The economic policies as reflected in the updated programme are partly consistent with the recommendations in the Broad Economic Policy Guidelines, specifically those with budgetary implications. While the programme contains a renewed commitment to allocate, as a matter of priority, proceeds stemming from higher than expected economic growth to improve the budgetary position, the updated programme lacks information on how the authorities intend to comply with the recommendation to limit the increase in real expenditure in Entity I (Federal Government and Social Security) to 1,5 %.

COUNCIL OPINION

of 9 March 2004

on the updated Stability Programme of Portugal, 2004-2007

(2004/C 68/04)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to 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 [1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission, after consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 9 March 2004 the Council examined the 2003 update of the stability programme of Portugal which covers the period from 2004 to 2007. The updated programme was submitted in December 2003 and largely complies with the data requirements of the revised 'Code of conduct on the content and format of stability and convergence programmes'. However, information notably on expected privatisation revenue would have been desirable.

On 5 November 2002, the Council decided that an excessive deficit existed in Portugal and issued a recommendation requesting Portugal to bring this situation to an end by 2003 at the latest.

The medium-term budgetary consolidation strategy of the 2003 update of the stability programme is similar to that adopted in the previous update. It is centred on three axes: 1. a comprehensive programme of structural reforms with a particular incidence in areas that bear directly on public finances, such as public administration, health-care, and education; 2. a sustained policy of curbing government consumption via wage moderation and a quasi-employment freeze; and 3. a gradual improvement in productivity and competitiveness to be fostered, inter alia, by a substantial cut in the corporate tax rate. In addition, the adoption in 2002 of a Budgetary Framework Law ('Lei de Estabilidade Orçamental') is expected to have reinforced fiscal coordination between different government levels. As a consequence, the Portuguese authorities project that the implementation of this medium-term adjustment strategy will bring about a cumulative decline by 3.2 percentage points in the government primary expenditure-to-GDP ratio over the period 2004 to 2007, partly offset by lower tax revenue to the amount of 0.7 percentage points of GDP.

The budgetary consolidation strategy adopted by the Portuguese authorities appears to be economically sound. In fact, an adjustment strategy that relies on expenditure restraint rather than on tax increases is considered to improve the confidence of private economic agents, thereby supporting growth over the medium-term. Moreover, such a strategy should secure a lasting improvement in public finances, and prevent the emergence of major imbalances in the private sector of the economy.

The 2003 update projects real GDP to increase by 1,0 % in 2004, after having declined by an estimated 0,8 % in 2003. For the period from 2005 to 2007, real GDP growth is estimated to average by 2,75 % per year. Employment growth is expected to pick up from 0,4 % in 2004 to 1,3 % on average in the period from 2005 to 2007. Declining from 3,3 % in 2003, HICP inflation is expected to stabilise at 2 % throughout the period from 2004 to 2007. The macroeconomic scenario underlying the update seems realistic, notably because the ongoing correction of major imbalances is about to be completed; moreover, it incorporates an element of prudence that could absorb moderate unfavourable shocks. The 'caution bias' is built around two assumptions: 1. an average growth rate only 0,25 of a percentage point above the figure projected for the EU as a whole, a plausible deviation for a catching-up country; and 2. constant export market-shares, in spite of the expected moderate gains in (labour) productivity and a significant deceleration in wage growth, in line with the Commission's Autumn 2003 forecast.

(1) OJ L 209, 2.8.1997.

The update targets a general government deficit of 2,8 % of GDP in 2004, following an expected deficit of 2,8 % of GDP in 2003 which was largely due to the repeated recourse to sizeable one-off measures. In the subsequent years, the projections are for a gradual reduction in headline deficits, to a ratio of 1,1 % of GDP in 2007. In cyclically-adjusted terms, based on Commission calculations according to the commonly agreed methodology, the deficit is set to fall by 0,4 percentage points to 1,7 % of GDP in 2004, and eventually to 0,7 % of GDP by 2007.

Largely on account of substantial nominal deficits and sluggish growth, the debt ratio is rising by almost 7 percentage points of GDP between 2000 and 2004, reaching exactly the reference value of 60 % in 2004. Subsequently, it is projected to abate to 57 % of GDP by 2007.

Compliance with the budgetary targets of the programme update is subject to two major risks: first, the likelihood of a tax revenue shortfall in 2004, and second, failure to restrain growth in total social transfers to the extent (implicitly) envisaged in the programme already in 2004. In such circumstances, a slippage in the budgetary targets for 2004 would have repercussions over the entire programme period, requiring either appropriate offsetting measures or a revision of budgetary targets. Naturally, the determined implementation of the structural reforms with a budgetary impact is crucial for the attainment of the programme objectives.

On the basis of the current policies, risks of imbalances in the long term cannot be completely ruled out for Portugal. The high deficit and the rising debt-to-GDP ratio may undermine the sustainability of public finances in the longer term, hence the timely achievement of a budgetary position close to balance is imperative. The budgetary strategy outlined in the programme is compatible with improving the sustainability of public finances. This strategy is mainly based on budgetary consolidation over the medium-term, resulting from government consumption restraint, and the expected gains from the completion of structural reforms. A strict monitoring of pension and health-care expenditure trends is crucial to avoid future budgetary imbalances. Failure to do so would imply a rising debt over time once the impact of ageing takes place.

Pension regimes have been undergoing reform since 2001, a process which has not yet been completed. The long-term projections for pension expenditure presented in the 2003 programme update seem not to have taken into consideration the impact of some measures already adopted and of others which are planned. Moreover, an early assessment of the effects of the 2001 reform of the general social security pension regime seems to suggest that its long-term sustainability has not been improved. Against this background, the programme implicitly assumes a sharp deceleration in the average annual growth rate of total social transfers, without spelling out the measures required to secure this result.

The economic policies as reflected in the 2003 update are broadly consistent with the recommendations of the Broad Economic Policy Guidelines, specifically those with budgetary implications. Although the improvement in the cyclically-adjusted deficit for 2006 and 2007 appears to be less than 0,5 percentage point annually, the composition of the budgetary adjustment follows the recommendation that calls for deficit reduction to be obtained mainly through expenditure restraint. Moreover, the recommendation requesting Portugal to undertake structural reforms in areas with a direct impact on budgetary consolidation is being followed in a timely fashion.