On the basis of current policies, the Council considers that public finances in Luxembourg are in a good position to meet the projected costs of an ageing population. However, the Council notes that the assessment of the sustainability of public finances in Luxembourg is very sensitive to developments as regards the number of cross-border workers. The Council considers that the commitment to sustain a balanced budget position in coming years is broadly appropriate in light of the projected budgetary impact of ageing populations, and welcomes measures to improve the attractiveness of third pillar private pensions.

COUNCIL OPINION

of 7 March 2003

on the updated Stability programme for Portugal, 2003 to 2006

(2003/C 64/02)

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 by the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 7 March 2003 the Council examined the updated stability programme for Portugal, which covers the period 2003 to 2006. The updated programme projects general government finances to improve steadily, from a deficit of 2,8 % of GDP in 2002 to a deficit of 0,5 % of GDP in 2006. Government gross debt is expected to decrease from 58,8 % of GDP in 2002 to 52,7 % in 2006.

The Council notes that the updated programme broadly complies with the requirements of the revised 'code of conduct on the content and format of stability and converge programmes'. The updated programme was adopted by the government on 20 December and presented to parliament, which discussed it and adopted early in January a declaration of approval by a large majority, including the support of the main opposition party. The updated programme was then formally submitted to the Commission. The Portuguese authorities have thus effectively kept the commitment made to the Council on 5 November, in the framework of the recommendation under Article 104(7), to present before the end of the year an updated stability programme. The Council considers that the economic policies as reflected in the planned measures in the programme update broadly comply with the 2002 Broad Economic Policy Guidelines.

The update's macroeconomic scenario shows a small acceleration of GDP growth to 1,3 % in 2003 (from an estimated growth rate of 0,7 % in 2002), which in the light of the most recent information available, pointing to a further deceleration in economic activity in the second half of 2002, looks somewhat optimistic. For the period 2004 to 2006, the macroeconomic scenario presented in the programme update appears plausible as far as the pace of economic growth is concerned (an average growth rate of close to 3 % per year). The planned measures of structural reform should generate beneficial supply side effects, allowing the economy to rely on greater export strength.

The Council considers that regaining an appropriate level of external competitiveness is of paramount importance for Portugal in the light of the level of inflation and real wage developments over the last years. To that end, securing wage moderation and sustained increases in productivity are key requirements, also as a way to secure a decline in inflation. In this context, the Council welcomes the government's guideline to use, from 2003 onwards, the average inflation forecast for the euro-area as the benchmark for wage negotiations, as well as the freezing of most wages in the government sector in 2003. This latter measure should have favourable spill-over effects in the private sector of the economy.

On 5 November 2002, in the light of a government deficit of 4,1 % of GDP in 2001, the Council decided that an excessive deficit existed in Portugal and issued a recommendation to Portugal according to Article 104(7) of the Treaty. In the terms of this recommendation, the Portuguese authorities were urged to:

(i) implement with resolve their budgetary plans for 2002 which aim at reducing the deficit to 2,8 % of GDP in that year. The Council established a deadline of 31 December 2002 for the Portuguese government to take all necessary measures to bring the excessive deficit to an end;

(ii) adopt and implement the necessary budgetary measures to ensure that the government deficit in 2003 is further reduced clearly below 3 % of GDP and that the government debt ratio is kept below the 60 % of GDP reference value.

[1] OJ L 209, 2.8.1997, p. 1.

The Council notes with satisfaction that, according to preliminary figures, the general government deficit has been reduced below 3 % of GDP in 2002, in spite of weaker-than-anticipated growth. The Council acknowledges the firm resolve of the Portuguese government in pursuing budgetary consolidation. Budgetary developments in the further course of 2002 turned out less favourable than expected in the rectifying budget adopted in June, mainly due to the further weakening in economic activity, but also to lower-than-expected proceeds from sales of government property. As a consequence, and with a view to reducing the deficit as recommended by the Council, the Portuguese authorities adopted a number of one-off measures at the end of the year, which in total are estimated to have raised additional revenue of about 1,5 % of GDP.

The Council notes that substantial challenges remain in 2003 to achieve the deficit target of 2,4 % of GDP and to put the deficit on a downward trajectory. Two factors appear particularly critical in this regard. First, in the light of recent economic data confirming the marked slowdown in economic activity in the second half of 2002, the programme's assumption for GDP growth of 1,25 % for 2003 appears somewhat optimistic, and further budgetary tightening might be necessary. Second, additional measures to be taken in 2003 may be necessary as the beneficial impact of the one-off measures implemented in 2002 wears off. The Council therefore urges the Portuguese authorities to ensure that the deficit remains well below 3 % of GDP in 2003. A sustained correction of the budgetary imbalance should help the revival of economic confidence. Moreover, the Council considers that an early and determined implementation of the comprehensive and ambitious programme of structural reform envisaged in the stability programme update should be conducive to greater confidence, enabling a faster recovery of economic growth.

The Council acknowledges the projected improvement in the underlying balance by more than 0,5 % of GDP per year, taking the underlying deficit from about 3,5 % of GDP in 2002 to a situation close-to-balance by 2005, in line with the commitments taken by Portugal in the recommendation adopted by the Council on 5 November 2002. In 2003, however, the improvement in the underlying deficit amounts to approximately 2 percentage points of GDP, the adjustment effort being considerably higher due to the need to replace the one-off measures adopted in 2002. The consolidation strategy envisaged is thus front-loaded and in compliance with the objectives of the Stability and Growth Pact.

The Council also notes with satisfaction that the consolidation strategy adopted rests mainly on the restraint of government expenditure, to be achieved partly by tighter control of the public sector wage bill, and partly by the effects of a comprehensive programme of structural reform. Such a strategy is in line with the general recommendations of the Broad Economic Policy Guidelines. The Council urges the Portuguese authorities to ensure that the implementation of this strategy offsets the revenue losses caused by the announced gradual phasing-in of a substantial lowering in corporate taxes, thereby leading to an underlying budgetary position close-to-balance at the end of the period. In this context, the Council draws attention to the potential budgetary risks associated with a significant tax reduction that is not matched by firm control over government expenditure, which could be facilitated by implementing expenditure ceilings. A sensitivity analysis suggests that in the event of the low growth scenario considered in the programme update materialising, the actual balance may deteriorate significantly in the absence of offsetting discretionary measures. In addition, the Council reaffirms that the commitment made by the Portuguese authorities to continue to improve the collection of government data is key to ensure an effective budgetary surveillance.

The Council notes that while remaining below the 60 % of GDP reference value, the government debt ratio has increased in recent years. The Council welcomes the Portuguese authorities' intentions to bring the debt level down to 52,7 % of GDP by 2006, unwinding the sharp deterioration registered between 2000 and 2002. The reduction in the debt ratio over the programme period is to be achieved by the gradual improvement of the primary surplus, together with the assumption of no major net financial operations taking place in the coming years.

On the basis of current policies, the risk of unsustainable public finances in the light of ageing populations cannot be excluded. If debt reduction is to make a noticeable contribution towards meeting the budgetary cost of ageing populations, then reaching a balanced position by 2006 is essential; this should be part of an ambitious three-pronged strategy to meet the long-term budgetary consequences of ageing and may have to include the running of surpluses. Running sound public finances over the long run will allow to achieve a significant reduction of the debt ratio prior to the budgetary impact of ageing populations taking hold. Therefore determined implementation of the structural reforms in order to curb the growth of age-related expenditure, to broaden the tax bases, and to increase the overall growth potential of the economy, is essential to achieve long-term stability.