EUROPEAN
COMMISSION

Brussels, 19.5.2022
C(2022) 3501 final

COMMISSION OPINION

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on the Draft Budgetary Plan of Portugal

{SWD(2022) 706 final}

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013[1] 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 of 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 by 15 October, presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

3. The general escape clause has been active since March 2020.[2] On 2 June 2021, on the basis of the Commission's 2021 spring forecast, the Commission considered that the conditions to continue to apply the general escape clause in 2022 were met.[3]

4. Next Generation EU, including the Recovery and Resilience Facility, supports a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 established the Recovery and Resilience Facility[4], which provides financing support for the implementation of reforms and investments, notably to promote the green and digital transitions, thereby strengthening the economies' resilience and potential growth. Part of this support is in the form of non-repayable financial support ('grants'), entailing a fiscal impulse financed by the EU budget. By contributing to economic recovery and to strengthening long-term growth, it supports public finances, growth and job creation in the medium and long term.

5. On 2 June 2021, the Commission emphasised in its communication that the coordination of national fiscal policies remains crucial to underpin the recovery. In this context, the Commission set out its view that the overall fiscal stance, taking into account national budgets and the Recovery and Resilience Facility, should remain supportive in 2021 and 2022. Fiscal policy should remain agile and adjust to the evolving situation as warranted, and a premature withdrawal of fiscal support should be avoided. Once health risks diminish, fiscal measures should gradually pivot to more targeted measures that promote a resilient and sustainable recovery. Finally, with economic activity gradually normalising in 2021, Member States' fiscal policies should become more differentiated in 2022, taking into account the state of the

[1] Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p. 11).

[2] 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.

[3] Communication from the Commission on economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021) 500 final.

[4] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and resilience Facility (OJ L57, 18.2.2021, p.17).

recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. All Member States should preserve nationally financed investment. As the recovery takes hold, fiscal policy should prioritise higher public and private investment, supporting the transition towards a green and digital economy.

In its recommendations on the 2021 Stability Programmes on 18 June 2021, the Council also recommended that, when economic conditions allow, Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, investment should be enhanced to boost growth potential.

The Council, on 13 July 2021, further recommended to euro area Member States[5] to take action, individually and collectively within the Eurogroup, in the period 2021–2022 to ensure a policy stance that supports the recovery from the COVID-19 crisis. When the epidemiological and economic conditions allow, emergency measures should be phased out while combatting the social and labour-market impact of the crisis. Recalling the need for prudent medium-term fiscal positions and debt sustainability, while enhancing investment, the Council also called for particular attention to the quality of budgetary measures.

On 2 March 2022, the Commission, in its Communication[6], noted that fiscal policies needed to stand ready to react to the rapidly changing circumstances in light of the evolving policy environment and that the continued application of the general escape clause in 2022 would allow fiscal policy to adjust to address the immediate challenges posed by this crisis.

6. On 18 June 2021, in its recommendations on the 2021 Stability Programmes, the Council highlighted that the established indicators of fiscal adjustment set out in Regulation (EC) No 1466/97[7] need to be considered in the context of the current circumstances. Specifically, the assessment of the overall fiscal stance at the current juncture should take into account the transfers from the EU budget (such as those from the Recovery and Resilience Facility). Furthermore, the assessment also needs to take into account the phasing-out of COVID-19 crisis-related temporary emergency measures that were designed to support health systems and compensate workers and firms for the losses in income due to lockdowns and supply chain disruptions, while their withdrawal is accompanied by the easing of lockdown restrictions that will support growth.

Accordingly, the fiscal stance in 2021 and 2022 is measured by the change in primary expenditure (net of discretionary revenue measures), excluding COVID-19 crisis-related temporary emergency measures but including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth.[8] Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is conducive to a

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5 Council Recommendation of 13 July 2021 on the economic policy of the euro area, OJ C 283, 15.7.2021, p. 1.

6 Communication from the Commission to the Council: Fiscal policy guidance for 2023, Brussels, 2.3.2022, COM(2022) 85 final.

7 Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 209, 2.8.1997, p. 1), as amended.

8 The Commission’s estimates of medium-term potential growth do not include the positive impact of reforms that are part of the Recovery and Resilience Plan and can boost Portugal’s potential growth.

sustainable recovery consistent with the green and digital transitions, attention is also paid to the evolution of nationally financed primary current expenditure (net of discretionary revenue measures and excluding COVID-19 crisis-related temporary emergency measures) and investment.

CONSIDERATIONS CONCERNING PORTUGAL

7. On 15 October 2021, Portugal submitted a Draft Budgetary Plan for 2022. On 27 October 2021, the draft law on the State Budget for 2022, which was the basis for that Draft Budgetary Plan, was rejected by the Portuguese Parliament. On 15 November 2021, the Commission sent a letter to the Portuguese authorities noting that this Plan was no longer valid, as it was based on the draft law on the State Budget for 2022, which had been rejected by the Portuguese Parliament and, therefore, could not be enacted as a law. On the basis of that understanding, the Commission did not adopt an opinion on Portugal's Draft Budgetary Plan for 2022, of 15 October 2021. The Commission also invited the Portuguese authorities to submit a new Draft Budgetary Plan for 2022 to the Commission and the Eurogroup, in due course, and as soon as a government presented to the Portuguese Parliament a new draft law on the State Budget for 2022. Following a general election on 30 January 2022, the new government took office on 30 March 2022.

8. On 14 April 2022, Portugal submitted a new Draft Budgetary Plan for 2022. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

9. On 18 June 2021, the Council recommended that in 2022 Portugal[9] should use the Recovery and Resilience Facility to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Moreover, it should preserve nationally financed investment. The Council also recommended Portugal to limit the growth of nationally financed current expenditure.

   The Council also recommended Portugal to pursue, when economic conditions allow, a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term, and at the same time, to enhance investment to boost growth potential.

   The Council also recommended Portugal to pay particular attention to the composition of public finances, on both the revenue and expenditure sides of the national budget, and to the quality of budgetary measures in order to ensure a sustainable and inclusive recovery; to prioritise sustainable and growth-enhancing investment, in particular investment supporting the green and digital transition; and to give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including, where relevant, by strengthening the coverage, adequacy and sustainability of health and social protection systems for all.

10. The Portuguese economy grew by 4.9% in 2021, while consumer price inflation was 0.9%. According to the Commission 2022 spring forecast, the Portuguese economy is projected to further expand by 5.8% in 2022, and consumer prices are expected to accelerate by 4.4% this year. By comparison, the Draft Budgetary Plan projects real GDP to grow more moderately by 4.9% in 2022, and consumer price inflation is forecast to be slightly lower at 4.0%. The difference between both projections is

[9] Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Portugal, OJ C 304, 29.7.2021, p. 102.

mainly due to stronger growth in private consumption and net exports in the Commission's forecast for 2022, as the services sector, particularly foreign tourism, is set to rebound strongly from a low base in the previous year. Against that background, it should be noted that, contrary to the Plan, the Commission forecast already incorporates the preliminary flash estimate for GDP growth in the first quarter of 2022.[10] The Commission and the Draft Budgetary Plan forecast similar labour market developments for 2022, but the unemployment rate is projected to be slightly lower at 5.7% in the Commission forecast, compared with 6.0% in the Plan. Overall, with the benefit of hindsight from the favourable preliminary flash estimate for GDP growth in the first quarter of 2022, the macroeconomic assumptions in the Plan are cautious in 2022. Portugal complies with the requirement of Regulation (EU) No 473/2013, since the draft budget is based on independently endorsed macroeconomic forecasts.

11. Portugal submitted its Recovery and Resilience Plan on 22 April 2021. The Council approved the assessment of Portugal's Recovery and Resilience Plan and the respective Council Implementing Decision on 13 July 2021. A pre-financing payment of Recovery and Resilience Facility grants of 0.9% of GDP was made to Portugal in August 2021. The Draft Budgetary Plan assumes that expenditure amounting to 0.03% of GDP in 2021, and 1.3% in 2022 will be funded by non-repayable financial support ('grants') from the Recovery and Resilience Facility. Expenditures financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without adding to the general government deficit and debt. The Plan also assumes expenditure financed through loan support from the Recovery and Resilience Facility, with direct impacts on the general government deficit and debt amounting to 0.1% and 0.7% of GDP, respectively, in 2022. The Commission 2022 spring forecast includes a similar amount of expenditures financed by Recovery and Resilience Facility grants in its budgetary projections. Simulations by the Commission services show that the Recovery and Resilience Plan, together with the rest of the measures of the European Union Recovery Instrument, has the potential to increase the GDP of Portugal by 1.5% to 2.4% by 2026, not including the possible positive impact of structural reforms, which can be substantial.

12. Portugal's general government deficit was 2.8% of GDP in 2021. In line with the Commission 2022 spring forecast, the general government deficit in the Draft Budgetary Plan is planned to decrease to 1.9% of GDP in 2022, mainly due to broad-based economic growth and the gradual wind-down of the temporary measures taken in response to the COVID-19 pandemic. The general government debt ratio is planned to decrease from 127.4% of GDP at end-2021 to 120.7% at end-2022. The Commission 2022 spring forecast projects a lower general government debt-to-GDP ratio of 119.9% in 2022, due to the Commission's forecast of stronger nominal GDP growth in that year.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including downside risks related to Russia's invasion of Ukraine, gas supply bottlenecks and further constraints on supply chains. In response to the COVID-19 pandemic, Portugal provided significant liquidity support to companies and households, such as guarantees and tax deferrals.

[10] According to the preliminary flash estimate for GDP growth in the first quarter of 2022, Portugal's GDP is estimated to have increased by 2.6% quarter-on-quarter and 11.9% year-on-year, thus surprising on the upside. For additional information see: Eurostat, Euro Indicators 52/2022, of 29 April 2022.

This support does not have a direct or immediate budgetary impact, but guarantees represent contingent liabilities for the general government sector. The Commission estimates that the guarantees taken up amounted to around 4% of GDP at 14 April 2022. This is on top of previously contracted contingent liabilities, linked to past bank rescue operations and vulnerabilities in some state-owned enterprises.

13. For 2022, the Draft Budgetary Plan reports a package of new fiscal policy measures with an overall budgetary cost of 1.8% of GDP, of which 0.4 percentage points relate to revenue measures and 1.4 percentage points to expenditure measures.

On the revenue side of the budget, the measures notably comprise a reform of the personal income tax, including a review of its tax brackets (0.1% of GDP). Furthermore, the Plan provides for tax measures to mitigate the impact of high energy prices, including a general reduction of the fuel tax, a reimbursement of the additional value-added tax raised on the higher fuel prices via the fuel tax (which is to be calibrated on a weekly basis to neutralise the rising tax burden on fuel consumption), and a freeze on the carbon rate under the fuel tax (jointly 0.3% of GDP).

On the expenditure side of the budget, the measures reflect the ongoing response to the COVID-19 pandemic, through continued subsidies to firms, social benefits to households, and additional health-related spending (jointly 0.5% of GDP). The Plan also accounts for additional rescue aid to the country's flag carrier airline, TAP Air Portugal (0.3% of GDP). Another special increase in pensions above Portugal's reference rate for pension indexation (linked to inflation and economic growth) and an across-the-board increase in public sector wages (albeit below the inflation forecast for 2022) (jointly 0.2% of GDP) further add to pre-pandemic upward pressures on public current spending. Furthermore, the Plan specifies expenditure measures to mitigate the impact of high energy prices, including a temporary subsidy on fuel consumption, a subsidy to firms to compensate for rising gas-related costs, a set of sector-specific subsidies (including road haulage and passenger transport, agriculture and fisheries), and a subsidy to the national electricity system (with a view to reducing access tariffs to the electricity grid) (jointly 0.3% of GDP). It also reflects a one-time social benefit of EUR 60 in April 2022 to low-income households most vulnerable to rising prices.

Based on the Commission's forecast, the COVID-19 crisis-related temporary emergency measures will decrease from 2.3% of GDP in 2020 and 2.2% in 2021, to 0.7% in 2022.

According to the Draft Budgetary Plan, gross fixed capital formation is expected to increase from 2.5% of GDP in 2021 to 3.2% in 2022, prompted by the ongoing implementation of Portugal's Recovery and Resilience Plan. These projections are broadly in line with the Commission 2022 spring forecast.

Some of the fiscal-structural measures in the Plan, such as the continuation of the review of public expenditure, are aimed at strengthening the quality of budgetary measures and contributing to the long-term sustainability of public finances, as recommended by the Council on 18 June 2021. A complete assessment of the fiscal-structural reforms implemented by Portugal is presented as part of the assessment of the implementation of the Recovery and Resilience Plan and in the 2022 Country Report.

14. The Commission 2022 spring forecast projects an expansionary fiscal stance of -2.0% of GDP in 2022.[11] Portugal is projected to use the Recovery and Resilience Facility in 2022 to finance additional investment. The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 0.5 percentage points of GDP in 2022 compared to 2021. Nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 0.2 percentage points in 2022.[12] At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) in 2022 is projected to provide an expansionary contribution of 1.1 percentage points to the overall fiscal stance. This significant expansionary contribution includes the additional impact of the above-mentioned measures to address the economic and social impact of the increase in energy prices (0.6% of GDP), as well as the costs of providing support to displaced persons following the invasion of Ukraine by Russia (0.1% of GDP), while an increasing public sector wage bill, ageing-related expenditure and intermediate consumption are expected to continue to exert upward pressure on public current spending. In particular, the higher increase in consumer prices compared to the GDP deflator is also projected to affect the expansionary contribution of nationally financed primary current expenditure to the overall fiscal stance in 2022. Portugal is expected to broadly limit the growth of nationally financed current expenditure in 2022.

15. The Draft Budgetary Plan does not include budgetary projections beyond 2022.[13]

16. In 2022, based on the Commission's forecast and including the information incorporated in the Draft Budgetary Plan, the fiscal stance, including the impulse provided by the Recovery and Resilience Facility, is projected to be supportive. As recommended by the Council, Portugal plans to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. As recommended by the Council, Portugal also plans to preserve nationally financed investment. Portugal broadly limits the growth of nationally financed current expenditure as the significant expansionary contribution of nationally financed current expenditure in 2022 is mainly due to the above-mentioned measures to address the economic and social impact of the increase in energy prices, as well as the costs of providing support to displaced persons. Given the level of Portugal's government debt and high sustainability challenges in the medium term, when taking supportive budgetary measures, it is important to preserve prudent fiscal policy in order to ensure sustainable public finances in the medium term.

    The Commission recalls the importance of the composition of public finances and the quality of budgetary measures, including through growth-enhancing investment, notably supporting the green and digital transition. Making decisive progress in

[11] A negative sign of the indicator corresponds to an excess of primary expenditure growth compared with medium-term economic growth, indicating an expansionary fiscal policy.

[12] Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0.2 percentage points of GDP.

[13] Portugal's medium-term budgetary strategy was presented in the 2022 Stability Programme, of 29 April 2022 (with a cut-off date of 25 March 2022). According to the Programme, the general government deficit is planned to decline from 1.9% of GDP in 2022 to 0.7% in 2023, and to maintain a steady downward path until a balanced budget is achieved in 2025 and a small surplus of 0.1% is reached in 2026. At the same time, the general government debt-to-GDP ratio is planned to decrease from 120.8% in 2022 to 115.4% in 2023, and to remain on a steadily declining path, narrowing to 101.9% in 2026.

strengthening expenditure control, cost-efficiency, and appropriate budgeting – in particular through intensified efforts in the planned review of public expenditure and in the implementation of measures to improve the financial sustainability of the National Health Service and state-owned enterprises – remains important to facilitate the rechannelling of public resources towards new strategic policy priorities, such as delivering on the twin transition.

Portugal is invited to regularly review the use, effectiveness and adequacy of the support measures, including those aimed at addressing the increase in energy prices, and stand ready to adapt them to changing circumstances.

Done at Brussels, 19.5.2022

For the Commission
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