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To: Permanent Representatives Committee/Council

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Subject: COUNCIL RECOMMENDATION on the 2023 National Reform Programme of Portugal and delivering a Council opinion on the 2023 Stability Programme of Portugal

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Delegations will find attached the above-mentioned draft Council Recommendation, as discussed by the Council and European Council, based on the Commission Recommendation COM(2023) 622 final.

## COUNCIL RECOMMENDATION

of ...

### **on the 2023 National Reform Programme of Portugal and delivering a Council opinion on the 2023 Stability Programme of Portugal**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(2) and Article 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<sup>1</sup>, 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<sup>2</sup>, 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,

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> OJ L 306, 23.11.2011, p. 25.

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) Regulation (EU) 2021/241 of the European Parliament and of the Council<sup>3</sup>, which established the Recovery and Resilience Facility ('the Facility'), entered into force on 19 February 2021. The Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the Union. In line with the priorities of the European Semester, the Facility contributes to economic and inclusive recovery and to the implementation of sustainable and growth-enhancing reforms and investments, in particular reforms and investments to promote the green and digital transitions and to make the Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the Union and support the continued implementation of the European Pillar of Social Rights. The maximum financial contribution per Member State under the Facility was updated on 30 June 2022, in accordance with Article 11(2) of Regulation (EU) 2021/241.

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<sup>3</sup> Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

- (2) On 22 November 2022, the Commission adopted the 2023 Annual Sustainable Growth Survey, marking the start of the 2023 European Semester for economic policy coordination. On 23 March 2023, the European Council endorsed the priorities of the 2023 Annual Sustainable Growth Survey, which are centred around the four dimensions of competitive sustainability. On 22 November 2022, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2023 Alert Mechanism Report, in which it identified Portugal as one of the Member States that may be affected or may be at risk of being affected by imbalances. As such, an in-depth review would be needed. On the same date, the Commission also adopted an opinion on Portugal's 2023 draft budgetary plan. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2023 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area<sup>4</sup> ('2023 Recommendation on the euro area') on 16 May 2023 and the Joint Employment Report on 13 March 2023.

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<sup>4</sup> Council Recommendation of 16 May 2023 on the economic policy of the euro area (OJ C 180, 23.5.2023, p. 1).

- (3) While the Union's economies are showing remarkable resilience, the geopolitical context continues to have a negative impact. As the Union stands firmly with Ukraine, the Union's economic and social policy agenda is focused on reducing the negative impact of energy shocks on both vulnerable households and firms in the short term, and on keeping up efforts to deliver on the green and digital transitions, support sustainable and inclusive growth, safeguard macroeconomic stability and increase resilience in the medium term. It also focuses heavily on increasing the Union's competitiveness and productivity.
- (4) On 1 February 2023, the Commission issued a communication entitled 'A Green Deal Industrial Plan for the Net-Zero Age' ('the Green Deal Industrial Plan'). The aim of the Green Deal Industrial Plan is to boost the competitiveness of the Union's net-zero industry and support the fast transition to climate neutrality. It complements ongoing efforts under the European Green Deal and REPowerEU. It also aims to provide a more supportive environment for scaling up the Union's manufacturing capacity for the net-zero technologies and products required to meet the Union's ambitious climate targets, and to ensure access to relevant critical raw materials, including by diversifying sourcing, properly exploiting geological resources in Member States and maximising the recycling of raw materials. The Green Deal Industrial Plan is based on four pillars: a predictable and simplified regulatory environment, faster access to finance, the enhancement of skills, and open trade for resilient supply chains. On 16 March 2023, the Commission issued a further communication entitled 'Long-term competitiveness of the EU: looking beyond 2030', structured along nine mutually reinforcing drivers with the objective of working towards a growth-enhancing regulatory framework. It sets policy priorities aimed at actively ensuring structural improvements, well-focused investment and regulatory measures for the long-term competitiveness of the Union and its Member States. The recommendations below help address those priorities.

- (5) In 2023, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Facility. The full implementation of the recovery and resilience plans remains essential for delivering the policy priorities under the European Semester, as the plans address all or a significant subset of the relevant country-specific recommendations issued in recent years. The 2019, 2020 and 2022 country-specific recommendations remain equally relevant for the recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.
- (6) Regulation (EU) 2023/435 of the European Parliament and of the Council<sup>5</sup> (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to rapidly phase out the Union's dependence on Russian fossil-fuel imports. This will contribute to energy security and the diversification of the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. The REPowerEU Regulation enables Member States to add a new REPowerEU chapter to their national recovery and resilience plans in order to finance key reforms and investments that will help achieve the REPowerEU objectives. Those reforms and investments will also help boost the competitiveness of the Union's net-zero industry as outlined in the Green Deal Industrial Plan and address the energy-related country-specific recommendations issued to the Member States in 2022 and, where applicable, in 2023. The REPowerEU Regulation introduces a new category of non-repayable financial support, made available to Member States in order to finance new energy-related reforms and investments under their recovery and resilience plans.

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<sup>5</sup> Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1).

- (7) On 8 March 2023, the Commission adopted a communication providing fiscal policy guidance for 2024 ('the communication of 8 March 2023'). It aims to support the preparation of Member States' stability and convergence programmes and thereby strengthen policy coordination. The Commission recalled that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023. It called for fiscal policies in 2023–2024 that ensure medium-term debt sustainability and raise potential growth in a sustainable manner and invited Member States to set out in their 2023 stability and convergence programmes how their fiscal plans will ensure that the Treaty reference value of 3 % of gross domestic product (GDP) is adhered to and ensure plausible and continuous debt reduction, or for debt to be kept at prudent levels in the medium term. The Commission also invited Member States to phase out national fiscal measures introduced to protect households and firms from the energy price shock, starting with the least targeted ones. It indicated that, if support measures needed to be extended because of renewed energy price pressures, Member States should better target such measures at vulnerable households and firms. The Commission stated that the fiscal recommendations would be quantified and differentiated. Moreover, as proposed in its communication of 9 November 2022 on orientations for a reform of the EU economic governance framework, the fiscal recommendations would be formulated on the basis of net primary expenditure. It recommended that all Member States continue to protect nationally financed investment and ensure the effective use of the Facility and other Union funds, in particular in light of the green and digital transitions and resilience objectives. The Commission indicated that it will propose to the Council to open deficit-based excessive-deficit procedures in spring 2024 on the basis of the outturn data for 2023, in line with existing legal provisions.

- (8) On 26 April 2023, the Commission presented legislative proposals to implement a comprehensive reform of the Union's economic governance rules. The central objective of the proposals is to strengthen public debt sustainability and promote sustainable and inclusive growth in all Member States through reforms and investments. In its proposals, the Commission aims to improve national ownership, simplify the framework and move towards a greater medium-term focus, in combination with effective and more coherent enforcement. According to the Council conclusions of 14 March 2023 on orientations for a reform of the EU economic governance framework, the objective is to conclude the legislative work in 2023.
- (9) On 22 April 2021, Portugal submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines set out in Annex V to that Regulation. On 13 July 2021, the Council adopted its Implementing Decision on the approval of the assessment of the recovery and resilience plan for Portugal<sup>6</sup>. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5) of Regulation (EU) 2021/241, stating that Portugal has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed.
- (10) On 29 April 2023, Portugal submitted its 2023 National Reform Programme and, on 29 April 2023, its 2023 Stability Programme, in line with Article 4(1) of Regulation (EC) No 1466/97. To take account of their interlinkages, the two programmes have been assessed together. In accordance with Article 27 of Regulation (EU) 2021/241, the 2023 National Reform Programme also reflects Portugal's biannual reporting on the progress made in achieving its recovery and resilience plan.

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<sup>6</sup> ST 10149/21; ST 10149/21 ADD 1; ST 10149/21 ADD 1 REV 1.

- (11) On 24 May 2023, the Commission published the 2023 country report for Portugal. It assessed Portugal's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2022 and took stock of Portugal implementation of the recovery and resilience plan. On the basis of that analysis, the country report identified gaps with regard to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Portugal's progress in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

- (12) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Portugal and published its results on 24 May 2023. The Commission concluded that Portugal is experiencing macroeconomic imbalances. In particular, vulnerabilities related to high private, government and external debt are receding but remain present. After a temporary interruption due to the outbreak of the COVID-19 pandemic, private-sector and government debt ratios returned to declining paths in 2021 and are expected to continue declining, favoured by economic growth. While those ratios are now below pre-pandemic levels, they still remain at elevated levels. The clearly negative net international investment position improved as well, both before and after the COVID-19 pandemic, and external indebtedness is projected to further recede, supported by continued economic growth despite some slowdown in 2023. The small current account deficit worsened marginally in 2022, reflecting higher energy prices, but that deterioration was mitigated by the further marked recovery in exports, in particular tourism exports. Going forward, the assumed continued easing of energy prices and a further increase in tourism exports, as well as ongoing policies in support of energy efficiency and renewables, are projected to balance the current account and to further support the adjustment of the net international investment position. House prices have grown strongly for several years, while non-performing loans continued to decline from already moderate levels. The further reduction of vulnerabilities could be hindered by the impact of the tightening of financial conditions and an uncertain external environment, and their potential impact on economic growth. Policy progress has been favourable, with a particular focus on the recovery and resilience plan, and the continuing implementation of the recovery and resilience plan should deliver further improvements.
- (13) According to data validated by Eurostat, Portugal's general government deficit decreased from 2,9 % of GDP in 2021 to 0,4 % in 2022, while general government debt fell from 125,4 % of GDP at the end of 2021 to 113,9 % at the end of 2022.

- (14) The general government balance has been impacted by the fiscal policy measures taken to mitigate the economic and social impact of the increase in energy prices. In 2022, such fiscal policy revenue-decreasing measures included a general fuel tax reduction and the carbon rate update freeze under the fuel tax, while such fiscal policy expenditure-increasing measures included a one-time payment support payable in October 2022 for different population groups, such as pensioners, employees, children and the youth, lump-sum payments to low-income households most vulnerable to rising energy prices, and an allocation to the national electricity system to reduce electricity grid tariffs. The Commission estimates the net budgetary cost of those measures at 2,0 % of GDP in 2022. At the same time, the estimated cost of temporary emergency measures related to the COVID-19 crisis dropped to 0,8 % of GDP in 2022, from 2,0 % in 2021.
- (15) On 18 June 2021, the Council recommended that in 2022 Portugal<sup>7</sup> use the Facility to finance additional investment in support of the recovery, while pursuing a prudent fiscal policy. Moreover, the Council recommended that Portugal preserve nationally financed investment and limit the growth of nationally financed current expenditure.

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<sup>7</sup> Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Portugal (OJ C 304, 29.07.2021, p. 102).

- (16) According to the Commission estimates, the fiscal stance<sup>8</sup> in 2022 was supportive, at -1,5 % of GDP. As recommended by the Council, Portugal continued to support the recovery with investments financed by the Facility. Expenditure financed by grants under the Facility and other Union funds amounted to 1,2 % of GDP in 2022 (1,7 % of GDP in 2021). That decrease in expenditures in 2022 was due to the lower expenditure financed by other Union funds, while that financed by the Facility increased between 2021 and 2022. Nationally financed investment provided a contractionary contribution of 0,1 percentage points to the fiscal stance<sup>9</sup>. Portugal therefore did not preserve nationally financed investment, which was not in line with the Council recommendation. At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) provided an expansionary contribution of 1,9 percentage points to the fiscal stance. That significant expansionary contribution included the additional impact of measures taken to mitigate the economic and social impact of the increase in energy prices (additional net budgetary cost of 2,0 % of GDP). Portugal therefore sufficiently limited the growth in nationally financed current expenditure.
- (17) The macroeconomic scenario underpinning the budgetary projections in the 2023 Stability Programme is cautious in 2023 and in line with the Commission's 2023 spring forecast thereafter. The government projects real GDP to grow by 1,8 % in 2023 and 2,0 % in 2024. By comparison, the Commission's 2023 spring forecast projects higher real GDP growth of 2,4 % in 2023 and somewhat lower growth of 1,8 % in 2024. The difference is explained by a higher growth contribution from net exports in the Commission's 2023 spring forecast, while the government expects higher investment growth in both 2023 and 2024.

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<sup>8</sup> The fiscal stance is measured as the change in primary expenditure (net of discretionary revenue measures), excluding temporary emergency measures related to the COVID-19 crisis but including expenditure financed by non-repayable support (grants) from the Facility and other Union funds, relative to medium-term potential growth. For more details see Box 1 in the Fiscal Statistical Tables.

<sup>9</sup> Other nationally financed capital expenditure provided an expansionary contribution of 0,2 percentage points of GDP.

(18) In its 2023 Stability Programme, the government expects that the general government deficit will remain at 0,4 % of GDP in 2023. According to the 2023 Stability Programme, the general government debt-to-GDP ratio is expected to decrease from 113,9 % at the end of 2022 to 107,5 % at the end of 2023. The Commission's 2023 spring forecast projects a government deficit of 0,1 % of GDP for 2023. This is lower than the deficit projected in the 2023 Stability Programme, mainly due to higher revenue projected in the Commission's 2023 spring forecast, namely from both indirect and direct taxes. The Commission's 2023 spring forecast projects a lower general government debt-to-GDP ratio, of 106,2 % at the end of 2023. The difference is mainly due to the more favourable debt-reducing growth-interest rate differential projected in the Commission's 2023 spring forecast.

(19) The general government balance in 2023 is expected to continue to be impacted by the fiscal policy measures taken to mitigate the economic and social impact of the increase in energy prices. They consist of measures extended from 2022, in particular lump-sum payments to low-income households most vulnerable to increased energy prices, the general fuel tax reduction and the carbon rate update freeze under the fuel tax, as well as measures already announced in 2022 but with an impact on the government balance in 2023, such as the allocation to support the transitional regime for stabilising gas prices paid by firms that remains in force throughout the year. The net budgetary cost of the support measures is projected in the Commission's 2023 spring forecast at 0,8 % of GDP in 2023<sup>10</sup>. Most of the measures in 2023 do not appear to be targeted at the most vulnerable households or firms, and do not fully preserve the price signal to reduce energy demand and increase energy efficiency. As a result, the amount of targeted support measures, to be taken into account in the assessment of compliance with the Council Recommendation of 12 July 2022<sup>11</sup>, is estimated in the Commission's 2023 spring forecast at 0,3 % of GDP in 2023 (compared to 1 % of GDP in 2022). Finally, the general government balance in 2023 is expected to benefit from the phasing-out of temporary emergency measures related to the COVID-19 crisis, which have been estimated at 0,8 % of GDP.

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<sup>10</sup> The figure represents the level of annual budgetary cost of those measures, including current revenue and expenditure as well as — where relevant — capital expenditure measures.

<sup>11</sup> Council Recommendation of 12 July 2022 on the National Reform Programme of Portugal and delivering a Council opinion on the 2022 Stability Programme of Portugal, (OJ C 334, 1.9.2022, p. 181).

- (20) In its Recommendation of 12 July 2022, the Council recommended that Portugal ensure in 2023 a prudent fiscal policy, in particular by limiting the growth of nationally financed primary current expenditure below medium-term potential output growth<sup>12</sup>, taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. At the same time, Portugal should stand ready to adjust current spending to the evolving situation. Portugal was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Facility and other Union funds.

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<sup>12</sup> Based on the Commission's 2023 spring forecast, the medium-term (10-year average) potential output growth of Portugal is estimated at 7,6% in nominal terms.

(21) In 2023, the fiscal stance is projected in the Commission's 2023 spring forecast to be expansionary (-0,7 % of GDP), in a context of high inflation. This follows an expansionary fiscal stance in 2022 (-1,5 % of GDP). The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 is projected to provide a contractionary contribution of 0,3 percentage points to the fiscal stance. Therefore, the projected growth of nationally financed primary current expenditure is in line with the Council Recommendation of 12 July 2022. The projected contractionary contribution of nationally financed primary current expenditure is due, in substance, to the reduced costs of the support measures (targeted and untargeted) to households and firms in response to energy price hikes (by 1,1 percentage points of GDP). The main drivers of growth in nationally financed primary current expenditure (net of new revenue measures) are the persistent pressures on public current spending, including on public-sector wages and pensions, driven in particular by permanent rises in public-sector wages and discretionary pension increases. Expenditure financed by grants under the Facility and other Union funds is projected to amount to 2,2 % of GDP in 2023, while nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 0,3 percentage points<sup>13</sup>. Therefore, Portugal plans to finance investment through the Facility and other Union funds, and it is projected to preserve nationally financed investment.<sup>14</sup> It plans to finance public investment for the green and digital transitions, and for energy security, including through industry decarbonisation projects, production of renewable hydrogen and other renewable gases, and the digitalisation of schools, which are partly funded by the Facility and other Union funds.

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<sup>13</sup> Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0,3 percentage point of GDP, notably driven by the estimated reduced capital transfers to state-owned enterprises in 2023.

<sup>14</sup> Expenditure financed by Recovery and Resilience Facility grants and other Union funds amounted to 2,2% of GDP in 2023, while nationally financed investment provided an expansionary contribution to the fiscal stance of 0,3 percentage point. Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0,1 percentage point of GDP.

- (22) According to the 2023 Stability Programme the general government deficit is expected to decline to 0,2 % of GDP in 2024. The decrease in 2024 mainly reflects the planned containment of current expenditure, notably in intermediate consumption, compensation of employees and subsidies, along with a sustained growth on the revenue side. According to the 2023 Stability Programme, the general government debt-to-GDP ratio is expected to decrease to 103,0 % at the end of 2024. On the basis of the policy measures known at the cut-off date of the forecast, the Commission's 2023 spring forecast projects a government deficit of 0,1 % of GDP in 2024. This is slightly lower than the deficit projected in the 2023 Stability Programme, mainly due to the more buoyant revenue growth, particularly in taxes, projected in the Commission's 2023 spring forecast. The Commission's 2023 spring forecast projects a similar general government debt-to-GDP ratio, of 103,1 % at the end of 2024.
- (23) The 2023 Stability Programme does not include information on the phasing-out of energy support measures in 2024. The Commission currently assumes the full phasing-out of energy support measures in 2024. This is based on the assumption of no renewed energy price increase.

- (24) Regulation (EC) No 1466/97 calls for an annual improvement in the structural budget balance toward the medium-term budgetary objective, with 0,5 % of GDP as a benchmark.<sup>15</sup> Taking into account fiscal sustainability considerations, an improvement in the structural balance of at least 0,3 % of GDP for 2024 would be appropriate, according to the Commission. To ensure such an improvement, and in accordance with the Commission's methodology, the growth in net nationally financed primary expenditure<sup>16</sup> in 2024 should not exceed 1,8 %, as reflected in this Recommendation. At the same time, the remaining energy support measures (currently estimated by the Commission at 0,8 % of GDP in 2023) should be phased out in 2023, if energy-market developments so permit and starting with the least targeted measures, and the related savings should be used to reduce the government deficit.
- (25) Assuming unchanged policies, the Commission's 2023 spring forecast projects the net nationally financed primary expenditure to grow at 2,8 % in 2024, which is above the recommended growth rate. The adjustment projected in the Commission's 2023 spring forecast is less than the savings from the full phasing-out of the energy support measures. This is due to measures with a projected permanent expenditure-increasing impact and to revenue-reducing personal income tax reforms.

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<sup>15</sup> Article 5 of Regulation (EC) No 1466/97 also requires an adjustment of more than 0,5% of GDP for Member States with a government debt exceeding 60 % of GDP, or with more pronounced debt sustainability risks.

<sup>16</sup> Net primary expenditure is defined as nationally financed expenditure net of discretionary revenue measures and excluding interest expenditure and cyclical unemployment expenditure.

- (26) According to the 2023 Stability Programme, government investment is expected to increase from 3,2 % of GDP in 2023 to 3,4 % of GDP in 2024. The higher investment reflects higher nationally financed investment and investment financed by the Union, namely through the Facility. The 2023 Stability Programme refers to reforms and investments that are expected to contribute to fiscal sustainability and sustainable and inclusive growth. Those reforms and investments include measures to modernise and simplify public financial management and to upgrade public financial management information systems, such as the development of a model for monitoring the budgetary and financial execution of general government, the operationalisation of the state accounting entity, as well as the integration of programme budgeting and spending reviews in the regular budgetary process, which are part of the recovery and resilience plan.

(27) The 2023 Stability Programme outlines a medium-term fiscal path until 2027. According to the 2023 Stability Programme, the general government deficit is expected to gradually decline to 0,1 % of GDP in 2025, to achieve a balanced budgetary position in 2026 and later to reach a small surplus of 0,1 % of GDP in 2027. Therefore, the general government deficit is planned to remain below 3 % of GDP over the Programme horizon. According to the 2023 Stability Programme, the general government debt-to-GDP ratio is expected to decrease from 103,0 % at the end of 2024 to 92,0 % by the end of 2027. A more growth-friendly composition of public finances, on both the revenue and expenditure sides of the public budget, would strengthen Portugal's long-term fiscal sustainability while improving the business environment and contributing to sustainable and inclusive growth. Tax benefits are widely used in the Portuguese tax system, with more than 500 tax benefits spread over more than 60 legal texts. This increases complexity and diminishes the system's transparency, while at the same time resulting in forgone revenue. The cost efficiency of existing tax benefits would benefit from being systematically monitored and assessed, allowing for significant improvements in this area. Furthermore, State and municipal surcharges complicate the corporate income tax system, which creates an additional burden for both the tax administration and businesses. The efficiency of Portugal's revenue administration could be strengthened to encourage voluntary compliance, while helping reduce tax evasion and fraud. The administrative cost of tax collection is high and has further increased in recent years (by approximately 5 % from 2018 to 2020). At the same time, the time taken to pay taxes in Portugal appears to be longer than in other Member States. The already high outstanding tax arrears continued to increase (they stood at 45,9 % of total revenue by the end of 2020, well above the Union average).

(28) The capacity of benefits under Portugal's social protection system to reduce poverty is low and decreased further in 2021, while the evolution of the share of people at risk of poverty was among the worst in the Union (increasing by 2,4 percentage points), against a backdrop of general stability in most Member States. The adequacy of the minimum income remains low and is well below the poverty threshold. Such figures challenge Portugal's capacity to attain the poverty reduction goals set out in the European Pillar of Social Rights Action Plan. At the same time, the social protection system remains complex, as various types of social benefits appear to serve similar objectives. The ensuing complexity and fragmentation results in relatively low take-up rates and a lack of effective focus on people who are most in need, hampering the coverage and ultimately the adequacy of social benefits. The simplification of existing benefits together with a timely implementation of the national strategy to combat poverty will increase Portugal's capacity to face future social challenges.

(29) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. The implementation of Portugal's recovery and resilience plan is underway, albeit with risk of some delays. Portugal submitted two payment requests, corresponding to 58 milestones and targets in the recovery and resilience plan and resulting in an overall disbursement of EUR 2,98 billion. The Portuguese recovery and resilience plan is ambitious and complex in nature. Strong governance and continuous monitoring of the plan are essential to minimise the risk of delays. The inclusion of the new REPowerEU chapter in the recovery and resilience plan will allow additional reforms and investments to be financed in support of Portugal's strategic objectives in the field of energy and the green transition. The systematic and effective involvement of local and regional authorities, social partners and other relevant stakeholders remains important for the successful implementation of the recovery and resilience plan, as well as other economic and employment policies going beyond that plan, in order to ensure broad ownership of the overall policy agenda. On 26 May 2023, Portugal submitted an amendment of its plan, revised with new measures, including a REPowerEU chapter, and taking into account the increased maximum financial contribution<sup>17</sup>. In accordance with Article 14(6) of Regulation (EU) 2021/241, Portugal also submitted its request for additional loan support under the Facility.

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<sup>17</sup> The maximum financial contribution for Portugal was updated on 30 June 2022 to an amount of EUR 15,5 billion in grants, in line with Article 11(2) of Regulation (EU) 2021/241.

- (30) The Commission approved all Portugal's cohesion policy programming documents in 2022. Proceeding with the swift implementation of the cohesion policy programmes in complementarity and synergy with the recovery and resilience plan, including the REPowerEU chapter, is key to achieving the green and digital transitions, increasing economic and social resilience, and achieving balanced territorial development in Portugal.
- (31) Beyond the economic and social challenges addressed by the recovery and resilience plan and cohesion policy programmes, Portugal faces a number of additional challenges related to the circular economy, energy and the green transition.
- (32) Portugal is far below the Union average in making progress towards a circular economy, in resource productivity in industries and with regard to waste management indicators, with marked regional differences. The average municipal recycling rate is particularly low (30,5 % in 2021, far from the Union target of 50 % by 2020) and varies by region. Achieving the Union targets for the next decade, including reaching 55 % recycling of municipal waste by 2025, will require significant efforts. Improvements are needed to increase the prevention, minimisation, sorting, reuse and recycling of waste, in line with the higher steps in the waste hierarchy, thereby diverting waste away from landfills and incinerators, and to modernise waste recycling and treatment facilities. Examples of how to better achieve those objectives include increasing landfill and incineration charges, introducing a residual waste tax and raising charges on municipalities that fail to meet recycling targets. In addition, the process could be accelerated by extending the separate collection of waste and further developing schemes such as 'pay-as-you-throw', 'deposit return' and Extended Producer Responsibility.

(33) Despite the progress made, including in the context of the energy crisis, Portugal remains highly dependent on imported fossil fuels, with oil and gas making up 45 % and 23 % respectively of its energy mix in 2021. In addition, Portugal's high dependency on gas for electricity production poses risks in terms of security of supply, especially considering the scarcity of hydroelectric power due to more frequent droughts. To accelerate the decarbonisation efforts, a number of measures could be further pursued that build on and go beyond the reforms and investments that are part of Portugal's recovery and resilience plan. To accelerate the take-up of renewables, Portugal could follow up on the progress it made last year on streamlining its permitting process, including by increasing the capacity of the administration dealing with permitting, increasing digitalisation in renewables production and introducing more favourable spatial planning arrangements for offshore wind, the potential for which remains under-exploited. Further action to promote self-consumption, including rooftop solar, and renewable energy communities would also be beneficial. In spite of growth, the number of renewable energy communities in Portugal is still low, and there is scope to facilitate their licensing and to create incentives schemes.

(34) As more renewables are integrated, further investment to expand the storage and network capacity will be essential to safeguard the balance of the electricity grid. Portugal could benefit from strengthening its electricity interconnections, as the interconnection level with Spain is still low compared to its 2030 targets. The status of the transmission and distribution grid could be improved through the reinforcement of the internal grid, additional investments in electricity storage and further digitalisation of the grid. The relatively low roll-out of smart meters hampers the development of a decentralised system of renewable energy production. To address its high degree of reliance on fossil fuels in buildings and reduce energy consumption, Portugal needs to accelerate its efforts on energy efficiency beyond what is set out in the Portuguese recovery and resilience plan and cohesion policy programmes. Further measures should also contribute to addressing the high share of the Portuguese population experiencing energy poverty. Stepping up efforts to incentivise deep renovations, including by delivering technical assistance to applicants, could accelerate the take-up of renovation projects. In addition, Portugal could benefit from a strengthened framework for financial schemes to leverage private investment for energy-efficient renovation. By doing so, Portugal could target more grant-based resources towards households in need. Portugal's consumption of natural gas has dropped by 16 % in the period between August 2022 and March 2023, compared with the average gas consumption over the same period in the preceding five years, beyond the 15 % reduction target laid down in Council Regulation (EU) 2022/1369<sup>18</sup>. Portugal could keep pursuing efforts to temporarily reduce gas demand until 31 March 2024 pursuant to Council Regulation (EU) 2023/706<sup>19</sup>.

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<sup>18</sup> Council Regulation (EU) 2022/1369 of 5 August 2022 on coordinated demand-reduction measures for gas (OJ L 206, 8.8.2022, p. 1).

<sup>19</sup> Council Regulation (EU) 2023/706 of 30 March 2023 amending Regulation (EU) 2022/1369 as regards prolonging the demand-reduction period for demand-reduction measures for gas and reinforcing the reporting and monitoring of their implementation (OJ L 93, 31.3.2023, p. 1).

- (35) Labour and skills shortages in sectors and occupations key for the green transition, including manufacturing, deployment and maintenance of net-zero technologies, are creating bottlenecks in the transition to a net-zero economy. High-quality education and training systems that respond to changing labour market needs and targeted upskilling and reskilling measures are key to reducing skills shortages and promoting labour inclusion and reallocation. To unlock untapped labour supply, those measures need to be accessible, in particular for individuals and in sectors and regions most affected by the green transition. Portugal is facing shortages of skills needed for the green transition, in particular in the construction and manufacturing sectors. It would benefit from strengthening its policies for upskilling and reskilling linked to the green transition.
- (36) In the light of the Commission's assessment, the Council has examined the 2023 Stability Programme and its opinion<sup>20</sup> is reflected in recommendation (1).

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<sup>20</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

- (37) In view of the close interlinkages between the economies of euro-area Member States and their collective contribution to the functioning of the economic and monetary union, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to (i) preserve debt sustainability and refrain from broad-based support to aggregate demand in 2023, better target fiscal measures taken to mitigate the impact of high energy prices and reflect on appropriate ways to wind down support as energy price pressures diminish; (ii) sustain a high level of public investment and promote private investments to support the green and digital transitions; (iii) support wage developments that mitigate the loss in purchasing power while limiting second-round effects on inflation, further improve active labour-market policies and address skills shortages; (iv) improve the business environment and ensure that energy support to companies is cost-effective, temporary and targeted to viable firms and that it maintains incentives for the green transition; and (v) preserve macro-financial stability and monitor risks while continuing to work on completing the banking union. For Portugal, recommendations (1), (2) and (4) contribute to the implementation of the first, second and third recommendations set out in the 2023 Recommendation on the euro-area.
- (38) In the light of the Commission's in-depth review and its assessment, the Council has examined the 2023 National Reform Programme and the 2023 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendation (1). Policies referred to in recommendation (1) help address vulnerabilities linked to government debt. Recommendation (2) contributes to addressing recommendation (1). Policies referred to in recommendation (1) contribute to both addressing imbalances and implementing the recommendations set out in the 2023 Recommendation on the euro area, in line with recital 37.

HEREBY RECOMMENDS that Portugal take action in 2023 and 2024 to:

1. Wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. Should renewed energy price increases necessitate new or continued support measures, ensure that such support measures are targeted at protecting vulnerable households and firms, are fiscally affordable and preserve incentives for energy savings.

Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 1,8 %<sup>21</sup>, unless a higher reference rate in net nationally financed primary expenditure growth is estimated to be compatible with Portugal reaching its medium-term budgetary objective of -0,5 % of GDP, *inter alia* if interest expenditure is lower than currently projected by the Commission.

Preserve nationally financed public investment and ensure the effective absorption of grants under the Facility and of other Union funds, in particular to foster the green and digital transitions.

For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, in order to achieve a prudent medium-term fiscal position.

Improve the effectiveness of the tax and social protection systems, in particular by prioritising the simplification of both frameworks, strengthening the efficiency of their respective administrations and reducing the associated administrative burden.

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<sup>21</sup> Which is estimated to correspond to an annual improvement in the structural budget balance of at least 0,3% of GDP for 2024, as described in recital 24.

2. Accelerate the implementation of its recovery and resilience plan, including by ensuring adequate administrative capacity and, following the recent submission of the addendum, including the REPowerEU chapter and the additional loan request, rapidly start the implementation of the related measures. Proceed with the speedy implementation of cohesion policy programmes, in close complementarity and synergy with the recovery and resilience plan.
3. Improve the conditions for the transition towards a circular economy, in particular by increasing waste prevention, recycling and reuse in order to divert waste away from landfills and incinerators.
4. Reduce overall reliance on fossil fuels. Further accelerate the deployment of renewables by further simplifying and digitalising permitting in order to allow for additional wind, in particular offshore, and solar electricity production, as well as promoting self-consumption and renewable energy communities. Increase electricity interconnection capacity and upgrade the electricity transmission and distribution grids, enabling investment in electricity storage and digitalisation of the grid, including a faster roll-out of smart meters. Accelerate investment in energy efficiency by promoting financial schemes to attract private investment and supporting households in need. Step up policy efforts aimed at the provision and acquisition of skills and competences needed for the green transition.

Done at Brussels,

*For the Council*

*The President*

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