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

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees and finalized by the Economic and Financial Committee, based on the Commission Proposal COM(2023) 622 final.

Recommendation for a

COUNCIL RECOMMENDATION

**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 Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, 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 imbalances², and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

- (1) Regulation (EU) 2021/241 of the European Parliament and of the Council³, which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the EU. In line with the European Semester priorities, it contributes to economic and inclusive recovery and to the implementation of sustainable and growth-enhancing reforms and investments, in particular to promote the green and digital transition and 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 EU and support the continued implementation of the European Pillar of Social Rights. The maximum financial contribution per Member State under the Recovery and Resilience Facility was updated on 30 June 2022, in accordance with Article 11(2) of Regulation (EU) 2021/241.
- (2) On 22 November 2022, the Commission adopted the 2023 Annual Sustainable Growth Survey⁴, marking the start of the 2023 European Semester for economic policy coordination. The European Council endorsed the priorities of the survey around the four dimensions of competitive sustainability on 23 March 2023. 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, and for which 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, which the Council adopted on 16 May 2023, as well as the proposal for the 2023 Joint Employment Report analysing the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights, which the Council adopted on 13 March 2023.

³ 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).

⁴ COM(2022) 780 final.

- (3) While the EU economies are showing remarkable resilience, the geopolitical context continues to have a negative impact. As the EU stands firmly with Ukraine, the EU economic and social policy agenda is focused on reducing the negative impact of energy shocks on both vulnerable households and companies in the short term, and on keeping up efforts to deliver on the green and digital transition, support sustainable and inclusive growth, safeguard macroeconomic stability and increase resilience in the medium term. It also focuses heavily on increasing the EU's competitiveness and productivity.
- (4) On 1 February 2023, the Commission issued the Communication *A Green Deal Industrial Plan for the Net-Zero Age*⁵ to boost the competitiveness of the EU's net-zero industry and support the fast transition to climate neutrality. The plan complements ongoing efforts under the European Green Deal and REPowerEU. It aims to provide a more supportive environment for scaling up the EU's manufacturing capacity for the net-zero technologies and products required to meet the EU's ambitious climate targets, as well as ensuring 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 plan is based on four pillars: a predictable and simplified regulatory environment, speeding up access to finance, enhancing skills, and open trade for resilient supply chains. On 16 March 2023, the Commission also issued the Communication *Long-term competitiveness of the EU: looking beyond 2030*⁶, structured along nine mutually reinforcing drivers with the objective to work towards a growth enhancing regulatory framework. It sets policy priorities aimed at actively ensuring structural improvements, well focused investments and regulatory measures for the long-term competitiveness of the EU and its Member States. The recommendations below help address those priorities.

⁵ COM(2023) 62 final.

⁶ COM(2023) 168 final.

- (5) In 2023, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Recovery and Resilience Facility. Fully implementing 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 also for recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.
- (6) The REPowerEU Regulation⁷ adopted on 27 February 2023 aims to rapidly phase out the EU's dependence on Russian fossil fuel imports. This will contribute towards energy security and the diversification of the EU's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. The 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. They will also help boost the competitiveness of the EU's net-zero industry as outlined in the Green Deal Industrial Plan for the Net-Zero Age 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 to finance new energy-related reforms and investments under their recovery and resilience plans.

⁷ 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. It aims to support the preparation of Member States' stability and convergence programmes and thereby strengthen policy coordination⁸. 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 as well as raise potential growth in a sustainable manner. Member States were invited to set out in their 2023 stability and convergence programmes how their fiscal plans will ensure that the 3% of GDP deficit reference value is adhered to as well as plausible and continuous debt reduction, or for debt to be kept at prudent levels in the medium term. The Commission 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 target such measures much better than in the past towards vulnerable households and firms. The Commission proposed that the fiscal recommendations would be quantified and differentiated. Moreover, as proposed in its Communication on orientations for a reform of the EU economic governance framework⁹, the fiscal recommendations would be formulated on the basis of net primary expenditure. It recommended that all Member States should continue to protect nationally financed investment and ensure the effective use of the Recovery and Resilience Facility and other EU funds, in particular in light of the green and digital transition 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 COM(2023) 141 final.

⁹ COM(2022) 583 final.

- (8) On 26 April 2023, the Commission presented legislative proposals to implement a comprehensive reform of the EU'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 at improving national ownership, simplifying the framework and moving towards a greater medium-term focus, combined with effective and more coherent enforcement. According to the Council Conclusions adopted on 14 March 2023, 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 of Annex V to that Regulation. On 13 July 2021, the Council adopted its Decision on the approval of the assessment of the recovery and resilience plan for Portugal¹⁰. The release of instalments is conditional on a decision by the Commission, taken in accordance with Article 24(5) of Regulation (EU) 2021/241, 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.

¹⁰ Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Portugal (ST 10149/21; ST 10149/21 ADD 1; ST 10149/21 ADD 1 REV 1).

- (11) The Commission published the 2023 country report for Portugal¹¹ on 24 May 2023. 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. Based on this analysis, the country report identified gaps with respect 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 on implementing the European Pillar of Social Rights and on achieving the EU headline targets on employment, skills and poverty reduction, as well as progress in achieving the UN's Sustainable Development Goals.

¹¹ SWD(2023) 622 final.

- (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 2023¹². It 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 pandemic, private sector and government debt ratios returned to declining paths in 2021 and are expected to continue declining, favoured by economic growth. While they are now below pre-pandemic levels, they remain at still elevated levels. The clearly negative net international investment position improved too, both before and after the 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, especially of tourism. 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 adjustment in 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 main risks to the further narrowing of vulnerabilities relate to the impact of the tightening of financial conditions and to an uncertain external environment, and their potential impact on economic growth. Policy progress has been favourable, with a particular focus on the RRP, and continuing implementing the RRP should deliver further improvements.
- (13) Based on data validated by Eurostat,¹³ 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.

¹² SWD(2023) 641 final.

¹³ Eurostat-Euro Indicators, 47/2023, 21.4.2023.

- (14) The general government balance has been impacted by the fiscal policy measures adopted to mitigate the economic and social impact of the increase in energy prices. In 2022, such revenue-decreasing measures included a general fuel tax reduction and the carbon rate update freeze under the fuel tax, while such 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 these measures at 2.0% of GDP in 2022. At the same time, the estimated cost of COVID-19 temporary emergency measures dropped to 0.8% of GDP in 2022, from 2.0% in 2021.
- (15) On 18 June 2021, the Council recommended that in 2022 Portugal¹⁴ use the Recovery and Resilience Facility to finance additional investment in support of the recovery, while pursuing a prudent fiscal policy. Moreover, Portugal should preserve nationally financed investment. The Council also recommended Portugal to limit the growth of nationally financed current expenditure.

¹⁴ 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 stance¹⁵ 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 Recovery and Resilience Facility. Expenditure financed by Recovery and Resilience Facility grants and other EU funds amounted to 1.2% of GDP in 2022 (1.7% of GDP in 2021). This decrease in expenditures in 2022 was due to the lower expenditure financed by other EU funds, while that financed by the Recovery and Resilience Facility increased between 2021 and 2022. Nationally financed investment provided a contractionary contribution of 0.1 percentage points to the fiscal stance.¹⁶ 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. This significant expansionary contribution included the additional impact of measures 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 Stability Programme is cautious in 2023 and in line with the Commission 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 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 forecast for 2023, while the government expects higher investment growth in both 2023 and 2024.

¹⁵ The fiscal stance is measured as the change in primary expenditure (net of discretionary revenue measures), excluding Covid-19 crisis-related temporary emergency measures but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth. For more details see Box 1 in the Fiscal Statistical Tables.

¹⁶ Other nationally financed capital expenditure provided an expansionary of 0.2 percentage points of GDP.

- (18) In its 2023 Stability Programme, the government expects that the general government deficit ratio will remain at 0.4% of GDP in 2023. According to the 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 2023 spring forecast projects a government deficit of 0.1% of GDP for 2023. This is lower than the deficit projected in the Stability Programme, mainly due to higher revenue projected in the Commission 2023 spring forecast, namely from both indirect and direct taxes. The Commission 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 2023 spring forecast.
- (19) The government balance in 2023 is expected to continue to be impacted by the fiscal policy measures adopted 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), and 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 in force throughout the year. The net budgetary cost of the support measures is projected in the Commission 2023 spring forecast at 0.8% of GDP in 2023¹⁷. Most of the measures in 2023 do not appear targeted to 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 fiscal recommendation for 2023, is estimated in the Commission 2023 spring forecast at 0.3% of GDP in 2023 (compared to 1% of GDP in 2022). Finally, the 2023 government balance is expected to benefit from the phasing out of COVID-19 temporary emergency measures of 0.8% of GDP.

¹⁷ 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.

- (20) On 12 July 2022, the Council recommended¹⁸ 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 growth¹⁹, 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 Recovery and Resilience Facility and other Union funds.

¹⁸ 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.

¹⁹ Based on the Commission 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 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 recommendation of the Council. 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, notably driven by permanent rises in public sector wages and discretionary pensions increases. Expenditure financed by Recovery and Resilience Facility grants and other EU 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 points²⁰. Therefore, Portugal plans to finance investment through the Recovery and Resilience Facility and other EU funds, and it is projected to preserve nationally financed investment.²¹ It plans to finance public investment in 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 Recovery and Resilience Facility and other EU funds.

²⁰ Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0.3 percentage points of GDP, notably driven by the estimated reduced capital transfers to state-owned enterprises in 2023.

²¹ Expenditure financed by Recovery and Resilience Facility grants and other EU 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 points. Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0.1 percentage points of GDP.

- (22) According to the 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. The programme expects the general government debt-to-GDP ratio to decrease to 103.0% at the end of 2024. Based on policy measures known at the cut-off date of the forecast, the Commission 2023 spring forecast projects a government deficit of 0.1% of GDP in 2024. This is slightly lower than the deficit projected in the programme, mainly due to more buoyant revenue growth, particularly in taxes, in the Commission forecast. The Commission 2023 spring forecast projects a similar general government debt-to-GDP ratio, of 103.1% at the end of 2024.
- (23) The 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 hinges upon the assumption of no renewed energy price increases.
- (24) Council Regulation (EC) No 1466/97 calls for an annual improvement in the structural budget balance toward the medium-term objective by 0.5% of GDP as a benchmark.²² 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 expenditure²³ 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, contingent on energy market developments and starting from the least targeted ones, and the related savings should be used to reduce the government deficit.

²² Cf. Article 5 of Council Regulation (EC) No 1466/97, which 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.

²³ Net primary expenditure is defined as nationally financed expenditure net of discretionary revenues measures and excluding interest expenditure as well as cyclical unemployment expenditure.

- (25) Assuming unchanged policies, the Commission 2023 spring forecast projects 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 forecast is less than the savings from the full phasing out of energy support measures. This is due to measures with a projected permanent increasing impact on expenditure, as well as revenue-reducing personal income tax reforms.
- (26) According to the 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 EU, namely through the Recovery and Resilience Facility. The programme refers to reforms and investments, that are expected to contribute to fiscal sustainability and sustainable and inclusive growth. These 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 Stability Programme outlines a medium-term fiscal path until 2027. According to the programme, the general government deficit is expected to gradually decline to 0.1% of GDP in 2025, achieving a balanced budgetary position in 2026, to later reach a small surplus of 0.1% of GDP in 2027. The general government deficit is therefore planned to remain below 3% of GDP over the programme horizon. According to the 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 texts²⁴. This increases complexity and diminishes the system's transparency while at the same time representing foregone revenue. The cost efficiency of existing tax benefits would benefit from being systematically monitored and assessed, allowing for significant improvements in this area. Furthermore, the corporate income tax system is complicated by state and municipal surcharges, creating 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 EU 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 EU average).

²⁴ 'Tax benefits in Portugal – concept, methodology and practice', Working Group on Tax Benefits, May 2019.

- (28) On Portugal's social protection system, the capacity of social benefits for reducing 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 EU (increasing by 2.4 p.p.), against a backdrop of general stability across most Member States. The adequacy of minimum income remains low and is well below the poverty threshold. These figures challenge Portugal's capacity to attain the poverty reduction goals 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) and Annex V, criterion 2.2 of Regulation (EU) 2021/241, 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, however with risk of some delays. Portugal submitted 2 payment requests, corresponding to 58 milestones and targets in the plan and resulting in an overall disbursement of EUR 2.98 billion. The Portuguese RRP 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 the plan, 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 contribution²⁵. In accordance with Article 14(6) of Regulation (EU) 2021/241, Portugal also submitted its request for an additional loan support under the Recovery and Resilience Facility.

²⁵ 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 the RRF Regulation (Regulation (EU) 2021/241).

- (30) The Commission approved all of 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 transition, increasing economic and social resilience, as well as 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 EU average in making progress towards a circular economy, as well as resource productivity in industries and waste management indicators, with marked regional differences. The average municipal recycling rate is particularly low (30.5% in 2021, far from the EU target of 50% by 2020) and varies by region. Achieving the EU targets for the next decade, including reaching 55% recycling of municipal waste by 2025, will require significant effort. Improvements are needed to increase the prevention, minimisation, sorting, reuse and recycling of waste, thereby diverting waste away from landfills and incinerators, and to modernise waste recycling and treatment facilities, in line with the higher steps in the waste hierarchy. Examples of how to better achieve these 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 also 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, the country'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 investment and reforms 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. Despite growing, the number of renewable energy communities in Portugal is still low, and there is scope to facilitate their licensing and 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 internal grid reinforcement, additional investment 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 5 years, beyond the 15% reduction target. Portugal could keep pursuing efforts to temporarily reduce gas demand until 31 March 2024²⁶.

²⁶ Council Regulation (EU) 2022/1369 and Council Regulation (EU) 2023/706.

- (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, these measures need to be accessible, in particular for individuals and in sectors and regions most affected by the green transition. Portugal is facing green skills shortages in particular in the construction and manufacturing sectors. It would benefit from strengthening policies for upskilling and reskilling linked to the green transition.
- (36) In light of the Commission's assessment, the Council has examined the 2023 Stability Programme and its opinion²⁷ is reflected in recommendation (1) below.

²⁷ Under Articles 5(2) and 9(2) of Council 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 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 high public investment and promote private investment to support the green and digital transition; (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, 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 euro area recommendations.
- (38) In light of the Commission's in-depth review and this 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) below. 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 for 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 these are targeted at protecting vulnerable households and firms, 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%²⁸, unless a higher reference rate in net nationally financed primary expenditure growth is estimated to be compatible with Portugal reaching its MTO 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 RRF grants and other EU 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, 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.

²⁸ 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, also by ensuring an 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, 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 to allow for additional wind particularly 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 the 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