

Brussels, 16 October 2002

Commission considers that an excessive government deficit exists in Portugal

The European Commission, in an opinion on the budgetary situation prepared under the obligations of Article 104.5 of the Treaty and adopted today, concludes that an excessive deficit exists in Portugal. On the basis of Article 104.6, it recommends to the Council to adopt a similar decision. Finally, the Commission recommends to the Council to address a recommendation to Portugal, in the sense of Article 104.7. The Portuguese government should adopt and implement all necessary measures in order to ensure that the general government deficit is reduced to clearly below 3% of GDP in 2003 and that the government debt ratio is kept below 60% of the GDP reference value. Necessary measures have to be adopted at the latest by 5 March 2003. With today's decision the Commission is honouring its obligations laid down in Article 104 of the Treaty, as well as its political commitments given in the European Council resolution on the Stability and Growth Pact for a strict, timely and effective functioning of the Pact.

The Commission **opinion** (Article 104.5 of the Treaty) takes up the major findings of the Commission report prepared last month ([IP/02/1360](#)), also taking into account the opinion on that report given by the Economic and Financial Committee on 3 October. Its main conclusions are:

The government deficit in Portugal was equal to 4.1% of GDP in 2001, thereby **clearly exceeding the reference value of 3%**. Government debt, while rising to 55.5% of GDP by the end of 2001, was still below the 60% reference value.

The deficit in 2001 did not result from an unusual event outside the control of Portugal, nor did it result from a severe economic downturn.

From 1999 to 2001, according to the revised data, the government deficit increased from 2.4% to 4.1% of GDP. While economic growth slowed markedly during that period, the increase in the deficit mainly reflects a weakening in the underlying budgetary position. **The increase in the deficit therefore reflects mainly a weakening in the underlying budgetary position.** The cyclically adjusted deficit has widened nearly as much as the actual deficit.

Although the government adopted a rectifying budget in June 2001, involving cuts in expenditure to the amount of 0.6% of GDP, the deficit in that year increased for a number of reasons, relating to developments of both revenues and expenditures: On the revenue side: (i) revenue losses implied by the reform of direct taxes implemented in 2001 have been underestimated; (ii) efficiency gains in tax collection and administration have turned out lower than anticipated. On the expenditure side: (i) the rise in the public sector wage bill has been above budgetary plans; (ii) social spending, notably on health care, exceeded ex-ante budget allocations.

The government gross debt ratio remained below 60% of GDP up to 2001. It declined from 54.4% in 1999 to 53.3% in 2000, but rebounded to 55.5% in 2001, mainly as a result of the rise in the government deficit and the deceleration of GDP growth.

A new government that came into office in April 2002 presented to parliament a rectifying budget for 2002, which became law in early June. The rectifying budget includes consolidation measures totalling about ½% of GDP, notably an increase in the standard VAT rate from 17 to 19% and cuts in public investment spending. The new budgetary target for 2002 is 2.8% of GDP, which compares with an initial target of 1.8% laid down in the last update of the stability programme. **It can be concluded that, in the absence of the rectifying budget, the 2002 deficit could have been above 3½% of GDP.** In order to ensure the deficit to be brought down below the 3% ceiling in 2002, the government has proposed to parliament, in addition to the saving measures already adopted, to sell, if needed, a number of public assets.

While it can be expected that the deficit will be reduced in 2002, it appears uncertain whether the excessive deficit situation will be corrected this year. In any case, such an assessment can only be made on the basis of budgetary results, which will not be available until early 2003. Moreover, **in view of the severe deficiencies in the statistical base** that long prevented the budgetary problems from being recognised, **it has to be ensured that the recorded public accounts henceforth provide a true picture of the actual situation.** The progress in consolidation to be achieved will depend on the determined efforts by the authorities, but also on overall economic developments. Indeed, the government debt ratio is projected to rise to 59.3% of GDP in 2002, a level just under the 60% reference value. 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.

Based on this opinion, the Commission has addressed a **recommendation** to the Council (Article 104.6). The Council is asked to decide that from an overall assessment it follows that an excessive deficit exists in Portugal.

Finally, the Commission issued a **recommendation for a Council recommendation** to Portugal, according to Article 104.7. It is recommended to the Portuguese government to put an end to the present excessive deficit situation as rapidly as possible and by 2003 at the latest. With this in view the Portuguese authorities should implement with resolve the saving measures announced in the rectifying budget adopted in May. They should adopt and implement the necessary measures to ensure that the deficit is reduced to clearly below 3% of GDP in 2003 and that the government debt ratio is kept below the 60% of GDP reference value. In this regards, the Commission notes with satisfaction the recent approval of a budgetary stability law and welcomes the efforts made by the Portuguese government to implement structural reforms and thereby foster growth and employment. In any case, a deadline of 5 March 2003 is established for the Portuguese government to take all necessary measures. The Portuguese authorities shall 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.

Economic and finance Ministers are expected to reach a decision on this point in the Ecofin meeting of 5 November.

In the light of the data to be reported by 1 of March 2003 the Commission will assess whether the excessive deficit for Portugal has been corrected and that the Portuguese authorities have applied the necessary measures to lower the deficit clearly below 3% in 2003.

Treaty establishing the European Community (Amsterdam consolidated version)

Article 104

1. Member States shall avoid excessive government deficits.
2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria:
 - a) whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless:
 - either the ratio has declined substantially and continuously and reached a level that comes close to the reference value;
 - or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;
 - b) whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The reference values are specified in the Protocol on the excessive deficit procedure annexed to this Treaty.
3. If a Member State does not fulfil the requirements under one or both of these criteria, the Commission shall prepare a report. The report of the Commission shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State. The Commission may also prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State.
4. The Committee provided for in Article 114 shall formulate an opinion on the report of the Commission.
5. If the Commission considers that an excessive deficit in a Member State exists or may occur, the Commission shall address an opinion to the Council.
6. The Council shall, acting by a qualified majority on a recommendation from the Commission, and having considered any observations which the Member State concerned may wish to make, decide after an overall assessment whether an excessive deficit exists.
7. Where the existence of an excessive deficit is decided according to paragraph 6, the Council shall make recommendations to the Member State concerned with a view to bringing that situation to an end within a given period. Subject to the provisions of paragraph 8, these recommendations shall not be made public.
8. Where it establishes that there has been no effective action in response to its recommendations within the period laid down, the Council may make its recommendations public.

9. If a Member State persists in failing to put into practice the recommendations of the Council, the Council may decide to give notice to the Member State to take, within a specified time-limit, measures for the deficit reduction which is judged necessary by the Council in order to remedy the situation. In such a case, the Council may request the Member State concerned to submit reports in accordance with a specific timetable in order to examine the adjustment efforts of that Member State.
10. The rights to bring actions provided for in Articles 226 and 227 may not be exercised within the framework of paragraphs 1 to 9 of this Article.
11. As long as a Member State fails to comply with a decision taken in accordance with paragraph 9, the Council may decide to apply or, as the case may be, intensify one or more of the following measures:
 - to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities;
 - to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;
 - to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected;
 - to impose fines of an appropriate size.The President of the Council shall inform the European Parliament of the decisions taken.
12. The Council shall abrogate some or all of its decisions referred to in paragraphs 6 to 9 and 11 to the extent that the excessive deficit in the Member State concerned has, in the view of the Council, been corrected. If the Council has previously made public recommendations, it shall, as soon as the decision under paragraph 8 has been abrogated, make a public statement that an excessive deficit in the Member State concerned no longer exists.
13. When taking the decisions referred to in paragraphs 7 to 9, 11 and 12, the Council shall act on a recommendation from the Commission by a majority of two-thirds of the votes of its members weighted in accordance with Article 205(2), excluding the votes of the representative of the Member State concerned.
14. Further provisions relating to the implementation of the procedure described in this Article are set out in the Protocol on the excessive deficit procedure annexed to this Treaty.

The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the ECB, adopt the appropriate provisions which shall then replace the said Protocol.

Subject to the other provisions of this paragraph, the Council shall, before 1 January 1994, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, lay down detailed rules and definitions for the application of the provisions of the said Protocol.