EUROPEAN
COMMISSION

Brussels, 18.11.2020
SWD(2020) 866 final

COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Portugal

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Portugal

{C(2020) 8516 final}

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EXECUTIVE SUMMARY

- Portugal's economic outlook has changed abruptly due to the outbreak of the COVID-19 pandemic. The Draft Budgetary Plan projects real GDP to contract by 8.5% in 2020, before recovering by 5.4% in 2021. The Commission 2020 autumn forecast projects a stronger economic downturn for 2020 – with real GDP expected to contract by 9.3% – but it is broadly in line for 2021. The macroeconomic and fiscal outlook continue to be affected by high uncertainty due to the COVID-19 pandemic.
- The COVID-19 pandemic is taking a toll on Portugal's public finances. The budget balance in the Draft Budgetary Plan is expected to turn into a deficit of 7.3% of GDP in 2020, driven by the operation of automatic stabilisers and fiscal policy support. The deficit is planned to decrease to 4.3% of GDP in 2021, on the back of the expected economic recovery and the lower fiscal burden of crisis mitigation measures. This assumes additional public investment of ¼ % of GDP and matching grants under the Recovery and Resilience Facility in 2021. According to the Commission 2020 autumn forecast, the budget balance is also projected to turn into a deficit of 7.3% of GDP in 2020, but it is expected to improve more moderately to 4.5% of GDP in 2021.
- In response to the COVID-19 crisis, Portugal implemented in 2020 measures to strengthen the resilience of the health system, preserve jobs and livelihoods, provide adequate social support, safeguard business continuity, and support the resumption of activity, with an estimated budgetary cost of 2.8% of GDP. According to the Draft Budgetary Plan, the take-up of public guarantees linked to the crisis response amounts 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.
- The Draft Budgetary Plan reports a package of new measures for 2021 with an overall budgetary cost of 0.9% of GDP. These notably include temporary measures envisaging the extension of support schemes for employment and the resumption of activity and a new social benefit to sustain workers' income. The Draft Budgetary Plan also specifies some new permanent measures, whose budgetary cost is nevertheless contained at 0.2% of GDP. 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.
- The COVID-19 pandemic is expected to lead to a spike in Portugal's public debt-to-GDP ratio in 2020. According to the Draft Budgetary Plan, the debt-to-GDP ratio will jump up to 134.8% in 2020, before dropping to 130.9% in 2021. The Commission 2020 autumn forecast projects a slightly swifter decline of the debt-to-GDP ratio in 2021, since it factors in the pre-financing of 10% of the grants under the Recovery and Resilience Facility (EUR 1.4 billion or 0.7% of GDP) as a financial transaction with an ensuing debt-reducing effect.
- On 20 May 2020, the Commission prepared a report under Article 126(3) of the Treaty analysing whether Portugal was compliant with the deficit criterion. Overall, the analysis suggested that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 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.

- Overall, most measures in the Draft Budgetary Plan of Portugal are supporting economic activity against the background of considerable uncertainty. At the same time, it would be useful to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances. Moreover, 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.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2021 Draft Budgetary Plan of Portugal (hereafter called the Plan), which was submitted on 15 October 2020 in compliance with Regulation (EU) No 473/2013.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact and, on 23 March 2020, the Ministers of Finance of the EU Member States agreed with the Commission assessment. The clause facilitates the coordination of budgetary policies in times of severe economic downturn. As indicated in the Annual Sustainable Growth Strategy 2021[1] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance, the activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State, which should continue to deliver targeted and temporary fiscal support in 2021, provided that this does not endanger fiscal sustainability in the medium term. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply, while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Public finances in 2021 are also expected to be influenced by the proposed establishment of the Recovery and Resilience Facility, alongside the proposal of the reinforced long-term budget of the EU for 2021-2027. The Recovery and Resilience Facility is envisaged to provide a total envelope of EUR 672.5 billion in loans and non-repayable financial support (grants) to support the implementation of investments and reforms in the EU Member States. The 2021 Draft Budgetary Plan of Portugal takes into account measures related to the reforms and investments, and their associated costs, envisaged under the Recovery and Resilience Facility.

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 of an excessive deficit in Portugal as defined by Article 126(2) of the Treaty.[2] 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.

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

2 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).

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

For 2020, real GDP in the Plan is projected to contract by 8.5%. The economic downturn in 2020 is expected to reflect the negative contributions of both domestic demand and net exports. For 2021, real GDP growth in the Plan is forecast to rebound by 5.4%. Domestic demand is projected to be the main driver of the economic recovery, but external demand is also expected to contribute. According to the Plan, the unemployment rate is projected to increase to 8.7% in 2020, before decreasing somewhat to 8.2% in 2021. Inflation is expected to remain subdued in 2020 and to pick up only moderately in 2021. The macroeconomic forecast in the Plan cannot be compared with that in the 2020 Stability Programme, given that the latter did not contain a complete macroeconomic scenario. The macroeconomic and fiscal outlook continue to be affected by high uncertainty due to the COVID-19 pandemic.

Compared with the Plan, the Commission forecasts a stronger economic downturn for 2020, but a similar recovery for 2021. Specifically, for 2020, the Commission projects real GDP to fall more sharply by 9.3%. As regards domestic demand, while the Commission projects private demand to drop at a lower rate than real GDP – as crisis mitigation measures partly offset losses in household income – investment is forecast to be the strongest hit due to lingering uncertainty. As regards external demand, both exports and imports are projected to decrease at double-digit rates, with the former being especially impacted by the disruption in foreign tourism. For 2021, the Commission also forecasts real GDP to rebound by 5.4%, but the drivers of the economic recovery differ somewhat. The Commission forecasts a swifter recovery in domestic demand in 2021, sustained by stronger growth in both private consumption and investment. This is projected to be offset by weaker external demand, as the effects from the crisis are likely to linger, particularly in foreign tourism. 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. Risks are tilted to the downside due to Portugal’s high reliance on foreign tourism, where uncertainty remains high.

Portugal’s independent body as defined in Regulation (EU) No 473/2013 – the Public Finance Council (“Conselho das Finanças Públicas”, CFP) – assessed and endorsed the macroeconomic forecast in the Plan. The endorsement is attached to the Plan. In its endorsement, the CFP raised no major reservations as to the macroeconomic forecast in the Plan. For 2020, the CFP considered that the risks surrounding the macroeconomic forecast in the Plan did not differ substantially from those incorporated in the projections of other institutions, and that the extent of the economic fallout would depend on the evolution of the COVID-19 pandemic throughout the second half of the year, as well as on the effectiveness of the crisis mitigation measures. For 2021, the CFP considered that the macroeconomic forecast in the Plan was broadly in line with other institutions. The CFP also issued a broader opinion on the fiscal scenario in the Plan.[3]

[3] See CFP’s Report No 14/2020, of 26 October 2020.

Table 1: Comparison of macroeconomic developments and forecasts

	2019	2020			2021		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	2.2	n.a.	-8.5	-9.3	n.a.	5.4	5.4
Private consumption (% change)	2.4		-7.1	-7.9		3.9	4.9
Gross fixed capital formation (% change)	5.4		-7.4	-10.2		5.3	6.3
Exports of goods and services (% change)	3.5		-22.0	-21.0		10.9	9.7
Imports of goods and services (% change)	4.7		-17.8	-15.6		7.2	7.5
Contributions to real GDP growth:							
- Final domestic demand	2.6		-5.9	-6.7		3.9	4.6
- Change in inventories	0.1		-0.6	-0.2		0.1	0.1
- Net exports	-0.5		-1.9	-2.4		1.3	0.7
Output gap[1]	3.8		-5.8	-6.5		-1.9	-2.7
Employment (% change)	0.8		-3.8	-3.8		1.0	2.1
Unemployment rate (%)	6.5		8.7	8.0		8.2	7.7
Labour productivity (% change)	1.4		-4.8	-5.7		4.3	3.2
HICP inflation (%)	0.3		-0.1	-0.1		0.7	0.9
GDP deflator (% change)	1.7		1.5	2.2		0.9	1.3
Comp. of employees (per head, % change)	3.5		3.6	0.6		1.5	2.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.0		-0.3	0.2		0.9	0.6

Note:

[1]In percentage of potential GDP, with potential GDP growth recalculated by the Commission services on the basis of the Plan's scenario using the commonly agreed methodology.

Sources:

2020 Stability Programme (SP); 2021 Draft Budgetary Plan (DBP); Commission 2020 autumn forecast (COM); Commission calculations.

3. Recent and planned fiscal developments

On 20 July 2020, the Council addressed recommendations to Portugal in the context of the European Semester. In the area of public finances and in line with the general escape clause, the Council recommended Portugal to take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, Portugal should pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

3.1. Deficit developments

For 2020, the Plan[4] sets a target of 7.3% of GDP for the general government deficit, thereby reversing the surplus observed in 2019. The fiscal targets in the Plan cannot be compared with those in the 2020 Stability Programme, given that the latter did not contain plans for the general government deficit. The Plan entails an upward revision of the latest deficit target set in the 2020 Supplementary Budget.[5] Compared with the latest fiscal targets for 2020, the Plan projects significantly lower revenue from indirect taxes and sales (by 0.5% and 0.2% of GDP, respectively), which are to be only partly offset by higher revenue from social contributions and direct taxes (by 0.4% and 0.2% of GDP, respectively). On the expenditure side, and also compared with the latest fiscal targets for 2020, the Plan expects lower spending on intermediate consumption and interest (both by 0.2% of GDP), which are planned to be counterbalanced by higher spending on items directly associated with the crisis response, including subsidies, compensation of employees, and other capital expenditure[6] (each by 0.1% of GDP).

Like the Plan, the Commission forecasts for 2020 a general government deficit of 7.3% of GDP. On the revenue side, and despite the somewhat less favourable economic conditions in its macroeconomic forecast for 2020, the Commission projects slightly higher revenue from indirect taxes (by 0.1% of GDP), in line with budgetary execution observed so far in the year. On the expenditure side, the Commission expects slightly higher spending on intermediate consumption and compensation of employees (both by 0.1% of GDP), reflecting pre-pandemic pressures. The COVID-19 crisis is expected to affect Portugal's deficit in 2020 mainly through two channels: firstly, the automatic stabilisers responding to the economic downturn – with a deficit-increasing effect of around 5.0% of GDP; secondly, the crisis mitigation measures – with an overall deficit-increasing effect of around 2.8% of GDP.

For 2021, the Plan sets 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 revenue related to the reimbursement of the pre-paid margin that was deducted from the financial assistance loan granted by the European Financial Stability Facility (EFSF) – which amounts to 0.5% of GDP – is projected to accelerate the reduction of the deficit in 2021. Following a prolonged period of subdued public investment, it is planned to gain momentum in 2021 and increase by almost a quarter to 2.9% of GDP. In that regard, the Plan assumes additional public investment and matching grants of ¼ % of GDP under the Recovery

4 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.

5 Law No 27-A/2020, of 24 July.

6 Focusing on other capital expenditure, the upward revision in the Plan, compared with the 2020 Supplementary Budget, partly reflected the higher budgetary cost of the rescue aid measures to TAP Air Portugal – the country's flag carrier – from EUR 0.9 billion to EUR 1.2 billion (this is, from 0.5% to 0.6% of GDP).

and Resilience Facility, which are included in both the revenue and expenditure projections therein.[7]

Compared with the Plan, the Commission forecast for 2021 projects a higher deficit of 4.5% of GDP. This partly stems from the different working assumptions in the Commission forecast regarding the budgetary 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 in 2021, the Commission forecast assumes, in the budgetary projection for 2021, the 10% pre-financing of the Recovery and Resilience Facility grants[8] 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. On the expenditure side, in line with its no-policy-change assumption, the Commission forecast includes higher expenditure related to the Recovery and Resilience Facility of ¼ % of GDP that is considered to be credibly announced and sufficiently specified in view of Portugal's draft Recovery and Resilience Plan.[9] 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. Moreover, the Commission projects lower revenue from direct taxes for 2021, notably from Corporate Income Tax (CIT), where collection lags are expected to put a drag on revenue growth. On the expenditure side, the Commission expects somewhat lower spending in 2021 on intermediate consumption and social transfers (both by 0.2% of GDP) – with the latter reflecting more favourable views on labour market developments –, which are however partly offset by higher spending on subsidies (by 0.2% of GDP) partly linked to the crisis response.

Risks to the budgetary outlook are tilted to the downside, linked to the accumulation of public contingent liabilities stemming from some public corporations. This adds to risks related to pre-pandemic public contingent liabilities, including those linked to past bank support measures. The Commission forecast for the general government balance in 2021 considers a deficit-increasing capital transfer related to a loan to be

[7] The statistical treatment of the financial support provided by the Recovery and Resilience Facility is subject to ongoing discussions between Eurostat and the Member States.

[8] The amount of pre-financing is based on the Council Presidency compromise proposal for the Regulation of the Recovery and Resilience Facility (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

[9] 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 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.

granted by the Portuguese Resolution Fund – which is classified inside the perimeter of general government – to Novo Banco, amounting to ¼ % of GDP. 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.

The fiscal stance is planned to be supportive to GDP growth in both 2020 and 2021, with the recalculated structural balance[10] in the Plan deteriorating by 1.8% and 0.3% of GDP in each year, respectively. It should be noted, however, that the Plan does not fully observe the Commission's principles for the classification of one-off measures insofar as it classifies as such rescue measures to airlines and the calling of pandemic-related public guarantees (see Section 4). If these measures were not classified as one-off, the recalculated structural balance in the Plan would worsen by around 2.5% of GDP in 2020 and stabilise in 2021. The reading of the fiscal stance is broadly confirmed by the change of the structural balance in the Commission forecast.[11] However, a mechanical reading of traditional indicators is not well suited at the current juncture to assessing the fiscal stance. The introduction and subsequent withdrawal of sizeable temporary emergency measures distort the picture, as the corresponding changes in the level of public spending from one year to the next affect the indicators used to assess the fiscal stance. Excluding the temporary emergency measures from the calculation of the fiscal stance indicators provides a more representative assessment of the underlying fiscal support to economic activity.

The report accompanying the Draft State Budget for 2021 – which was submitted to national parliament on 12 October 2020 – includes a reference to Portugal's medium-term fiscal plans, which were absent from this year's Stability Programme. For 2022, the Portuguese authorities project a general government deficit of 2.8% of GDP – therefore below the Treaty reference value of 3% of GDP –, in a context where GDP would resume its pre-pandemic level. Under a no-policy-change assumption, the Commission also projects the deficit to decline to 3% of GDP in 2022, amid a gradual phasing-out of fiscal support measures and further improving economic conditions.

[10] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

[11] In the Commission 2020 autumn forecast, the measures taken in response to the COVID-19 outbreak are not treated as one-off and, therefore, they are not excluded from the estimation of the structural balance.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2019		2020			2021			Change: 2019-2021
	COM	DBP	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**42.7**	**42.7**	n.a.	**42.6**	**42.8**	n.a.	**43.5**	**43.0**	**0.8**
of which:									
- Taxes on production and imports	15.0	15.0		14.5	14.6		14.5	14.4	-0.5
- Current taxes on income, wealth, etc.	9.8	9.8		9.3	9.3		9.4	9.2	-0.4
- Capital taxes	0.0	0.0		0.0	0.0		0.0	0.0	0.0
- Social contributions	11.8	11.8		12.5	12.5		12.2	12.2	0.4
- Other (residual)	6.1	6.1		6.3	6.4		7.4	7.1	1.3
Expenditure	**42.7**	**42.7**		**49.9**	**50.0**		**47.8**	**47.4**	**5.1**
of which:									
- Primary expenditure	39.7	39.7		46.9	47.1		45.2	44.8	5.5
of which:									
Compensation of employees	10.7	10.7		12.0	12.1		11.7	11.7	1.0
Intermediate consumption	5.2	5.2		5.8	6.0		5.7	5.5	0.5
Social payments	18.2	18.2		20.5	20.6		19.9	19.7	1.7
Subsidies	0.4	0.4		1.6	1.6		0.9	1.0	0.5
Gross fixed capital formation	1.9	1.9		2.5	2.5		2.9	2.9	1.0
Other (residual)	3.3	3.3		4.5	4.4		4.1	3.9	0.8
- Interest expenditure	3.0	3.0		2.9	2.9		2.6	2.6	-0.4
General government balance (GGB)	**0.1**	**0.1**		**-7.3**	**-7.3**		**-4.3**	**-4.5**	**-4.4**
Primary balance	**3.1**	**3.1**		**-4.3**	**-4.4**		**-1.7**	**-1.8**	**-4.8**
One-off and other temporary measures	-0.6	-0.6		-1.2	-0.5		0.0	0.2	0.6
GGB excl. one-offs	**0.7**	**0.7**		**-6.1**	**-6.7**		**-4.3**	**-4.7**	**-5.0**
Output gap[1]	3.8	3.4		-5.8	-6.5		-1.9	-2.7	-5.4
Cyclically-adjusted balance[1]	-2.0	-1.8		-4.2	-3.8		-3.3	-3.0	-1.6
Structural balance (SB)[2]	**-1.4**	**-1.2**		**-3.0**	**-3.3**		**-3.3**	**-3.3**	**-2.2**
Structural primary balance[2]	1.6	1.8		-0.1	-0.3		-0.7	-0.6	-2.6

Notes:

[1] Output gap (in percentage of potential GDP) and cyclically adjusted balance according to the Plan as recalculated by Commission on the basis of the Plan's scenario using the commonly agreed methodology.

[2] Structural (primary) balance corresponds to cyclically adjusted (primary) balance excluding one-off and other temporary measures.

Sources:

2020 Stability Programme (SP); 2021 Draft Budgetary Plan (DBP); Commission 2020 autumn forecast (COM); Commission calculations.

3.2. Debt developments

The Plan expects the COVID-19 crisis to bring to a halt the reduction of the general government debt-to-GDP ratio observed since 2016. For 2020, the debt-to-GDP ratio is planned to spike to 134.8%. The sudden primary deficit (4.3% of GDP) and the unfavourable denominator effect arising from the expected contraction of nominal GDP (8.7% of GDP) are the main drivers of this increase in 2020. Despite the higher debt stock, the interest burden is expected to decrease slightly, helped by still favourable financing conditions. The stock-flow adjustment is planned to be positive in 2020 (at 1.4% of GDP), mostly in view of an increase in the net acquisition of financial assets linked to state-owned enterprises. Compared with the Plan, the Commission projects a somewhat higher debt-to-GDP ratio of 135.1% in 2020, which is consistent with a slightly higher primary deficit and a stronger economic downturn.

For 2021, the general government debt-to-GDP ratio is planned to resume its downward path, decreasing to 130.9%. While a further – though smaller – primary deficit (1.7% of GDP) will add to the debt stock in 2021, it is planned to be more than compensated by the effect of the favourable differential between nominal GDP growth and interest rates (5.4% of GDP). The interest burden is projected to continue to decrease to 2.6% of GDP in 2021. Compared with the Plan, the Commission projects a swifter decline of the debt-to-GDP ratio to 130.3% in 2021, due to the assumed pre-financing of 10% of the grants under the Recovery and Resilience Facility. In the case of Portugal this is expected to amount to around EUR 1.4 billion (0.7% of GDP), which is treated as a financial transaction leading to a negative stock-flow adjustment and an ensuing debt-reducing effect.

A risk underlying the budgetary forecast relates to the sizeable amount of public guarantees provided and taken up so far (see Section 4). The possibility that the calling of public guarantees may exceed what is currently assumed in the Plan represents a downside risk to the debt-to-GDP ratio for 2021 and subsequent years.

Table 3: Debt developments

(% of GDP)	2019	2020			2021		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**117.2**	n.a.	**134.8**	**135.1**	n.a.	**130.9**	**130.3**
Change in the ratio	-4.3		17.6	17.9		-3.9	-4.9
Contributions[2]:							
1. Primary balance	**-3.1**		**4.3**	**4.4**		**1.7**	**1.8**
2. "Snow-ball" effect	**-1.6**		**11.7**	**11.9**		**-5.4**	**-5.8**
Of which:							
Interest expenditure	3.0		2.9	2.9		2.6	2.6
Real growth effect	-2.6		10.7	11.7		-6.8	-6.8
Inflation effect	-2.0		-1.9	-2.8		-1.2	-1.6
3. Stock-flow adjustment	**0.4**		**1.4**	**1.4**		**-0.2**	**-0.9**

Notes :

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Sources :

2020 Stability Programme (SP); 2021 Draft Budgetary Plan (DBP); Commission 2020 autumn forecast (COM); Commission calculations.

4. MEASURES UNDERPINNING THE DRAFT BUDGETARY PLAN

The Draft Budgetary Plan focuses on the policy response undertaken in the context of the COVID-19 outbreak in 2020 and the measures planned to sustain the recovery in 2021. Fiscal support measures should be tailored to the specific situation of each Member State, but as a rule, they should be well targeted and temporary. Their use and effectiveness should be regularly reviewed by the national authorities. Depending on the development of the pandemic, emergency measures should be adjusted and combined with other measures that improve economic fundamentals, support the green and digital transition and have a positive impact on demand.

4.1. Measures in 2020

In response to the COVID-19 pandemic, Portugal has implemented a multipronged package of measures with direct budgetary impact in 2020. The 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 – notably on ventilators – with an estimated budgetary cost of around 0.4% of GDP in 2020. Secondly, various measures were taken in the first half the year to preserve jobs and livelihoods, provide adequate social support and safeguard business continuity, with an estimated direct 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.

Against the background of the easing of restrictions over the summer, new measures in force as of July 2020 were geared towards helping firms resume their normal level of activity. These notably included the prolongation of short-time work schemes and a dedicated subsidy to support the normalisation of business activity, whose take-up until September was nevertheless somewhat limited. In addition, withdrawing the obligation to carry out pre-payments under CIT in 2020 is expected to lead to a sizeable loss in government revenue of around 0.6% of GDP.

Portugal is also supporting firms through 'liquidity measures'[12], including public guarantees (see Table 4.1). Such public guarantees constitute contingent liabilities for the government and may negatively impact the budget balance to the extent that they are eventually called on. The most important of these has been a publicly guaranteed scheme for investment and working capital loans granted by commercial banks, for which Portugal obtained approval by the Commission in the context of the

[12] Subject to more detailed information, the competent statistical authorities are to examine whether those liquidity measures entail an immediate impact on the general government balance or not.

State aid Temporary Framework[13] for a maximum of EUR 13 billion (6.6% of GDP). The Plan reports public guarantees with an overall maximum amount of 4% of GDP. These notably include publicly guaranteed credit lines of 3.3% of GDP that are accessible to small- and medium-sized enterprises, as well as firms facing difficulties as a result of the COVID-19 crisis, in particular those performing accommodation and food service activities. According to the Plan, the take-up of such publicly guaranteed credit lines so far in 2020 – which corresponds to the actual public contingent liability – amounts to 2.8% of GDP. Portugal also deferred towards the second half of 2020 a number of firms' tax and contributory obligations. While these measures would be ultimately budget-neutral provided that the associated payment were carried out in the second half of 2020[14], they provided additional liquidity to firms.

Table 4.1: Guarantees adopted in response to the COVID-19 outbreak

List of measures	Description	Adoption status	Maximum amount of contingent liability (% of GDP)	Actual take-up (% of GDP)
1	• Pandemic-related publicly guaranteed credit lines	Adopted	3.3	2.8
2	• Short-term facility "OECD 2020" – top-up to publicly guaranteed export credits	Adopted	0.4	0.0
3	• Public guarantee under SURE	Adopted	0.2	0.0
4	• Public guarantee under the pandemic-related Pan-European Guarantee Fund	Adopted	0.1	0.0
		Total	**4.0**	**2.8**

Source :
2021 Draft Budgetary Plan.

According to the Plan, Portugal's general government balance in 2020 is expected to be affected by one-off measures – that is, measures that are intrinsically non-recurrent – with an overall deficit-increasing impact of 1.2% of GDP. These notably include the third activation of Novo Banco's contingent capital mechanism (0.5% of GDP). At the same time, the Plan does not observe the Commission's principles for the classification of one-off measures insofar as it classifies as such rescue measures to airlines – notably to TAP Air Portugal (0.6% of GDP in 2020) and SATA Air Açores (0.1% of GDP in 2020). Both operations are examples of non-one-off measures, since they are deficit-increasing and under the control of the government. More broadly, in light of the activation of the general escape clause, the measures taken in response to the COVID-19 outbreak in 2020 are not to be treated as one-off and are thus not excluded from the estimation of the structural balance. One-off measures in the Commission forecast are thus projected to lead to a lower deficit-increasing impact of 0.5% of GDP in 2020.

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.

[13] The Commission adopted on 19 March a Temporary Framework (revised subsequently) to enable Member States to use the flexibility foreseen under State aid rules to support the economy in view of the COVID-19 outbreak.

[14] Risks surrounding the budgetary impact of these measures are tilted to the downside, linked to possible insolvencies and deterioration in compliance culture.

4.2. Measures in 2021

The Plan reports a package of new measures with a direct budgetary impact of 0.9% of GDP in 2021 – 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 (see Table 4.2). 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 Plan specifies a new benefit to support workers' income and a temporary reduction in withholdings of the Personal Income Tax (PIT), with a planned overall budgetary cost of 0.3% of GDP. The Plan assumes a first calling of public guarantees linked to liquidity measures targeting the private sector in the amount of 0.1% of GDP, which is however classified as one-off against the Commission's recommendation not to classify as such measures linked to the crisis response (see Section 4.1). 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 (REACT-EU) and the Recovery and Resilience Facility, with a deficit-reducing effect of 0.7% of GDP. Compared with 2020, temporary crisis mitigation measures are planned to weigh less on the deficit in 2021.

According to the Commission 2020 autumn forecast, some measures in the Draft Budgetary Plan for 2021 are assessed as not temporary, but their estimated budgetary cost is nevertheless contained at 0.2% of GDP. These include staff reinforcements in the civil service – particularly in health and education –, another increase in low pensions and the full-year impact of the reduction of Value-added Tax (VAT) on electricity. These measures broadly follow up on similar initiatives adopted in previous years. The deficit-increasing effect of these measures is planned to be partly compensated by the deficit-reducing effect stemming from additional efficiency savings from the ongoing review of public expenditure (0.1% of GDP). The budgetary cost of the new measures planned for 2021 as reported in the Plan is broadly in line with the Commission's own projections.

Overall, based on the information presented in the Draft Budgetary Plan and taking into account the Commission 2020 autumn forecast, most of the measures planned by Portugal in 2021 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. At the same time, it would be useful 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.

Table 4.2: Main discretionary measures in the Draft Budgetary Plan

List of measures	Description	ESA code	Adoption status	Impact[1] (% of GDP) 2020	Impact[1] (% of GDP) 2021
Revenue side					
1	• Reduction of VAT on electricity	D.2	Adopted		0.1
2	• Temporary reduction of PIT withholdings	D.5	Planned		0.1
3	• Transfers under REACT-EU	D.7+D.9	Planned		-0.5
4	• Reimbursement of EFSF pre-paid margin	D.9	Planned		-0.5
5	• Capital transfers under the Recovery and Resilience Facility	D.9	Planned		-0.2
6	• BPP public guarantee recovery	D.9	Planned		0.0
7	• Other measures on the revenue side		Planned		0.0
		Sub-total on the revenue side			-1.1
Expenditure side					
8	• Staff reinforcement in the civil service, particularly in health and education	D.1	Planned		0.1
9	• Measures to support employment and activity	D.3	Planned		0.5
10	• Support for workers' income	D.3	Planned		0.2
11	• IVaucher applying to spending on restaurants, accommodation and culture	D.3	Planned	n.a.	0.1
12	• Increase in pensions	D.62	Planned		0.0
13	• Increase in the unemployment benefit minimum threshold	D.62	Planned		0.0
14	• Other pandemic-related measures	D.1+D.62+D.632	Planned		0.1
15	• 2021 spending review	P.2	Planned		-0.1
16	• Personal protective equipment and other health-related spending	P.2	Planned		0.1
17	• Additional public investment under the Recovery and Resilience Facility	P.51	Planned		0.2
18	• Digitalisation of schools	P.51	Planned		0.1
19	• Calling of pandemic-related public guarantees	D.9	Planned		0.1
20	• Capital transfer to Novo Banco	D.9	Planned		0.1
21	• Rescue aid to TAP Air Portugal	D.9	Planned		0.2
22	• Court ruling on Lisbon Municipality	D.9	Planned		0.1
		Sub-total on the expenditure side			2.0
Total					**0.9**

Note:

[1] Change compared with previous year. A positive (negative) sign indicates a deficit-increasing (-decreasing) impact.

Source:

2021 Draft Budgetary Plan.

5. ANNEX

Mandatory variables not included in the Draft Budgetary Plan

The Draft Budgetary Plan does not include some mandatory variables for the basic assumptions including, in particular: (i) in table 1.c. "Labour market developments", the 2019 level of the unemployment rate; and, (ii) in table 1.d. "Sectoral balances", the level of the statistical discrepancy as a percentage of GDP.

Not included mandatory variables do not impede the Commission's ability to assess the Draft Budgetary Plan based on the Plan's assumptions.