COMMISSION OF THE EUROPEAN COMMUNITIES

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EU RESTRICTED

Recommendation for a

COUNCIL RECOMMENDATION TO PORTUGAL

with a view to bringing an end to the situation of an excessive government deficit - Application of Article 104(7) of the Treaty

(presented by the Commission)

EXPLANATORY MEMORANDUM

On 25 July last, the Commission received official confirmation from the Portuguese authorities that the general government deficit in 2001 amounted to 4.1% of GDP, thereby clearly exceeding the reference value of 3% of GDP. The figure was confirmed in Portugal's submission by 1 September under the semi-annual reporting of government deficits and debt levels. Based on this evidence, the Commission initiated the Excessive Deficit Procedure for Portugal.

The application of the excessive deficit procedure (EDP) is governed by Article 104 of the Treaty (ex 104c), Council Regulation N°1467/97 "on the speeding up and clarifying the implementation of the excessive deficit procedure", which is part of the Stability and Growth Pact. It is also affected by the political commitments enshrined in the Resolution of the Amsterdam European Council on the Stability and Growth Pact of 17 June 1997.

In an initial step of the EDP, the Commission prepared a report according to Art. 104.3 of the Treaty. That report was adopted by the Commission on 24 September. It concluded that in 2001, the general government deficit in Portugal had risen to 4.1% of GDP, significantly exceeding the reference value of 3%. Gross government debt went up to 55.5% of GDP by end-2001, still remaining below the 60% reference value. The excess of the Portuguese deficit in 2001 over the reference value did not result from an unusual event outside the control of the Portuguese authorities, nor was it the result of a severe economic downturn. On developments in 2002 the report concluded that while it was clear that the deficit would be reduced, it was not yet possible to assess whether the deficit would stay below the 3% of GDP reference value. Moreover, given that the debt-to-GDP ratio was projected at just under the 60% reference value, any slippage in budgetary execution or a deceleration in nominal GDP growth could imply a breach of the debt ceiling.

Treaty Art. 104.4 states that "the Committee provided for in Article 114 (i.e. the Economic and Financial Committee) shall formulate an opinion on the report of the Commission". The Committee issued its opinion on 3 October (document EFC/ECFIN/476/02 rev 1), concluding that "budgetary developments in Portugal last year were such that the first criterion in the second paragraph of Article 104 *[i.e. the ratio of the government deficit to GDP not exceeding the 3% reference value]* was not respected. Consideration of other relevant factors supported the assessment based on this criterion. The EFC also took note of the strong commitment by the Portuguese authorities to take all the necessary measures in 2002 to correct the situation, but considered that the budgetary data so far this year did not as yet confirm a correction.

The Commission, having examined the relevant factors taken into account in its report and having regard to the opinion of the EFC, is of the opinion that an excessive deficit exists in Portugal. This opinion, adopted by the Commission on 16 October, is herewith addressed to the Council, according to Article 104.5 of the Treaty. The Commission recommends that the Council shall decide accordingly, in conformity with Article 104.6. In addition, the Commission is submitting to the Council a recommendation for a Council recommendation to be addressed to Portugal with a view to bringing an end to the situation of an excessive government deficit, according to Treaty Article 104.7.

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with a view to bringing an end to the situation of an excessive government deficit - Application of Article 104(7) of the Treaty

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission under Article 104(7) and Article 104(13)

Whereas in stage three of Economic and Monetary Union (EMU), Member States are according to Article 104 of the Treaty shall avoid excessive government deficits;

Whereas 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;

Whereas the Amsterdam Resolution of the European Council on the Stability and Growth Pact of 17 June 1997 solemnly invites all parties, namely the Member States, the Council and the Commission to implement the Treaty and the Stability and Growth pact in a strict an timely manner;

Whereas the Council has decided, in accordance with Article 104 (6), that an excessive deficit exists in Portugal;

Whereas having decided on the existence of an excessive deficit in Portugal, the Council, in accordance with Article 104(7) of the Treaty and Article 3(4) of Regulation EC 1467/97, shall adopt a Recommendation establishing a deadline of four months at the most for effective action to be taken by Portugal to correct the excessive deficit position; whereas the Council takes note of the budgetary measures taken in May 2002 which aim at reducing the deficit level to 2.8% of GDP in 2002, as well as those planned for 2003; whereas the Council welcomes the measures announced by the Portuguese authorities, but shall establish a deadline of 5 March 2003 at the latest for the Portuguese government to take measures to bring the existence of an excessive deficit to an end within the deadline established by this Council Recommendation.

Whereas Article 3(4) of Regulation EC 1467/97 requires that the Recommendation adopted by the Council in accordance with Article 104(7) also establishes a deadline for the correction of the excessive deficit, which should be completed in the year following its identification; whereas in the absence of special circumstances and given that the deficit level breached the reference value in 2001, Portugal should aim to bring the deficit level below 3% of GDP in 2002 and no later than 2003;

Whereas the notification of September 2002 based on the work of the ad-hoc commission has been validated by Eurostat; whereas in both the report of the Commission and the Opinion of the Economic Financial Committee, attention was drawn to the serious deficiencies in the reporting of budgetary data; whereas the Commission and the Council take note of efforts by the Portuguese authorities to improve the reliability and timeliness of the reporting of budgetary data; whereas there is a need to take steps to improve the reliability and timeliness of budgetary data used in the multilateral surveillance process;

Whereas, in accordance with Article 104(12) of the Treaty, a Council decision under Article 104(6) on the existence of an excessive deficit will only be abrogated if the excessive deficit, in the view of the Council, has been corrected; whereas the Council will take into account compliance with the recommendation made under Article 104(7) when taking decisions in accordance with Article 104(12);

HEREBY RECOMMENDS:

the Portuguese authorities to implement with resolve their budgetary plans for 2002 The Council notes that the Portuguese government adopted in May 2002 a rectifying budget aiming at reducing the deficit in 2002 to 2.8% of GDP. ;

the Portuguese authorities in particular, to ensure a rigorous budgetary execution and a thorough implementation of the saving measures announced in the rectifying budget, in order to attain the deficit target as planned;

the Portuguese government to put an end to the present excessive deficit situation as rapidly as possible and by 2003 at the latest;

the Portuguese government to adopt and implement the necessary budgetary measures to ensure that the government deficit in 2003 is further reduced to clearly below 3% of GDP and that the government debt ratio is kept below the 60% of GDP reference value. The Council establishes a deadline of 5 March 2003 at the latest for the Portuguese government to take such measures to bring the excessive deficit to an end within the deadline established by this Council Recommendation;

the Portuguese authorities to present before the end of the year an updated stability programme covering 2003 and the years beyond including ambitious budgetary targets for the achievement of the medium term budgetary position of close to balance or in surplus, and to secure that the debt ratio is brought back to a declining path;

that Portugal should improve the collection and processing of general government data to correct the serious deficiencies revealed in this regard in Portugal.

the reinforcement of the co-ordination mechanisms of budgetary policy and to secure the process of budgetary consolidation. In this regard, the Council notes with satisfaction the recent approval of a *budgetary stability law* aimed at strengthening budgetary co-ordination and fiscal discipline among the constituent sectors of general government, thereby assisting in the management of fiscal policy. Furthermore, the Council welcomes the efforts that are being made by the Portuguese government to reduce the government deficit on a permanent basis as well as to implement policies to foster growth, employment and competitiveness. The Council encourages the Portuguese government to implement these policies with determination;

This recommendation is addressed to the Republic of Portugal.

Done at Brussels, […]

For the Council
The President
[…]