EUROPEAN
COMMISSION

Brussels, 18.11.2020
C(2020) 8516 final

COMMISSION OPINION

of 18.11.2020

on the Draft Budgetary Plan of Portugal

{SWD(2020) 866 final}

(Only the Portuguese text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan, presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

3. On 20 March 2020, the Commission adopted a Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission.[3] As indicated in the Annual Sustainable Growth Strategy 2021[4] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance[5], Member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term.

4. On 27 May 2020, the Commission put forward its proposal for the creation of a new recovery instrument Next Generation EU[6], alongside the proposal for the reinforced long-term budget of the EU for 2021-2027.[7] This proposal includes the establishment of a Recovery and Resilience Facility offering large-scale financial support for both

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1 Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

2 The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

3 https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/

4 Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

5 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

6 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions – Europe's moment: Repair and Prepare for the Next Generation, Brussels, 27.5.2020, COM(2020) 456 final.

7 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions – The EU budget powering the recovery plan for Europe, Brussels, 27.5.2020, COM(2020) 442 final.

public investments and reforms. By contributing to the economic recovery and by providing financial support to strengthen the economy's long-term growth, the Recovery and Resilience Facility will help public finances to return to more favourable positions in the near term and will contribute to strengthening their sustainability in the medium and long term.

CONSIDERATIONS CONCERNING PORTUGAL

5. On 15 October 2020, Portugal submitted the Draft Budgetary Plan for 2021. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

6. On 20 July 2020, the Council recommended Portugal[8] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Portugal to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

   On 20 May 2020, the Commission issued a report under Article 126(3) of the Treaty. This was against the background that the Commission considered its latest forecast for the general government deficit in 2020 as sufficiently compelling prima facie evidence[9] of an excessive deficit in Portugal as defined by Article 126(2) of the Treaty. The report concluded that the deficit criterion was not fulfilled. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

7. According to the Commission 2020 autumn forecast, the Portuguese economy is expected to contract by 9.3% in 2020 and grow by 5.4% in 2021. The Draft Budgetary Plan projects real GDP to fall more moderately by 8.5% in 2020, before also rebounding by 5.4% in 2021. For 2020, the Commission projects a stronger decline in both domestic and external demand. For 2021, the Commission expects a swifter recovery in domestic demand, but projects weaker external demand, as the effects from the crisis are likely to linger, particularly in foreign tourism. The unemployment rate in the Draft Budgetary Plan is projected to increase to 8.7% in 2020, before decreasing to 8.2% in 2021. Labour market developments in the Commission forecast are expected to follow a similar pattern in both years, but the unemployment rate is projected to remain at somewhat lower levels. According to both the Commission forecast and the Draft Budgetary Plan, inflation is expected to remain subdued in 2020 and to pick up only moderately in 2021. Risks are tilted to the downside due to Portugal's high reliance on foreign tourism, where uncertainty remains high.

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8 Council Recommendation of 20 July 2020 on the National Reform Programme of Portugal and delivering a Council opinion on the 2020 Stability Programme of Portugal, OJ C 282, 26.8.2020, p. 142 – 148.

9 The factors taken into account by the Commission when forming its views on the prima facie evidence of an excessive deficit in Portugal in 2020 are explained in the ensuing report in accordance with Article 126(3) of the Treaty of 20 May 2020, COM(2020) 537 final.

Portugal complies with the requirement of Regulation (EU) No 473/2013 since the Draft Budgetary Plan is based on an independently endorsed macroeconomic forecast.

8. For 2020, the Draft Budgetary Plan[10] sets a target of 7.3% of GDP for the general government deficit, thereby reversing the surplus observed in 2019. The operation of automatic stabilisers and fiscal policy support are expected to be the main drivers of this deterioration. The Commission forecast also projects a deficit of 7.3% of GDP for 2020, despite the slightly different expected composition of public finances. Specifically, somewhat higher revenue from indirect taxes in the Commission forecast for 2020 is projected to be offset by slightly higher spending on compensation of employees and intermediate consumption.

For 2021, the Draft Budgetary Plan defines a target of 4.3% of GDP for the general government deficit – a marked decline compared with 2020. The expected economic recovery and the lower fiscal burden exerted by the crisis mitigation measures are the main drivers of this improvement. One-off revenues related to the reimbursement of the pre-paid margin that was deducted from the financial assistance loan granted by the European Financial Stability Facility (0.5% of GDP) is projected to accelerate the reduction of the deficit in 2021. The Draft Budgetary Plan assumes additional public investment of ¼ % of GDP and matching grants under the Recovery and Resilience Facility. The Commission forecast projects a higher deficit of 4.5% of GDP for 2021. This partly stems from the different working assumptions in the Commission forecast regarding the impact of the Recovery and Resilience Facility on both revenue and expenditure. For the time being, since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place only in 2021, the Commission forecast assumes in the budgetary projections for 2021 the 10% pre-financing of the Recovery and Resilience Facility grants and treats it as a financial transaction with no impact on the budget balance, but with a public debt-reducing impact. In the case of Portugal, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to around EUR 1.4 billion in 2021.[11] On the expenditure side, in line with its no-policy-change assumption, the Commission forecast includes the above-mentioned higher expenditure related to the Recovery and Resilience Facility of ¼ % of GDP that is considered to be credibly announced and sufficiently specified.[12] At the same time, the Commission forecast does not factor in yet higher revenue from the associated matching grants. Therefore, the evolution of the deficit in 2021 could turn out more favourable as a result of the higher revenue from the deployment of investments under the Recovery and Resilience Facility.

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10 Portugal submitted a second version of its Draft Budgetary Plan on 16 October 2020, which constitutes the basis for the current assessment. In this version, Portugal revised the classification as one-off of some crisis response measures.

11 Indicative number based on the Council Presidency compromise proposal for the RRF Regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

12 The treatment of the Recovery and Resilience Facility (RRF) in the Commission's 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission's Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). In line with the customary no policy-change assumption, the forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of the Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudice to the assessment of the Recovery and Resilience Plans.

According to the Draft Budgetary Plan, the general government debt-to-GDP ratio is projected to spike to 134.8% in 2020, bringing debt reduction to a temporary halt. For 2021, the debt-to-GDP ratio is planned to resume a downward path, decreasing to 130.9%. The Commission 2020 autumn forecast projects the debt-to-GDP ratio to increase to 135.1% in 2020, and to decrease more swiftly to 130.3% in 2021, since it factors in the above-mentioned pre-financing of 10% of the grants under the Recovery and Resilience Facility as a financial transaction with an ensuing debt-reducing effect.

Risks to the budgetary forecast are tilted to the downside, linked to the accumulation of public contingent liabilities stemming from some public corporations. This comes on top of non-negligible pre-pandemic public contingent liabilities. As in other countries, the government has provided public guarantees to sustain economic activity and sectors particularly hit by the pandemic. Should these guarantees be called, this will be reflected in public debt and deficits in the future.

9. In response to the COVID-19 pandemic, Portugal has implemented a multipronged package of measures in 2020. The Draft Budgetary Plan does not report explicitly updated estimates for the impact of those measures in 2020. According to the Commission 2020 autumn forecast, the overall budgetary cost of the crisis response measures taken in 2020 is projected to add up to around 2.8% of GDP – of which 2.2% of GDP on the expenditure side and 0.6% of GDP on the revenue side. Firstly, measures were taken to reinforce the resilience of the health system. In particular, these included additional spending on personal protective equipment, health staff reinforcements and health-related investment with an estimated budgetary cost of around 0.4% of GDP in 2020. Secondly, various measures were taken in the first half of the year to preserve jobs and livelihoods, provide adequate social support and safeguard business continuity, with an estimated budgetary cost of around 1.1% of GDP in 2020. Among these, Portugal's short-time work schemes allowing for the temporary interruption of work or reduction of normal working time and the related exemption from employer's social security contributions have been the most prominent measures, with an estimated budgetary cost of around 0.6% of GDP in 2020. Thirdly, against the background of the easing of restrictions over the summer, additional measures were taken to help firms resume their normal level of activity – including a prolongation of short-time work schemes, additional subsidies to firms and changes to pre-payments under Corporate Income Tax. Moreover, Portugal deployed rescue aid measures to airlines in 2020, with a budgetary cost of 0.7% of GDP. These measures were complemented with 'liquidity measures' such as tax and social contribution deferrals and publicly guaranteed credit lines for firms, including those to finance working capital and long-term investment. The 2021 Draft Budgetary Plan estimated public guarantees at 4% of GDP. The take-up of those guarantees is estimated at 2.8% of GDP. Overall, the measures taken by Portugal in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

10. For 2021, the Draft Budgetary Plan reports a package of new fiscal measures with an overall budgetary cost of 0.9% of GDP – whereby the deficit-increasing impact of 2% of GDP of measures on the expenditure side is partly offset by the deficit-reducing impact of 1.1% of GDP of measures on the revenue side. These notably include temporary measures envisaging the extension of support schemes for employment and the resumption of activity, with a planned budgetary cost of around 0.5% of GDP. To preserve livelihoods, the Draft Budgetary Plan specifies a new

benefit to support workers' income and a temporary reduction in withholdings of the Personal Income Tax, with a planned overall budgetary cost of 0.3% of GDP. At the same time, crisis mitigation measures are planned to be partly financed by EU funds under the Recovery Assistance for Cohesion and the Territories of Europe, as well as the Recovery and Resilience Facility, with a deficit-reducing effect of 0.7% of GDP. According to the Commission 2020 autumn forecast, while measures amounting to 0.7% of GDP are temporary, another 0.2% of GDP appear not to be temporary. These include staff reinforcements in the civil service, another increase in low pensions and the full-year impact of the reduction of Value-added Tax on electricity. The budgetary cost of these measures is planned to be partly compensated by efficiency savings from the ongoing review of public expenditure. The budgetary cost of the new measures planned for 2021 as reported in the Draft Budgetary Plan is broadly in line with the Commission's own projections. The fact that crisis mitigation measures are planned to weigh less on the deficit in 2021 should support the improvement of public finances next year.

11. The Commission is of the opinion that the Draft Budgetary Plan of Portugal is overall in line with the recommendation adopted by the Council on 20 July 2020. Most of the measures set out in the Draft Budgetary Plan of Portugal are supporting economic activity against the background of considerable uncertainty. Given the level of Portugal's government debt and high sustainability challenges in the medium term before the outbreak of the COVID-19 pandemic, it is important for Portugal to ensure that, when taking supportive budgetary measures, fiscal sustainability in the medium term is preserved. Portugal is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

It is anticipated that Portugal will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament.

Done at Brussels, 18.11.2020

For the Commission
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