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COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMISSION OPINION

on the existence of an excessive deficit in Portugal

Application of Article 104(5) of the Treaty establishing the European Community

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THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

1. Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future¹, although some of the costs of the government support could be recouped in the future.
2. The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the 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, and thereby ensuring long-term sustainability of public finances.

LEGAL BACKGROUND

3. Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 “on speeding up and clarifying the implementation of the excessive deficit procedure”², which is part of the Stability and Growth Pact.

¹ See the Eurostat decision of 15 July 2009 on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis, Eurostat News Release N° 103/2009.

² OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the “Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm.

4. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).
5. Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to “take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State”.
6. On the basis of the data notified by the Portuguese authorities in April 2009³ and taking into account the Commission services’ spring forecast, the Commission adopted a report under Article 104(3) for Portugal on 7 October 2009⁴.
7. Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 October 2009.
8. Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. In order to reach a conclusion on whether an excessive deficit exists or may occur, the Commission considers that account should be taken of: (i) the conclusions of its report under Article 104(3) and (ii) the opinion of the Economic and Financial Committee on this report. On the basis of these elements, the Commission has established a number of considerations for Portugal.

CONSIDERATIONS CONCERNING PORTUGAL

9. Since the start of stage III of economic and monetary union, two EDPs have been opened for Portugal. The last was initiated in June 2005 by the Commission with the adoption of a report under Article 104(3) in view of a planned deficit of 6.2% of GDP in 2005. In September 2005, following the recommendations from the Commission, the Council decided that an excessive deficit existed in Portugal and addressed a recommendation to Portugal with a view to bringing the excessive deficit situation to an end, in accordance with Articles 104(6) and 104(7) of the Treaty. This Recommendation established a deadline of 2008 at the latest for the correction of the excessive deficit. The general government deficit declined significantly from an

³ According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Portugal can be found at:
http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

⁴ All EDP-related documents for Portugal can be found at the following website:
http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

actual 6.1% of GDP in 2005 to 3.9% of GDP in 2006 and further to 2.6% of GDP in 2007 below the 3% of GDP reference value, mainly with measures of a permanent nature and a restrictive fiscal stance in those years. Therefore, the excessive deficit situation in Portugal had been corrected and the Council, based on a recommendation by the Commission, decided to abrogate its decision on the existence of an excessive deficit in Portugal in July 2008 under Article 104(8) of the Treaty.

10. According to data notified by the Portuguese authorities in April 2009, the general government deficit in Portugal was planned to reach 3.9% of GDP in 2009, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that the planned deficit was not close to the 3% of GDP reference value, but that the planned excess over the reference value could be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact, on the basis of the information available at the time of the report. The planned excess over the reference value could not be considered temporary.
11. According to more recent data notified by the Portuguese authorities in October 2009, the general government deficit in Portugal is now planned to reach 5.9% of GDP in 2009, thus remaining above and not close to the 3% of GDP reference value. This deficit figure includes a fiscal stimulus package of GDP as a response to the EERP. Despite external imbalances limiting to some extent the room for manoeuvre in fiscal policy, Portugal benefited from the successful consolidation particularly between 2005 and 2007 and was able to introduce a fiscal stimulus package for 2009 of around 1½% of GDP per year, including mostly temporary measures, such as infrastructure investment. Based on the Commission services' autumn 2009 forecast, the planned excess over the reference value still qualifies as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it results from a severe economic downturn in 2009 in the sense of the Treaty and the Stability and Growth Pact. According to the Commission services' autumn 2009 forecast GDP would contract by 2.9% in 2009 and grow by 0.3% in 2010, respectively. This will have a significant negative impact on the budgetary position in 2009 and 2010. Furthermore, the planned excess over the reference value cannot be considered temporary in the sense of the Treaty and the Stability and Growth Pact. According to the Commission services' autumn 2009 forecast, the general government headline deficit is projected to increase to 8% of GDP in both 2009 and 2010, and to 8.7% of GDP in 2011 under a no-policy change scenario. In 2010 and 2011, despite the discontinuation of most of the measures of extraordinary nature linked to the crisis in 2009, no improvement in the fiscal position is expected due to the continued recessionary environment, the working of automatic stabilisers and a marked growth in interest expenditure. Overall, the deficit criterion in the Treaty is not fulfilled.
12. According to data notified by the Portuguese authorities in October 2009, the general government gross debt has been above the 60% of GDP reference value and is planned to stand at 74.5% of GDP in 2009. According to the Commission services' autumn 2009 forecast, the general government debt-to-GDP ratio is projected to increase significantly over the forecast period from 66.3% in 2008 to 91.2% in 2011. The debt ratio cannot be considered as diminishing sufficiently and approaching the reference value at a satisfactory pace within the meaning of the Treaty and the Stability and Growth Pact. The debt criterion in the Treaty is not fulfilled.

13. In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report “relevant factors”. According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Portugal, the double condition is not met. Considered on their own merit, the relevant factors are, on balance, relatively favourable.
14. The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

CONCLUSION

15. The monitoring of the budgetary situation in Portugal and, in particular, the examination of the compliance with the criteria laid down in Article 104(2) has led the Commission to prepare a report in accordance with Article 104(3) of the Treaty. The Commission, having taken into account its report and the opinion of the Economic and Financial Committee, is of the opinion that an excessive deficit exists in Portugal.