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Lisbon 30 November 2009

European Commission  
Directorate General Economic and Financial Affairs

# **Policies to achieve fiscal sustainability**

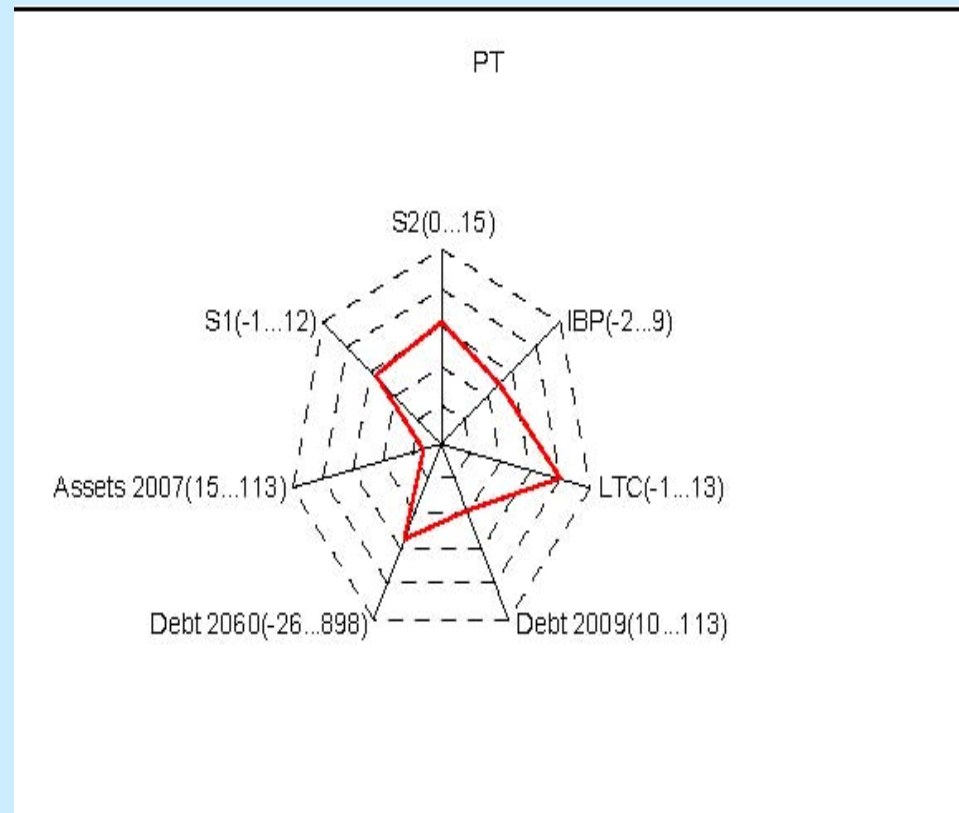
## ***Discussion***

by  
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Head of Unit - DG ECFIN-F-3  
European Commission



# FISCAL SUSTAINABILITY

- Portugal appears to be at **medium risk** with regard to the fiscal sustainability.
- The long-term budgetary **impact of ageing** is lower than the average in the EU.
- **Pension reforms** expected to contain the increase in pension expenditure.
- **High debt ratio**: it could go over 90% of GDP in 2011
- **Current fiscal position** is a cause of concern

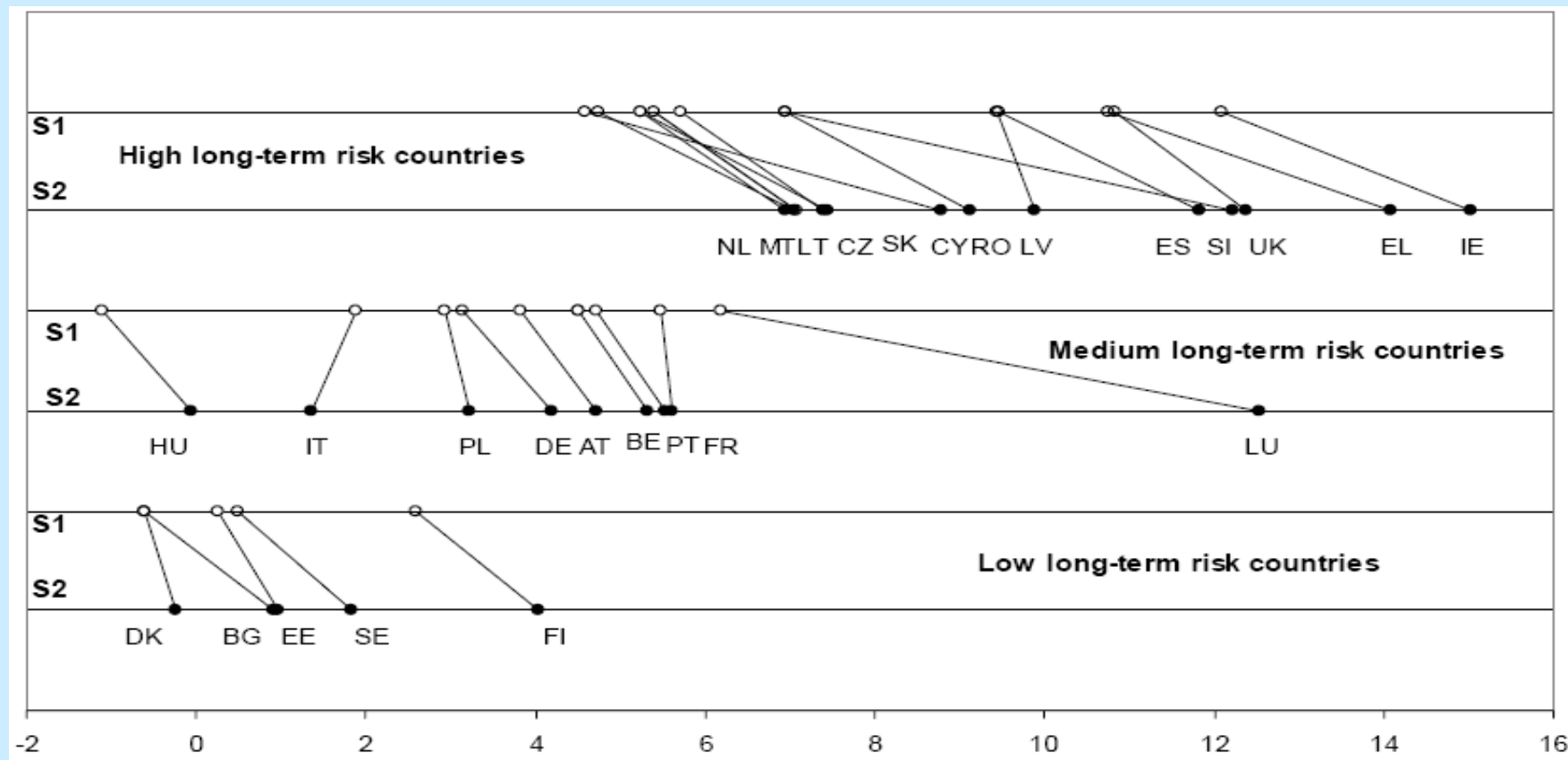


Source: Sustainability Report 2009



# FISCAL SUSTAINABILITY: PORTUGAL IN THE EU CONTEXT: A BORDER CASE OF MEDIUM (TILTED TOWARDS HIGH) RISK?

## OVERALL RISK CLASSIFICATION AND THE SUSTAINABILITY GAPS

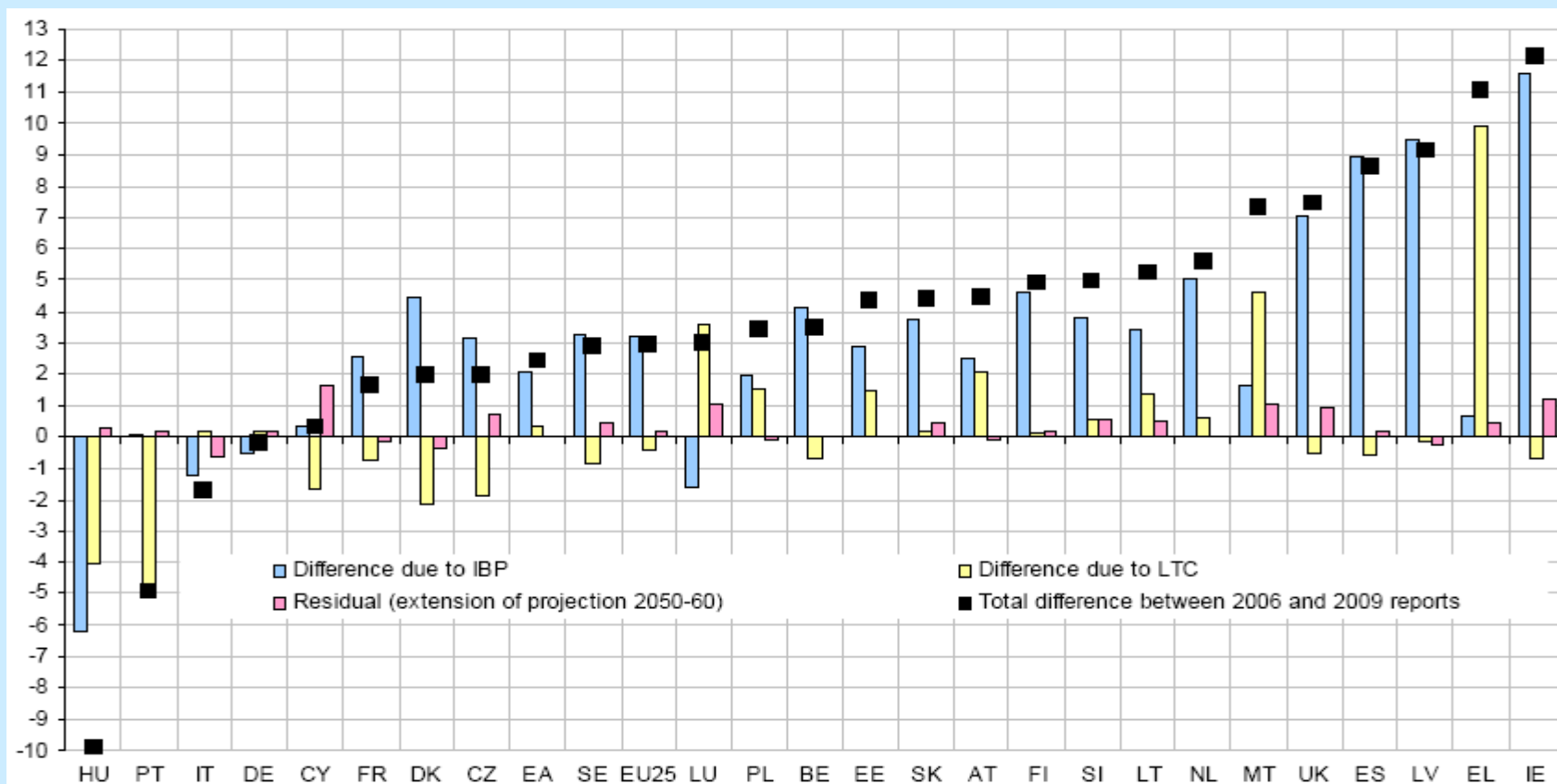


Source: Sustainability Report 2009



# FISCAL SUSTAINABILITY: PENSIONS REFORMS EXPECTED TO REDUCE PORTUGAL'S COSTS OF AGEING...

SUSTAINABILITY INDICATOR (S2) NOW COMPARED WITH INDICATOR IN THE  
2006 SUSTAINABILITY REPORT

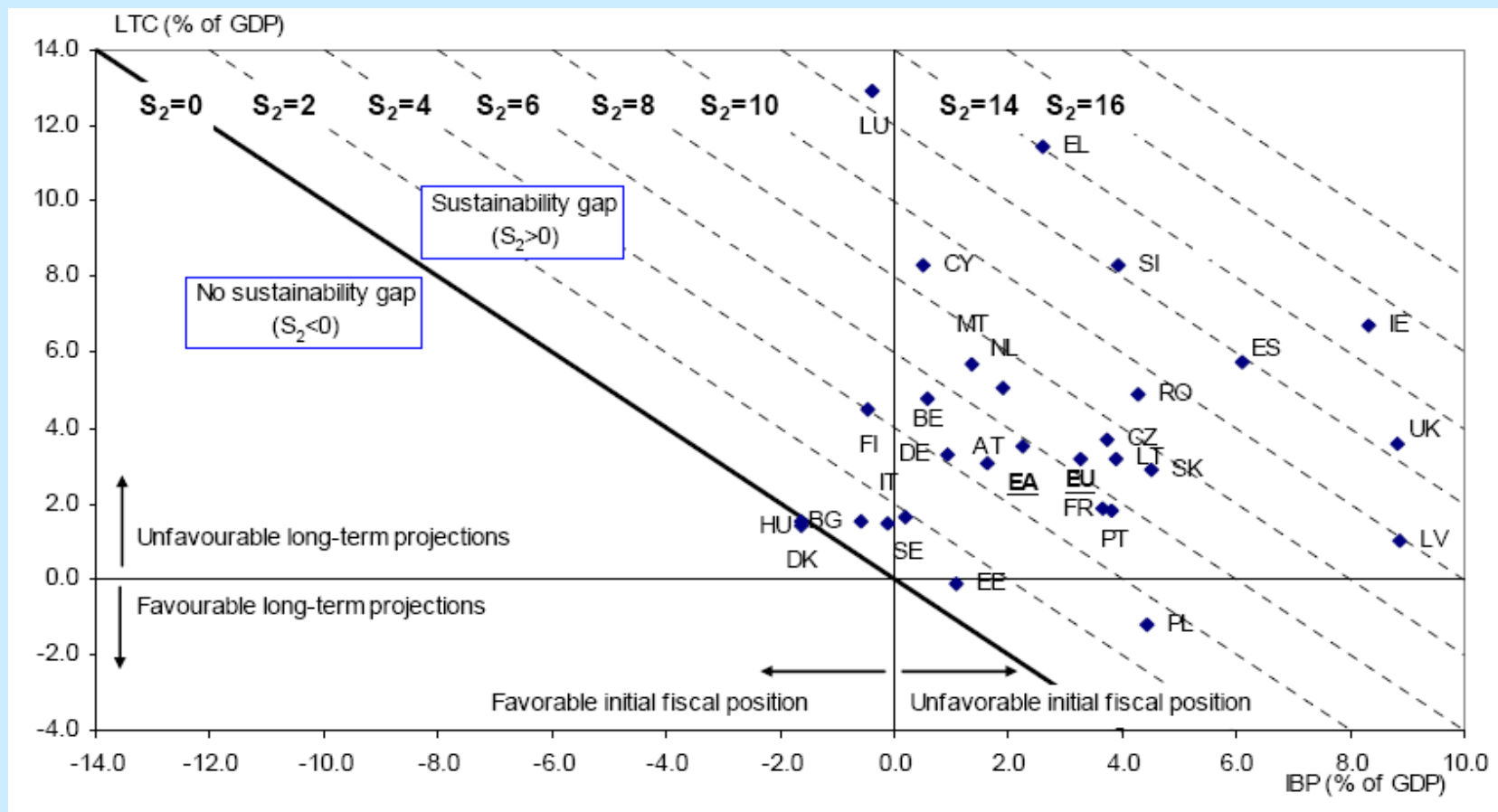


Source: Sustainability Report 2009



# FISCAL SUSTAINABILITY: ...BUT PORTUGAL'S CURRENT FISCAL POSITION IS WORRYING

## DECOMPOSITION OF THE SUSTAINABILITY INDICATOR (S<sub>2</sub>)



Source: Sustainability Report 2009



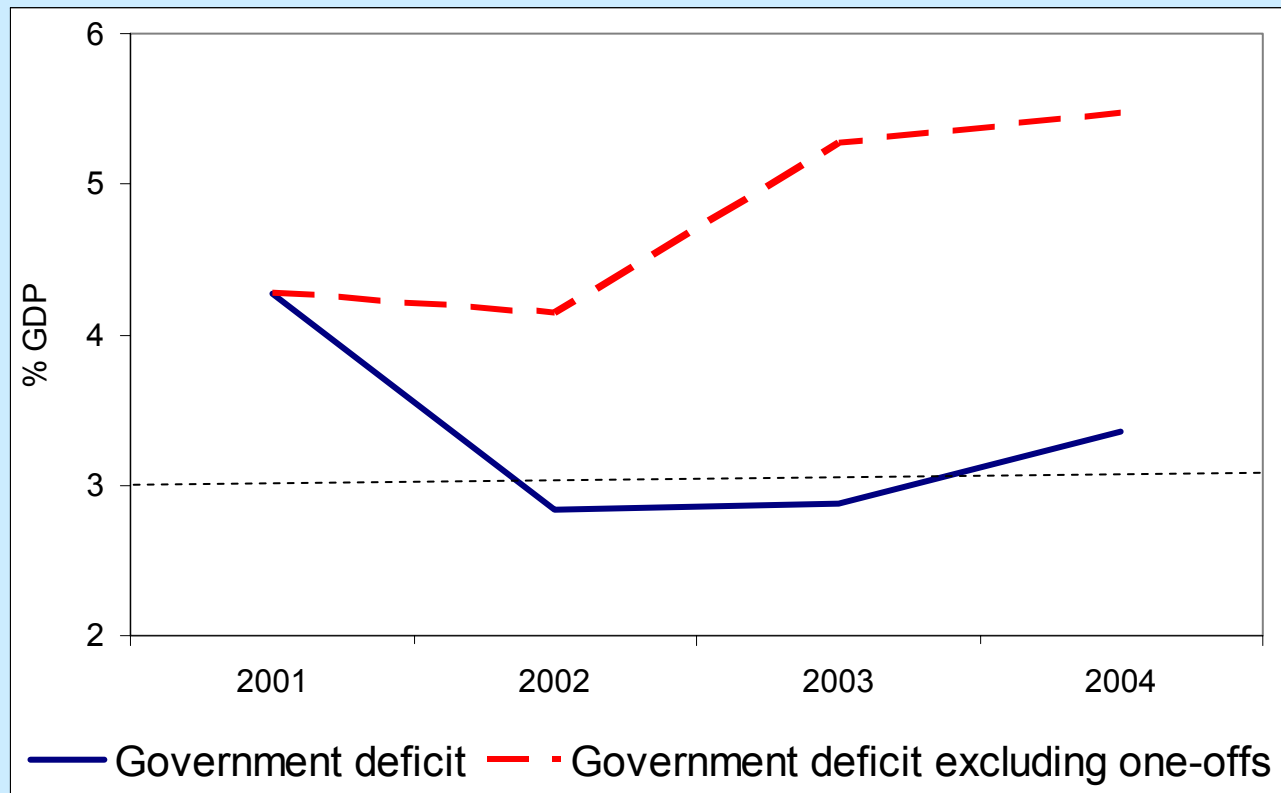
# THE 2002 EXCESSIVE DEFICIT PROCEDURE

On the basis of a deficit of 4.1% of GDP in 2001, the Council recommended:

- “(...) to implement with resolve their budgetary plans for 2002, which aim at reducing the deficit in 2002 to 2,8% of GDP. (...)”
- (...) 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.



# THE 2002 EXCESSIVE DEFICIT PROCEDURE: DEFICIT OUTTURNS



# THE 2005 EXCESSIVE DEFICIT PROCEDURE

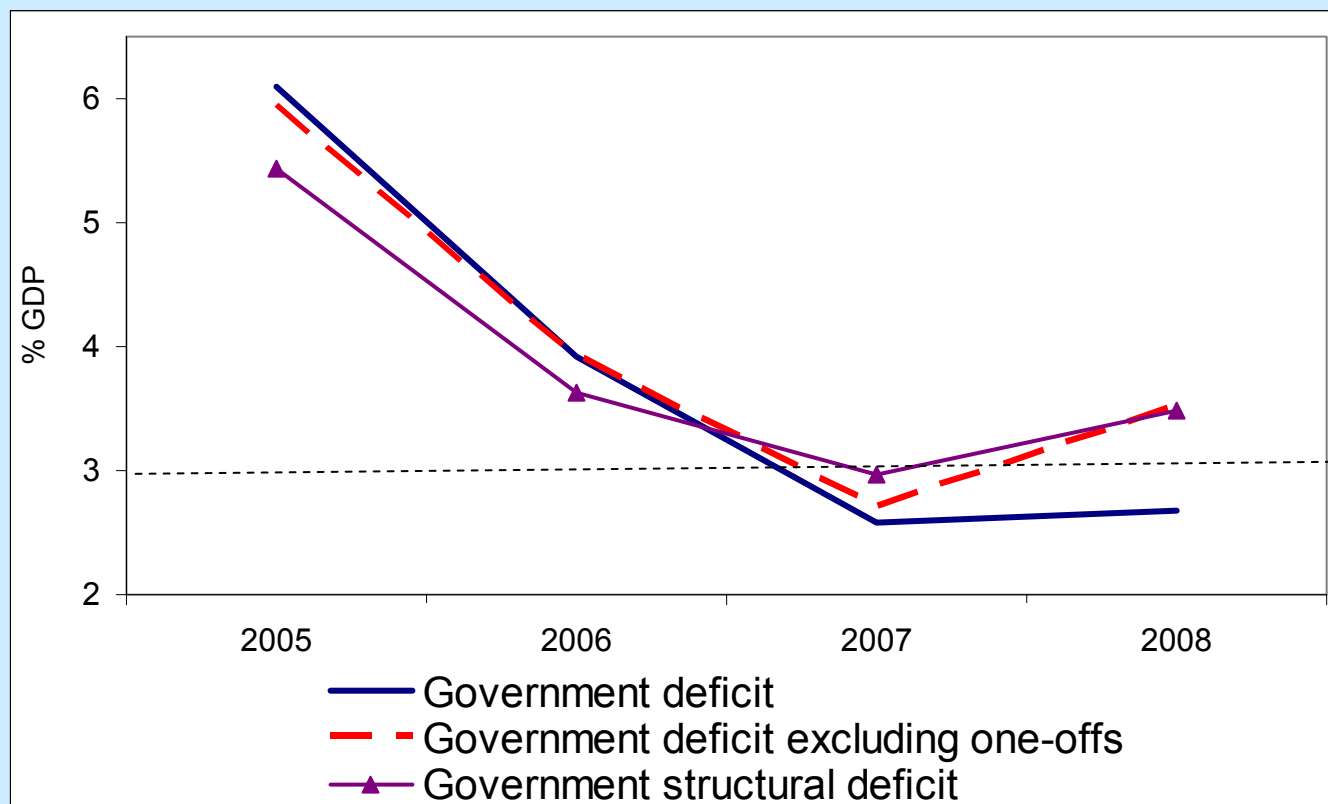
On the basis of a planned deficit of 6.2% of GDP in 2005 and a debt ratio then at 61.9% of GDP in 2004, the Council recommended that the Portuguese authorities should :

- «bring the **government deficit** below 3% of GDP in a credible and sustainable manner by 2008 (...), to this end, (...)
  1. limit the deterioration of the fiscal position in 2005, (...);
  2. (...) ensure a sustained and marked correction of the cyclically-adjusted deficit, excluding one-off and other temporary measures, by (...) 1,5% of GDP in 2006 from 2005, followed by (...) at least,  $\frac{3}{4}$ % of GDP in each of the two subsequent years;
  3. rapidly implement reforms to contain and reduce expenditure over the coming years;
- ensure that the **government gross debt ratio** is brought onto a firm downward path (...) by ensuring that debt developments reflect progress in the reduction of the deficit, by avoiding debt-increasing financial transactions, and by considering carefully the possible impact on debt of major public investment projects, including those in partnership with the private sector. (...) »
- that **budgetary consolidation** (...) is sustained through a reduction in the cyclically-adjusted deficit, net of one-offs and other temporary measures, by at least 0.5% of GDP per year after the excessive deficit has been corrected.

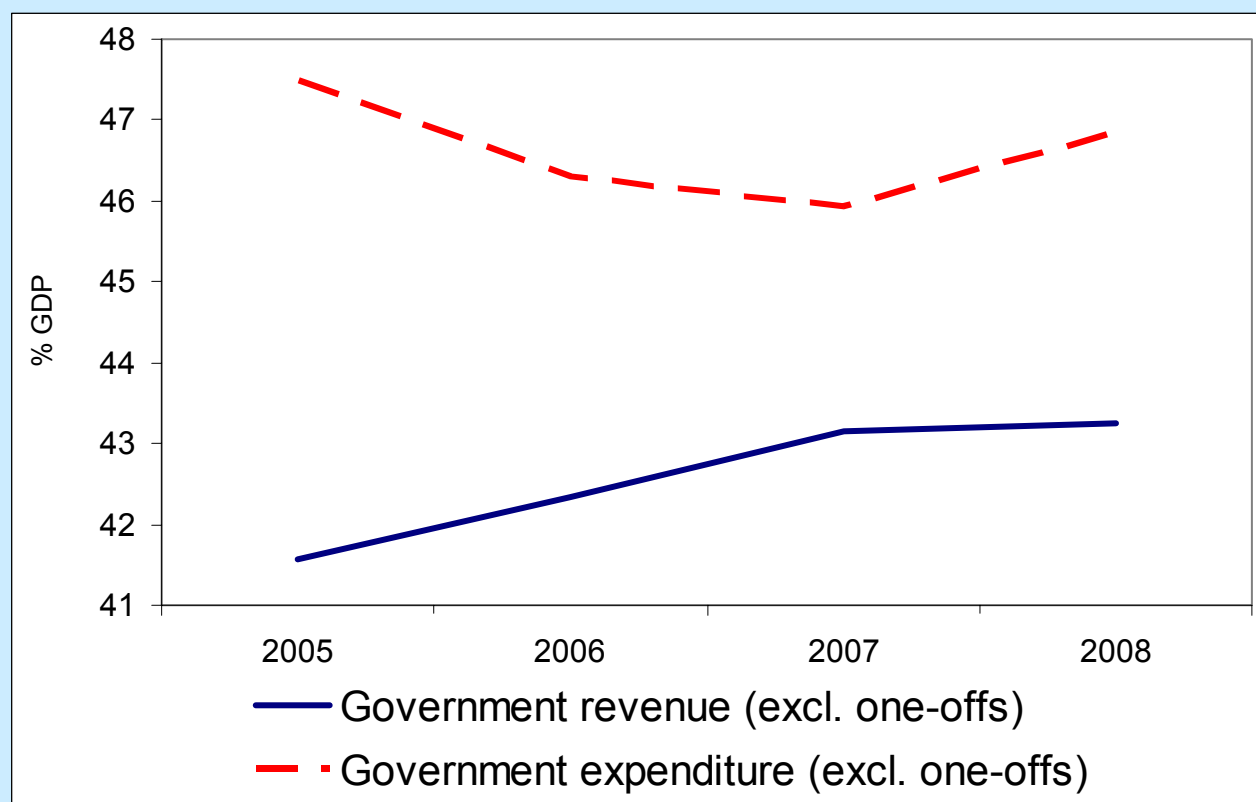




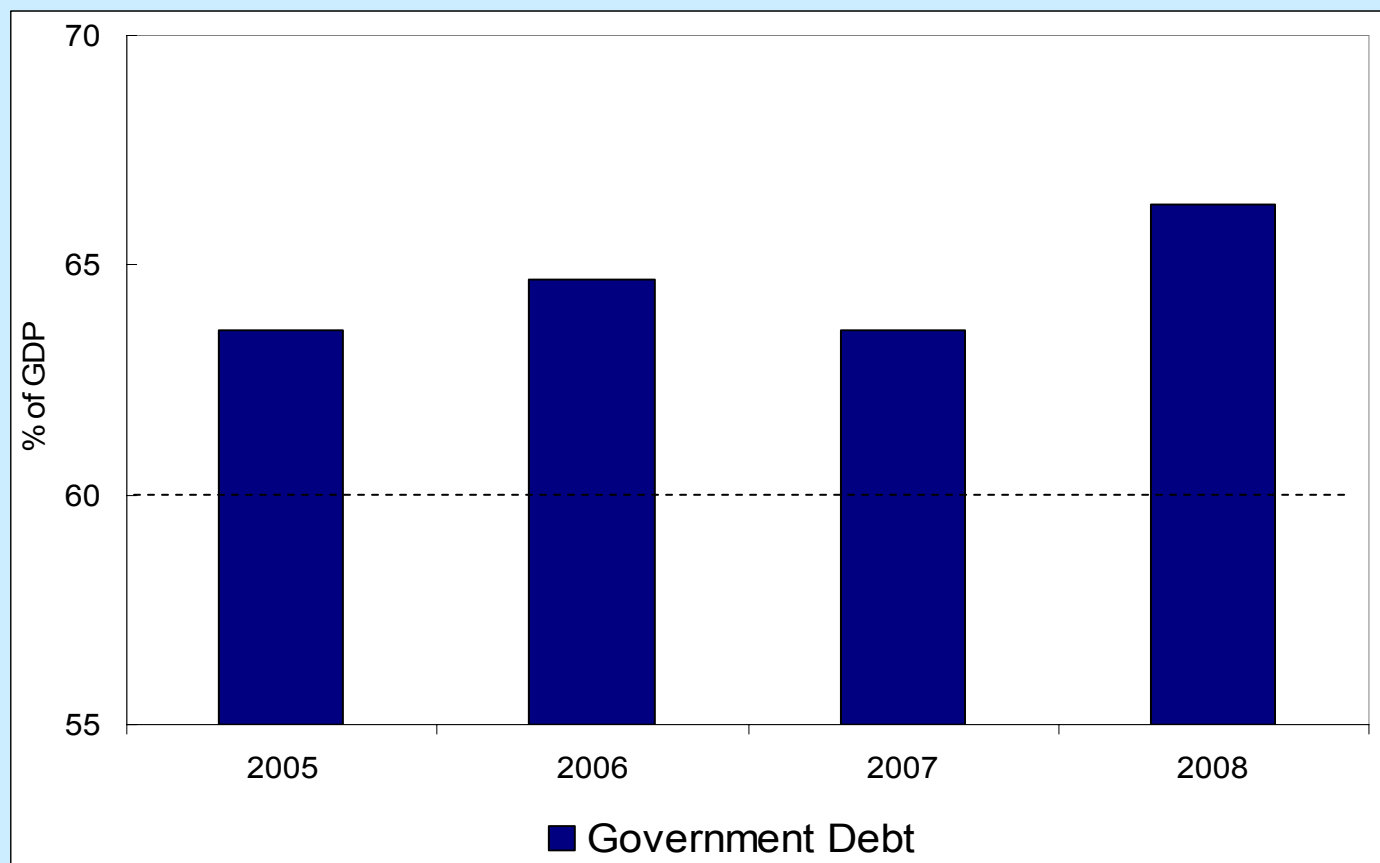
# THE 2005 EXCESSIVE DEFICIT PROCEDURE: DEFICIT OUTTURNS



# THE 2005 EXCESSIVE DEFICIT PROCEDURE: REVENUE AND EXPENDITURE OUTTURNS



# THE 2005 EXCESSIVE DEFICIT PROCEDURE: DEBT OUTTURNS



# PUBLIC FINANCE INDICATORS: THE **EXCESSIVE** DEFICIT AND DEBT IN 2009

## Summary of key public finance indicators

(% of GDP)	2008	2009	
		PT (April 2009)	COM (autumn 2009)
<b>Government balance</b>	-2.6	-5.9	<b>-8.0</b>
<b>Government debt</b>	66.4	74.6	<b>77.4</b>
<b>GDP (% change)</b>	0.0	-3.4	<b>-2.9</b>



# THE 2009 EXCESSIVE DEFICIT PROCEDURE

The Commission **recommends** that the Portuguese authorities:

- bring the general government deficit below 3% of GDP in a credible and sustainable manner by **2013** and to:
  - a) implement the consolidation strategy envisaged in the January 2009 update of the Stability Programme;
  - b) ensure an average annual fiscal effort of 1¼ % of GDP over the period 2010-2013;
  - c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2013 and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.



# THE 2009 EXCESSIVE DEFICIT PROCEDURE

The Commission has also **recommended** Portugal to:

- seize any opportunity to accelerate the reduction of the gross debt ratio back towards the reference value;
- strengthen the enforceable nature of its medium-term budgetary framework and continue to improve the monitoring of the budget execution throughout the year.

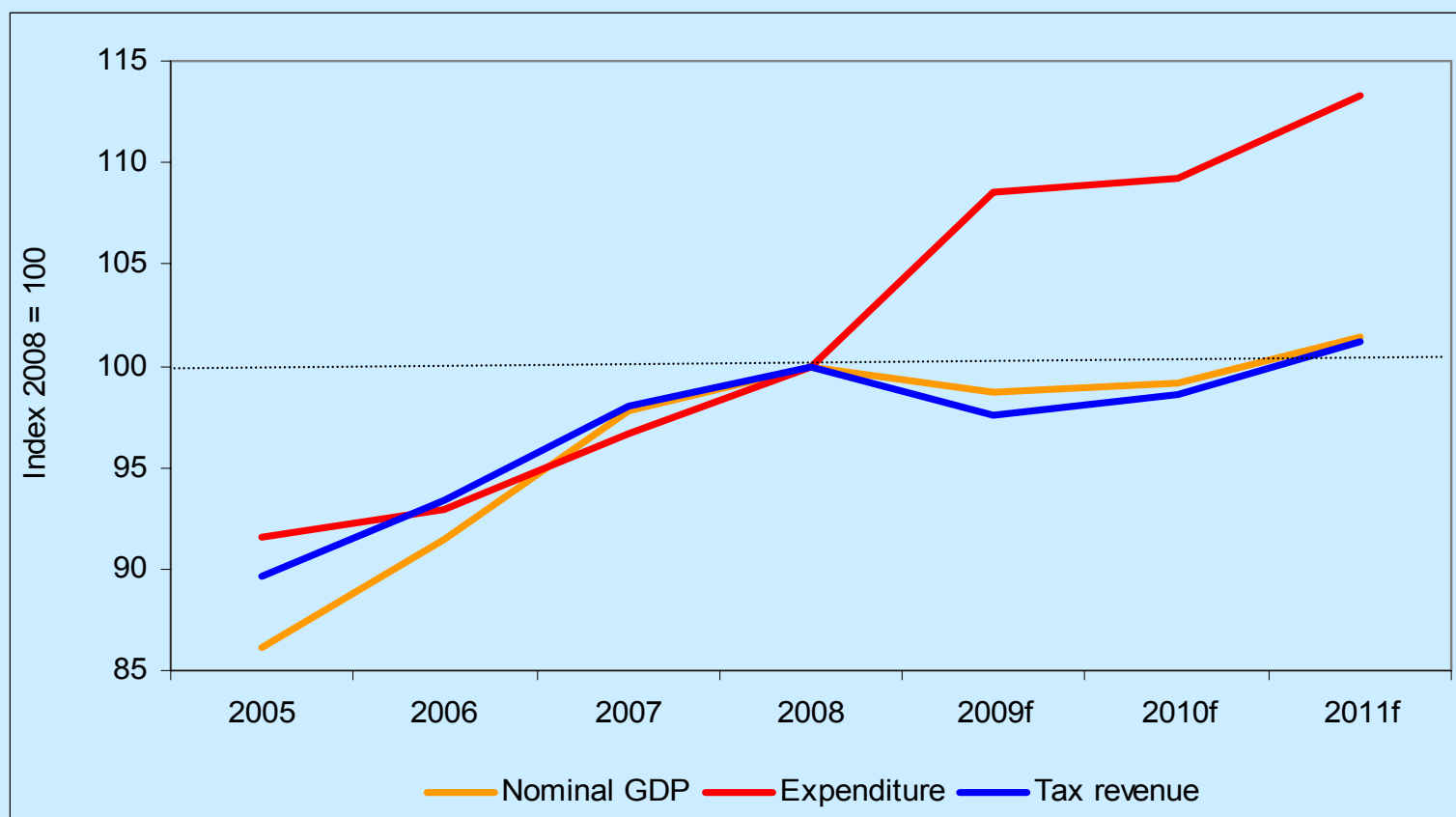
The Portuguese authorities are also **invited** to:

- implement reforms with a view to raising potential GDP growth
- enhance the quality of public finances

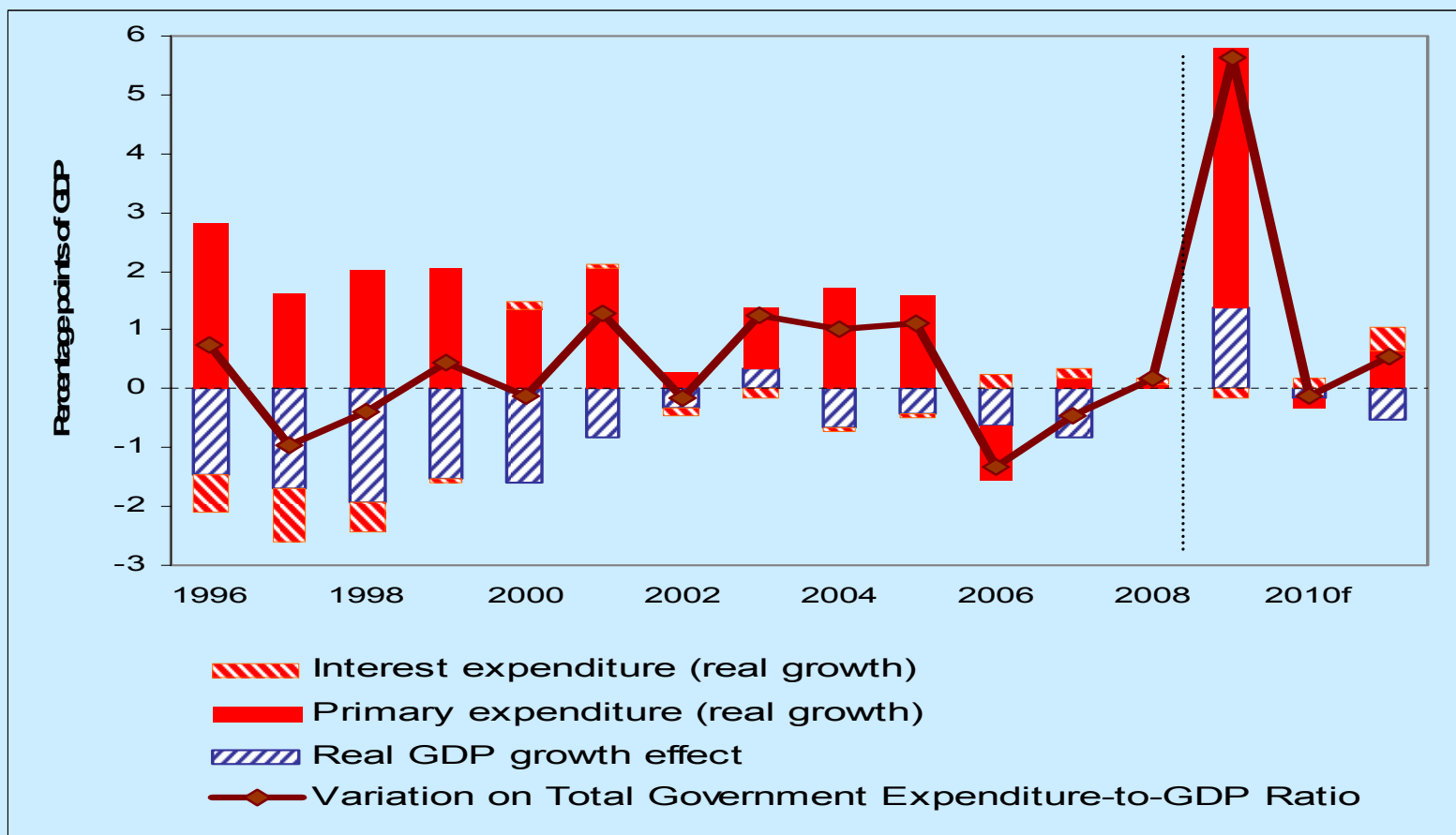


# RECESSION TAKES A LASTING TOLL ON PUBLIC FINANCES

BOTH REVENUE AND PARTICULARLY EXPENDITURE TRENDING UP



# EXPENDITURE RATIO: (LOW) DENOMINATOR EFFECT IS WEIGHING





# FISCAL POLICY AND THE BUDGETARY FRAMEWORK

Shortcomings in the **conduct of fiscal policy in Portugal include:**

- lack of fiscal discipline
- insufficient budgetary planning
- episodes of pro-cyclical fiscal policies

This can partly be attributed to the significant **weaknesses of its domestic fiscal framework:**



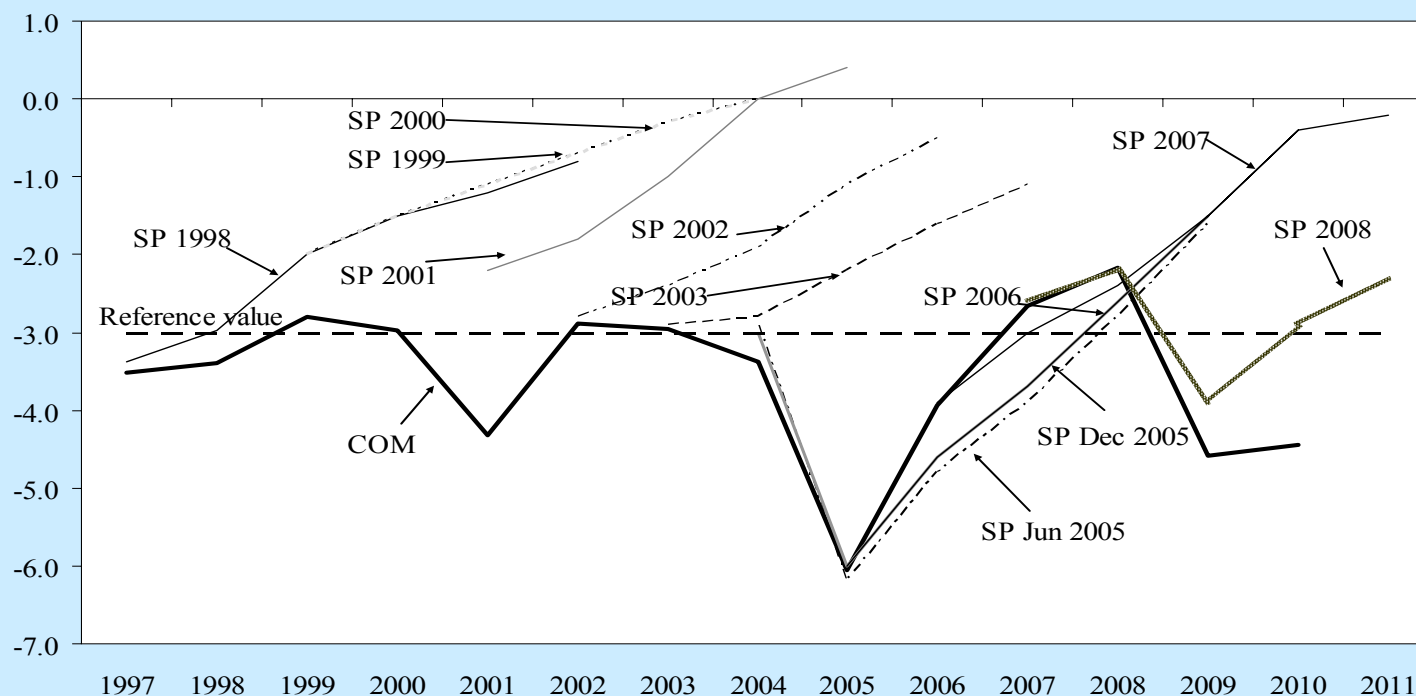
# WEAKNESSES OF THE PORTUGUESE BUDGETARY FRAMEWORK

- Low coverage of its three budget balance rules, which cover close to 30% of general government finances
- The monitoring and enforcement mechanisms of these rules are rather weak and no independent body is involved in these tasks.
- Low adequacy between medium-term budgetary targets and short term fiscal outcomes (e.g. the systematic deviations from the medium-term target in the Stability Programme - next slide).
- Portugal ranks in the 24th position across the 27 Member States regarding the quality of its medium-term fiscal planning.



# MEDIUM-TERM BUDGETARY TARGETS AND SHORT TERM FISCAL OUTCOMES: **DEFICIT**

Government balance projections in successive programmes (% of GDP)

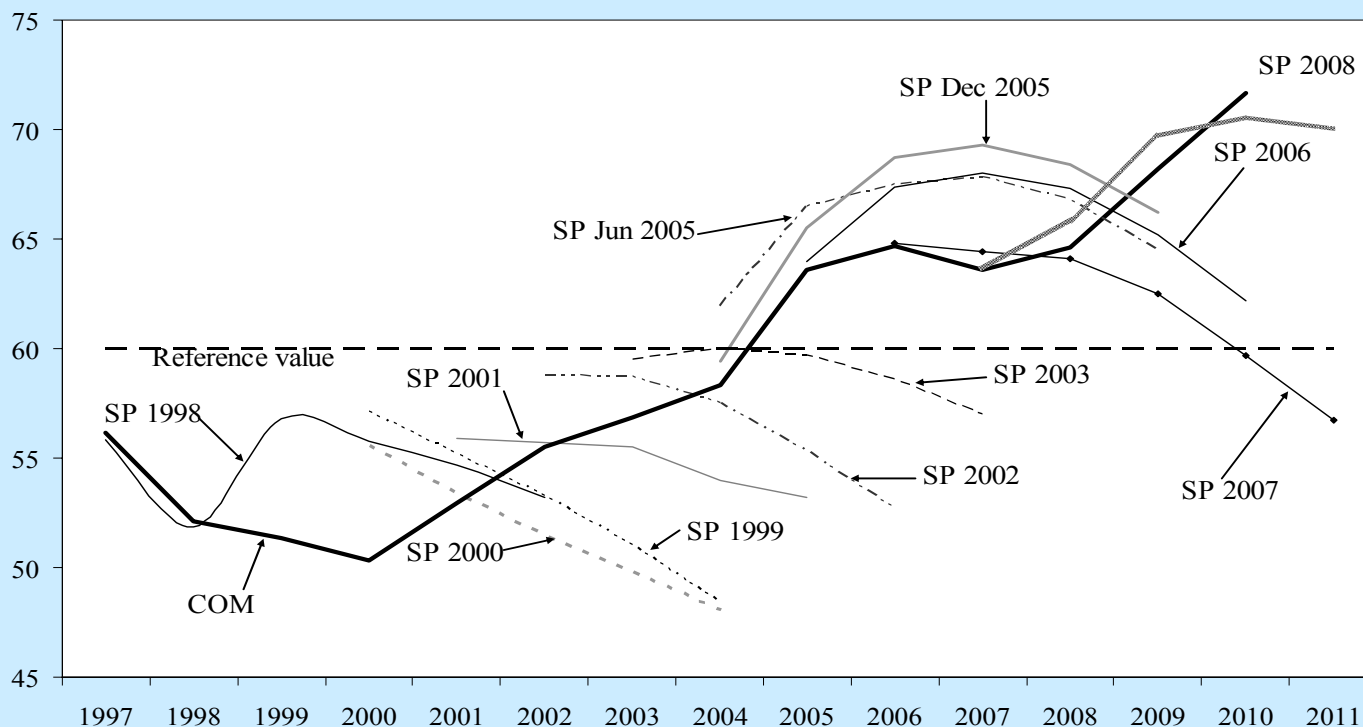


Source: Commission services' (COM) and successive stability programmes



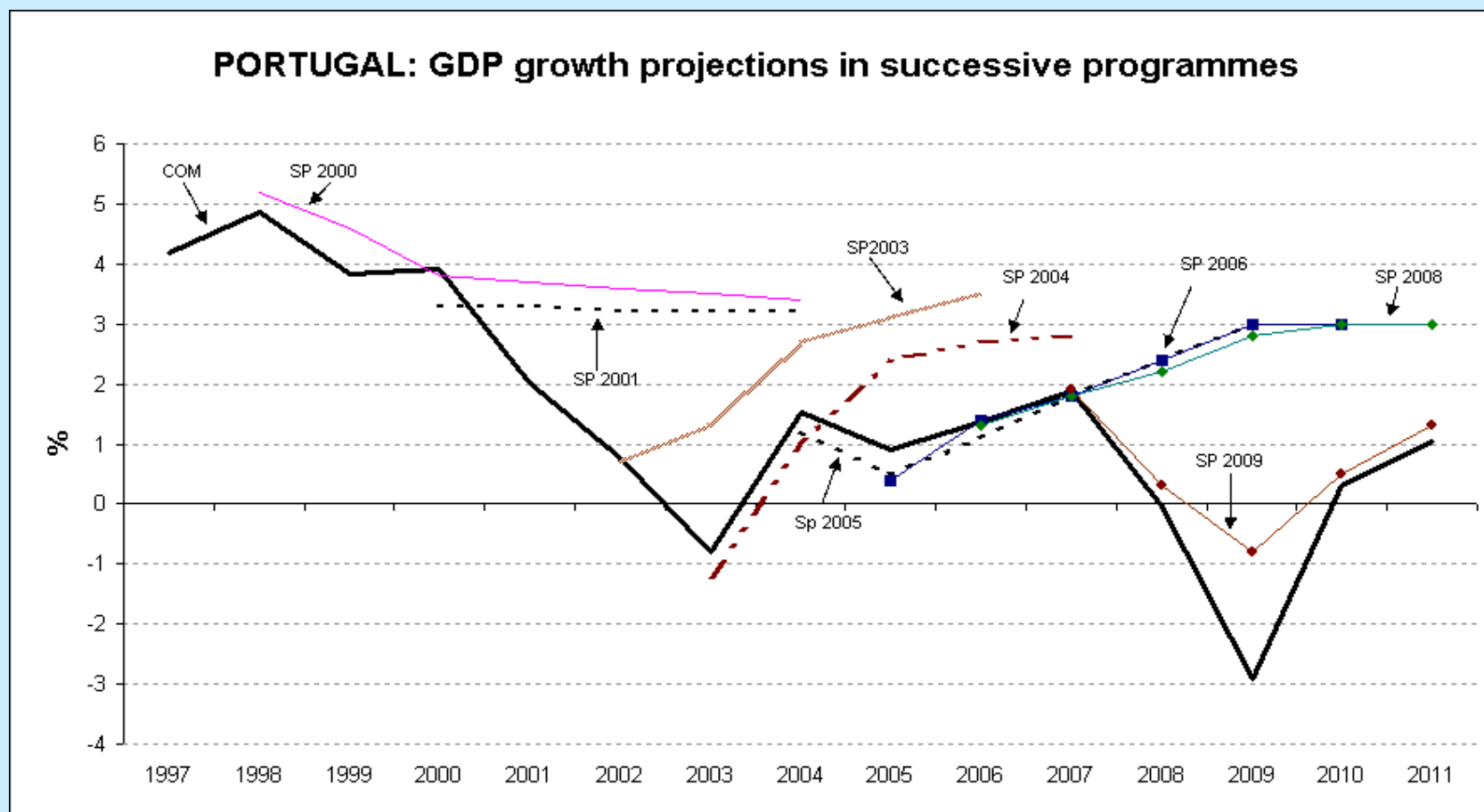
# MEDIUM-TERM BUDGETARY TARGETS AND SHORT TERM FISCAL OUTCOMES : **DEBT**

Debt projections in successive programmes (% of GDP)



Source: Commission services' (COM) and successive stability programmes

# MEDIUM-TERM TARGETS AND OUTCOMES: GDP GROWTH



Source: Commission services' (COM) and successive stability programmes

