COMMISSION OF THE EUROPEAN COMMUNITIES

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EU RESTRICTED



Recommendation for a

# COUNCIL DECISION

**on the existence of an excessive deficit in Portugal - Application of Article 104(6) of the Treaty establishing the European Community**

(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.

Recommendation for a

**COUNCIL DECISION**

**on the existence of an excessive deficit in Portugal – Application of Article 104(6) of the Treaty establishing the European Community**



THE COUNCIL OF THE EUROPEAN UNION

Having regard to the Treaty establishing the European Community, and in particular Article 104(6) thereof,

Having regard to the recommendation from the Commission under article 104(6),

Having regard to the observations made by Portugal,

Whereas in stage three of Economic and Monetary Union (EMU), according to Article 104 of the Treaty Member States 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 excessive deficit procedure under article 104 provides for a decision on the existence of an excessive deficit; whereas the Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the excessive deficit procedure; whereas Council Regulation (EC) 3605/93[1] amended by Council Regulation (EC) 475/00[2] and by Commission Regulation (EC) 351/2002[3] lay down detailed rules and definitions for the application of the provision of the said Protocol;

Whereas 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; whereas the Commission has addressed such an opinion on Portugal to the Council on 16 October 2002; whereas, according to this opinion:

(a) Portugal has reported information on its budgetary situation to the Commission by September 2002. Thereupon, the Commission has, in accordance with Article 4 of the Protocol on the excessive deficit procedure, provided the statistical data for the application of the said Protocol;

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[1] OJ No L332, 31.12.1993, p.7.
[2] OJ No L 058, 3.03.2000, p. 1.
[3] OJ No L 055, 26.02.2002 p. 23.

(b) In accordance with Article 104(3) of the Treaty, the Commission has prepared in September 2002 a report on Portugal which takes account of the relevant factors;

(c) In accordance with Article 104(4) of the Treaty, the Economic and Financial Committee has formulated an opinion on the report of the Commission;

(d) The Commission considers that there exists an excessive deficit in Portugal;

Whereas Article 104(6) of the Treaty lays down that the Council should consider any observations which the Member State concerned may wish to make before the Council decides after an overall assessment whether an excessive deficit exists;

Whereas the overall assessment leads to the following conclusions: in the late 1990s, when Portugal enjoyed strong economic growth, progress in fiscal consolidation has been limited, with the general government deficit remaining well above 2% of GDP. Thus, there had been little budgetary leeway to accommodate for the effects of a cyclical slowdown or for such changes in accounting as required to comply with the European System of Accounts 1995. From 1999 to 2001, the deficit increased from 2.4% to 4.1% of GDP, significantly exceeding the reference value of 3% in 2001. Over the same period, government gross debt remained below 60% of GDP, but rose from 54.4% to 55.5% of GDP. Part of the deficit increase in 2001 was due to the rectification of government accounts, the other part to deviations of budget execution from targets. While economic growth has slowed markedly, the fiscal slippage mainly reflects a weakening in the underlying budgetary position. A rectifying budget adopted in June 2001 proved insufficient as to prevent the deficit from breaching the threshold set by the Treaty. A new government that came into office in April 2002 adopted a rectifying budget providing for, inter alia, an increase in the standard VAT rate and, on the expenditure side, cuts in public investment. While the Portuguese government has declared its firm commitment to its new deficit target of 2.8% of GDP set for 2002, it is yet uncertain whether the excessive deficit situation will actually be corrected. Moreover, government debt is projected to rise to 59.3% of GDP in 2002, a level just under the 60% reference value. Thus, any slippage in budgetary execution and/or a deceleration in nominal GDP growth could imply a deficit above 3% of GDP and a breach of the government debt reference value.

HAS DECIDED AS FOLLOWS:

*Article 1*

From an overall assessment it follows that an excessive deficit exists in Portugal.

*Article 2*

This decision is addressed to the Republic of Portugal.

Done at Brussels, ……..2002.

*For the Council*