ p.p. of GDP in 2001 might prove challenging given the agreed rise in contractual wages in the government sector of 3.7 % (which could lead to an increase in effective wages of around 5½ %.)

- The planned budgetary and structural reform measures outlined in the programme are broadly in line with the Broad Economic Policy Guidelines. Among the most urgent reforms are the implementation of the new basic law for the budget and measures in the area of health care to improve expenditure control and efficiency. Moreover, with a view to ensuring the sustainability of government finances in the longer term, a rapid implementation of social security framework law would be desirable. An expeditious and determined implementation of these reforms, some of which were already announced in previous updates of the programme, would be necessary to strengthen the overall credibility of the economic and budgetary policy strategy.

The Stability and Growth Pact, adopted by the Amsterdam European Council in June 1997, requires countries participating in the euro-zone to present stability programmes to the Council and the Commission. These programmes provide information on how countries intend to meet the objectives of the Pact and in particular the medium term goal of a budget close to balance or in surplus.

Key figures from the stability programme of Portugal

		2000	2001	2002	2003	2004
Real GDP growth (percentage change)	January 2001	3.3	3.3	3.2	3.2	3.2
	February 2000	3.3	3.6	3.6	3.5	3.5
General government deficit (% of GDP)	January 2001	1.5	1.1	0.7	0.3	0.0
	February 2000	1.5	1.1	0.7	0.3	0.0
General government debt (% of GDP)	January 2001	55.6	53.4	51.5	49.8	48.1
	February 2000	57.1	55.3	53.3	51.0	48.4
Consumer price deflator (annual percentage change)	January 2001	2.7	2.8	2.5	2.2	2.0
	February 2000	2.0	1.9	1.8	1.9	1.0