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Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Portugal

{SWD(2025) 222 final}

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Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies 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 Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) 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:

General considerations

(1) Regulation (EU) 2024/1263, which entered into force on 30 April 2024, specifies the objectives of the economic governance framework, which aims at promoting sound and sustainable public finances and sustainable and inclusive growth and resilience through reforms and investments, and preventing excessive government deficits. The Regulation stipulates that the Council and the Commission conduct multilateral surveillance in the context of the European Semester in accordance with the objectives and requirements set out in the TFEU. The European Semester includes, in particular, the formulation, and the surveillance of the implementation of country-specific recommendations. The Regulation also promotes national ownership of fiscal policy and emphasises its medium-term focus, combined with more effective and coherent enforcement. Each Member State must submit to the Council and the Commission a national medium-term fiscal-structural plan, containing its fiscal, reform and investment commitments, over 4 or 5 years, depending on the length of the national legislative term. The net expenditure[2] path in these plans has to comply with the

[1] OJ L, 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

[2] Net expenditure as defined in Article 2, point (2), of Regulation (EU) 2024/1263: ‘net expenditure’ means government expenditure net of (i) interest expenditure; (ii) discretionary revenue measures; (iii) expenditure on programmes of the Union fully matched by revenue from Union funds; (iv) national expenditure on co-financing of programmes funded by the Union; (v) cyclical elements of unemployment benefit expenditure; and (vi) one-offs and other temporary measures.

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Regulation's requirements, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period, or for it to remain at prudent levels below 60% of gross domestic product (GDP), and to bring and/or maintain the general government deficit below the 3%-of-GDP Treaty reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in the Regulation, the adjustment period may be extended by up to three years.

(2) Regulation (EU) 2021/241 of the European Parliament and of the Council[3], which established the Recovery and Resilience Facility (the 'RRF'), entered into force on 19 February 2021. The RRF provides financial support to Member States for implementing reforms and investments, delivering a fiscal impulse financed by the Union. In line with the priorities of the European Semester for economic policy coordination, the RRF fosters economic and social recovery while driving sustainable reforms and investments, in particular promoting the green and digital transitions and making 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.

(3) Regulation (EU) 2023/435 of the European Parliament and of the Council[4] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to phase out the Union's dependence on Russian fossil-fuel imports. This helps achieve energy security and diversify the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Portugal added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

(4) 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 that Regulation, 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. On 13 July 2021, the Council adopted its Implementing Decision approving the assessment of the recovery and resilience plan for Portugal[5], which was amended under Article 18(2) on 10 October 2023 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter[6]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5), stating that Portugal has satisfactorily achieved the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory achievement requires that the

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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, ELI: http://data.europa.eu/eli/reg/2021/241/oj).

4 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, ELI: http://data.europa. eu/eli/reg/2023/435/oj).

5 Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Portugal (10149/2021).

6 Council Implementing Decision of 10 October 2023 amending the Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Portugal (13351/23).

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achievement of preceding milestones and targets for the same reform or investment has not been reversed.

(5) On 21 January 2025, the Council, upon the recommendation of the Commission, adopted a recommendation endorsing the national medium-term fiscal-structural plan of Portugal[7]. The plan was submitted in accordance with Article 11 and Article 36(1), point (a), of Regulation (EU) 2024/1263, covers the period from 2025 until 2028 and presents a fiscal adjustment spread over four years.

(6) On 26 November 2024, the Commission adopted an opinion on the 2025 draft budgetary plan of Portugal. On the same date, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the 2025 Alert Mechanism Report, in which it did not identify Portugal as one of the Member States for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2025 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[8] on 13 May 2025 and the Joint Employment Report on 10 March 2025.

(7) On 29 January 2025, the Commission published the Competitiveness Compass, a strategic framework that aims to boost the EU's global competitiveness over the next five years. It identifies the three transformative imperatives of sustainable economic growth: (i) innovation; (ii) decarbonisation and competitiveness; and (iii) security. To close the innovation gap, the EU aims to foster industrial innovation, support the growth of start-ups through initiatives like the EU Start-up and Scale-up Strategy, and promote the adoption of advanced technologies like artificial intelligence and quantum computing. In pursuit of a greener economy, the Commission has outlined a comprehensive Affordable Energy Action Plan and a Clean Industrial Deal, ensuring that the shift to clean energy remains cost-effective, competitiveness-friendly, particularly for energy-intensive sectors, and is a driver for growth. To reduce excessive dependencies and increase security, the Union is committed to strengthening global trade partnerships, diversifying supply chains and securing access to critical raw materials and clean energy sources. These priorities are underpinned by horizontal enablers, namely regulatory simplification, deepening of the single market, financing competitiveness and a Savings and Investments Union, promotion of skills and quality jobs, and better coordination of EU policies. The Competitiveness Compass is aligned with the European Semester, ensuring that Member States' economic policies are consistent with the Commission's strategic objectives, creating a unified approach to economic governance that fosters sustainable growth, innovation and resilience across the Union.

(8) In 2025, the European Semester for economic policy coordination continues to develop alongside the implementation of the RRF. The full implementation of the recovery and resilience plans remains essential for delivering on the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations

[7] Council Recommendation of 21 January 2025 endorsing the medium-term fiscal-structural plan of Portugal, OJ C/2025/641, 10.2.2025.

[8] Council Recommendation of 13 May 2025 on the economic policy of the euro area (OJ C, C/2025/2782, 22.5.2025, ELI: http://data.europa.eu/eli/C/2025/2782/oj).

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issued in recent years. These country-specific recommendations remain equally relevant for the assessment of amended recovery and resilience plans in accordance with Article 21 of Regulation (EU) 2021/241.

(9) The 2025 country-specific recommendations cover the key economic policy challenges that are not sufficiently addressed by measures included in the recovery and resilience plans, taking into account the relevant challenges identified in the 2019-2024 country-specific recommendations.

(10) On 4 June 2025, the Commission published the 2025 country report for Portugal. It assessed Portugal's progress in addressing the relevant country-specific recommendations and took stock of Portugal's implementation of the recovery and resilience plan. Based on this analysis, the country report identified the most pressing challenges Portugal is facing. 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.

Assessment of the Annual Progress Report

(11) On 21 January 2025 the Council recommended the following maximum growth rates of net expenditure for Portugal: 5.0% in 2025, 5.1% in 2026, 1.2% in 2027, and 3.3% in 2028, which correspond to the maximum cumulative growth rates calculated by reference to 2024 of 17.4% in 2025, 23.4% in 2026, 24.8% in 2027, and 28.9% in 2028. On 30 April 2025 Portugal submitted its Annual Progress Report[9], on adherence to the recommended maximum growth rates of net expenditure and the implementation of reforms and investments responding to the main challenges identified in the European Semester country-specific recommendations. The Annual Progress Report also reflects Portugal's biannual reporting on the progress made in achieving its recovery and resilience plan in accordance with Article 27 of Regulation (EU) 2021/241.

(12) Russia's war of aggression against Ukraine and its repercussions constitute an existential challenge for the European Union. The Commission recommended to activate the national escape clause of the Stability and Growth Pact in a coordinated manner to support the EU efforts to achieve a rapid and significant increase in defence spending and this proposal was welcomed by the European Council of 6 March 2025. Following the request of Portugal on 30 April 2025, on [date] the Council, upon the recommendation of the Commission, adopted a recommendation allowing Portugal to deviate from, and exceed, the recommended maximum growth rates of net expenditure[10].

(13) Based on data validated by Eurostat[11], Portugal's general government surplus decreased from 1.2% of GDP in 2023 to 0.7% in 2024, while the general government debt fell from 97.7% of GDP at the end of 2023 to 94.9% at the end of 2024. According to the Commission's calculations, these developments correspond to a net expenditure growth rate of 12.0% in 2024. In the 2025 Annual Progress Report,

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9 The 2025 Annual Progress Reports are available on: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/annual-progress-reports_en

10 Council recommendation allowing Portugal to deviate from, and exceed, the recommended net expenditure path (Activation of the national escape clause), [Please complete: OJ C/2025/xxx, x.x.2025].

11 Eurostat-Euro Indicators, 22.4.2025.

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Portugal estimates the net expenditure growth in 2024 at 11.6%. The Commission estimates that the net expenditure growth was higher than in the Annual Progress Report. The difference between the Commission's calculations and the estimates of national authorities is due to the higher revenue-decreasing impact of discretionary revenue measures estimated by the Commission, particularly on measures related to personal income tax. Based on the Commission's estimates, the fiscal stance[12], which includes both nationally and EU financed expenditure, was expansionary, by 1.6% of GDP, in 2024.

(14) According to the Annual Progress Report, the macroeconomic scenario underpinning the budgetary projections by Portugal expects real GDP growth at 2.4% in 2025, while HICP inflation is projected at 2.4% in 2025. The Commission Spring 2025 Forecast projects real GDP to grow by 1.8% in 2025 and 2.2% in 2026, and HICP inflation to stand at 2.1% in 2025 and 2.0% in 2026.

(15) In the Annual Progress Report, the general government surplus is expected to decrease to 0.3% of GDP in 2025, while the general government debt-to-GDP ratio is set to decrease to 91.5% by the end of 2025. These developments correspond to net expenditure growth of 3.4% in 2025. The Commission Spring 2025 Forecast projects a general government surplus of 0.1% of GDP in 2025. The decrease of the surplus in 2025 mainly reflects the impact of fiscal policy measures estimated to increase expenditure, notably public wages and social transfers, and reduce revenues resulting from the update of the youth personal income tax scheme and corporate income tax incentives. According to the Commission's calculations, these developments correspond to net expenditure growth of 6.1% in 2025. These higher projections of net expenditure growth than in the Annual Progress Report are due to the Commission's lower estimated expenditure funded by transfers from the EU and the non-classification as one-offs of court decision yet to be materialised. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be expansionary, by 1.4% of GDP, in 2025. The general government debt-to-GDP ratio is set to decrease to 91.7% by the end of 2025. The decrease of the debt-to-GDP ratio in 2025 mainly reflects a favourable interest-rate growth differential coupled with a projected primary surplus.

(16) General government expenditure amounting to 1.5% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 0.7% of GDP in 2024, according to the Commission Spring 2025 Forecast. Expenditure financed by Recovery and Resilience Facility non-repayable support enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Portugal.

(17) General government defence expenditure in Portugal remained stable at 0.8% of GDP from 2021 to 2023[13]. According to the Commission Spring 2025 Forecast, expenditure on defence is projected to remain stable at 0.8% of GDP in both 2024 and 2025. This

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[12] The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

[13] Eurostat, government expenditure by classification of functions of government (COFOG).

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corresponds to no change compared to 2021. The period when the national escape clause is activated (2025-2028) allows Portugal to reprioritise government expenditure or increase government revenue so that lastingly higher defence expenditure would not endanger fiscal sustainability in the medium term.

(18) According to the Commission Spring 2025 Forecast, net expenditure in Portugal is projected to grow by 6.1% in 2025 and 18.8% cumulatively in 2024 and 2025. Based on the Commission Spring 2025 Forecast, the net expenditure growth of Portugal in 2025 is projected to be above the recommended maximum growth rate, corresponding to a deviation[14] of 0.4% of GDP in annual terms. When considering 2024 and 2025 together, the cumulative growth rate of net expenditure is also projected to be above the recommended maximum growth rate, corresponding to a deviation of 0.5% of GDP. Taking into account the flexibility for higher defence spending provided by the national escape clause, the cumulative deviation of net expenditure remains stable at 0.5% of GDP, below the 0.6% of GDP threshold for the cumulative deviation.

(19) Moreover, the Council recommended that Portugal wind down the emergency energy support measures before the 2024/2025 heating season. According to the Commission Spring 2025 Forecast, while the net budgetary cost[15] of emergency energy support measures is estimated at 0.3% of GDP in 2024, it is projected to decrease to 0.1% in 2025. The emergency energy support measures were only partly wound down before the 2024/2025 heating season. This is not fully in line with what was recommended by the Council.

(20) The Annual Progress Report does not include budgetary projections beyond 2025. Based on policy measures known at the cut-off date of the forecast, the Commission Spring 2025 Forecast projects a general government deficit of 0.6% of GDP in 2026. The change of the general government balance in 2026 mainly reflects the impact of the reduction of the corporate income tax rate as defined in the 2025 State Budget Law, and the pick-up of public investment financed by RRF loans. These developments correspond to net expenditure growth of 6.3% in 2026. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be expansionary, by 1.2% of GDP in 2026. The general government debt-to-GDP ratio is projected by the Commission to decrease to 89.7% by the end of 2026. The decrease of the debt-to-GDP ratio in 2026 mainly reflects the continued favourable interest-growth rate differential and the projected primary surplus.

Key policy challenges

(21) Population ageing alongside a shrinking working-age population puts the sustainability of Portugal's pay-as-you-go pension system under pressure. While public pension spending is expected to increase, there will be fewer contributors into the system. Public pension spending is expected to peak in 2046 (15.2% of GDP), positioning Portugal in the top three Member States with the highest pension expenditure-to-GDP ratio[16]. However, if in 2025 there are nearly two contributors per

[14] From 2026 these figures will appear in the control account that is established in Article 22 of the Regulation (EU) 2024/1263.

[15] The figure represents the level of the annual budgetary cost of those measures, including revenue and expenditure and, where applicable, net of the revenue from taxes on windfall profits of energy suppliers.

[16] European Commission, 2024 Ageing Report: Economic and Budgetary Projections for the EU Member States (2022-2070), Institutional Paper 279, April 2024.

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pensioner, in 2046 it is expected there will only be around one. The ensuing deficit within the public pension system balance would need to be covered by national resources by means of transfers from the national budget or the Portuguese reserve fund for public pension schemes (known as the *Fundo de Estabilização Financeira da Segurança Social*). Population ageing weighs on Portugal's public finances not only through its impact on the public pension system but also through its impact on the tax system. For instance, a lower number of working-age individuals could decrease revenues from labour taxation. In recent years, Portugal has implemented reforms to improve the sustainability of its pension system by, for example, indexing the statutory retirement age to life expectancy. Nonetheless, policies such as early retirement schemes and special contributory rates add pressure to the country's public pension system, which could impact its sustainability.

(22) 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. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, finalising the effective implementation of the recovery and resilience plan, including the REPowerEU chapter, is essential to boost Portugal's long-term competitiveness through the green and digital transitions, while ensuring social fairness. To deliver on the commitments of the recovery and resilience plan by August 2026, it is essential for Portugal to accelerate the implementation of reforms and investments by addressing relevant challenges. On 13 May 2025, the Council adopted its Implementing Decision amending the assessment of the recovery and resilience plan for Portugal to take into account objective circumstances compromising the timely implementation of some investments. However, challenges remain in terms of administrative capacity, public procurement rules and lengthy permitting procedures affecting, in particular, large investment projects. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful and timely implementation of the recovery and resilience plan.

(23) The implementation of cohesion policy programmes, which encompass support from the European Regional Development Fund (ERDF), the Just Transition Fund (JTF), the European Social Fund Plus (ESF+) and the Cohesion Fund (CF), has accelerated in Portugal. It is important to continue efforts to ensure the swift implementation of these programmes, while maximising their impact on the ground. Portugal is already taking action under its cohesion policy programmes to boost competitiveness and growth. At the same time, Portugal continues to face challenges, including those relating to boosting competitiveness, including by developing or manufacturing critical technologies, skills shortages and mismatches, increasing water resilience, especially in Algarve and in Alentejo and housing affordability and availability. In accordance with Article 18 of Regulation (EU) 2021/1060, Portugal is required – as part of the mid-term review of the cohesion policy funds – to review each programme taking into account, among other things, the challenges identified in the 2024 country-specific recommendations. The Commission proposals adopted on 1 April 2025[17] extend the

[17] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) 2021/1058 and (EU) 2021/1056 as regards specific measures to address strategic challenges in the context of the mid-term review - COM(2025) 123 final

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deadline for submitting an assessment – for each programme – of the outcome of the mid-term review beyond 31 March 2025. It also provides flexibilities to help speed up programme implementation and incentives for Member States to allocate cohesion policy resources to five strategic priority areas of the Union, namely competitiveness in strategic technologies, defence, housing, water resilience and energy transition.

(24) The Strategic Technologies for Europe Platform (STEP) provides the opportunity to invest in a key EU strategic priority by strengthening the EU's competitiveness. STEP is channelled through 11 existing EU funds. Member States can also contribute to the InvestEU programme supporting investments in priority areas. Portugal could use these initiatives to support the development or manufacturing of critical technologies, including clean and resource-efficient technologies.

(25) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Portugal faces several additional challenges related to: i) the sustainability of its pension system, ii) simplification, iii) business environment, iv) research and innovation, v) access to finance and growth financing, vi) tax administration, tax evasion and tax avoidance, vii) quality of law making, viii) transport, ix) renewable energy, x) energy infrastructure and networks, xi) energy efficiency, xii) environmental policy, xiii) resource management, xiv) housing, xv) skills, xvi) quality jobs and xvii) social fairness.

(26) As set in the Competitiveness Compass, all the EU, national, and local institutions must make a major effort to produce simpler rules and to accelerate the speed of administrative procedures. The Commission has set ambitious goals for reducing administrative burden: by at least 25% and by at least 35% for SMEs; and has created new tools to achieve these goals, including systematic stress test of the stock of EU legislation and enhanced stakeholders' dialogue. To match this ambition, Portugal also needs to take action. 51% of businesses consider the complexity of administrative procedures to be a problem for their company when doing business in Portugal[18]. Despite the progress made over recent years, administrative and regulatory burdens remain a major constraint to the operation of businesses in Portugal. Over 83% of Portuguese firms report business regulation as an obstacle to investment, compared to 66% in the EU. Furthermore, the assessment of the OECD product market regulation indicators for 2023 and 2024 classifies Portugal as the ninth worst performer out of 38 OECD countries. These barriers weigh on the attractiveness of the Portuguese markets, reduce competition and undermine Portuguese firms' capacity to expand, innovate and boost their productivity. In particular, firms continue to report long industrial licensing and permitting procedures, which they consider to be a major barrier to investment. Despite some progress made in shortening and streamlining these processes, local authorities face difficulties in implementing the new procedures, and practices can differ significantly across regions and municipalities. Barriers also remain on access to several retail and professional services, even if Portugal made some significant steps forward, for instance by reviewing the legal regimes for several self-regulated professions between 2023 and 2024.

(27) The conditions for firms that are trying to access finance have been improving over the last few years and the proportion of firms reporting access to finance as a constraint to investment is now broadly in line with the EU average. However, Portuguese firms rely predominantly on bank loans and internal funding. Other sources of financing,

[18] 'Businesses' attitudes towards corruption in the EU' Flash Report, Eurobarometer Report (April 2024).

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such as venture and equity capital, have been increasingly adopted over the last few years but remain markedly less common than for the EU average. Portuguese capital markets remain underdeveloped, and account only for 24.4% of GDP, compared to an average of 67.6% at EU level. The Portuguese authorities launched and strengthened several initiatives to support investment in private equity and venture capital, such as the capitalisation and resilience fund managed by *Banco Português de Fomento*, programmes supporting start-ups or targeting specific sectors, as well as the recent review of the capital markets code. However, further progress is needed for Portugal to catch up with European peers and attract more private equity investors and investments, possibly including public-private risk sharing, to target firms with higher growth potential and sectors with strong productivity profiles. More widespread use of equity instruments would, among other things, support start-ups and innovation, increase local firms' capacity to scale up and expand their operation, improve managerial practices and boost productivity. Financial literacy in Portugal is weak and, in the 2023 Eurobarometer financial literacy survey, only 16% of Portuguese received a 'high' score, the second worst result in the EU. Financial literacy in the country could be improved to enable a more effective allocation of savings and to improve firms' understanding of the specific benefits and risks of each available financing instrument.

(28) Tax expenditures are widespread in the Portuguese tax system. There are more than 500 tax expenditures over several different legal texts. This instrument can be an effective tool to achieve specific policy objectives. Nonetheless, it also results in foregone revenue, contributes to the tax system's complexity and could have implications for income inequality. Portugal took a first step in tackling its large number of tax expenditures by setting up a new tax policy unit (known as U-TAX) that aims to monitor and evaluate tax expenditures. The design of the corporate income tax adds to the complexity of the tax system. Its rate structure is composed of both a state tax and municipal surtaxes. The state tax depends on the amount of each firm's taxable profits. On top of this, municipalities can set a surtax of up to 1.5%. As a result, the statutory rate of the corporate income tax can vary from 12.5% to 30.5%, depending on a firm's size and location. This design could also disincentivise firms from scaling up, hindering greater economies of scale and associated efficiency gains, while increasing the scope for profit shifting within the country. In terms of the tax administration, Portugal's outstanding tax arrears relative to GDP remain one of the highest in the EU.

(29) The justice system is becoming more efficient but continues to face challenges with lengthy proceedings and a sizeable backlog of cases, in particular in the administrative and tax courts. It will be important for Portugal to continue making progress in reducing the backlog of pending cases, as well as their duration, in both first-instance and second-instance courts, and to ensure the availability of adequate resources for the justice system.

(30) Investment in research and development has picked up over recent years but remains insufficient for the Portuguese national research and innovation system to catch up with the EU average. The share of spending on research and development in relation to GDP increased to 1.7% in 2024, supported by an increase in private spending, while public research and development intensity remained stable at 0.6%. Portuguese authorities have implemented a wide range of programmes to support research and innovation. However, several of them, such as the mobilising and green agendas, will only be completed over the next few years. While long lasting benefits are expected

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from these programmes, it will be paramount for Portugal to sustain adequate incentives to research, development and innovation beyond these programmes. To this end, it will be crucial to evaluate and implement sound policies and to support efficient expenditure by targeting sectors displaying the highest potential for growth and value added.

(31) On the quality of law making, Portugal is only making limited use of impact assessments and *ex post* policy evaluations. In 2021, significant progress was made in implementing *ex ante* policy evaluations in Portugal, through the establishment of PlanAPP, a national body to support the development of public policies. However, *ex post* impact assessments are not common and are limited to selected legislative acts. A wider use of *ex post* evaluations would allow authorities to better gauge the impact of new policies and legislations, as well as to assess the effectiveness of the *ex ante* evaluations already in place. Transparency of stakeholders' involvement in the legislative process could also be improved.

(32) Portugal remains highly dependent on imported fossil fuels, with oil and gas making up 47.2% and 16.8%, respectively, of its energy mix in 2023. The transport sector accounts for the largest share of final energy consumption representing 37.5% of the total. The transport sector is heavily reliant on oil and petroleum products, which make up 92% of its final energy consumption, highlighting the country's significant dependence on fossil fuels. Portugal records sizeable fossil-fuel subsidies without a planned phase-out before 2030. In particular, fossil-fuel subsidies that address neither energy poverty in a targeted way nor respond to genuine energy security concerns, hinder electrification and are not crucial for industrial competitiveness could be considered a phase-out priority. In Portugal, fossil-fuel subsidies such as tax reductions and exemptions for diesel for freight companies and public transport are economically inefficient, perpetuate reliance on fossil fuels and disincentivise the shift to electric vehicles and other sustainable solutions. Investing in sustainable mobility and railway infrastructure that ensures seamless integration with the EU network would accelerate decarbonisation, build resilience, reduce regional disparities, and foster social cohesion.

(33) Portugal has been adopting legislation to ease permitting procedures. However, the legislation is still too complex, particularly with regard to spatial planning at national, regional and local levels, with a lack of standardised rules and clear guidelines. Portugal's public authorities lack the tools to continuously monitor the implementation of legislation and track the progress of renewable energy plants and often lack the necessary technical skills to evaluate the projects. The number of renewable energy communities in Portugal is still low, and there is scope to facilitate their licensing and create incentives schemes. To accelerate the take-up of renewables, Portugal could continue to follow up on the progress it made over recent years on streamlining its permitting process, including by increasing the capacity of the public administration dealing with permitting, increasing digitalisation in renewables production and consolidating the overall regulatory framework. Further action to promote self-consumption (including rooftop solar) and renewable energy communities would also be beneficial. In 2023, Portugal's renewable energy sources, driven by hydropower and strong winds, supplied 87.7% of the country's electricity, achieving a new record. Solar was the renewable source that increased most, going up by 36%. The significant increase in the share of renewable energy played a role in the significant decrease in electricity prices, which fell below pre-crisis levels. As more renewables are integrated, and as electrification of demand proliferates, further investments to expand

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and upgrade the electricity grid, promote fossil-free solutions such as storage and demand-side response, and further digitalise the grid will be essential to safeguard the balance of the electricity grid and to ensure more stability in the electricity wholesale market. The lack of transparency around available distribution grid capacity and expansion plans makes it difficult for developers to plan and invest in new projects. It is essential to streamline connection procedures, increase grid connection transparency, and provide a clear, long-term auction planning framework. Moreover, logistical challenges, component shortages, and lower profitability have hindered renewable projects, leading to delays in implementation. Incentives to further develop long-term contracts such as power purchase agreements (PPAs) would also help make the market more stable by increasing long-term sustainability and therefore attractiveness of renewables investments. However, renewable PPAs are limited in Portugal at present, with 0.42 GW contracted. Despite efforts made by Portugal to increase the electricity interconnection level with Spain, this level of electricity interconnection is still below 2030 targets.

(34) A high share of the Portuguese population experiences energy poverty. To address its high degree of reliance on fossil fuels in buildings and to reduce energy consumption, Portugal could accelerate its efforts on energy efficiency beyond what is set out in its recovery and resilience plan. Stepping up efforts to incentivise deep renovations, including by delivering technical assistance to applicants, could accelerate the take-up of energy efficiency renovation projects. In addition, Portugal could benefit from a strengthened framework for financial schemes to make best use of private investment for energy-efficient renovation. By doing so, Portugal could target more grant-based resources towards households in need.

(35) Portugal is far below the EU average for circular economy benchmarks, as well as targets for resource productivity in industries and waste management indicators, with marked regional differences. The average municipal recycling rate is particularly low (30.1% in 2023, far from the EU target of 55% by 2025) and varies by region. Portugal’s circular use of materials had a rate of 2.8% in 2023, well below the EU average of 11.8%. Some progress has been made through initiatives and regulations both at national and municipal levels. Support from EU funds and the private sector will be critical to meet recycling and circular economy targets, including through: i) investment in infrastructure for separate waste collection, ii) development or adaptation of waste treatment facilities, and iii) technological upgrades to enable the pay-as-you-throw tariff scheme to be rolled out nationwide.

(36) Portugal, especially in its southern regions, is heavily affected by natural hazards, such as droughts, fires and flooding, with increased frequency and intensity due to climate change. Reduced annual rainfall, water scarcity and increased temporal variability affect river flows, aquifer recharge, and flood risk, impacting many economic sectors, such as agriculture, drinking water production, and energy generation, including hydropower, while undermining the sustainability of public finances through escalating costs. Portugal has increased its capacity to adapt to climate change, including by developing sectoral adaptation plans. In 2024, Portugal finalised a national roadmap for adaptation to climate change until 2100, but it would be important to further incorporate climate adaptation into water management policies. By implementing an integrated and sustainable water management strategy, including the recent ‘Water that Unites’ strategy, Portugal could ensure that key sectors will still have access to water, while also securing sufficient and good quality water for ecological functions, particularly for sensitive and biodiverse ecosystems, such as

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wetlands. Streamlining the governance structure of the water sector would also help achieve effective coordination between national, regional and local levels. To improve water management, further investments in wastewater collection and treatment, reduction of leaks in the networks and improved monitoring (of water quantity and quality) are crucial. Special attention could be paid to: i) restoring the natural sponge function of the landscape; ii) reducing ground water extraction; ii) restoring wetlands and rivers, including flood plains; and iv) rolling out other nature-based solutions. Moreover, Portugal could take advantage of the potential of water reuse.

(37) Portugal still faces challenges in access to healthcare and its long-term care system is not prepared for a rapidly ageing population. Overall, the country's health system performs comparatively well, and Portugal has been implementing significant reforms, including reforms in primary healthcare and mental healthcare, as well as a reform of the governance model of the hospitals of the National Health Service. Portugal has also been investing in healthcare infrastructure and services across the country, including under its recovery and resilience plan. However, the National Health Service continues to face significant shortages of healthcare workers, with an impact on accessibility to healthcare services, for example, long waiting times and uneven access between income groups and between regions across the country. Between 2020 and 2024, only around half of the positions opened to recruit doctors for the National Health Service were filled and the country faces a considerable amount of emigration among its graduate nurses. Despite some efforts taken in recent years to promote the attractiveness of careers in the National Health Service, there is scope for simplifying and speeding up recruitment procedures in order to promptly hire the necessary professionals and to continue attracting healthcare workers. In addition, almost a quarter of the Portuguese population is aged 65 or over, with a lower than EU average score on heathy life years, and public investment in long-term care being lower than the EU average, and coverage rates in long-term care remaining low across all regions. Despite an increase in recent years, the workforce is not sufficient to keep up with the demand, leading to a heavy reliance on informal carers. By addressing these aspects, while preserving the sustainability of the National Health Service, Portugal could promote more years of quality life for its population and ensure that the care needs of the elderly are met.

(38) Skills mismatches are an obstacle to competitiveness and productivity. The supply of skills does not match the market needs, which contributes to sectoral labour shortages, including in information and technology fields. The low availability of staff with the right skills is a major obstacle reported by companies. The mismatches also fuel high levels of youth unemployment (21.6% in 2024, compared to 14.9% in the EU), with many young people in unemployment holding either qualifications that are too low or qualifications in areas of low employability in the country. Portugal could also benefit from a reliable forecast of future market needs that could help inform a better alignment between the higher education offer and the market, as well as inform career choices. In addition, the development of the skills required for an evolving economy is further hindered by the declining adult participation in lifelong learning (from 38% in 2016 to 33% in 2022). Despite recent measures encouraging adults to enrol in learning and training, including investments under the Portuguese recovery and resilience plan, there is scope for businesses and companies to further engage in skilling and upskilling activities and promote a culture of adult learning in the country. Furthermore, Portugal's population continues to generally have low levels of qualifications (in 2023, around 41% of people aged 25-64 had a low educational attainment level, well above the EU average of 24.7%), which is a chronic barrier to

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productivity in the country. However, recent years have shown significant progress in increasing the qualification levels of the population. To sustain this progress, the country could benefit from addressing the increased share of early leavers from education and training in recent years (from 6% in 2021 to 8.1% in 2023).

(39) House prices in Portugal have been rising consistently, outpacing the EU average increase over the past decade. High demand in large cities and popular tourism areas has largely driven increases in prices and rents, with stark differences compared to interior regions. This situation impacts labour mobility and availability, also affecting the prospects of young people. The lack of affordable housing is also resulting in an increased number of people experiencing homelessness or living in informal settlements. Portugal is implementing measures to expand its social and affordable housing stock, yet shortages remain significant. At the same time, persistently low construction rates over recent years have restricted the supply of new homes at affordable prices. A large stock of empty houses and derelict buildings – around 700 000 – presents an opportunity to incorporate more housing into the market, especially in constrained areas. In addition, Portugal could benefit from promoting more efficient public transportation solutions and investing in the attractiveness of other territories to reduce the pressure on constrained areas. Ultimately, addressing Portugal's housing challenges will require a comprehensive approach, as solutions focused on increasing supply need to go hand-in-hand with measures that integrate demand-side dynamics and incentives into both the rental and ownership markets.

(40) 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, in 2025, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to implement the 2025 Recommendation on the economic policy of the euro area. For Portugal, recommendations (2), (3), (4) and (5) help implement the first euro-area recommendation on competitiveness, while recommendation (3), (4) and (5) help implement the second euro-area recommendation on resilience, and recommendation (1) and (5) helps implement the third euro-area recommendation on macroeconomic and financial stability set out in the 2025 Recommendation.

HEREBY RECOMMENDS that Portugal take action in 2025 and 2026 to:

1. Reinforce overall defence spending and readiness in line with the European Council conclusions of 6 March 2025. Adhere to the maximum growth rates of net expenditure recommended by the Council on 21 January 2025, while making use of the allowance under the national escape clause for higher defence expenditure. Take action to ensure the medium-term fiscal sustainability of the pension system.

2. In view of the applicable deadlines for the timely completion of reforms and investments under Regulation (EU) 2021/241, accelerate the implementation of the recovery and resilience plan, including the REPowerEU chapter. Accelerate the implementation of cohesion policy programmes (ERDF, JTF, ESF+, CF), building, where appropriate, on the opportunities offered by the mid-term review. Make optimal use of EU instruments, including the scope provided by the InvestEU and the Strategic Technologies for Europe Platform, to improve competitiveness.

3. Simplify regulation, improve regulatory tools and reduce administrative burden on businesses, mainly by reducing barriers to industrial licensing and removing other obstacles to their capacity to scale up and boost innovation and productivity. Foster private investment into venture capital and private equity for local businesses,

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including public-private risk sharing, and improve financial literacy. Increase the efficiency of administrative and tax courts, to decrease the length of proceedings. Improve the effectiveness of the tax system, particularly by strengthening the efficiency of its administration and reducing the associated administrative burden. Foster evidence-based policy making including by conducting *ex post* public policy evaluations. Sustain the focus of investment-related economic policy on research and innovation. Strengthen stakeholders' involvement and increase transparency in the preparation of public policies.

4. Reduce overall reliance on fossil fuels in the transport sector in particular by phasing out fossil-fuel subsidies, and by investing in sustainable transport, particularly in rail, taking into account regional disparities. Further accelerate the roll-out of renewables by providing a predictable, regulatory framework with clear and digital procedures for permitting including for collective self-consumption and renewable energy communities. Enhance stability in the electricity market through long-term contracts, investment in energy storage capacities and demand-side response tools. Strengthen the capacity of the electricity transmission and distribution grid, improve connection procedures and increase their transparency to incentivise investments in the national network. Step up policy efforts aimed at the provision and acquisition of skills, and competences needed for the green transition, particularly for the public administration. Accelerate investment in energy efficiency by promoting financial schemes to attract private investment and supporting households experiencing energy poverty. Improve the conditions for the transition towards a circular economy, particularly by increasing waste prevention, recycling and reuse to reduce landfill and incinerator waste. Improve water management to strengthen climate change adaptation and ensure long-term economic and environmental resilience. Implement an integrated water management strategy and streamline water governance. Promote investments in wastewater collection and treatment, the reduction of leaks and water monitoring, develop nature-based solutions, water body rehabilitation and improve water efficiency and reuse.

5. Ensure equal access to quality health and long-term care, while preserving the sustainability of the National Health Service. Address skills mismatches by improving the skills level of the population and by making education and adult learning more relevant to the needs of the labour market. Address housing affordability and availability in high demand areas, by eliminating barriers to renting vacant houses and renovating derelict buildings and promote efficient public transport connections to reduce the pressure on house prices in urban centres and improve the attractiveness of other territories.

Done at Brussels,

For the Council
The President

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