EuroMemo GROUP

Discussion Paper No. 02/2018

The alternative nature of the Portuguese economic policy since 2016

Authors: Luís Lopes[*] and Margarida Antunes[°]

Executive summary

The Portuguese government that took office in November 2015 has aroused great expectations at the political, economic and academic levels. It was an unusual experience within the Eurozone since the new government intended to reconcile the fulfilment of European budgetary rules with a household income led growth policy. This approach clearly departed from general European government policies as well as from the economic policy guidelines prescribed by the European institutions. It can also be seen as a test of the member states‘ autonomy in the design of their own fiscal policy as well as a test of the Eurozone and its political capacity to frame alternative economic policies.

The Portuguese government initiative has shown that the attempt to reconcile these two policies requires a permanent trade-off between them in which the economic expansionary policies have been penalized. Although the alternative nature of the macroeconomic policy cannot be denied, it is gradually losing this feature, despite continuing government emphasis on the demand-side of the economy and understanding of the importance of wages as a component of income. This policy change has been evident since 2017, when the government centred its main concern on reducing public debt.

Nowadays, after a fiscal policy that improved the household income and allowed the public deficit-to-GDP ratio to fall below 3%, it seems more difficult to move to a new level of fiscal policies that improve public services quality and public infrastructures within the context of European budgetary rules. And this seems to mean that the European institutions, by conditioning the national fiscal policies, are also determining the public services in areas such as health, education, social services, and transport, and, after all, the role of national states as autonomous institutions.

[*] CeBER and Faculty of Economics, University of Coimbra, Portugal
[°] CECES, CeBER and Faculty of Economics, University of Coimbra, Portugal

ISSN 2523-9163
November 2018

Introduction

Between 2011 and 2014 Portugal was subject to a financial assistance programme agreed with the European Union and the International Monetary Fund (IMF). The assistance programme was implemented during that period by a right-wing coalition government. A government that stated clearly it was politically and ideologically identified with the framework and content of the assistance programme memorandum. Furthermore, the government even proclaimed the purpose to "go beyond the memorandum" in some key matters such as the liberalization of the economy and the reduction of the size of the state. That government coalition won the legislative election in October 2015, albeit with only 37% of the votes. This result showed that a clear majority of the Portuguese electorate were rejecting the coalition government that had been responsible for the austerity policies undertaken during that period.

It was precisely this reading of the election results that led to a political agreement engaging all the left-wing parties for the formation of a PS (Socialist Party) government, as the second most voted political party in that election, supported in Parliament by the BE (Left Bloc), the PCP (Portuguese Communist Party) and the PEV (Ecologist Party-The Greens). The common goal of this agreement was to put an end to the contractionary demand-side policy cycle initiated in 2011 and therefore to reverse its effects on household disposable income and on the country's economic expectations. However, only the PS assumed from the outset the will and the need to respect the European budgetary rules, since the other left-wing parties have always had a critical view regarding the current Eurozone.[1]

The new Portuguese government took office in November 2015 and generated from the start some mistrust among European institutions. It was an uncommon experience within the Eurozone since the new government intended to make compatible the fulfilment of European budgetary rules with a household income led growth policy. This approach was clearly distinguished from the general European government policies as well as from the economic policy guidelines prescribed by the European institutions. The Portuguese government initiative has shown that the attempt to reconcile European budgetary rules with expansionary demand-side fiscal policies requires a permanent trade-off between these two guidelines. In this process, these economic expansionary policies have been particularly penalised. It also generated some political stress on the left-wing political arena.

The Portuguese government has been subject to a tight and continuous scrutiny, both internally and externally, and faced some difficulties to design the economic policy mix that would make compatible the two above mentioned guidelines. The originality of the Portuguese government's undertaking is quite enlightening on the discussion on the maximum leeway the Stability and Growth Pact (SGP) concedes to member-states to develop their national economic policies. A detailed analysis of the Portuguese case may be an important contribution to this discussion. Section 1 will analyse the Portuguese fiscal policy during the last two years. Section 2 will examine the political and economic meaning of this policy. Having taken into account the Portuguese case, section 3 will address the maximum leeway for national fiscal policies allowed by SGP rules and the corresponding loss of national autonomy in the design of a member state's own fiscal policy.

Portuguese fiscal policy in 2016 and 2017

The 2016 Portuguese budget was the first since 2010 especially designed to operate as an instrument for an expansionary demand-side economic policy. Throughout 2016 and 2017 a number of policy measures were undertaken aiming at improving household disposable income, namely: (i) the restoration of civil servants' wages to their pre-crisis level; (ii) the elimination of the personal income surtax that had been imposed in 2011; (iii) the adjustment made

[1] For further details on the context of the emergence of this Portuguese political experience, see Antunes and Lopes (2016a).

on the retirement pensions that had been frozen in 2010, and the increase of the lower ones; (iv) the restoration of some social benefits to their 2011 value, and increases in most of them; and (v) the setting up of employment measures to foster permanent job contracts.

This range of measures risked to boost government expenditure but, after all, the public deficit-to-GDP ratio fell to 2% in 2016 and to 0.9% in 2017 (3% if the recapitalization of the state owned bank Caixa Geral de Depósitos (CGD) was considered[2]). These final results were rather bellow initial estimations for these years and correspond, respectively, to a reduction of 2.4 percentage points (p.p.) and 1.1 p.p. in relation to the previous year. As far as the public debt is concerned, it registered a slight increase in 2016, but it fell by 4.2 p.p. of GDP in 2017, the best result since 2011 (Table 1). Although a lower primary surplus has been registered in 2017 in comparison with 2016, the dynamic effect has reduced the public debt-to-GDP ratio due to the fact that the nominal GDP growth rate was higher than the public debt implicit interest rate. There has also been a favourable effect on the deficit-debt adjustment, since the effects on the decrease of the public debt-to-GDP ratio that did not result from the previous two effects were positive (mainly as result of the decline in debt caused by early repayment of the IMF loan and the reduction of debt corresponding to the reimbursement by the banking sector of contingent convertibles bonds held by the state).

Table 1: Indicators of Public Finances, General government, % of GDP, 2011-2017

	2011		2012		2013		2014		2015		2016		2017	
	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)
Budget balance	-7.4	3.8	-5.7	1.7	-4.8	0.9	-7.2	-2.4	-4.4	2.8	-2.0	2.4	-3.0	-1.0
Primary balance	-3.1	5.2	-0.8	2.3	0.0	0.8	-2.3	-2.3	0.2	2.5	2.2	2.0	0.9	-1.3
Structural balance	-6.7	1.8	-3.6	3.1	-3.1	0.5	-1.8	1.3	-2.3	-0.5	-2.0	0.3	-1.1	0.9
Primary structural balance	-2.3	3.2	1.3	3.6	1.8	0.5	3.1	1.3	2.2	-0.9	2.2	0	2.8	0.6
Gross debt	111.4	15.2	126.2	14.8	129.0	2.8	130.6	1.6	128.8	-1.8	129.9	1.1	125.7	-4.2

Note: Structural indicators as a percentage of potential GDP.
Source: AMECO.

The reductions of the public deficit-to-GDP ratio in the two years have dissimilar explanations, as the main contribution to these results is not the same. The main contribution to that result in 2016 comes from the expenditure side, which accounts for 83% of the reduction, while in 2017 it comes from the revenue side which has been responsible for 72% of the reduction.

These figures alone may not give a clear picture of the main factors contributing to the government's fiscal policy options in 2016. The decrease of expenditure would have been less pronounced in the absence of a temporary increase in capital expenditure and other one-off measures in 2015. Government expenditure would have declined by 1% over the previous year and not by 3.8% had those measures not been taken in 2015, corresponding respectively to a reduction of 1.8 p.p. and 3.2 p.p. as share of GDP. The GDP growth, which has raised the denominator of the public deficit-to-GDP ratio, also contributed to these results. The expenditure decrease is essentially explained by the fall in the interest cost of and also by the reduction in public Gross

[2] The European Commission do not consider this issue as relevant in its assessment and recommendations regarding Portugal. In this paper, the analysis of the 2017 budget outturn considers the public deficit-to-GDP ratio to be 0.9% rather than 3%.

Fixed Capital Formation (GFCF) expenditure, the latter being sufficient to offset the increase of primary current expenditure. Public GFCF decreased by 28.9% in relation to 2015, falling even in relation to the estimate published with the state budget, by 21.7%. The public debt interest burden fell 4.3% compared to 2015 and 7.7% compared to the budget estimation. This can be mainly explained by the fall in the implicit interest rate on the public debt ratio (the ratio of the amount of interest paid over the stock of the previous year's public debt). The increase in primary current expenditure was due to the ending of some fiscal consolidation measures established in previous years, namely, the restoration of civil servants' wages and civil servants' weekly working hours, the unfreezing of retirement pensions and the increase in some social benefits. There was also registered an increase of 2.9% in intermediate consumption in relation to 2015, mostly due to expenditure on Public-Private Partnerships (PPPs), although corresponding to a decrease of 8.3% when compared to the original budget of the new government.[3] This difference between the amount of intermediate consumption initially budgeted and the amount executed can be mainly explained by the retention of some government expenditure[4], representing 0.3% of GDP, and, to a lesser extent, by expenditure on PPPs, which registered a value below the initial budget estimation (Portuguese Public Finance Council, 2017, p. 18).

The increase of the government revenue slowed in 2016 to less than half of that registered in 2015. Even in relation to the initial estimation it only increased by a quarter of that figure, despite the extraordinary settlement of tax and contribution debts, resulting from the Special Programme to Reduce Indebtedness to the State enacted in November 2016 and not foreseen in the state budget. The negative evolution of direct taxes, largely explained by the partial elimination of the personal income surtax, was not completely compensated by the increase of indirect tax revenue, namely excise taxes and also labour social contributions due to the increase of employment and the restoration of civil servants' wages. As a result, the tax burden in 2016 fell by 0.3 p.p. of GDP in comparison to 2015. Another explanation for the government revenue slowdown is the non-tax and non-contributory revenue, particularly the revenue related to the European Union's investment support programmes, which is reflected in the less favourable evolution of public GFCF (Portuguese Public Finance Council, 2017, p. 10).[5]

In 2017, the favourable economic environment and the reduction of the public debt interest costs, due to better financing conditions and to earlier amortization of loans, partly replaced by lower interest rates loans, may explain three-fifths of the deficit improvement (without considering one-off measures). The remainder is explained by the government discretionary fiscal policy (Conselho das Finanças Públicas, 2018, p. 3).

The government expenditure, after having decreased in 2016, increased in 2017 by 1.2% (6.1% if the impact of the recapitalization of CGD is considered), although, as a share of GDP, it fell 1.1 p.p., since nominal GDP grew at a higher rate. However, this rise corresponds only to one-third of the initially budgeted amount. Public GFCF expenditure is the main explanation for the expenditure increase in 2017. It grew by 21.5% (without considering the one-off measures of 2016), offsetting the downward

[3] Portugal is one of the European Union member-states that most utilized PPPs between 1990 and 2009, achieving the highest percentage of PPPs in GDP (Kappeler & Nemoz, 2010; Sarmento & Reis, 2013). The expenditure on PPPs involves some budgetary risk, because its final amount depends on the resolution of ongoing processes in which the private partner requires the restoration of the financial balance contracted. This is a right of the private partner when certain cases defined in contract occur. In addition, since 2012, some PPPs have been renegotiated to reduce the government expenditure and the conclusion of these processes may be difficult to foresee.

[4] The budgetary retention is a budgetary management instrument, consisting in the held back of a share of expenditure allocations of the central government departments and agencies. The release of these funds is normally subject to the authorization by the finance minister.

[5] The lower use of the European Union funds and their effects on public GFCF in 2016 have been justified by the government with the transition period between the Community support frameworks (the current framework began in 2014), which normally implies a slowdown in the use of these funds.

trend registered since 2011, with an exception in 2015. However, this increase of public GFCF expenditure represents less than half of the amount originally estimated and has been mainly applied in buildings (except dwellings) and local and regional governments. The primary current expenditure also rose in 2017, mainly due to an increase of expenditures on social benefits, since all retirement pensions have been updated and some social benefits have been improved, partially induced by the Social Support Indexation update, which had not changed (in nominal terms) between 2009 and 2016. This was partly offset by the reduction of expenditure on unemployment benefits, due to the drop in unemployment. Some fiscal consolidation measures launched in 2016 also induced an increase of expenditure on civil servants' wages. The above mentioned increase of expenditure has been partially offset by the 3.7% drop of public debt interest costs, following a trend that had begun in 2015.

But unlike 2016, the main contribution to the improvement of the public deficit in 2017 is found on the revenue side. In 2017, the government revenue grew by 3.9% (4.8% excluding the one-off measures of 2016), a percentage that is more than the triple that of 2016. The revenue increase has been lower than that initially planned by the government, since the growth of tax and contributory revenue did not offset the decline of other revenue. The main contribution for the registered higher tax revenue has been the evolution of indirect taxes and in particular the rise of Value Added Tax (VAT) revenue, which is mainly explained by household consumption and tourism growth, without changing VAT rates. The increase of direct tax revenue is explained essentially (94%) by the increase registered in corporate income tax, while tax revenue from personal income tax remained practically constant. This is explained by two opposite variations. On one hand, direct tax revenue increased as a result of higher wages and employment growth, but on the other hand it decreased due to the gradual elimination of the personal income surtax. The rise of revenue related to social contributions is a result of employment growth by 3.3% and, to a lesser extent, a result of full restoration of the civil servants' wages. Globally, the tax burden in 2017 increased 0.4 p.p. of GDP in relation to 2016, reaching 34.7% of GDP, which is the highest level registered since 1995. However, this should be read carefully. These achievements do not mean that there has been a discretionary fiscal policy targeted to this result. A part of this result is explained by the full restoration of the civil servants' wages, as above mentioned. This means that for an unchanged level of employment and GDP there has been a rise in tax revenue and social contributions. Furthermore, since the restoration of civil servants' wages in 2017 was also extended to higher wages, the corresponding income taxes induced higher government revenue in relation to those of 2016.

The fiscal policy during these two years shows that there has been a tight control of government expenditure. In 2016, fiscal control has been focused on expenditure retentions as well as on public GFCF expenditure while in 2017 public GFCF expenditure was the main target. Although public GFCF expenditure has increased, it remained far below the programmed level and most of it did not result from a discretionary central government fiscal policy, but from decisions of local and regional governments.

Economic and political reading of Portuguese fiscal policy since 2016

The trade-offs of fiscal policy

In many aspects the fiscal policy in 2016 and 2017 reflects the policy choices inscribed in the government's programme and in the agreements signed with the left-wing parties as above mentioned. Beyond fiscal policy, the government took the decision to increase the minimum wage for all workers in both years and has also restored four public holidays that had been cancelled by the previous government. A number of privatizations and concessions to the private sector were suspended and the procedures related to concession contracts for public transport companies that were in progress have been cancelled. The privatization process of the Portuguese airline, TAP, has also been reversed. The same type of measures is planned for 2018 and also for 2019. Among them, it is important to mention the personal income tax adjustment benefiting in particular the lower income households; the rise of all retirement pensions and new extraordinary increases for the lower ones; the unfreezing of career progressions and extraordinary regularisation of precarious labour contracts in the public sector.

However, upon closer reading, it is possible to detect a permanent exercise to reconcile these policies with the European budgetary rules. Despite this exercise, the Portuguese fiscal policy generated some mistrust among European institutions throughout 2016. The possibility of sanctions has been repeatedly mentioned, since Portugal had a public deficit-to-GDP ratio above 3% (Table 1). The European institutions made frequently clear that they did not believe that it would be possible to reconcile expansionary demand-side fiscal policies with the fulfilment of European budgetary rules. Still, the Council of the European Union (2016a, p.11) decided in August 2016 that Portugal should "put an end to the present excessive deficit situation by 2016" and should "reduce the general government deficit to 2.5 % of GDP in 2016."

In 2016, it was clear that the budget outturn, along with the reversal of some restrictive fiscal policies established in the previous years, with increasing effects on disposable income, was also concerned to meet the rule of the public deficit-to-GDP ratio. The government used intensely the budgetary retentions, which implied a reduction of intermediate consumption in the public services, and imposed a tight control of GFCF expenditure, which registered the lowest value since 1995 (the first year for which EUROSTAT statistics are available) (Graph 2) and the lowest in the European Union in 2016. In other words, the budget outturn of 2016 expresses a hard trade-off between, on one hand, the restoration of household disposable income and, on the other hand, the compliance with the public deficit-to-GDP rule. In the end, taking into account the performance of the primary structural deficit, which remained unchanged (Table 1), the fiscal policy can be considered neutral, despite the positive effects on household disposable income induced by specific demand-side government measures.

The budgetary results accomplished in 2016 led the European institutions to revoke in June 2017 the Excessive Deficit Procedure for Portugal. Portugal is currently submitted to the preventive arm of SGP, which implies: 1) a public deficit-to-GDP ratio not exceeding 3%; 2) compliance with the medium-term budgetary objective corresponding to a surplus of 0.25% of potential GDP in 2021. Portugal is one of the two member-states from which compliance with a budgetary surplus at potential GDP is required (European Parliament, 2018). This objective takes into account the structural adjustment necessary to comply with the public debt rule (see below). Because Portugal has a public debt-to-GDP ratio above 60% (it was 129.9% in 2016) and since the output gap (defined as the difference between actual and potential output levels, expressed in percentage points of potential output) is between -1.5% and +1.5%, it has to reduce annually the structural balance by an amount higher than 0.5 p.p. of GDP, being recommended a reduction of at least 0.6 p.p.; 3) a net expenditure growth[6] lower than the medium term potential GDP growth. For 2017 it means a reduction of 1.4% in real terms and, for 2018, an increase, in nominal terms, not above 0.1% and, for 2019, not above 0.7% (Amaral, 2017, p. 5; European Commission, 2017c, p. 4; 2018, pp. 3-4); 4) fulfilment of the transitional rule regarding the public debt-to-GDP ratio. Therefore, for three years (2017-2019), Portugal must progress sufficiently to meet the debt reduction benchmark at the end of that period (the excess over 60% of the public debt has to be reduced by at least 5% each year, on average, over three years). For this purpose, structural adjustment should reach 0.7 p.p.

[6] Expenditure net of interest expenditure, expenditure on European Union programmes fully matched by Union funds revenue, cyclical unemployment benefit expenditure, GFCF expenditure (net of Union funds revenue spent in this projects) smoothed over a four-year period. This is corrected for "discretionary revenue measures" and "revenue measures mandated by law". For further details, see European Commission (2017b, Annex 8) and Council of the European Union (2016b).

in 2017, and 1.1 p.p. in 2018 (Amaral, 2017, p. 5). The aim to comply with this list of budgetary rules influenced necessarily the budgetary outturn in 2017. Without including the public bank CGD recapitalization, the public deficit-to-GDP ratio reached 0.9% (as above mentioned), the structural deficit decreased 0.9 p.p. and the public debt-to-GDP ratio 4.2 p.p. (Table 1).

The stability programmes for 2016, 2017 and 2018, and the budgetary outturn of 2016 and 2017 show clearly that, in 2016, the main concern in relation to the European budgetary rules was the compliance with the public deficit-to-GDP ratio rule, because it was important for the government to leave the Excessive Deficit Procedure. The main concern in 2017 is also to reduce the public debt-to-GDP ratio according to European rules, which implies compliance with the structural balance rule. The fiscal policy in 2017, differently from 2016 and even 2015, may be considered a restrictive countercyclical policy (Conselho das Finanças Públicas, 2018, p. 5), since the primary structural balance registered a positive change (Table 1) in the economic recovery context.

The policy reorientation from the budget balance to the structural balance aims at introducing more clearly into the Portuguese fiscal policy the change which occurred in the European budgetary rules inscribed in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCGEM) of 2012.[7] This Portuguese policy reorientation means that the government has assumed harder external restrictions on its own discretionary fiscal policies and therefore on its own capacity to follow expansionary fiscal policies.

Some economic results

The GDP growth rates in 2016 and 2017 reflect this economic policy conditioning. In 2016, GDP grew 1.6%, 0.2 p.p. below the 2015 growth rate. Domestic demand has been the sole contribution for this result, since net external demand registered a null contribution, with exports and imports showing a symmetrical behaviour.

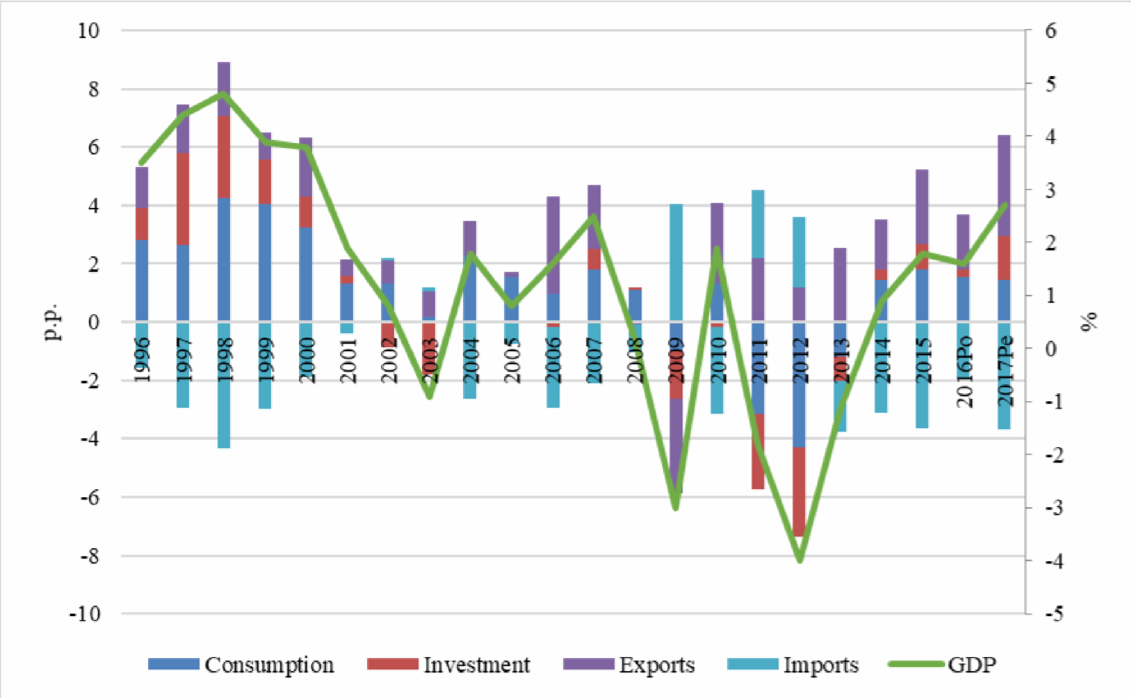
Domestic demand has been affected by divergent consumption and investment behaviour, as well as by its private or public origin. Domestic demand growth is essentially explained by private consumption growth, since public consumption almost stagnated. Private consumption reached 2.1%, the same growth rate registered in 2015, but the year-on-year change rate in the last quarter of 2016 has been much higher than the one registered in 2015. On the other hand, the public consumption quarterly year-on-year change rate decreased throughout the year, being null in the last quarter, which is related to the aforementioned expenditure retentions. Investment (GFCF) grew only 1.5%, reflecting a very low contribution to the annual GDP growth rate (Graph 1). An analysis by institutional sectors shows that public GFCF behaviour differs clearly from private GFCF evolution, since the first decreased 32.4% while the second rose 7.4%. In relation to the net external demand, exports made the greatest contribution to the GDP growth, although lower than in the previous year, which was fully offset by the negative contribution of imports. The main contribution for this result comes from the tourism sector whose exports grew 10.7% (Banco de Portugal, 2018, p. 101).

The 2017 GDP growth rate was the highest since 2000, reaching 2.7%, 1.1 p.p. above the 2016 one. The main contribution came again from domestic demand, since net external demand contributed negatively by 0.2 p.p., as the contribution of imports exceeded the contribution of exports in absolute value. The contribution of investment accelerated in relation to the previous year and largely explains the GDP growth rate rise (Graph 1). Investment grew 9.5%, 8 p.p. more than in 2016. Public investment made a major contribution to this result, since it rose 24.9%, a much higher growth rate than the private investment which grew 8.7%. Regarding consumption, private consumption rose almost at the same rate in 2016 and 2017 while public

[7] The methodology for determining the structural balance used by the European Commission has been subject to many criticisms. On this issue, see Sawyer (2012), Truger (2014) and Costantini (2015).
The reference to the structural balance had already been included in the reform of SGP in 2005, but it was after 2012 that this indicator assumed greater relevance in European budgetary rules.

consumption in 2017 registered a growth rate even lower than that in 2016, only 0.1%. Exports are another factor that especially induced the rise of the GDP growth rate, despite net external demand being negative. Exports increased 7.8%, 3.4 p.p. more than in the previous year, representing the higher contribution for GDP growth (Graph 1). Tourism is the key factor for this result for exports since it grew 19.5% (Banco de Portugal, 2018, p. 101).

Figure 1: GDP Growth rates (right scale) and contributions (left scale), 1996-2017



Note: Po - provisional value; Pe - preliminary value.
Source: Statistics Portugal and own calculations.

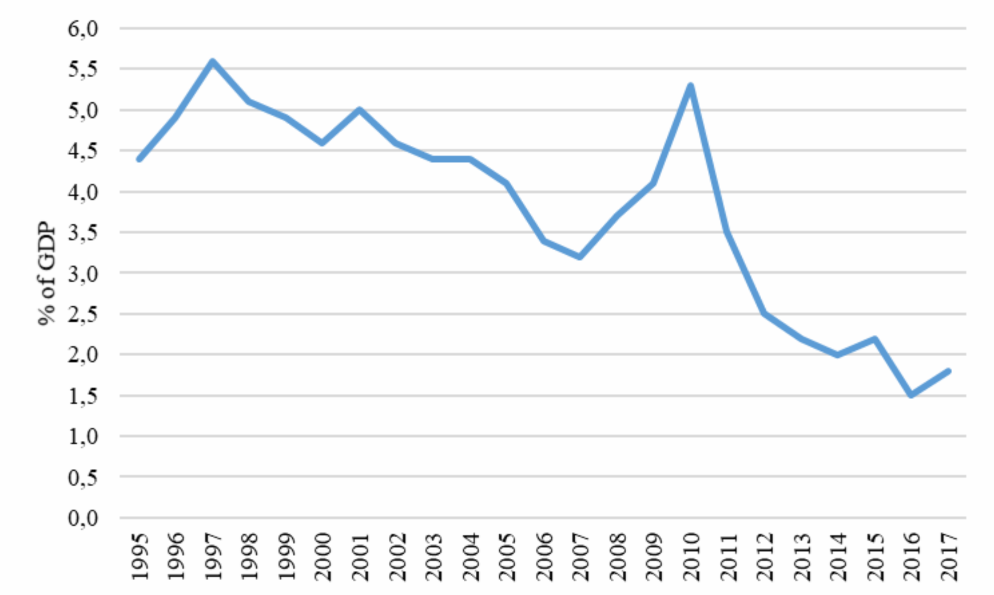
The main difference in GDP growth in 2016 and 2017 has to do with public investment. Public investment growth is far from what the country needs, on account of four reasons: a) Portugal has a GDP per capita of 77% of the European Union average. This shows that there is still a need for a set of new investments to improve public infrastructures in the areas of health, education, urbanization, R&D, culture and transports, especially railways[8]; b) public investment as a percentage of GDP has been declining since 2010 (except in 2015). It even declined over a three years period when a GDP decrease has been registered. This means that much of the new investments the country needs were not accomplished, nor even the maintenance investments; c) decrease of total investment (private and public), which declined 25% between 2007 and 2017. Public investment has direct effects on the economy and it is also a powerful driver for private investment in the short and long term. These effects may be greater if public investment is not carried out at the expense of other government expenditure and if the economy finds itself in a situation like the current one: below full employment and with low interest rates (Fournier, 2016; Observatoire Français des Conjonctures Économiques, 2016); d) the new needs of public investment in areas

[8] An unpublished 2016 report made by the public organization responsible for Portuguese infrastructures concludes that most rail lines are in a poor situation (Cipriano, 2018a). The lack of maintenance in passenger carriages and the degradation of the service provided are also evident (Cipriano, 2018b). Confirming these views, a Boston Consulting ranking of national railway systems places Portugal in third-to-last place in 2017, only above Romania and Bulgaria (Cipriano, 2018c).

such as digital economy and new technologies and those resulting from structural changes in environment and demography.

As asserted by Pereira *et al.* (2018, pp. 117-118), “public investment has functioned as an adjustment variable of public finance, being the first solution and the first element to adjust when it is necessary to reduce the public deficit.” This is what happened in Portugal between 2000 and 2007 (the Eurozone’s first years), and more recently after 2010 (Graph 2).

Figure 2: Public investment (GFCF), % of GDP



Source: Eurostat.

The Stability Programme 2018-2022 (Ministério das Finanças, 2018) shows that this budgetary strategy will be followed in the future. In order to reduce the public debt-to-GDP ratio, positive primary balances are planned along that period, reaching 4.5% in 2021. It is also planned to reach, as soon as 2020, the medium-term budgetary objective imposed by the European rules, one year ahead of the date foreseen in the previous stability programme (Table 2). During this period, fiscal policy is expected to be restrictive countercyclical, considering the expected positive changes in structural primary balances and the cyclical position of the economy.

Table 2: Indicators of Public Finances, General government, % of GDP, 2018-2022

	2018		2019		2020		2021		2022	
	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)	(%)	Var. (p.p.)
Budget balance	-0.7	2.3	-0.2	0.5	0.7	0.9	1.4	0.7	1.3	-0.1
Primary balance	2.8	1.9	3.2	0.4	3.9	0.7	4.5	0.6	4.4	-0.1
Structural balance	-0.6	0.5	-0.4	0.2	0.3	0.7	0.6	0.3	0.9	0.3
Primary structural balance	2.9	0.1	3	0.1	3.5	0.5	3.7	0.2	4	0.3
Gross debt	122.2	-3.5	118.4	-3.8	114.9	-3.5	107.3	-7.6	102.0	-5.3

Note: Structural indicators as a percentage of potential GDP.
Source: Ministério das Finanças (2018) (2018, estimated value; 2019-2022, forecast).

For Pereira *et al.* (2018), a budgetary strategy like that is not economically, socially or politically sustainable. It is not economically sustainable because it penalises GDP growth and thus the reduction of the public debt-GDP ratio. It is not socially sustainable since it can undermine the social support basis which is required for any budgetary strategy, taking into account the harmful effects on the maintenance and improvement of public services and public infrastructures. And it is not politically sustainable because it puts at risk the political majority that supports the government.

Pereira *et al.* (2018) suggest a different budgetary strategy for Portugal until 2021, arguing that it is possible to comply with the fundamental rules of SGP with a less restrictive fiscal policy and a stronger GDP growth. [9] They present a path for debt reduction they consider economically, socially and politically sustainable. The authors propose to increase government expenditure on investment, intermediate consumption in the health sector (this area corresponds to about 70% of all government expenditure on acquisition of goods and services), employees' compensation and social protection and a small reduction of tax revenue, essentially through the reduction of income taxes. This would allow a more moderate fiscal consolidation, with a lower positive primary balance along the above mentioned period, and a higher GDP growth that in turn would generate fiscal resources for stronger economic policies helping to reduce the public-debt-GDP ratio.

Also in the context of compliance with European budgetary rules, Blanchard and Portugal (2017) suggest that Portugal should follow an expansionary fiscal policy, considering that a potential GDP increase would lead to a reduction of the public debt-to-GDP ratio. The selected instruments for that would be: infrastructure investments, structural reform of the finance sector and recapitalization of banks, all of it financed by public debt. For these authors, Portugal, as ten years ago, is facing the same difficult trade-off between increasing competitiveness and reducing private and public debt. But while the priority was in the past to increase external demand, now the priority is the internal demand growth, supported by fiscal policy. [10] This new proposal seems a reversal of Blanchard's former position as chief-economist at the IMF during the period of financial assistance to Portugal. This proposal can also be seen as a criticism of the current Portuguese government.

The 2016 and 2017 GDP growth rates and the ones inscribed in the Stability Programme 2018-2022 (2.3% until 2020, 2.2% in 2021 and 2.1% in 2022) do not diverge from the GDP growth rates of the pre-crisis period. Between 2000 and 2007, the average annual growth rate did not reach 1.5%, with the highest rate, 2.5% being achieved in 2007, (Graph 1). In 2016 and 2017, GDP growth rates have benefited from favourable temporary factors, such as tourism growth, and occurred after a period of sharp GDP decline. Probably those rates would be lower if the government had not undertaken demand-side policies. Even so, GDP has not yet reached in 2017 the level of 2007, and GDP per capita in 2017 is 5 p.p. lower than in 2007.

A different case is the current account which registered much better results in 2016 and 2017 than in the pre-crisis period when it was permanently negative. The worst result was registered in 2008, when the current account deficit reached 12.1% of GDP. After two years with a practically balanced current account, 2016 and 2017 registered a current account surplus, mainly explained by the tourism sector, despite the oil price increase that partially attenuated this effect in 2017.

The labour market continued to improve in 2016 and 2017 but has not yet reached the pre-crisis situation. Active population only started to rise in 2017, the first year that employment surpassed 2011 levels. Even so, in comparison to 2016, there has been

[9] The authors based their data on the Stability Programme 2017-2021. They presented the first version of their work in September 2017, then updated in February 2018 where they included the 2017 GDP growth rate generating significant fiscal resources.

[10] The reference to the past is related to Blanchard (2007) when he recommended to Portugal a "competitive disinflation" policy, which should be achieved by the reduction of nominal wages.

an acceleration of the employment rate in 2017 and a decrease of the unemployment rate. In 2016 and 2017, 200 000 jobs were created in net terms, corresponding to 4.4% of total employment. Employment adjustment has been achieved through non-open-ended job contracts. The share of fixed-term job contracts in total employees has not registered any consistent improvement (Table 3). Looking only at the current new labour contracts, it is possible to observe a slight improvement in the quality of labour contracts during 2016 and 2017. In the first quarter of 2016, 30% of them were full-time open-ended contracts, 38% fixed-term contracts and the rest were other forms of precarious contract. In October 2017, the share of open-ended contracts has risen, despite representing only a share of 33.6%. Fixed-term contracts and essentially other forms of precarious contracts represented the major share of contracts (Centro de Estudos Sociais, 2017, p. 9; 2018, p. 3).

Table 3: Some indicators of labour market, 2011-2017

	2011	2012	2013	2014	2015	2016	2017
Active population (annual growth rate)	-	-0.8	-1.8	-1.1	-0.6	-0.3	0.8
Employment (annual growth rate)	-	-4.1	-2.6	1.6	1.1	1.2	3.3
Unemployment rate	12.7	15.5	16.2	13.9	12.4	11.1	8.9
Young unemployment rate	30.3	37.9	38.1	34.8	32	28	23.9
Long-term unemployment rate	6.7	8.4	10	9.1	7.9	6.9	5.1
Fixed-term contracts share	18.5	18.6	18.5	17.8	17.6	16.9	18.3
Labour underutilisation rate	19.6	23.8	25.4	23	21.3	19.5	16.5

Source: Statistics Portugal and own calculations.

Between 2015 and 2017, unemployment fell from 12.4% to 8.9%, which is mainly explained by the fall in long-term unemployment, which dropped from 7.9% to 5.1%. The youth unemployment rate dropped 8 p.p. and reversed in 2017 the downward trend of the young active population share of the total active population, one of the main factors that explain the high value of that rate. During the same period, the labour underutilisation rate dropped from 21.3% to 16.5%, which is essentially explained by the previous result and not by the decrease of the other elements.[11]

Despite this labour market improvement, there have been no important changes in wage conditions. In what concerns the labour income in 2017, the wage share was 2 p.p. lower than the 2007 level, although in absolute terms, the labour income has already reached an amount higher than the 2007 level. The nominal wage has increased since 2015 but at low rates. In 2016 there has been a rise of the real wage by 0.4% and in 2017 by 0.6% (Ministério do Trabalho, Solidariedade e Segurança Social, 2018b, p. 5). In 2016, this rise seems to have favoured the lower wages, since the employees' medium monthly earnings only increased up to the seventh decile and registered a stagnation in the upper deciles (Ministério do Trabalho, Solidariedade e Segurança Social, 2018a, p. 33). One explanation for that is the increase of the minimum wage by 10% during 2016 and 2017 (around 15%, by 2018). The number of full-time employees earning the minimum wage has increased. In April 2008 they were 6.8%, and 25.7% in April 2017 (last known figure). This shows the high number of workers whose wages are still in the lower deciles. Taking into account only the current new labour contracts, the gross average wage of open-end contracts has decreased about 6% from the first quarter of 2016 to the end of first semester of 2017, being lower than at the

[11] The labour underutilisation rate includes, beyond the unemployment people, the underemployed part-time workers, the inactive seeking work but not immediately available, and the inactive available to work but not seeking a job.

beginning of 2014. The average wage in fixed-contracts, on the contrary, increased 19% over the same period. The average wage in new contracts followed the rise in the minimum wage, being 17.5% higher than the previous one in 2016 and 19% higher in 2017 (Centro de Estudos Sociais, 2018, pp. 6-7).

This slow evolution of wages can be explained by the current situation of the collective labour agreements. There has been some recovery of these labour agreements in 2016 and 2017, but they remain still far from the pre-crisis situation. The number of workers potentially covered by these labour contracts in 2016 and 2017 remained less than half of those in 2008, but more than three times their number in 2013 and 2014 (Ministério do Trabalho, Solidariedade e Segurança Social, 2018b, p. 12).

Political reading on fiscal policy

Although there is growing concern in the government to comply with the European budgetary rules, the alternative nature of macroeconomic policy cannot be denied. The government has been able to value the demand-side of the economy, namely private consumption, which has been penalised in such way by the crisis that in 2017 had not yet reached the value of 2008. It also understood the importance of wages as a component of income and, as such, a determinant factor of domestic demand. In both aspects, the Portuguese government diverges from the European economic model, where supply-side economic policies predominate and wages are essentially considered as production costs. With this form of "doing differently," the government has given again precedence to the citizens and has been able to relieve social tensions as well as the feeling of uncertainty that lingered among the Portuguese people. All these factors have allowed the government to achieve one key result: the improvement of economic expectations, and with it, an incentive for private investment in the non-tradable sector as well as in the tradable imports substitution.

Nowadays, it seems that the government has lost some political capital. In 2016 and yet in 2017, the government was able to improve citizens' expectations, but the Portuguese are currently waiting for a new economic policy phase. Beyond the restoration of household disposable income, the Portuguese are expecting an increase in wages and the improvement of professional careers, in the public sector, as well as labour law changes in order to reduce job insecurity, to promote collective labour agreements and to eliminate the bank of individual labour hours[12], in the private sector. In the context of these not yet accomplished goals, the government is subjected to claims from the different professional groups of civil servants and also from trade unions.

In June 2018 a new Social Dialogue Agreement (Conselho Económico e Social, 2018) was signed by the government, the General Workers' Union (UGT) and employers' associations in order to change labour laws with the main purpose of, according to the government, reducing labour precariousness and the labour market segmentation. The agreement has raised many doubts related to the effective achievement of this objective. On one hand, this projected law will reduce the maximum duration limit of the fixed-term contracts and the total number of renewals, eliminates the bank of individual labour hours and creates a turnover tax. This is an additional social contribution on firms that resort recurrently to the fixed-term contracts and exceed the respective sectoral average. Its contributory base is the basic pay of fixed-term contracts and the tax rate is progressive with a ceiling of 2%. On the other hand, the form of very short-term labour contracts is extended to all sectors (up to now these contracts were restricted to tourism and agriculture) and their maximum duration is increased. As for the bank of labour hours, beyond to what is

[12] The bank of individual labour hours is a method of organizing working time agreed individually with worker in which the normal working hours can increase two hours a day, never exceeding a maximum of fifty hours per week, with a ceiling of one hundred and fifty hours a year. The worker can be compensated by the reduction of working hours on other days, longer holidays or payment in cash, this being defined by agreement between the worker and the firm. It was created in 2012 and, until then, there was only the bank of labour hours decided in collective labour agreements.

allowed via collective labour agreements, a bank of group labour hours is created, provided there is the consent of at least 65% of the workers. The experimental period for open-ended contracts is prolonged for some categories of workers. Finally, the new turnover tax has some limitations that may reduce its effectiveness in the reduction of precariousness of work. The very short-term contracts are not considered in measuring the share of fixed-term contracts and, in addition, since the reference is the sectoral average, it does not induce the reduction of fixed-term contracts in sectors that have a high average of these contracts as is the case of tourism. By government decision, some measures taken during the period of financial assistance, such as the loosening of dismissal conditions, were not included in the agreement. The confederation of workers linked to the PCP — the General Confederation of Portuguese Workers-Intersindical (CGTP-IN) — did not sign the Social Dialogue Agreement, arguing that the agreement will not reduce the labour precariousness, raising it in some cases, and will not promote the collective labour agreements. This agreement seems to have fostered labour tensions, in view of the demonstrations against the document that have been organized since then.

The Portuguese are also giving signs that it is necessary to further improve the quality of public services, mainly in the fields of education and health. Despite the increase of government expenditure in these two areas, it has not been sufficient to respond to the degradation occurred in previous years in the quantity of staff, the quality and quantity of materials and the degradation of equipment. The Portuguese seem to start asking why the gap between the planned public deficit and the actual one has not been used to improve these public services.

For the government, 2016 and 2017 were two years during which it had to prove to the European institutions that it was possible to follow economic policies with an alternative nature and, at the same time, to comply with the European budgetary rules, while the Portuguese felt that it was possible to have again a government they could politically trust. Although the government's political capital is still very high, the situation may change in 2018 and 2019. The government seems to have gained trust among European institutions, and the election of Finance Minister Mário Centeno to the Eurogroup presidency proves it. However, there are some political views stating that the austerity policies have not really ended and some of its expectations in improving living conditions are being undermined by the government's budgetary priorities.

What is the contribution to the discussion on the leeway of national fiscal policies in the Eurozone?

The Portuguese fiscal policy in the last two years is probably the best case-study for assessing the loss of national autonomy in the design of member states' own economic policy in favour of the European institutions, while, at the same time, each government is gradually pressed by the same institutions to assume a merely implementation role.

The SGP restrictions on national fiscal policies at European level are known since its launching. Also well known is the experience of the Eurozone member-states, before and after the crisis of 2010. But a government initiative like the Portuguese one since 2016 was not known. The current government, in contrast with other national governments in the Eurozone, aims to direct fiscal policy along its own path, different from the one that is proposed by the European institutions and, at the same time, wants to comply with European budgetary rules. Furthermore, it is a government whose political support includes political parties which are very critical regarding the current Eurozone and even propose the exit of Portugal from the Eurozone, as is the case of the PCP which has most recently defended this idea in a clearer way than in the past.

The Portuguese government experience has clearly shown that member-states leeway to use the state budget as an instrument of demand-side expansionary policy through expenditure increase is too narrow in the SGP context. This perspective on fiscal policy lost relevance in favour of the "governance by numbers" (Supiot, 2015), in which the state budget, and in particular the government expenditure, is gradually transformed from a policy instrument to an objective-indicator of economic policy (Antunes & Lopes, 2016b).

The "best use of the flexibility within the existing rules of the stability and growth pact" launched by the European Commission (2015) is far from being sufficient to change the situation. Instead, it seems to be another way for the European Union to impose its perspective on member-states. Under the preventive arm of SGP (the Portuguese specific situation in 2017), temporary deviations from the medium-term budgetary objective are only allowed in specific situations, such as the public investment, but provided that the maximum limit of 3% of the public deficit-to-GDP ratio is met and that national expenditure is co-funded by the European Union funds and thus under European rules. Another case is the "structural reforms", as long as they comply with certain criteria defined by the European Commission and their implementation is also subject to the European supervision. The European Commission intention to promote a stronger expansionary fiscal policy in the Eurozone (European Commission, 2016) also looks more like a change of rhetoric than a change of substance. The need to recover the domestic demand is at stake since the European economy's growth remains low and the European exports cannot support it, given the uncertain growth of the world economy. The European Commission then proposes an expansionary fiscal policy, since in the current zero-interest situation the income multiplier effects and spill over effects are higher than in other circumstances and the monetary policy of the European Central Bank (ECB) needs the support of fiscal policies.[13] This European Commission proposal seems to be a recognition of what should have been previously done and was not, but in substantive terms the policy framework remains the same. It is stated that the "fiscal sustainability remains a priority" (*Idem*, p. 9) and thus the expansionary fiscal policies are only recommended to those countries whose structural balance has already reached the medium-term budgetary objective. Furthermore, the expansionary fiscal policy is viewed in a more general strategic perspective in which "structural reforms" continue to be included.

The TSCGEMU, by shifting the focus of European budgetary rules from public balance to structural balance, is further restricting the ability of states to decide on their choices in economic policy and in particular on discretionary fiscal policies. It reflects the European political intention to more closely supervise national discretionary fiscal policies and thus the political and economic policy choices of national states.

Hereby, in 2016, the European institutions and also the IMF showed a permanent distrust of the Portuguese macroeconomic policy; their various estimates forecasted the non-performance of the public deficit-to-GDP rule. The doubts were not only on fiscal policy itself, but also on the macroeconomic policy orientation and in particular on the household income led growth policy. Given the budgetary and economic results achieved, the mistrust gave way to silence. In the analysis of Portugal they concentrate the justifications for the Portuguese economic results on European policies as if nothing different had happened in politics and in the economic policy in Portugal.

The European Commission has attributed the Portuguese budgetary outcome in 2016 to ECB policy and to moderate economic recovery, without referring to its origins. No reference is made to the economic policies with an alternative nature that were undertaken by the Portuguese government which were contrary to those privileged in the European economic model. Only the increase of the

[13] This proposal of the European Commission seems to result from Blanchard and Leigh (2013). This working paper is considered a landmark in the discussion of the fiscal multiplier size of the fiscal consolidation policies in the Eurozone after 2010, since one of the authors, Olivier Blanchard, was at the time chief-economist at the IMF, which then defended these policies in the European financial assistance programmes.

minimum wage is mentioned, and this to alert to the risks in the level of employment and competitiveness of the country (European Commission, 2017a, p. 11). Schäuble (2017, p. 4), the German finance minister until September 2017, considered that "Portugal made impressive progress" and that this "success" "also demonstrates that European stabilization policy works [and that] those states which have implemented and concluded assistance programmes show above-average growth." He cleverly reversed the outcome in favour of the European Union institutional framework. The ECB President Mario Draghi also attributes the improvement registered in the Standard & Poor's public debt rating in September 2017 to the reforms that have been implemented in the country and the improvement of the economic situation in Portugal and the Eurozone (European Parliament, 2017).

It is true that the Portuguese case could be embarrassing for the European Union, given its economic policy guidelines. On one hand, for the European institutions, Portugal could be considered the exception that allows them to keep the idea that compliance with the budgetary rules do not prevent national governments to undertake different economic policies at national level. This way the European institutions try to contradict those who argue that national elected governments within the Eurozone do not have any leeway to decide on their own economic policies. On the other hand, the Portuguese experience is a call to discuss at economic and political level why the European institutions have insisted on the supply-side economic policies. The reinterpretation of SGP rules in 2015 as well as the European proposal for expansionary fiscal policies through public investment do not shift the basic conception of national fiscal policies framework of, as viewed above.

The Portuguese fiscal policy started to lose its differentiating feature in 2017. Most of the demand-side policy measures that were the distinctive trace of the Portuguese government were practically finished in 2017. There has been also a change in fiscal policy management. In 2016, the government's main concern was to prove that it was possible to reconcile expansionary demand-side fiscal policies and the European budgetary rules, regarding in particular the public deficit-to-GDP ratio, thereby expecting to gather political reliance at home and abroad. However, since 2017, the emphasis has been put on the compliance with European budgetary rules and specifically with the public debt rules. This change, by implying a greater control over structural balances, also implies a greater limitation on a national discretionary fiscal policy. This has frequently emerged even regarding some fiscal measures initially proposed such as the unfreezing of progressions of the careers of the civil servants and the improvement of public services quality.

This political shift performed by the Portuguese government regarding the fiscal policy may change the reading that can be made if we have only into account 2016. The Portuguese fiscal policy in 2016 may be judged as a government political triumph over the European institutions, in the sense that it questioned some of their economic policy guidelines and economic forecasts, even having narrow leeway, taking into account the European budgetary rules. However, the Portuguese fiscal policy since 2017 seems to be a political triumph for the European institutions, since the government, on facing the trade-off between reducing public debt according to the European budgetary rules and meeting the Portuguese citizen's expectations, has chosen the former. In this respect, it seems there has been in both years a tacit connivance between the loser and the winner. There is a permanent loser after all: the collective choices of the Portuguese who rejected, in the October 2015 legislative elections, the austerity policies and trusted in the current government to reverse the direction of the fiscal policy.

Conclusions

The Portuguese government experience has aroused great expectations at the political, economic and academic levels, both internally and externally. Expectations mainly related to the Portuguese government's eventual success and how to reconcile the European budgetary rules and expansionary demand-side fiscal policies. It was simultaneously a test of the government's political capacity to carry out this endeavour, but primarily a test of the leeway for national fiscal policies in the SGP context and, after all, a test of the current Eurozone.

Taking into account 2016 only, the Portuguese fiscal policy seems to be a success story for the government, because it pursued an expansionary demand-side fiscal policy, as an alternative to past fiscal policies and to European guidelines, with successful results that allowed Portugal to exit the Excessive Deficit Procedure in June 2017. In 2017, since the government centred its main concern on reducing public debt and consequently structural balance according to the European budgetary rules, it has been difficult to find and maintain a policy mix that would reconcile both objectives without penalising either of them.

In this permanent exercise, the Portuguese fiscal policy is gradually losing its alternative nature and thus putting in question the reason why the Portuguese trusted in the government. Pereira *et al.* (2018, p. 166) consider that the Portuguese government should defend a downward revision of the medium-term budgetary objective in 2018. But even if the budgetary leeway were larger, the essential contradictions would remain.

Portugal needs not only to complete the convergence process towards the European income per capita level but also to compensate the harsh effects of the previous fiscal consolidation policy which affected in particular the public services quality and public infrastructures. And although it was possible for the government to improve the household income and the initial expectations of the Portuguese, it seems more difficult to move to a new level of fiscal policies meeting their needs within the context of European budgetary rules. And this seems to mean that the European institutions, by conditioning the national fiscal policies, are also determining the public services in areas such as health, education, social services, and transports, and, after all, the role of national states as autonomous institutions.

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www.euromemo.eu
info@euromemo.eu

ISSN 2523-9163

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The EuroMemo Group Discussion Paper Series is partially financed by transform! europe. Transform! is a network of 29 European organisations from 20 countries, active in the field of political education and critical scientific analysis.