Europaudvalget 2016
KOM (2016) 0293
Offentligt

EUROPEAN
COMMISSION

Brussels, 7.7.2016
SWD(2016) 240 final

COMMISSION STAFF WORKING DOCUMENT

Analysis by the Commission services of the budgetary situation in Portugal following the adoption of the COUNCIL RECOMMENDATION to Portugal on 21 June 2013 with a view to bringing an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a COUNCIL DECISION

estalishing that no effective action has been taken by Portugal in response to the Council Recommendation of 21 June 2013

{COM(2016) 293 final}

COMMISSION STAFF WORKING DOCUMENT

Analysis of the budgetary situation in Portugal

following the adoption of the COUNCIL RECOMMENDATION to Portugal of 21 June 2013 with a view to bringing an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Portugal in response to the

Council Recommendation of 21 June 2013

1. INTRODUCTION

Portugal has been under the excessive deficit procedure since 2 December 2009. On 9 October 2012, the Council concluded that unexpected adverse economic events with major unfavourable consequences for government finances could be considered to have occurred in Portugal and adopted a revised recommendation to correct the excessive deficit by 2014 at the latest. On 21 June 2013, the Council decided, in accordance with Article 126(7) of the Treaty on the Functioning of the European Union (TFEU) that although effective action had been taken by the Portuguese authorities in response to the Council recommendation of 9 October 2012, unexpected adverse economic events with major unfavourable consequences for government finances could be considered to have occurred in Portugal[1]. Following a recommendation from the Commission, the Council therefore adopted a revised recommendation under Article 126(7) TFEU and set a 2015 deadline to correct the excessive deficit. Specifically, in order to bring the general government deficit below the Treaty reference value of 3% of GDP by 2015 in a credible and sustainable manner, Portugal was recommended to: (a) bring the headline deficit to 5.5% of GDP in 2013, 4.0% of GDP in 2014 and 2.5% of GDP in 2015, which was deemed consistent with an improvement in the structural balance of 0.6% of GDP in 2013, 1.4% of GDP in 2014 and 0.5% of GDP in 2015, based on the Commission May 2013 update of the economic outlook for Portugal; (b) implement measures amounting to 3.5% of GDP to confine the 2013 deficit to 5.5% of GDP, including the measures defined in the 2013 Budget Law and additional measures included in the Supplementary Budget, namely, reductions in the wage bill, increased efficiency in the functioning of public administration, lower public consumption and better use of EU funds; (c) building on the public expenditure review, adopt permanent consolidation measures worth at least 2.0% of GDP in view of attaining a headline deficit of 4.0% of GDP in 2014 and aim at streamlining and modernising the public administration, addressing redundancies across the public sector functions and entities, improving the sustainability of the pension system and achieving targeted cost savings in individual line ministries; (d) adopt the necessary permanent consolidation measures to achieve the 2015 deficit target of 2.5% of GDP. Furthermore, Portugal was recommended to maintain reform momentum in public financial management by revising the Budget Framework Law by the end of 2013 to further enhance budgetary procedures and principles of budgetary management, accountability, transparency and simplification, and to continue efforts to limit contingent liabilities stemming from state-owned enterprises (SOEs) and public-private partnerships (PPPs).

In its recommendation, the Council established a deadline of 1 October 2013 for effective action to be taken and, in accordance with Article 10(2)(a) of Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, to report in detail the consolidation strategy envisaged to achieve the targets set out in the recommendation.

---

[1] The excessive deficit procedure had been opened by the Council decision of 2 December 2009 in accordance with Article 126(6) TFEU that an excessive deficit existed in Portugal.

Portugal reported on its EDP obligations in the framework of its macroeconomic adjustment programme. In line with Article 10(2)(a) of Regulation (EU) No 472/2013, it was exempted from a separate reporting under the excessive deficit procedure until the end of the economic adjustment programme (June 2014). No additional step in the excessive deficit procedure was necessary at that stage and thereafter.

According to the budgetary data notified by Portugal and validated by Eurostat on 21 April 2016, the general government deficit reached 4.4% of GDP in 2015. As a result, Portugal did not correct its excessive deficit by the recommended 2015 deadline.

This document examines the budgetary developments in Portugal since 2013. In addition, based on the Commission 2016 spring forecast, this document provides the basis for an assessment of whether Portugal has taken effective action towards correcting its excessive deficit over the 2013-2015 period. Section 2 discusses recent macro-economic and budgetary developments, section 3 provides a detailed analysis of budgetary developments over 2013-2015, section 4 assesses effective action and section 5 provides conclusions.

2. RECENT MACRO-ECONOMIC DEVELOPMENTS

After a deep recession in the period from 2011 to 2013, the Portuguese economy has returned to modest positive growth since the last quarter of 2013. Portugal's real GDP declined by 1.1% y-o-y in 2013, and resumed to positive annual growth in 2014. Real GDP increased moderately by 0.9% y-o-y in 2014 and then accelerated to 1.5% y-o-y in 2015, mainly driven by robust domestic demand growth. Since 2013, net external demand contributed negatively to annual real GDP growth, but to a gradually diminishing extent. Conditions in the labour market have significantly improved since the second quarter of 2013**.** Total employment declined by 2.9% in 2013, due to substantial drops at the beginning of the year, and then grew strongly by 1.4 % y-o-y in both 2014 and 2015. Consequently, the unemployment rate progressively decreased to 14.1% in 2014 and 12.6% in 2015. The reduction in unemployment over the past years has been much stronger than what could have been expected on the basis of the historical relationship between unemployment and GDP. This suggests that specific factors have played a role, such as the adjustment in real wages, negative migration flows and the reinforcement of active labour market policies. HICP inflation increased to 0.4% in 2013 and then turned negative to -0.2% in 2014, reflecting a negative contribution from energy prices. Despite the continuation of feeble energy prices in 2015, the demand-driven economic recovery, tax-increasing fiscal measures and the weakening of the euro exerted upward pressures on consumer price inflation which stood at 0.5%.

Real GDP growth came in higher in 2013 and 2014 than projected in the macro-economic scenario underpinning the Council recommendation of 21 June 2013 (-1.1% vs. -2.3% in 2013 and 0.9% vs. 0.6% in 2014). The difference was mainly due to stronger than expected domestic demand contribution (-2.0 pps. vs. -4.2 pps. in 2013 and 1.8 pps. vs. 0.0 pps. in 2014) and more actual employment growth of 1.4% vs. -0.5% in 2014. Both economic activity and employment fell particularly strongly in the last quarter of 2012, leading to a projected negative carry-over effect which did not fully materialise. In addition, stronger domestic demand outturn was partly related to the successful active labour market policies which contributed to higher consumer confidence and private consumption growth.

According to the Commission 2016 spring forecast, the economic recovery is set to continue moderately in 2016 and real GDP is projected to grow by 1.5% y-o-y. Private consumption is expected to lose momentum due to higher indirect taxes and the slight recovery in energy price inflation. The strong rebound in durables consumption in the first half of 2015 is not forecast to be maintained as still high unemployment and high debt levels are projected to keep upward pressures on household savings. Most of the soft investment indicators point to a weaker investment performance in 2016 as well. Business investment already decelerated significantly over the second half of 2015 and is not expected to resume its buoyant growth soon despite the relatively high capacity utilisation rate. Exports are forecast to grow in line with foreign demand, but imports are still expected to outbalance exports over the forecast horizon. As a result, the contribution of net trade to GDP growth is forecast to remain slightly negative. Employment creation is set to slow down in 2016, thereby becoming more aligned with GDP growth. Therefore, the unemployment rate is estimated to decrease to 11.6%. HICP inflation is projected to increase only marginally to 0.7% in 2016, mainly driven by higher taxes.

The macroeconomic scenario underlying the 2016 Budget is more optimistic than the Commission 2016 spring forecast. The Commission expects a slower economic recovery than the Portuguese authorities (1.5% vs. 1.8% real GDP growth). The more pessimistic scenario is mainly related to the contribution of domestic demand to GDP growth (1.5 pps. in the spring forecast against 2.4 pps. in the 2016 Budget). The spring forecast projects investment to grow by 1.6% rather than 3.9% according to the 2016 Budget, mostly due to persistent deleveraging pressures, the feeble external environment and high volatility in the financial markets. The Commission is also less optimistic with respect to private consumption growth in 2016 (1.8% compared to 2.4%). The development of private consumption over 2016 is expected to broadly reflect trends in real household disposable income and a stabilisation of the historically-low household saving rate. The projections also differ on the nominal side of the economy, as the Commission estimates a significantly lower increase of the GDP deflator in 2016 (1.4% compared to 2.1% in the 2016 Budget). Nonetheless, the expectations with regard to labour market developments in 2016 are broadly in line in both projections.

Table 1 – Comparison of macroeconomic developments and forecasts

	2013		2014		2015	2016	
	Outturn	COM May 2013	Outturn	COM May 2013	Outturn	Budget 2016	COM SF2016
Real GDP (% change)	-1.1	-2.3	0.9	0.6	1.5	1.8	1.5
Contributions to real GDP growth (pps)							
Domestic demand	-2.0	-4.2	1.8	0.0	2.5	2.4	1.5
Changes in inventories	0.0	0.0	0.3	0.0	-0.1	0.0	0.0
Net exports	0.9	1.9	-1.2	0.6	-0.9	-0.6	-0.1
Employment (% change)	-2.9	-3.9	1.4	-0.5	1.4	0.8	0.9
GDP deflator (% change)	2.3	1.7	1.0	1.3	1.9	2.1	1.4
Output gap (% of potential GDP)	-5.1	-4.6	-3.8	-3.5	-2.3	-1.3	-1.1
Potential output growth (% change)	-1.0	-1.3	-0.5	-0.5	-0.1	0.6	0.3

Source: COM May 2013 – Commission services May 2013 update of the economic outlook for Portugal, underlying the Council recommendation of 21 June 2013.COM spring forecast 2016; Ministry of Finance Portugal Budget 2016; COM SWD(2013) 394 final

3. BUDGETARY IMPLEMENTATION OVER 2013-2015 AND OUTLOOK FOR 2016

This section provides a detailed yearly analysis of budgetary developments over 2013-2015. It notably discusses the main fiscal policy measures adopted on both the revenue and the expenditure sides. The last subsection addresses the budgetary outlook for 2016.

3.1. Budgetary implementation in 2013

The general government deficit in 2013 turned out at 4.8% of GDP, significantly below the target recommended by the Council. That overachievement was in spite of a deficit-increasing one-off measure amounting to 0.4% of GDP, which resulted from a capital injection into Banif. However, on the other hand, the 2013 budgetary deficit also integrates a large deficit-improving one-off measure concerning a tax and social contributions debt recovery scheme worth 0.7% of GDP, resulting in a deficit net of one-offs of 5.1% of GDP.

Overall, fiscal consolidation in 2013 mainly reflected strong tax revenue growth (notably of State tax revenue and social contributions), coupled with an effective expenditure control. The most significant contribution on the revenue side came from the personal income tax (PIT) structure review that was estimated to yield around 1.2% of GDP in additional tax revenue. Indirect taxes, notably VAT, also contributed strongly to higher State tax revenue. Other policy actions whose budgetary impact was not quantified ex-ante, such as reforms to tackle tax fraud and evasion, are supposed to have contributed significantly to that outcome. Thus, the yields of actions to fight tax fraud and evasion are likely to have underpinned improved tax collection, especially on the back of the e-invoicing reform successfully implemented as from 2013. The authorities estimate that the fight against tax fraud and evasion may have accounted for a deficit-decreasing impact of around 0.4% of GDP in 2013, with the caveats of limitations of empirical methods to accurately measure this effect.

On the expenditure side, a series of consolidation measures was taken in particular regarding compensation of employees (employment restraint), social transfers (extraordinary contribution on pensions), intermediate consumption (PPPs, health etc.) and investment to offset the reinstatement of the 13th and 14th monthly payments for public sector wages and pensions following a ruling by the Constitutional Court.

Table 2 – Composition of budgetary adjustment

	2013	2014	2015
	Outturn	**Outturn**	**Outturn**
	(% of GDP)	**(% of GDP)**	**(% of GDP)**
Revenue	**45,1**	**44,5**	**43,9**
of which:			
- Taxes on production and imports	13,7	14,2	14,5
- Current taxes on income, wealth, etc.	11,4	10,9	10,8
- Social contributions	12,0	11,7	11,5
- Other (residual)	8,0	7,7	6,9
Expenditure	**49,9**	**51,7**	**48,3**
of which:			
- Primary expenditure	45,1	46,8	43,7
of which:			
Compensation of employees	12,5	11,8	11,3
Intermediate consumption	5,6	5,8	5,9
Social payments	20,4	19,7	19,2
Subsidies	0,6	0,7	0,7
Gross fixed capital formation	2,2	2,0	2,2
Other (residual)	3,7	6,8	4,4
- Interest expenditure	4,9	4,9	4,6
General government balance (GGB)	**-4,8**	**-7,2**	**-4,4**
Primary balance	**0,0**	**-2,3**	**0,2**
One-off and other temporary measures	0,3	-3,8	-1,2
Structural balance	**-2,5**	**-1,4**	**-2,0**
Change in structural balance	*0,6*	*1,1*	-0,6
Real GDP growth	-1,1	0,9	1,5
GDP deflator	2,3	1,0	1,9
Nominal GDP growth	1,1	1,9	3,4

COM May 2013 – Commission services May 2013 update of the economic outlook for Portugal, underlying the Council recommendation of 21 June 2013.

Table 3 – Main structural fiscal policy measures over 2013-2015 (i.e. excluding one-offs)

Revenue	**Expenditure**
2013	
PIT structure review (+1.2 % of GDP) CIT base broadening (+0.1% of GDP) Larger use of EU funds (+0.2% of GDP)	Lower wage bill - employment restraint and remuneration (-0.4% of GDP) Reduction in other social benefits (-0.3% of GDP) Savings in intermediate consumption across line ministries (-0.2% of GDP) Savings in PPPs (-0.1% of GDP) Savings in health sector (-0.1% of GDP) Reinstatement of the 13th and 14th salary and pension (+1.5% of GDP) Extraordinary solidarity contribution on pensions (-0.3% of GDP)
2014	
Increased contributions to special health systems (+0.1% of GDP) Optimised use of EU social and employment funds (+0.1% of GDP) Increased taxation of company and diesel cars (+0.1% of GDP) Increased taxation of alcoholic beverages and tobacco (+0.1% of GDP) Extraordinary contribution from the energy sector (+0.1 % of GDP)	Savings in intermediate consumption based on public expenditure review (PER) (-0.2% of GDP) Savings in compensation of employees in line ministries (PER) (-0.1% of GDP) Changes to the sustainability factor / Increase in retirement age (-0.1% of GDP) Lower other current expenditure (PER) (-0.1% of GDP) Lower social benefits (PER) (-0.1% of GDP) Lower investments (PER) (-0.2% of GDP) Lower other current expendiure in line ministries (-0.1% of GDP)
2015	
Modification of motorway levy (+0.1% of GDP) Other revenue measures (excise duties etc.) (+0.1% of GDP)	Extinction of extraordinary contribution on pensions (3.5%-10%) (+0.3% of GDP) Reversal of 20% of temporary public sector wage cuts (+0.1% of GDP) Public employment reduction (attrition) (-0.1% of GDP) Other measures related to personnel costs (-0.1% of GDP) Savings in pharmaceuticals spending (-0.1% of GDP) Savings in ICT costs (-0.1% of GDP) Savings in studies/consultancy etc. (-0.1% of GDP) Other measures related to intermediate consumption (-0.1% of GDP) Reduction of subsidies (-0.1% of GDP)
Note: A positive sign implies that revenue / expenditure increases as a consequence of this measure. Annual budgetary impacts are estimated by the Commission services. Measures with a budget impact of at least 0.1% of GDP are listed.	

3.2. Budgetary developments in 2014

The general government deficit reached 7.2% of GDP in 2014, thus falling considerably short of the target of 4.0% of GDP recommended by the Council. The negative deviation was, however, mostly the result of the capitalisation of Novo Banco by the Portuguese Resolution Fund, a one-off financial sector support operation accounting for 2.8% of GDP. Further major deficit-increasing one-off measures concerned the recapitalisation of Carris and STCP (worth 0.7% of GDP) and a write-off of a loan to BPN Crédito (0.1% of GDP). Without the impact of those one-off measures, the deficit target would have been overachieved in 2014.

However, the consolidation effort in structural terms slackened after the end of the economic adjustment programme. Following the end of the programme and successive Constitutional Court rulings on several 2014 Budget measures and 2015 budgetary plans, the government changed its budgetary strategy. Of the expenditure measures ruled unconstitutional, an amount of 0.3% of GDP in measures was not compensated for in 2014. Instead, the second Supplementary Budget 2014, that entered into force in October 2014, planned to compensate the remaining fiscal gap resulting from the Constitutional Court rulings and from higher pressures on various expenditure items by the expected higher fiscal impact of macroeconomic revisions, the upward revision of tax collection resulting from a more efficient fight against tax fraud and the use of budgetary reserves.

Thus, the fiscal adjustment was progressively reduced after the programme exit, with less effort on durable expenditure compression but, instead, relying on enhanced revenue performance stemming from the economic recovery. Furthermore, increased revenue from the fight against tax fraud and evasion (estimated by the authorities at 0.4% of GDP) was used to support higher public expenditure, rather than to make further progress in reducing both deficit and debt.

Finally, the amount of fiscal policy measures underpinning the budgetary targets for 2014 was significantly reduced over time from 2.3% of GDP planned at the time of the 2014 Budget to about 1.5% of GDP in the projection underlying the 2015 Budget. Thus, the amount of measures taken falls clearly short of the recommendation to take at least 2.0% of additional measures in 2014.

3.3. Budgetary developments in 2015

The general government deficit in 2015 as notified by Portugal and validated by Eurostat on 21 April 2016 reached 4.4% of GDP, considerably above the Treaty reference value of 3 % of GDP and above the target of 2.5% of GDP set by the Council in its Recommendation of 21 June 2013. The deficit-increasing one-off fiscal impact of the Banif resolution operation amounted to 1.4% of GDP. However, excluding also all other deficit-reducing one-off operations the deficit would still have been above the Treaty reference value. Since the deficit reduction (excluding the impact of one-offs) was based on cyclical factors rather than on additional structural measures, the structural balance is estimated to have deteriorated by about 0.6% of GDP in 2015.

Thus, the impact of structural measures foreseen in the 2015 Budget was considerably reduced to around 0.6% of GDP in structural measures. In particular, the budgetary impacts stemming from a series of low-yielding measures – notably, to reduce intermediate consumption and personnel costs, as well as increase some narrow-based indirect taxes – was somewhat offset by the effect of the partial extinction of the extraordinary solidarity contribution on pensions and the reversal of 20% of the temporary public sector wage cuts.

In national accounts, leaving aside the budgetary impact of the Banif resolution amounting to 1.4% of GDP, the 2015 Budget's own target of 2.7% of GDP was missed by 0.3% of GDP. While overall revenue fell short of the 2015 Budget's target by 1.0% of GDP (-0.3% of GDP for tax revenue and -0.7% for non-tax revenue) that shortfall was mostly offset by lower interest payments (-0.4% of GDP) and lower public investment (-0.4% of GDP). Slippages in compensation of employees and intermediate consumption were mostly covered by budgetary contingency reserves.

3.4. Projected budgetary developments in 2016

Taking into account an assessment of the fiscal policy measures specified in the 2016 Budget that entered into force on 31 March, the Commission 2016 spring forecast projects the general government deficit to fall to 2.7% of GDP in 2016. The structural balance is expected to slightly deteriorate further by about 0.25% of GDP in 2016.

The 2016 Budget itself targets a general government deficit of 2.2% of GDP and an improvement of the structural balance by 0.3% of GDP. The 2016 Budget intends to more than compensate revenue-decreasing measures of around 0.3% of GDP (notably the partial reversal of the PIT surcharge and the reduction of the VAT rate for restaurants) through revenue-increasing measures of around 0.5% of GDP, of which about two thirds relate to increases in indirect taxes (on petroleum products, tobacco, vehicles and the stamp duty), complemented by a series of smaller measures concerning direct taxes and enhanced compliance in both tax collection and Social Security. Expenditure-increasing measures amounting to 0.4% of GDP (mostly the gradual reversal of the public sector wage cuts, increases in a series of social benefits and the unfreezing of pension indexation) are planned to be more than compensated by expenditure-decreasing measures of close to 0.5% of GDP (most of which relate to the nominal freeze of intermediate consumption (except for PPPs), efficiency gains in other current expenditure, expenditure control in social transfers and a new civil servants rotation policy (2:1 replacement rule)). The tax revenue in the 2016 Budget is however also affected by negative carry-over effects of tax measures of previous years amounting to around 0.25% of GDP.

The Commission 2016 spring forecast incorporates more conservative yield estimates for some of the 2016 Budget measures, in particular as regards the nominal freeze of intermediate consumption and other current expenditure. The Commission forecast's less optimistic macroeconomic scenario also leads to lower projected revenue from taxes and social contributions, as well as higher social transfers.

The general government gross debt-to-GDP ratio that had increased from 68% in 2007 to 126.2% in 2012 has broadly stabilised thereafter, reaching 129.2% in 2013, 130.2% in 2014 and 129.0% in 2015. Taking into account the planned sales of financial assets in 2016, including Novo Banco, and continued primary surpluses, the Commission spring forecast projects the debt ratio to decrease to 126% at the end of 2016 and 124.5% at the end of 2017.

3.5. Progress in fiscal structural reforms

Fiscal-structural reforms have progressed in most areas albeit at differentiated pace. The Budget Framework Law was revised and strengthened but it is set to fully enter into force only in September 2018. Considerable efforts have been made to curb tax fraud and evasion and to reform the tax administration. Despite the progress made, there is still scope for strengthening tax compliance and enhancing the efficiency of the tax administration. The long-term sustainability of the pension system has been improved in recent years. At the same time, the proposal to undertake a comprehensive pension reform to address the system's short- to medium-term sustainability challenges announced in the 2015 Stability Programme has not been initiated.

Reform in the health care system with a view to ensure the sustainability of the National Health Service (NHS) is progressing at an adequate pace even if arrears in state-owned hospitals remain elevated. Public administration reforms to improve fiscal management at regional and local levels have been implemented over the past years.

The management framework of public-private partnerships (PPPs) has been substantially strengthened and the renegotiations of several PPPs were formally concluded in 2015. The operating balance of state-owned enterprises (SOEs) has improved considerably since 2011, although measures taken at the end of 2015 in the transport sector may entail fiscal risks.

4. EFFECTIVE ACTION in 2013-2015

4.1. Background information

The current assessment of effective action is based on the data notified by the Portuguese authorities in March 2016 and validated by Eurostat in April, and the Commission 2016 spring forecast. It takes into account the economic and budgetary developments since the Council recommendation of 21 June 2013. The methodology for assessing effective action is the one endorsed by the Council in June 2014. The assessment starts by comparing the headline deficit target and the recommended improvement in the structural balance in the Council recommendation with the headline deficit and the apparent fiscal effort, measured by the change in the structural budget balance. If the headline deficit and/or the required improvement in the structural balance are not achieved, a careful analysis is carried out. In the present case, that analysis is only based on the "top-down" approach, i.e. the adjusted change in the structural balance, as the Council recommendation issued during the economic adjustment programme only set targets for 2013 and 2014 that corresponded to full programme measures as opposed to the standard additional measures approach and did not fix any quantified target in terms of additional measures for 2015 necessary to reach the headline deficit target. A bottom-up assessment of the consolidation measures undertaken by the Portuguese authorities over the 2013-2015 period is therefore not feasible.

The adjusted change in the structural balance takes into account (i) the impact of revisions in potential output growth, and (ii) the impact of revenue windfalls/shortfalls compared to the baseline scenario underpinning the Council recommendation.

4.2. Headline targets and adjustment in the structural balance

The general government deficit remained above the recommended level both in 2014 and 2015, as well as above the Treaty reference value of 3% of GDP. In its recommendation of 21 June 2013, the Council recommended Portugal to achieve headline deficit targets of 5.5 % of GDP in 2013, 4.0 % in 2014 and 2.5% in 2015. While the target was overachieved in 2013, when the general government deficit reached 4.8% of GDP, the 2014 headline deficit of 7.2% of GDP and the 2015 headline deficit of 4.4% of GDP exceeded the EDP targets by 3.2% and 1.9% of GDP respectively. As the 2015 headline deficit of 4.4% of GDP also remained above the Treaty reference value, the excessive deficit has not been corrected by the recommended 2015 deadline.

Table 4: Comparison between recommended targets and outturn for headline balance and change of structural balance

	Headline balance			Change in the structural balance			
% of GDP	2013	2014	2015	2013	2014	2015	Cumulative 2013-2015
EDP targets	-5,5	-4,0	-2,5	0,6	1,4	0,5	2,5
Outturn	-4,8	-7,2	-4,4	0,5	1,1	-0,6	1,1
Deviation	0,7	-3,2	-1,9	-0,1	-0,3	-1,1	-1,4

In its recommendation of 21 June 2013, the Council recommended Portugal to improve its structural balance by 0.6% of GDP in 2013, 1.4% in 2014 and 0.5% in 2015. Based on the Commission 2016 spring forecast, the structural deficit fell from 3.1% of GDP in 2012 to 2.5% in 2013 and further decreased to 1.4% in 2014 but then increased to 2.0% in 2015. This implies an annual fiscal effort of 0.5% of GDP in 2013, 1.1% in 2014 and -0.6% in 2015, below the targets for each year. Thus, the structural balance over 2013-2015 only improved by 1.1% of GDP in cumulative terms, 1.4 pps. below the recommended 2.5% of GDP .

Altogether, the fact that both the headline targets in 2014 and 2015 and the structural deficit targets in all three years have been missed warrants a careful analysis.

4.3. Careful analysis

The correction for revisions in potential growth since June 2013 have a marginal impact on the estimated improvement in the structural balance from 2013 to 2015. At the time of the Council recommendation of 21 June 2013, potential output growth was estimated to stand at -1.3% in 2013, -0.5% in 2014 and -0.1% in 2015. Based on its 2016 spring forecast, the Commission estimates that potential growth reached -1.0 % in 2013, -0.5% in 2014 and -0.1% in 2015. Correcting for that development has only a minor impact in 2013, reducing the change in the structural balance by 0.1% of GDP as compared to the unadjusted structural balance.

Compared to the baseline, the 2016 spring forecast shows revenue windfalls of 1.1% of GDP in 2013 and 0.6% of GDP in 2014 followed by a revenue shortfall of 0.6% of GDP in 2015.

In 2013 and 2014 revenue developments, net of discretionary measures, evolved significantly more favourably than implied by standard elasticities. By comparison to the baseline scenario, the correction for revenue windfalls therefore leads to a significant decrease in current revenues both in 2013 and 2014 and thus to a corresponding significantly lower adjusted change in the structural balance as compared to the unadjusted change in the structural balance. In 2015, however, revenues fell short of what would be implied by standard elasticities, leading to a small improvement by 0.1% of GDP in the adjusted change in the structural balance, but still falling short by 0.4% of GDP from the recommended improvement. Owing to the strong windfalls in 2013 and 2014, the adjusted change of the structural balance reaches -0.1% of GDP in cumulative terms, thus falling short by 2.6% of GDP from the Council recommendation of an improvement of the structural balance by 2.5% of GDP.

At the same time, the overall picture reflected by the structural effort indicator is negatively affected by: (i) the changeover to ESA2010, in particular by the reclassification of some institutional units inside general government, as well as other methodological revisions regarding potential GDP growth and cyclical adjustment calculations (the estimated total impact on the cumulative structural effort amounts to about -0.8% of GDP over 2013-2015, mostly arising in 2013), and (ii) the fact that estimated yields from fight against tax fraud and evasion were not recorded as discretionary fiscal measures. However, even if both factors were fully considered[2], the adjusted change in the structural balance would still fall short by around 1 pp. of GDP from the recommended cumulative target of 2.5% of GDP.

Table 5 – Adjusted change in the structural balance (top-down)

	Adjusted change in the structural balance			
% of GDP	2013	2014	2015	Cumulative 2013-2015
EDP targets	0,6	1,4	0,5	2,5
Outturn	-0,7	0,5	0,1	-0,1
Deviation	-1,3	-0,9	-0,4	-2,6

While the fiscal adjustment was deemed on track with the commitments under the economic adjustment programme until April 2014, Portugal has not delivered the recommended fiscal effort thereafter.

5. CONCLUSIONS

Following the notification of the 2015 general government deficit and its validation by Eurostat, the 2015 deficit came out at 4.4% of GDP. Hence, Portugal did not correct its excessive deficit by the deadline recommended by the Council in June 2013 The headline deficit included the deficit-increasing one-off impact of 1.4% of GDP stemming from the financial sector support measure in the context of the Banif resolution at the end of 2015. Taking into account also the deficit-reducing one-off measures, the headline deficit net of one-offs would still have been above the Treaty reference value.

[2] Assuming e.g. the Portuguese authorities' own ex-post estimates of the yields of the fight against tax fraud and evasion of around 0.4% of GDP both in 2013 and 2014. For 2015 no estimates have been published yet but the yields are expected to be lower than in the two preceding years.

The cumulative fiscal effort over 2013-2015 is estimated at 1.1% of GDP, significantly below the 2.5% of GDP recommended by the Council. After correction for the effects of revised potential output growth and revenue windfalls/shortfalls, the adjusted cumulative fiscal effort is estimated at -0.1% of GDP, thus further below the 2.5% recommended structural effort.

Overall, since June 2014 the improvement of the headline deficit has been driven by the economic recovery and reduced interest expenditure in a low-interest rate environment. Windfall gains were not used to accelerate the deficit reduction and the volume of structural consolidation measures was not sufficient to reach the targets.

ANNEX – STANDARD TABLES

Table 1 – Adjustment of apparent structural effort for the revision in potential growth - details of calculations

	Potential GDP growth underlying the Council Recommendation (%)	Potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient α (% of nominal potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2013	-1,3	-1,0	-0,3	45,6	-0,1
2014	-0,5	-0,5	-0,1	46,8	0,0
2015	-0,1	-0,1	0,1	45,9	0,0

Table 2 – Adjustment of apparent structural effort for the expected revenue windfalls/shortfalls - details of calculations

	Change in current revenues (yoy) (billions of national currency)		Discretionary current revenue measures (billions of national currency)		Nominal GDP growth assumptions (%)		Current revenues in year t-1 (billions of national currency)		Revenue gap (billion of national currency)*	Correction coefficient β (% of nominal potential GDP)
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)=[(1')-(2')-ε*(3')*(4')]-[(1)-(2)-ε*(3)*(4)]	
2013	2,5	5,6	4,9	5,0	-0,6	1,1	65,6	69,2	1,8	1,1
2014	0,9	0,9	0,8	-0,3	1,8	1,9	68,1	74,8	1,0	0,6
2015	1,0	1,6	0,0	0,8	2,7	3,4	69,0	75,8	-1,1	-0,6