COMMISSION OF THE EUROPEAN COMMUNITIES

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RESTRICTED EU

Recommendation for a

COUNCIL RECOMMENDATION

with a view to giving early warning to Portugal in order to prevent the occurrence of an excessive deficit

and

Proposal for a

COUNCIL DECISION

making public this Recommendation

(presented by the Commission)

Ce document a été déclassé

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EXPLANATORY MEMORANDUM

The strengthened surveillance of budgetary positions under Council Regulation (EC) No 1466/97[1] as part of the Stability and Growth Pact includes an early warning system under which the Council will alert a Member State at an early stage to the need to take the necessary budgetary corrective action in order to prevent a government deficit becoming excessive. Article 6 of the regulation sets out, for Member States participating in the single currency, how the early warning system is applied. Regular monitoring by the Council of the implementation of stability programmes is carried out in particular with a view to identifying actual or expected significant divergence of the budgetary position from the medium-term objective, or the adjustment path towards it, as set in the programme for the government surplus/deficit. In the event that the Council identifies significant divergence then, with a view to giving early warning in order to prevent the occurrence of an excessive deficit, it addresses a recommendation to the Member State concerned to take the necessary adjustment measures. This early warning is made in accordance with the procedure of the Treaty Article 99(4) and is based on a recommendation from the Commission.

The Commission considers that there is significant divergence when latest estimates and forecasts for the government balance in the most recent and current or future years are appreciably worse than the targeted adjustment path set by the Member State in its preceding stability programme, in a situation in which the Member State's budgetary position is not yet consistent with the medium-term budgetary objective of close to balance or in surplus as required by the Stability and Growth Pact. In these circumstances, a further deterioration in the government deficit must be prevented in order to avoid the risk of an excessive deficit and there is a need to get back on track towards a sound medium-term budgetary position. The sources of deviations from plans, particularly the role of cyclical developments, must also be examined and will have relevance for assessing the appropriate policy response.

The second updated stability programme submitted by Portugal in January 2001 aimed for a government deficit of 1.1% of GDP in 2001 following a deficit of 1.8% in 2000 (excluding UMTS proceeds). In 2002 the deficit was planned to decline to 0.7% of GDP and in subsequent years the deficit was projected to narrow by approximately 0.4% of GDP each year to reach balance in 2004. The deficit projections were made on the assumption of annual real GDP growth of 3.3% in 2001 and 3.2% in the following years.

In the event economic growth slowed down in 2001; the official estimate is that real GDP rose by only 2.0%, which is considerably weaker than the original expected growth rate of 3.3%. Instead of declining, the government deficit widened in 2001, reaching 2.2% of GDP according to the updated programme's official estimate.

Revised government plans in the third updated stability programme submitted by Portugal in December 2001 aim for a government deficit of 1.8% of GDP in 2002 (compared with 0.7% in the previous update). The medium-term objective of reaching balance in 2004 is maintained. The projection for 2002 is made against real GDP growth of 1¾%, which leans towards the optimistic side. The latest economic forecasts by the Commission services, published in November 2001, show growth of only 1½%.

[1] Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies, OJ L 209, 2.8.1997, p.1.

The deviation of the deficit outturn in 2001 from the target set in the January 2001 updated stability programme can only be partly explained by the weakening in growth. Tax shortfalls due to an underestimation of the impact of the 2001 tax reform as well as lower than expected gains from the improvement in tax collection and administration have also depressed tax revenues. Moreover, government expenditure has grown faster than projected by the January 2001 update of the stability programme despite a corrective budget approved in June 2001, which included expenditure cuts amounting to roughly 0.6% of GDP. Overruns occurred, in particular, for current primary expenditure, which was only partly compensated by lower than projected interest and capital expenditure. As a result, there was a clear deterioration in the structural deficit in 2001. According to the method of the Commission services the cyclically adjusted budget deficit widened to some 2½% of GDP in 2001 and, although declining, is forecast to still be at 1¾% of GDP in 2002, far above balance in the general government finances and providing insufficient margin for not breaching the 3% of GDP threshold in the event, inter alia, of further unfavourable surprises on economic growth.

The Commission considers that the sizeable shortfalls from the January 2001 updated stability programme plans already evident in 2001 and forecast in 2002 constitute significant divergence which could lead to the occurrence of an excessive deficit. This calls for activation of the early warning system for the case of Portugal.

In 2002, the Portuguese government should monitor closely the implementation of budgetary plans, particularly as regards strict adherence to its 4% capping rule for the growth rate of nominal current primary expenditure in the general government. With the Portuguese economy in a weak cyclical position, it would not be desirable to tighten further the fiscal stance in 2002 beyond current intentions. However, any measures likely to lead to a further deterioration in the deficit should be avoided. Furthermore, any shortfall in tax revenues other than resulting from lower than expected economic growth should be compensated by additional measures. Once recovery is seen to be under way, then the Portuguese government should strengthen its efforts to move rapidly towards its medium-term objective, pursuing a tighter fiscal stance in the budgets for 2003 and 2004.

The Commission has adopted a recommendation for a Council recommendation giving an early warning to Portugal, and is passing it to the Council for decision. The Commission considers that, in the interests of openness and transparency, the Council early warning should be made public and has also adopted a proposal for a Council decision to this effect, in accordance with the provisions of Treaty Article 99(4).

Recommendation for a

COUNCIL RECOMMENDATION

with a view to giving early warning to Portugal in order to prevent the occurrence of an excessive deficit

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99(4) thereof,

Having regard to the recommendation of the Commission,

Whereas:

(1) Article 6 of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[1] as part of the Stability and Growth Pact establishes an early warning system for alerting a Member State at an early stage to the need to make the necessary budgetary adjustment to prevent a government deficit becoming excessive. An early warning shall be given in accordance with Article 6(2) when the Council identifies actual or expected significant divergence of the budgetary position in a Member State from the medium-term budgetary objective, or the adjustment path towards it, set in the Member State's stability programme for the government surplus/deficit.

(2) In the Resolution on the Stability and Growth Pact adopted in Amsterdam on 17 June 1997[2] the European Council invited all parties to implement the Treaty and the Stability and Growth Pact in a strict and timely manner.

(3) Portugal in January 2001 submitted its second updated stability programme on which the Council delivered an opinion on 12 March 2001[3]. This updated programme aimed for a government deficit of 1.1% of GDP in 2001, 0.7% in 2002 and 0.3% in 2003 and for a zero government balance in 2004.

(4) The government deficit in Portugal in 2001 is now estimated at 2.2% of GDP. The third updated stability programme submitted by Portugal in December 2001 now aims for a government deficit of 1.8% of GDP in 2002 and 1% in 2003 and maintains the objective of a zero government balance in 2004. The Commission services in November 2001 forecast a government deficit of 1.6% of GDP in 2002.

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ C 236, 2.8.1997, p. 1.
3 OJ C 109, 10.4.2001, p. 4.

(5) The shortfall of the government deficit in 2001 relative to the target of the January 2001 updated stability programme is only partly explained by the slower economic growth in 2001 than originally expected. Real GDP in Portugal rose by an estimated 2.0% in 2001, compared with 3.3% expected in the October 2000 updated programme. Other factors explaining the shortfall are an underestimation of the impact of the 2001 tax reform, lower than expected efficiency gains in tax collection and administration as well as higher than planned current expenditure excluding interest payments.

(6) Adjusted for the impact of cyclical fluctuations, the underlying government deficit, as estimated by the Commission services, at 2½ % of GDP in 2001 and at 1¾ in 2002 remains far above the balance in the general government finances and provides insufficient margin for not breaching the 3% of GDP nominal deficit laid down in the Treaty in the event of further unfavourable developments.

(7) The sizeable deviations from plans for the government deficit in 2001 and 2002 are evidence of significant divergence in terms of Article 6(1) and (2) of Council Regulation (EC) No 1466/97.

(8) There is a need for an early warning to be given alerting Portugal in order to prevent the occurrence of an excessive deficit.

HEREBY RECOMMENDS:

1. The Portuguese government should closely monitor budgetary developments in 2002. It should implement its budgetary plans for this year carefully in order to secure an improvement in the deficit. Therefore, any measures likely to lead to a further deterioration in the government deficit should be avoided, and any revenue shortfall other than explained by slower than expected economic growth should be compensated by additional measures.

2. Once economic recovery is established, the Portuguese government should strengthen its efforts to move rapidly towards its medium-term objective of a zero deficit in 2004. This will require strict respect in the budgets for 2003 and 2004 of the 4% capping rule for growth of nominal current primary expenditure in general government, and may also require additional discretionary measures.

This recommendation is addressed to Portugal.

Done at Brussels, [...]

For the Council
The President
[...]

Proposal for a

COUNCIL DECISION

making public the recommendation with a view to giving early warning to Portugal in order to prevent the occurrence of an excessive deficit

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99(4) thereof,

Having regard to the proposal of the Commission,

Whereas:

(1) On [...2002], the Council adopted its recommendation with a view to giving early warning to Portugal in order to prevent the occurrence of an excessive deficit, addressed to the Portugal Government.

(2) The Council considers that making public the recommendation will facilitate the surveillance and co-ordination of economic policies of Member States and the Community and will contribute to a better understanding among economic agents, facilitating the implementation of the recommended measures,

HAS DECIDED AS FOLLOWS:

Article 1

The Council recommendation of [....2002] with a view to giving early warning to Portugal in order to prevent the occurrence of an excessive deficit shall be published in the *Official Journal of the European Communities.*

Article 2

This Decision shall take effect on [.....2002].

Done at Brussels, [...]

For the Council
The President
[...]