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Recommendation for a

COUNCIL RECOMMENDATION

on the 2020 National Reform Programme of Portugal and delivering a Council opinion on the 2020 Stability Programme of Portugal

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

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(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 17 December 2019, the Commission adopted the Annual Sustainable Growth Strategy, marking the start of the 2020 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. On 17 December 2019, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Portugal as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area.

(2) The 2020 country report for Portugal[3] was published on 26 February 2020. It assessed Portugal's progress in addressing the country-specific recommendations adopted by

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] SWD(2020) 521 final.

the Council on 9 July 2019[4], the follow-up given to the recommendations adopted in previous years and Portugal's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 26 February 2020. The Commission's analysis led it to conclude that Portugal is experiencing macroeconomic imbalances. In particular, the large stocks of net external liabilities, private and public debt, and a high share of non-performing loans (NPL) constitute vulnerabilities in a context of low productivity growth.

(3) On 11 March 2020, the World Health Organization officially declared the COVID-19 outbreak a global pandemic. It is a severe public health emergency for citizens, societies and economies. It is putting national health systems under severe strain, disrupting global supply chains, causing volatility in financial markets, triggering consumer demand shocks and having negative effects across various sectors. It is threatening people's jobs, their incomes and companies' business. It has delivered a major economic shock that is already having serious repercussions in the European Union. On 13 March 2020, the Commission adopted a Communication[5] calling for a coordinated economic response to the crisis, involving all actors at national and Union level.

(4) Several Member States have declared a state of emergency or introduced emergency measures. Any emergency measures should be strictly proportionate, necessary, limited in time, and in line with European and international standards. They should be subject to democratic oversight and independent judicial review.

(5) On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact[6]. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. 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.

(6) Continued action is required to limit and control the spread of the pandemic, strengthen the resilience of the national health systems, mitigate the socio-economic consequences through supportive measures for business and households and to ensure adequate health and safety conditions at the workplace with a view to resuming economic activity. The Union should fully use the various tools at its disposal to support Member States' efforts in those areas. In parallel, Member States and the

[4] OJ C 301, 5.9.2019, p. 117.
[5] COM(2020) 112 final.
[6] COM(2020) 123 final.

Union should work together to prepare the measures necessary to get back to a normal functioning of our societies and economies and to sustainable growth, integrating inter alia the green transition and the digital transformation, and drawing all lessons from the crisis.

(7) The COVID-19 crisis has highlighted the flexibility that the single market offers to adapt to extraordinary situations. However, in order to ensure a swift and smooth transition to the recovery phase and the free movement of goods, services and workers, exceptional measures that prevent the single market from functioning normally must be removed as soon as they are no longer indispensable. The current crisis has shown the need for crisis preparedness plans in the health sector, which include in particular improved purchasing strategies, diversified supply chains and strategic reserves of essential supplies. They are key elements for developing broader crisis preparedness plans.

(8) The Union legislator has already amended the relevant legislative frameworks[7] to allow Member States to mobilise all unused resources from the European Structural and Investment Funds so they can address the exceptional effects of the COVID-19 pandemic. Those amendments will provide additional flexibility, as well as simplified and streamlined procedures. To alleviate cash flow pressures, Member States can also benefit from a 100% co-financing rate from the Union budget in the 2020-2021 accounting year. Portugal is encouraged to make full use of those possibilities to help the individuals and sectors most affected by the challenges.

(9) The socio-economic consequences of the pandemic are likely to be unevenly distributed across Portuguese regions due to different specialisation patterns, in particular in regions markedly relying on tourism, such as Algarve and the outermost regions of Madeira and the Azores. This entails a substantial risk of widening regional and territorial disparities within Portugal. Combined with the risk of a temporary unravelling of the convergence process between Member States, the current situation calls for targeted policy responses.

(10) On 16 May 2020, Portugal submitted its 2020 National Reform Programme and its 2020 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(11) Portugal is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. On 13 July 2018, the Council recommended Portugal to ensure that the nominal growth rate of net primary government expenditure[8] does not exceed 0,7% in 2019, corresponding to an annual structural adjustment of 0,6% of GDP. The

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[7] Regulation (EU) 2020/460 of the European Parliament and of the Council of 30 March 2020 amending Regulations (EU) No 1301/2013, (EU) No 1303/2013 and (EU) No 508/2014 as regards specific measures to mobilise investments in the healthcare systems of Member States and in other sectors of their economies in response to the COVID-19 outbreak (Coronavirus Response Investment Initiative) (OJ L 99, 31.3.2020, p. 5) and Regulation (EU) 2020/558 of the European Parliament and of the Council of 23 April 2020 amending Regulations (EU) No 1301/2013 and (EU) No 1303/2013 as regards specific measures to provide exceptional flexibility for the use of the European Structural and Investments Funds in response to the COVID-19 outbreak (OJ L 130, 24.4.2020, p. 1).

[8] Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

Commission's overall assessment confirms a significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019, and over 2018 and 2019 taken together. However, in light of the activation of the general escape clause, further steps under the significant deviation procedure for Portugal are not warranted.

(12) In its 2020 Stability Programme, the government did not include a macroeconomic scenario and plans for the general government balance and debt-to-GDP ratio for at least 2020. The 2020 Stability Programme estimates, however, that every 30 working days – i.e. around 1,5 full months – of confinement may, on average, trigger a negative impact on annual GDP of 6,5 percentage points. The macroeconomic and fiscal outlook is affected by high uncertainty due to the COVID-19 pandemic. There are country-specific risks underlying the budgetary projections, linked to the surge in public contingent liabilities stemming from some public corporations and the COVID-19-related measures targeting the private sector. This is on top of non-negligible pre-existing levels, partly related to potential further budgetary impacts of additional bank support measures.

(13) In response to the COVID-19 pandemic, and as part of a coordinated Union approach, Portugal has adopted budgetary measures to increase the capacity of its health system, contain the pandemic, and provide relief to those individuals and sectors that have been particularly affected. The 2020 Stability Programme reports estimates for the budgetary impacts of those measures on a either monthly or annual basis, without providing a projected annual aggregate figure for 2020. The measures include, among others, a one-time special support for firms for the resumption of business activity (EUR 508,0 million or 0,3% of GDP), a simplified scheme for the temporary interruption of work ("lay-off", EUR 373,3 million or 0,2% of GDP per month of application), and the purchase of personal protective equipment by the health system (0,1% of GDP per month of application).[9] The Commission estimates that an overall direct budgetary cost of around 2,5% of GDP may result from those measures in 2020. In addition, Portugal has announced measures that, while not having as a rule a direct budgetary impact, will contribute to support liquidity to businesses and households, which the 2020 Stability Programme estimates at close to EUR 25,2 billion or 12,5% of GDP. Those measures include tax deferrals for value-added, personal and corporate income taxes, as well as social contributions (EUR 7,9 billion or 3,9% of GDP) and also State guaranteed credit lines and other similar initiatives (EUR 4,0 billion or 2,0% of GDP). Overall, the measures taken by Portugal are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium-term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term.

(14) Based on the Commission 2020 spring forecast under unchanged policies, Portugal's general government deficit is forecast at 6,5% of GDP in 2020 and 1,8% in 2021. The general government debt-to-GDP ratio is projected to peak at 131,6% in 2020, before decreasing to 124,4% in 2021.

[9] The budgetary impacts are expressed as a percentage of GDP in 2020 according to the Commission 2020 spring forecast.

(15) On 20 May 2020, the Commission issued a report prepared in accordance with Article 126(3) of the Treaty for Portugal due to the projected breach of the 3% of GDP deficit threshold in 2020. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

(16) The COVID-19 pandemic hit Portugal in early March 2020, putting its health system under great pressure. The government swiftly implemented a broad range of strict containment measures, having enacted a constitutional state of emergency between 18 March 2020 and 2 May 2020 to limit as much as possible the spread of the disease and the loss of lives. Portugal took measures to strengthen the response capacity of the health system and to flatten the curve of infections, so as not to overwhelm hospitals. The national and global containment measures have severely curtailed economic activity in most sectors, hitting tourism and related activities particularly hard, and clouded the social and economic outlook in Portugal, particularly its micro, small and medium-sized enterprises (SMEs). The economy is projected to contract by 6,8% in 2020 and to rebound by 5,8% in 2021.

(17) To mitigate the immediate impact of the COVID-19 pandemic on people's health, high expenditure for the health system is being incurred on a broad front. Investments are needed to improve the resilience of the health system, securing equipment, products and infrastructure necessary to bolster crisis response capacities, including intensive care, testing, technological and applied medical research, and universal access, including outside urban areas and in the outermost regions of Madeira and the Azores. At the outset of the COVID-19 outbreak, a plan to introduce a new governance model for public hospitals was gradually under way, with substantial increases in annual budgets. Its steady implementation in the current juncture could help to strengthen the resilience of the health system. COVID-19 has demonstrated the fragility of long-term care facilities in Portugal, which have seen higher rates of infection and lethality. Despite improvements in the territorial coverage of long-term care in the last decade, overall access rates are low in all regions of the country. At the same time, before the COVID-19 outbreak, long-term healthcare expenditure was forecast to have one of the largest increases in the Union as percentage share of GDP. Continued efforts to improve efficiency and capacity of health and long-term care are necessary to deal with the current crisis as well as to address ageing-related challenges.

(18) Following sustained positive labour market developments since 2014, Portugal will now face extraordinary employment challenges as a result of the pandemic. According to the Commission forecast, unemployment is expected to rise to 9,7% of the active population in 2020 and recover to 7,4% in 2021, up from 6,5% in 2019. To support employment and mitigate the risk of job losses, Portugal has simplified and adapted the use of its existing scheme for the temporary interruption of work. Targeted use of Union's and national programmes could preserve jobs and economic activity, notably among small and medium-sized enterprises (SMEs). In the recovery phase, personalised and targeted active labour market policies, in particular upskilling and reskilling, will play a decisive role in keeping the workforce job-ready. Cooperation among employers, education and training institutions, and public employment services will be crucial to generating a recruitment surge.

(19) The outbreak of COVID-19 requires measures to mitigate social impacts and protect people in vulnerable situations, so that inequalities are not exacerbated. These include unemployment benefit schemes and income support for the most affected workers, including self-employed and nonstandard workers, access to services and measures

fostering reintegration in the labour market. The implementation of a national social contingency plan in cooperation with social partners and civil society could contribute to an immediate and coordinated response to mitigate the social consequences of the crisis. Policy changes to reverse the decline in the effectiveness of social transfers in recent years, e.g. increases in the minimum income, the solidarity supplement for the elderly, pensions and family benefits have had a positive effect on income distribution. Nevertheless, social transfers (excluding pensions) reduced the proportion of population at risk of poverty by only 23,8% in Portugal in 2018, significantly below the EU average of 34%. In addition, the adequacy of the minimum income scheme is among the lowest in the Union, providing incomes of only 40% of the national poverty threshold.

(20) The COVID-19 pandemic poses significant demands on the use of digital technologies to ensure the continued access to education and business activity, against the background of the necessary adoption of social distancing measures. Portuguese schools and training centres have closed and traditional, in-person learning has been disrupted. Around 6% of households still have no access to the internet, affecting an estimated 50,000 pupils, and internet access and telecommunications network coverage vary widely between urban and rural areas. Students from socio-economically advantaged families are better placed to manage the challenges posed by distance learning. In addition, Portugal has a large digital skills deficit. In 2019, 48% of the population lacked basic digital skills, including about 26% with no digital skills at all and the proportion of those having never used the internet is twice the EU average. Current circumstances call for intensive implementation of e-training courses and efforts to help people suffering from digital exclusion to overcome the obstacles in accessing distance learning. The adoption of digital technologies by businesses to offer alternative working arrangements and digital services would allow business continuity to firms whose services can be provided online, hence mitigating the impact of the restrictions in some sectors. This is particularly relevant in Portugal whose economy is mostly characterized by micro-enterprises concentrated in traditional sectors. One of the main factors hindering the digitalisation of SMEs is the digital knowledge gap, which originates by overall low levels of digital literacy among managers and employees.

(21) To prevent avoidable bankruptcies and allow firms to survive the shock and remain competitive, Portugal adopted a set of measures aimed at supporting viable firms, and in particular SMEs, which have been affected by the imposition of the social distancing measures, implying restrictions to operations and a drop in domestic and global demand. These measures focus on provision of the liquidity support, including through guarantees funded by the state and financial institutions, direct subsidies, tax deferrals and reduction of social contributions. They focus in particular on the hardest hit sectors, including tourism, hospitality, and related economic activities, as well as manufacturing and exporting companies. It is important that such measures are timely and efficiently implemented by the public institutions and private intermediaries. In this context, the Portuguese government streamlined the process to access the credit lines, namely the documentation to be presented by firms. In the process of designing and implementing these measures, the resilience of the banking sector needs to be taken into account. Additional policy action aims at supporting entrepreneurship and the self-employed.

(22) To foster the economic recovery, it will be important to front-load mature public investment projects and promote private investment, including through relevant

reforms. Growth enhancing investments to support research and innovation, digitalisation, connectivity and green transition will contribute to the recovery of the Portuguese economy and redirect it towards long-term sustainable growth. Investments in transport infrastructure could address the peripheral situation of Portugal, in particular by closing railway connection gaps with Spain and by allowing the exploitation of the underused potential of Portuguese ports. Portugal's National Energy and Climate Plan reports important investment needs to tackle the climate and energy transition. There is still a wide margin to improve energy efficiency in buildings and reduce energy consumption in business. Better energy connectivity of the Iberian Peninsula could enable more competition and facilitate the deployment of renewable energy. Investment can also support anticipating the adverse effects of climate change, such as floods and forest fires, as well as improving water and waste management and developing the potential of the circular economy. The programming of the Just Transition Fund for the period 2021-2027 could help Portugal to address some of the challenges posed by the transition to a climate neutral economy, in particular in the territories covered by Annex D to the country report[10]. This would allow Portugal to make the best use of that fund.

(23) The Portuguese justice system has become more efficient in recent years, thanks to a number of measures that continue to be implemented. However, the pandemic and resulting recession may lead to an increase in litigation that could exacerbate remaining bottlenecks, in particular the lengthy proceedings and high case backlogs in administrative and tax courts. Increased efficiency and resilience of the justice system could improve business environment, particularly benefiting domestic SMEs and investors.

(24) While the present recommendations focus on tackling the socio-economic impacts of the pandemic and facilitating the economic recovery, the 2019 country-specific recommendations adopted by the Council on 9 July 2019 also covered reforms that are essential to address medium- to long-term structural challenges. Those recommendations remain pertinent and will continue to be monitored throughout next year's European Semester annual cycle. That also applies to recommendations regarding investment-related economic policies. The latter recommendations should be taken into account for the strategic programming of cohesion policy funding post-2020, including for mitigating measures and exit strategies with regard to the current crisis.

(25) Past years witnessed several aggregate improvements in the Portuguese banking system. Profitability metrics improved on the back of efforts to increase the sector's efficiency and the reduction of provisions and impairments. Given the improved profitability, the banking system proceeded on its path to strengthen capital ratios. Yet, own funds levels are still below EU average. The ratio of NPLs continued its multiyear downward trend but remains double the EU ratio. Income generation capacity remains a challenge amidst low interest rates and in an economy with a still high indebtedness level. More recently, the weakening economy, the COVID-19 crisis and the low interest rate environment will create challenges for the banking sector and will be reflected in the credit quality of loans granted. Furthermore, Portuguese banks remain exposed to some geographies highly dependent to commodity price developments, namely oil. The exposure to these geographies is sensitive to market

[10] SWD(2020) 251 final.

risk, foreign exchange and credit risk, and may impact the credit quality of loans granted to firms exposed to these geographies.

(26) Lengthy insolvency proceedings have been identified as one of the key factors preventing banks from dealing promptly with the existing stock of NPLs. They also have a substantial influence on the pricing of these assets on the secondary market, as the outcomes, measured as payments to creditors, are insufficient. The breakdown of NPLs continues to show a consistently high proportion of corporate loans (about two thirds), which are least amenable to a swift, standardised approach. In recent years, several amendments have been made to both insolvency and the civil enforcement proceedings. Further adjustments, in particular targeting unjustified delay, would help for both creditors and borrowers, with the latter benefiting from a fresh start.

(27) The European Semester provides the framework for continuous economic and employment policy coordination in the Union, which can contribute to a sustainable economy. Member States have taken stock of progress regarding United Nations' Sustainable Development Goals (SDGs) implementation in their 2020 National Reform Programmes. By ensuring the full implementation of the recommendations below, Portugal will contribute to the progress towards the SDGs and to the common effort of ensuring competitive sustainability in the Union.

(28) Close coordination between economies in the economic and monetary union is key to achieve a swift recovery from the economic impact of the COVID-19. Portugal should, as a Member State whose currency is the euro – and taking into account political guidance by the Eurogroup – ensure its policies remain consistent with the euro area recommendations and coordinated with those of the other euro area Member States.

(29) In the context of the 2020 European Semester, the Commission has carried out a comprehensive analysis of Portugal's economic policy and published it in the 2020 country report. It has also assessed the 2020 Stability Programme and the 2020 National Reform Programme and the follow-up given to the recommendations addressed to Portugal in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Portugal, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(30) In the light of that assessment, the Council has examined the 2020 Stability Programme and its opinion[11] is reflected in particular in recommendation (1) below.

(31) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2020 National Reform Programme and the 2020 Stability Programme. The present recommendations take into account the need to tackle the pandemic and facilitate the economic recovery as a first necessary step to permit an adjustment of imbalances. Recommendations directly addressing the macroeconomic imbalances identified by the Commission under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1), (2), (3) and (4),

HEREBY RECOMMENDS that Portugal take action in 2020 and 2021 to:

1. In line with the general escape clause, take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery. When

[11] Under Article 5(2) of Council Regulation (EC) No 1466/97.

economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. Strengthen the resilience of the health system and ensure equal access to quality health and long-term care.

2. Support employment and prioritise measures to preserve jobs. Guarantee sufficient and effective social protection and income support. Support the use of digital technologies to ensure equal access to quality education and training and to boost firms' competitiveness.

3. Implement the temporary measures aimed at securing access to liquidity for firms, in particular small and medium-sized enterprises. Front-load mature public investment projects and promote private investment to foster the economic recovery. Focus investment on the green and digital transition, in particular on clean and efficient production and use of energy, rail infrastructure and innovation.

4. Increase the efficiency of administrative and tax courts.

Done at Brussels,

For the Council
The President