ESC: Economic and Social Council
Portugal

Opinion

on the

Budget Strategy Document

2012-2016

(Approved in plenary on 23 May 2012)

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INTRODUCTION

The Economic and Social Council (ESC) is issuing this opinion on the Budget Strategy Document 2012-2016 (BSD) at the request of the Assembly of the Republic and in accordance with Article 2 of Law No 108/91 of 17 August.

The ESC considers this a very important document, since it establishes the key features of fiscal policy to 2016, a subject which is of growing importance in view of the severe difficulties which the country is currently facing.

The ESC stresses the importance of a document of this type for framing and directing economic and social activities. In this context, it recommends identifying investment incentive measures, a fiscal policy task which is critical for economic growth. It welcomes, however, the readability and credibility provided by the chapter on "sensitivity and budgetary risks".

The ESC considers that the climate of trust created among the international institutions by the signing of the social consultation agreement known as the "Commitment for Growth, Competitiveness and Employment", and by the external evaluation which is being made under the Economic and Financial Assistance Programme (EFAP), is highly positive.

The key issue in relation to the content of the BSD is whether unduly prolonging the austerity policy linked to the implementation of the "troika" memorandum could, apart from its highly negative effects on the Portuguese economy and society, even affect the feasibility of achieving the stated objectives in relation to the budget deficit.

It is important to begin by noting that the BSD is provided for in the Economic Assistance Programme from which Portugal is benefiting. The document summarises the government's strategy for removing the persistent macroeconomic imbalances that have led to the accumulation of excessive indebtedness by households, businesses and the state and, as a result, to the request for external assistance. The aim of the adjustment set out in the BSD is therefore to reduce public expenditure, increase revenues, or both.

The ESC recognises the effort that Portugal has made to work towards trying to comply with the requirements of the Economic Assistance Programme, despite the extremely negative international financial and economic context which the country has had to face.

The ESC considers that, although efforts aimed at consolidation of the public finances should continue, consideration should be given to the possibility of reviewing the rate of consolidation and the main elements of its implementation, so as to allow the implementation of measures favouring competitiveness and investment to stimulate economic growth, as well as measures enhancing job creation and preservation.

The ESC therefore reiterates the position that it took in its opinion on the state budget for 2012 (p. 12): "In the face of the anticipated worsening of the European and global economic situation – a situation which differs significantly from the scenario that was considered when the EFAP that is currently being implemented was under negotiation - the ESC recommends that as soon as budget implementation data clearly show that genuine reduction of public expenditure and of the budget deficit are at risk, and before the economic and social situation worsens irretrievably, the government should begin negotiations with the institutions that make up the "troika" with the aim of extending the deadlines for the public deficit reduction targets.

In these circumstances, renegotiating the conditions on reduction of the deficit, including the deadlines, would help to prevent strangulation of our economy, which would jeopardise any possibility of economic recovery and growth for many years and would increase the impoverishment of the Portuguese people".

The ESC repeats that it is becoming essential to come up with solutions at European Union level that can improve the financing conditions facing governments and businesses, while at the same time providing the necessary conditions for economic growth and increased employment in the EU and all its Member States. If European policies do not change, there is a serious risk that all of the collective efforts that Portugal has made may not be enough to overcome the severe crisis which the country is facing.

I – MACROECONOMIC FRAMEWORK

The macroeconomic framework presented by the government indicates weak GDP growth in 2013 (0.6%), followed by a significant increase in 2014 (2.0%), continuing in the two subsequent years to reach GDP growth of 2.8% in 2016, at which point the government believes that the output gap will have been closed.

As far as demand is concerned, the government's projections take the view that growth in 2013 will be led by exports alone, given that domestic demand will once again show a fall. Domestic demand will begin to increase from 2014, but still only slightly, and exports will remain the main driver of growth.

According to the projections, the reduction in the growth of domestic demand - and thus also in the growth of imports – will, along with a very substantial increase in exports (an annual average of 6.4% between 2013 and 2016), allow for the balance of trade to be almost in balance in 2016, with a surplus on the current and capital account of 5% of GDP.

The ESC considers that although the macroeconomic scenario on which the BSD is based is not an impossible one, its realisation is subject to major risks, particularly concerning the development of the external context but also arising from the creation of a vicious cycle of recession due to the policies that have been implemented. There are three basic sets of reasons that lead the ESC to believe that there are risks to the realisation of the macroeconomic scenario, reasons linked to supply, demand, and the financing of the economy.

In relation to supply, the ESC considers that the continuing fall in gross fixed capital formation (GFCF) since 2002 (which, since that year, has increased only in 2007, and even then only by 2.6%, leading to GFCF in 2013 being 40% less than in 2001) suggests that productive capacity has not grown substantially. Indeed, it must have fallen as a result of the increasing number of businesses moving, closing or going bankrupt in recent years. In these circumstances, it is very doubtful that potential output can increase at the projected rate, even supposing, as indicated in the document, growth in GFCF of 3.6% annually from 2014.

In addition, the growth accounting presented by the government in Table 6 points to a substantial increase in the growth of total factor productivity – in the absence of which potential GDP would not increase – without giving any justification for this.

In particular, as regards production capacity for export, the scenario anticipated in the BSD would involve exports being about 28% higher in 2016 than in 2012; in the absence of adequate justification, this would seem to exceed the conditions of supply in the export sector.

As regards demand, the ESC believes that growth in private consumption from 2014 is far from guaranteed. It is true that that year will follow a sharp fall in 2012, further added to in 2013, making recovery appear more plausible. However, the fall in real income, the high level of household indebtedness and, in particular, the substantial increase in the unemployment rate which has occurred recently and which is likely to continue in the near future make it difficult, without more justification, to accept that private consumption will recover from 2014.

Similarly, the ESC does not find any firm grounds in the document for accepting that investment will recover. Public investment will fall further, and private investment will continue to be affected by negative expectations and serious funding problems for businesses. It is true that the projected recovery in investment would only involve a return to the 2011 level, but even that unambitious goal will be very difficult to achieve in the absence of active investment promotion policies, which the document does not contain.

As far as exports are concerned, it should first of all be noted that the relatively positive changes in exports from 2010 to 2012 largely involve making up for the fall in 2009, with the projected value for 2012 being only 6.7% above that of 2007.

According to the BSD, the value of exports in 2016 will be 28.3% above that in 2012. The ESC does not believe that the document contains sufficient justification, whether in the import projections of our main trading partners or the policies announced, for an increase in demand for our exports at the projected rate, which, at 6.4% *per annum*, will be far above the pre-crisis rate of 4.4% between 2001 and 2007. It is true that there have been very positive developments in terms of market diversification, with stronger positions having been won in customer countries outside Europe. However, the ESC considers that in the absence of further justification in the BSD, there is no reason to suppose that such desirable further diversification will be sufficient to achieve the document's objectives.

As regards the financing of the economy, the ESC regrets that the only references in the document are in relation to the past. The ESC insists that this is a critical issue in relation to the functioning of the economy. Credit problems severely restrict the possibilities for economic growth and are a factor in the increase in the number of businesses that are closing down or going bankrupt, even those for which, on the face of it, the economic conditions for success are there. The ESC considers that in the absence of a substantial improvement in financing conditions for businesses – the need for which is not even discussed in the document – the necessary conditions for the economy to be able to create productive capacity, and therefore to grow, will not be satisfied. On the contrary, the recession may deepen.

In addition to these three basic sets of reasons, the economic situation in Europe is extremely difficult, and the deepening crisis in Greece and Spain could have a very serious impact on the Portuguese economy.

The ESC also notes that the labour market situation could worsen still further, and very quickly, in the coming years.

The ESC considers that there is no reason at present to believe that it is possible, as the document claims, for employment in 2016 to be almost 5% higher than in 2012 and close to the 2010 level, particularly in view of the delay in adopting economic and employment policies to counteract the negative trend in terms of employment. That is not only because of the doubts that the ESC has already expressed as to the possibility of economic growth, but also because, even assuming that the economy were to grow in line with the framework set out in the BSD, job creation at the level projected by the document would require a much lower rate of productivity growth than expected.

Indeed, the possibility of exit from recession and the fact that growth is essentially dependent on exports make such a limited projected increase in productivity, and therefore the projected rate of job creation, barely plausible. On the contrary, the ESC considers that pursuing the policy of austerity implies not a fall in unemployment, but rather a further increase.

The scale that unemployment has already reached, and the rate at which it is growing, are enough in themselves to justify a reconsideration of economic and social policies, since unemployment is, in the present circumstances, the greatest problem facing Portuguese society. The ESC highlights the fact that most of the fall in employment is taking place in services, particularly activities such as wholesale and retail trade, accommodation, catering and similar services, and education.

The ESC also considers that the costs of adjustment of the Portuguese economy remain unequally distributed, with wage income hit harder than other forms of income. Indeed, it is projected that real salaries (deflated by GDP) will fall by 0.6% per annum between 2011 and 2016, while productivity per worker will increase by 0.6%, meaning that salaries will fall as a proportion of GDP at a rate of about 1.2% per annum.

In view of all these constraints, the ESC considers that continuing with the policy of austerity, as recommended by the document, could put the country on the road to economic stagnation or contraction and increasing unemployment, further worsening the situation of many Portuguese families, particularly those that are the most highly indebted and the most affected by unemployment. Besides the social consequences, this could have budgetary consequences that are so negative as to jeopardise the fiscal consolidation goals.

The ESC also considers that the policies set out in the BSD could lead to a major deterioration in the social situation in the country, seriously affecting national cohesion and threatening economic adjustment efforts.

II – BUDGETARY STRATEGY

The medium-term goal for the consolidation of the public finances set by the BSD is an overall deficit of 0.5% of GDP in 2016, a figure which the document considers to be equal to the structural deficit and thus to comply with the targets in the fiscal pact currently being approved by 25 European Union Member States.

According to the document, this outcome will be achieved by reducing public spending as a proportion of GDP compared to 2012 (- 4.5 percentage points), since a reduction in public revenues is projected for the current year, albeit a small one (- 0.4 percentage points).

The reduction in expenditure essentially results from reducing the proportion of GDP spent on social benefits (- 1.3 percentage points), staff costs (- 1.3 percentage points) and capital expenditure (- 0.9 percentage points).

The ESC is deeply concerned about the reduction in the proportion of GDP spent on social benefits (even though, according to the BSD, part of this effect can be explained by the fall in unemployment expected over the projection period), meaning that in absolute terms, the real value of these benefits will have almost stagnated between 2012 and 2016, with an increase of 1.6% at constant prices. This appears to include not adjusting pensions, with the exception of the smallest (p. 25 of the BSD), leading to a substantial fall in the real value of pensions, some of which are not very large. In view of the ageing population and the likely increase in the unemployment rate, the changes to social benefits could further cut the incomes of many needy families.

The ESC also has serious reservations about the changes in capital expenditure - which are reflected, directly or indirectly, in investment - since they involve a very substantial fall in absolute terms compared to 2012 (a reduction of 23.3% at constant prices). The ESC notes that, in addition to the potential negative effects of these changes on the creation of the conditions for economic competitiveness, they will contribute to reducing the rate of economic growth as a result of their negative multiplier effects on economic activity.

The scenario for 2013 is not significantly different from the medium-term scenario. About 44% of the projected impact of the measures to reduce expenditure as a proportion of GDP will result from reduction of social benefits and capital expenditure. The ESC once again emphasises the negative effects of such reductions, particularly in a year in which the country will still be seriously affected by this year's recession. The effects which these reductions may have on economic growth and social cohesion will therefore be particularly significant in 2013, meaning that here too it will be necessary to reconsider the possibility of adjusting the budgetary target.

III – SUSTAINABILITY OF PUBLIC FINANCES

The analysis of the long-term sustainability of the public finances is, as the document states, critically dependent on the macroeconomic assumptions made for the period of the analysis.

The ESC does not believe that it is possible to formulate assumptions for changes in macroeconomic aggregates with a reasonable degree of certainty over a five-decade time horizon. The relevance of such long-term sustainability analyses is essentially in terms of exploring alternatives.

In this context, the ESC highlights the fact that it does not seem acceptable, in relation to social security, to consider only GDP growth of less than 2% *per annum* over the next five decades, given that this implies, in all likelihood, that convergence with the other European Union countries will not take place. Indeed, such a low trend growth rate would mean that the goal of returning to the path of economic growth and prosperity - mentioned on page 6 of the document - had to a large extent failed.

The ESC considers that it cannot be concluded on the basis of these projections that social security is not sustainable, given that the assessment of its sustainability is critically dependent on the rate of economic growth chosen.

The ESC considers it essential that social security should genuinely guarantee confidence and security, particularly in a time of crisis such as the present. In this respect, the ESC believes that social security must not be called into question or used as an instrument to combat the budget deficit, thus compromising the social protection which it should ensure and creating uncertainty for the people of Portugal.

The ESC considers that from the point of view of the sustainability of the public finances, reducing the public debt as a proportion of GDP is, as the document shows, of major importance. However, there may be an issue here over how fast this should go. Taking a relatively low rate of growth as the base scenario means that, given the public deficit target, the reduction of the public debt as a percentage of GDP would take place more slowly. A higher growth rate would lead to a much quicker reduction of the public debt, as indeed is shown by Figure IV.6 of the document, and would call into question what may be an excessively rapid rate of debt reduction and thus also of fiscal consolidation.

The ESC considers that footnote 9 on page 39 of the BSD does not imply that the cuts in holiday and Christmas bonuses are no longer temporary.

IV – QUALITY OF PUBLIC FINANCES

In general terms, the budgetary policies set out in chapter V are still very short on detail.

The reorganisation of the state, the revision of the legal framework governing the public administration and the retraining of its staff are certainly very important aspects. However, there is not enough detail in the document concerning how these goals will be achieved for the ESC to be able to issue a reasoned opinion.

The ESC welcomes the government's intention to reform the tax system and the fact that, in relation to corporation tax, this reform has the aim of promoting the internationalisation and competitiveness of Portuguese firms. However, it regrets the fact that there is no reference in the stated goals of this reform to tax equity and fairness. On the contrary, the ESC is concerned at the plans to reduce personal income tax brackets, allowances and exemptions, with negative consequences for many taxpayers. Reduction and limitation of tax advantages and allowances is already planned for 2013 (Table II.4), particularly in relation to personal income tax and corporation tax, along with a substantial reduction in property tax exemptions and an adjustment of excise taxes. In this respect, it is also important to bear in mind that among the OECD countries, Portugal has seen one of the greatest increases in the tax burden on income from work, exceeding the average for those countries. Recent Eurostat data indicate that the percentage increase in the standard rate of VAT between 2000 and 2012 was the second greatest in the EU, and that during that period corporation tax fell by less than the European average. This context has to be borne in mind when discussing the planned tax reform. However, the ESC is in favour of the goals of simplifying tax law and substantially expanding the network of double tax treaties. Once again, however, more detail is needed on the tax reform mentioned in the document.

Still in relation to the tax reform, the ESC believes that, although tackling tax evasion and avoidance is important, it must not be limited to the Strategic Plan for Combating Tax and Customs Evasion and Avoidance, approved in October 2011, as the document seems to suggest.

The ESC is also very concerned about the absence of any plan of action in relation to tackling the informal economy, which has reached a very large scale and which, as a result of the substantial loss of tax receipts that it causes, is currently one of the main obstacles to strengthening competitiveness, fair competition and improvement of the public finances.

The ESC highlights the consequences of a substantial, continuing and indiscriminate reduction of civil service staff for the provision and quality of public services, as well as for the role which the state can and should play in supporting economic development, particularly at regional and local level.

In relation to state enterprises, the concerns expressed in the document are too narrow, being limited to a short-term analysis of the financing conditions of these enterprises.

The ESC considers that it is very important to make a substantial improvement to the indebtedness of these enterprises, as mentioned in the document, but is concerned at the way that the document calls for a number of such enterprises to cut back their activities, in apparent disregard of the fact that many of them provide essential public services, and ignoring the negative effects on employment. The ESC considers that this issue needs to be discussed in depth between all the parties involved.

Finally, the ESC highlights the effects of the policy of austerity in relation to social justice and inequality. Besides the consequences in terms of damage to the labour market, it also notes, among other things, the fact that a significant number of workers are covered by the national minimum wage, which lost purchasing power and was not adjusted in 2012; the reduction in the number of collective labour agreements concluded; the reduction in the coverage of unemployment benefits; and the reduction in the number of beneficiaries of non-contributory social benefits.

EXPLANATIONS OF VOTES

Conselho Económico e Social
PORTUGAL

CGTP
INTERSINDICAL NACIONAL

OPINION ON THE BUDGET STRATEGY DOCUMENT 2012-2016
EXPLANATION OF VOTE

1- The General Confederation of Portuguese Workers (CGTP-IN) considers that the preparatory work on the draft opinion on the Budget Strategy Document (BSD) within the Permanent Commission for Economic and Social Policy (CEPES) was very positive. The acceptance of several amendments made it possible to produce a good document, which is quite critical of the main features of the budgetary policy established by the government for the period to 2016.

2- Indeed, this opinion leaves no room for doubt as to the areas of concern in relation to the macroeconomic framework presented by the government, particularly the following:

- the macroeconomic scenario on which the BSD is based will be very difficult to realise if the austerity policy that has been followed up to now is pursued for the next four years;
- it is equally doubtful that potential output can grow at the projected rate, given that productive capacity, which has been falling since 2002 (with gross fixed capital formation in 2013 less than 40% of that in 2001), can be expected to fall further as a result of the increasing number of businesses moving, closing or going bankrupt in recent years;
- the projections made in relation to production capacity for export and productivity growth are not duly justified and do not have a proper basis;
- it is far from guaranteed that private consumption will grow, given the fall in real income, the high level of household indebtedness and, in particular, the substantial increase in the unemployment rate, which is likely to continue in the near future;
- public investment will fall further and private investment will continue to be affected by negative expectations and serious funding problems for businesses;

- credit problems severely restrict the possibilities for economic growth and are a factor in the increase in the number of businesses that are closing down or going bankrupt, as a result of which, in the absence of an improvement in financing conditions, not only will the necessary conditions for the economy to be able to create productive capacity, and therefore to grow, not be there, but on the contrary the recession may deepen.

3- The ESC also highlights:

- the state of the labour market, which could worsen very rapidly in the coming years, with the ESC even considering that pursuing the policy of austerity implies not a fall in unemployment, but rather a further increase. However, the ESC argues that the scale that unemployment has already reached and the rate at which it is growing are enough in themselves to justify a reconsideration of economic and social policies, since unemployment is, in the present circumstances, the greatest problem facing Portuguese society;
- the unequal distribution of the costs of adjustment of the Portuguese economy, which will continue to be unbalanced, hitting wage income harder than other forms of income;
- the effects of the substantial, continuing and indiscriminate reduction of civil service staff, in terms of the services provided and their quality, as well as the role which the state can and should play in supporting economic development, particularly at regional and local level;
- the effects of the policy of austerity in relation to social justice and inequality, besides its consequences in terms of damage to the labour market and the conditions of supply of labour. The ESC highlights the fact that, according to the BSD, salaries will fall as a proportion of GDP at a rate of about 1.2% per annum between 2011 and 2016, and expresses its serious concern at the reduction in social benefits as a proportion of GDP;
- the need for social security to be treated as a guarantee of confidence and security, particularly in a time of crisis such as the present; the opinion also considers that the government's planned tax reform should take into account tax equity and fairness.

3- Finally, the ESC considers that continuing with the policy of austerity, as the BSD recommends, could put the country on the road to economic stagnation or contraction and increasing unemployment, further worsening the situation of many Portuguese families; besides its social consequences, this could have budgetary consequences that are so negative as to jeopardise the fiscal consolidation goals.

Furthermore, the ESC also states that the policies set out in the BSD could lead to a major deterioration in the social situation in the country, seriously affecting national cohesion and threatening economic adjustment efforts.

The ESC therefore recommends that, in these circumstances, renegotiating the conditions agreed with the troika in connection with the reduction of the deficit, including the deadlines, would help to prevent strangulation of the economy, worsening of the recession and impoverishment of the Portuguese people.

4- Given this assessment, which the ESC expressly sets out in this opinion and with which the CGTP-IN entirely agrees, it is incomprehensible that, contrary to that assessment, the opinion gives weight to the so-called agreement for "growth, competitiveness and employment", even though that agreement obviously conflicts with the concerns expressed throughout the opinion, causes imbalances in the employment relationship in favour of employers, encourages a model of competitiveness based on reducing labour costs, and will lead to labour unrest.

The CGTP-IN therefore opposes the inclusion of this point, not only for the basic reason mentioned above, but also because its inclusion in an opinion on the medium-term budget strategy makes no sense.

5- Furthermore, the "agreement", by guaranteeing compliance with the measures and deadlines set out in the EFAP, will dramatically impoverish the country, particularly workers, young people and pensioners, while at the same time worsening the damage to the productive sector; it will thus restrict the possibilities of economic growth, with all the consequences that flow from that, whether for compliance with financial commitments, given the increasing debt, or in the context of the creation of a solid base for the country to recover its strength and provide better living conditions for the population as a whole, particularly workers and their families, who have suffered severely from the reduction in purchasing power and disposable income.

That is in addition to the plans to make changes to labour legislation that would weaken workers' status in employment relationships still further, treating them in a less collective manner and making redundancies less costly, bringing more unemployment with less social protection, longer working hours for less pay, an increasing cost of living together with the removal of holiday and Christmas bonuses, etc.

6- These are therefore the reasons why, although the CGTP-IN agrees with the main points of the opinion, with its critique and its concerns in relation to the BSD presented by the government, it cannot vote for the document but is instead abstaining.

Lisbon, 23.5.2012

The representatives of the CGTP-IN

Explanation of vote

The cooperative sector, represented by CONFAGRI and CONFECOOP, declares that the tax reform which the government intends to undertake, and to which this ESC opinion refers (in the third paragraph of chapter IV – Quality of Public Finances) must comply with the Constitution of the Republic, and so with its Article 85, which states:

"1. The state shall encourage and support the creation and activities of cooperatives.

2. The tax and financial advantages for cooperatives, as well as more favourable conditions for obtaining credit and technical assistance, shall be laid down by law."

CONFAGRI	CONFECOOP
[Signed]	[Signed]