Portugal

Macroeconomic outlook and forecasts

The pandemic crisis has impacted Portugal hardly compared to other EU member states, with a GDP contraction of 7.6% in 2020 compared to 2019. During the first and second quarter 2020, the Portuguese GDP contracted by respectively 4% and 14% (q-q change), then recovered in the third quarter by 13.4% and 0.2 in the last quarter of 2020. The sharp decrease in the economic activities linked to tourism (e.g. - 61.3% in guests and -63.0% in overnight stays compared to 2019), a sector representing 8% of the national GDP and 10% of the total workforce (OECD 2020), significantly contributed to worsen the depth of the crisis. According to the 2021 summer forecast by the European Commission, the Portuguese GDP is projected to return to its pre-crisis level (2019-Q4) by the third quarter of 2022.

To cushion the effects of the crisis, the government put in place a fiscal package equal to around 2% of GDP in 2020 and 4% of GDP in 2021. Fiscal measures accompanied traditional automatic stabilizers and aimed to support households (1% GDP), employment (0.6% GDP) and healthcare (0.6% GDP). Thanks to the deployment of job retention schemes, the unemployment rate increased only to a limited extent from 6.5% in 2019 to 6.8% in 2020. Yet, the employment rate decreased by 1.7 pp compared to the previous year and it is expected to return to the pre-crisis level by 2023. In addition to discretionary fiscal measures, the government intervened to facilitate the access of companies and the self-employed to working capital, by putting in place loans and guarantees' measures for a total amount equal to respectively 1% GDP and 7.4% GDP.

The measures adopted to tackle the Covid-19 crisis, with the exception of those regarding liquidity, had a large impact on public deficit. From a small surplus of 0.1% of GDP in 2019, the budget balance of Portugal worsened turning into a 5.7% deficit of GDP in 2020, 4.5% GDP in 2021 and is projected to remain negative until 2025 (-1.1% GDP). Similarly, the debt to GDP ratio has increased considerably from the level of 2019 (116.8%) to peaking at 133.6% in 2020 and is then projected to decrease to 128% GDP in 2021 and 114.3% in 2025.

As a result, Portugal is projected to face in the short term high fiscal sustainability risks. According to the Debt Sustainability Monitor (2020), in the medium term, Portugal is deemed to face high fiscal sustainability risks. At the same time, there are mitigating factors for the risks associated with Portugal's public debt position, notably linked to the public debt profile with the lengthening of debt maturities and a diversified and large investors' base as well as historically low borrowing costs supported by the Euro system's interventions.

Table 1. Macroeconomic developments and forecasts Portugal

	2019	2020	2021	2022	2023	2024	2025	2026
GDP Growth (y-y % change)	2,2	-7,6	4	4,9	2,8	2,4	2,2	n.a.
Employment (% change)	0,8	-1,7	0,2	1,1	0,8	0,8	0,8	n.a.
Unemployment rate (%)	6,5	6,8	7,3	6,7	6,4	6	5,8	n.a.
HICP inflation (% change)	1,2	-0,1	0,8	0,9	1,1	1,3	1,5	n.a.
Gov balance (% GDP)	0,1	-5,7	-4,5	-3,2	-2,2	-1,6	-1,1	n.a.
Debt to GDP (% GDP)	116,8	133,6	128	123	120,7	117,1	114,3	n.a.

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This country sheet is part of the research programme on the preparation and implementation of the EU's Recovery and Resilience Facility. Image credit: Vecteezy.com © CEPS 2021

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Source: Own elaboration, based on Portugal Recovery and Resilience Plan

Portugal structural challenges before Covid-19

When Portugal entered the pandemic crisis, some of the structural challenges affecting the country were already addressed during the economic adjustment program. Reforms in the public administration, the labour and product market regulation in particular proved successful in the years following the Great Recession (see European Commission 2016). This notwithstanding, persisting structural problems remained (see Table 2)

Table 2. Portugal country specific challenges before Covid-19

Policy area	Challenges
Labour market	High youth unemployment
	Gender pay gap remains above the EU average
	Low proportion of unemployed people using PES
	Low level of qualification of the workforce
	Working poor people in households with high work intensity and with children is among the highest in the EU
Education and skills	High social segregation between schools
	Digital skills deficit
	Transition to higher education more challenging for upper-secondary VET students.
	Problem with ageing teaching workforce and lack of digital skills
Justice	Inefficiency in administrative and tax courts
	Lengthy and increasing duration of trials
Research and innovation	Subdued investment in intellectual property and R&D
	Economic structure remains anchored in traditional low-tech sectors
	Railway interoperability is a major bottleneck
Public administration	High administrative burden
	Late payments
	Complex tax system and still low business-friendly investment environment
Taxation	Burdensome administrative and taxation elements especially in retail sector
	VAT policy gap remain high
Product market	Low degree of competition especially in construction and service sectors
	Restrictiveness of regulation for several professions.
Social policies	High level of pat risk of poverty and social expulsion among unemployed, inactive, and elderly (especially in rural areas)
	Limited impact of social transfers on poverty reduction
	Weak state's investments in social housing

Source: Own elaboration, based on the Country Report for Portugal 2020

With respect to labour market policies, despite the pre-pandemic positive trends in terms of increasing employment rate and falling unemployment, Portugal suffered several challenges, including high segmentation, high skills mismatch, declining integration of low-skilled workers, high gender pay gap, and low-effectiveness of Public Employment Services (PES). The younger generations were particularly penalized, with young unemployment rates among the highest in the EU (18.3% vs 15.3% in 2019). Part of the labour market challenges are also explained by structural problems affecting the Portuguese education system. Despite growing investments in education in the years before the pandemic, Portugal was still far from the levels seen before the economic crisis. High job instability, ageing, and underinvestment in upskilling and reskilling of teachers negatively affected students' educational outcomes. In 2019 Portugal had still a high rate of early school leavers (10.6% in 2019) above the EU average (10.2%), and a low participation rate to adult learning (10.3% in 2018, vs 11.1% EU average). In the same year, 48% of the population lacked basic digital skills, including about 26% with no digital skills at all and the proportion of those having never used the internet is twice the EU average

Labour market and educational challenges in part negatively affected productivity growth which remained sluggish in Portugal, limiting the economy's potential. In this respect, additional obstacles and barriers to productivity were posed by low public investments, subdued investments in research and innovation, an economic structure anchored to traditional low and medium to low tech sector, and low level of industry's digitalization. These challenges are further aggravated by regulatory barriers restricting competition for professional and business services, burdensome administrative and taxation elements, bottlenecks in the railway's interoperability as well as regulatory barriers and long-lasting concessions in the management of ports and the provisions of ports' services. In addition, productivity growth in Portugal is still hampered by

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delays in payment of the public administration as well as administrative burdens in starting a business, dealing with construction permits and getting credits. One of the lengthiest judicial proceedings and highest backlogs of pending cases further negatively affect investments in Portugal.

Finally, structural problems characterized the Portuguese welfare state. Despite the efforts of the government to tackle the risks of poverty, Portugal remained one of the countries with the highest AROPE rate, especially in rural areas. In this respect, poverty-reducing impact of social transfers is comparatively low in Portugal and also minimum income adequacy remains low. In addition, Portugal was characterized by a high share of material deprivation in large part explained by the increasing housing prices and the traditional weak public investments in housing policies. With respect to the National Health Service, pre-pandemic challenges existed in access to health care and out-of-pocket payments, among the highest in Europe. The distribution of health resources (facilities and health professionals) was unequal and sub-optimal, and there were shortages in specific areas (of nurses in general and of specialists in rural areas). Long-term care system was highly fragile with low access rates and low-educated workforce.

In addition to structural weaknesses, Portugal experienced significant challenges related to the green and digital transition. First, it is far below the EU average on circular economy and waste management indicators, challenges remain in water management, air quality remains a concern, and building energy efficiency is not picking up. Second, Portugal ranks only 19th amongst EU countries in the Commission's 2020 Digital Economy and Society Index (DESI). The main concerns emerge from the low investment in human capital, the scarce use of internet services, the low digitalization of SMEs and the overall lower than the EU average digitalization of businesses and integration of digital technology into businesses.

The Portuguese NRRP: key numbers and timeline

Portugal was the first European Union member State to submit its national plan for recovery and resilience (NRRP) to the European Commission. The Plan was given a positive assessment by the European Commission on 16th June 2021 and was finally approved by the Council on 13 July 2021. It includes 37 reforms and 83 investments' projects for a total amount of EUR 16.6 billion, consisting of EUR 14 billion in grants and EUR 2.7 billion in loans. Reforms and investments' projects are grouped in three missions, named *Resilience*, *Climate Transition* and *Digital Transition*, which include respectively 9, 6 and 5 components. As shown in Table 3, most of the reforms are expected to be adopted in the Portuguese NRRP while the large share of investments' projects is planned to be completed between 2025 and 2026.

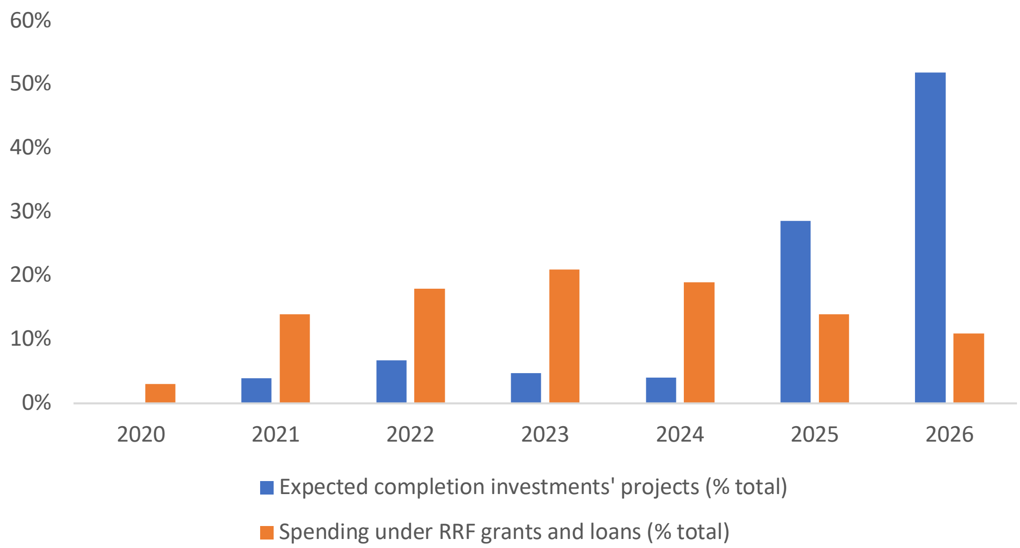
Table 3. Timeline for completion of reforms and investments under Portuguese NRRP, by year (% total)

	2020	2021	2022	2023	2024	2025	2026	TOT
RRF Investments' projects [EUR billion]	0	1,06	0,75	1,11	0,56	9,42	3,71	16,61
RRF Investments' projects (% total)	0%	6%	5%	7%	3%	57%	22%	100%
RRF Reforms [number]	2	13	4	6	2	5	0	32
RRF Reforms (% total)	6%	41%	13%	19%	6%	16%	0%	100%

Source: Own elaboration, based on Portuguese NRRP

The completion of the projects goes along with the request for payments to the Commission. Yet, planned expenditure under RRF in Portugal is expected to start well before 2025 and 2026. As showed in Figure 1, the planned recovery spending under the RRF largely concentrates between 2021 and 2024 when 79% of the spending will take place. Such difference of time reflects the necessary period that new investments' projects require to be implemented.

Figure 1. Planned Portuguese expenditure financed under RRF grants and loans and expected completion of investments' projects (% total)

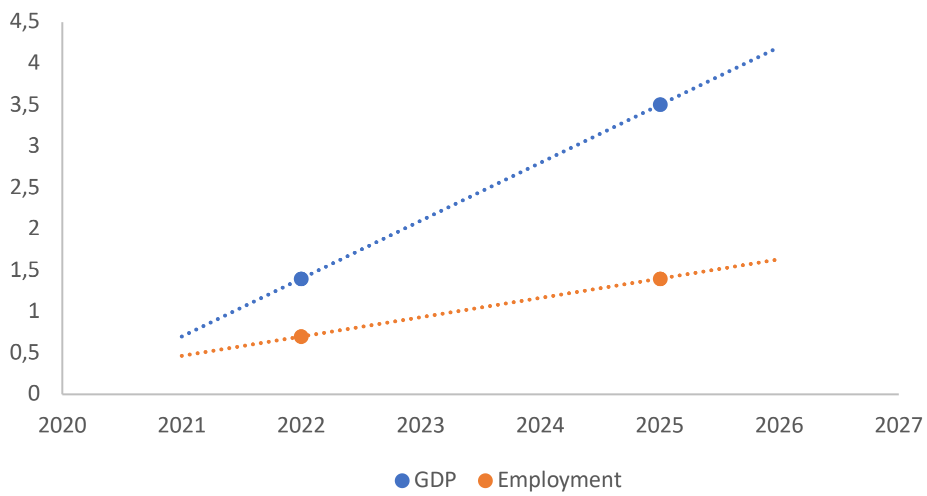


Source: Own elaboration, based on Portugal Stability Programme (2021) and Portuguese NRRP (2021).

With respect to the governance of the plan, it is centralized and will be carried out by the Ministry of Planning through a mission structure, called "Recuperar Portugal" (Recover Portugal), supervised by a President, a vice President and four coordinators corresponding to the four main levels of coordination based on different tasks and objectives. The first one consists in a strategic level of policy coordination with the interministerial commission of the NRRP chaired by the Prime Minister. The second level is a follow-up ensured by the National Monitoring Commission, chaired by an independent personalities and entities. Third, a monitoring level ensured by the mission structure "Recover Portugal" and finally, a fourth level of audit and control ensured by an Audit and Control Committee (CAC), chaired by the General Inspectorate of Finance (IGF).

According to the stylized impact simulations run by the Portuguese government with the QUEST macroeconomic model, the NRRP is expected to have a very positive impact both on employment and GDP especially in the medium term (Figure 2Figure 2). More in details, the plan expects an increase in the average annual GDP growth rate of 0.7 percentage points (pp), with the GDP of 2025 pp above what it would be compared to the scenario without the NRRP. In terms of the labor market, in 2025 the employment rate is expected to be 1.4 pp above the scenario without NRRP.

Figure 2. NRRP impact on GDP and employment - deviations from baseline scenario



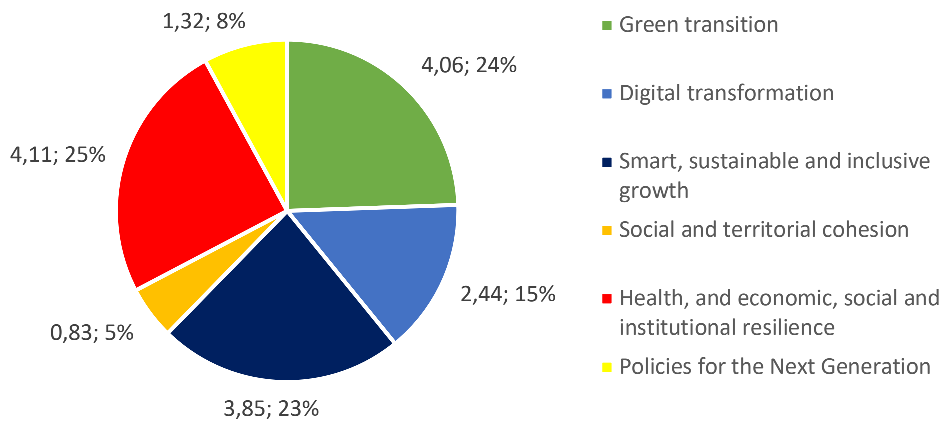
Source: own elaboration, based on Portugal NRRP

Investments in the Portuguese NRRP

Following the Commission guideline, the Portuguese NRRP investments are meant to address the objectives included in the six pillars of RRF. Notably, almost half of the Portuguese plan's funds are under two pillars:

Health, economic, social, and institutional resilience (25%) and *green transition* (24%) whereas *Smart, sustainable, and inclusive growth* and *Digital transformation* planned respectively the 23% and 15% of the investments. The remaining funds are allocated to *Policies for Next Generation* (8%), and *Social and territorial cohesion* (5%) pillars. With respect to the distribution of the funding across economic activities, the Portuguese plan distributes the resources evenly, with the largest share allocated to Professional, scientific, and technical activities (21.4%), Construction (20.6%), Human health and social work activities (13.3%) and Education (11.3%).

Figure 3. Portuguese investments by 6 RRF pillars (EUR billion, % total)



Source: Own elaboration, based on Portuguese NRRP

A closer look at the breakdown of the six Portuguese pillars gives a better understanding of the investments' prioritization.

Under the *Health, economic, social, and institutional resilience* pillar, the most relevant projects include the launch of the Access to Hosing Support Programme and other housing actions for a total of €2.7 billion, as well as measures to support the health care sector (€1.38 billion), especially on primary health and digital healthcare transition. The *Smart, sustainable and inclusive growth* pillar includes investments aimed to increase the competitiveness and resilience of the Portuguese economy through measures designed to strengthen research, by fostering the transfer of its results to the business sector, thus promoting innovation and investment. Among the most relevant funded projects there are the launch of the Mobilising Agendas/Alliances for Business Innovation and for Green Reindustrialisation (€0.92 billion) and the creation and capital reinforcement of the Portuguese National Promotional Bank *(Bank Banco Português de Fomento*) (€1.55 billion). Under the *Green transition* pillar, the main projects include investments in the sustainable mobility, notably in the renovation of the metro networks (€0.97 billion), tax incentives for industries' decarbonisation (€0.71 billion) and investments in the energy efficiency of both residential and public administration buildings (€0.54 billion). Under the *Digital transition* pillar, the most relevant projects include tax credits for companies' digital transition (€0.65 billion), investments in the digitalization of the public administration (€0.58 billion) and of the educational system (€0.55 billion). Funds under the *Next Generation* pillar are dedicated to the modernization of the provision and establishments of education and vocational training (€0.71 billion) and to incentivize the reskilling of adults and to give an impulse to STEAM subjects in the higher education (€0.35 billion). Finally, the *Social and territorial cohesion* pillar includes projects to strengthen, expand, upgrade and reform social services that respond to the challenges of childcare, ageing, long-term care, and disabilities (€0.42 billion). Table 4 below indicates the 10 largest investments included in the Portuguese NRRP.

Table 4. Portugal 10 strategic projects financed by RRF and timeline

Strategic investments	€ bn	Description	Timeline
Supporting schemes for access to housing programme	2,7	Providing decent and adequate housing for at least 26,000 households in need and increasing housing conditions in the housing stock, with a focus on less developed regions.	2Q2026

Establishment of the Portuguese National Promotional Bank	1,55	Providing the Portuguese National Promotional Bank, Banco *Português de Fomento*, with a capital buffer and investing in viable Portuguese firms to address the structural problems of limited access to finance and undercapitalization.	4Q2025
Decarbonization of industries and businesses' R&D and innovation sector	1,26	Supporting small and medium enterprises in the green transition. Launch of Mobilising Agendas/Alliances for Business Innovation.	4Q2025
Vocational education and training institutions and digitalization of education	1,21	Upgrading technological laboratories and technical equipment in secondary schools and professional training centres. Digitalization of education.	4Q2025
Digital health transition and Primary Health Care	0,77	Modernizing the computer systems of the National Health Service and increasing the digitalization of medical records compliant with appropriate security principles.	4Q2024
Digital transition of businesses (digital upskilling)	0,65	Supporting small and medium enterprises and their workers with tailored digital skill trainings and tailored coaching to help them make the best use of digital technologies.	3Q2025
Protecting vulnerable forest areas	0,61	Adapting land management to transform the landscape of vulnerable forest territories to prevent fires, increase climate and economic resilience and protect biodiversity.	4Q2025
Strengthening metro network	0,6	Expansion of Porto Metro Network - Casa da Música-Santo Ovídio and Lisbon Metro Network - Red Line to Alcântara	4Q2025
Energy efficiency in residential buildings	0,3	Financing a large-scale renovation programme to increase the energy efficiency of residential buildings.	4Q2025
Modernization of justice and business environment	0,27	Removing barriers to investment, increasing the efficiency of administrative and tax courts; simplifying the insolvency framework	4Q2025

Source: Own elaboration

Portugal key structural reforms

Reforms included in the national plan aim to address some of the key challenges affecting the Portuguese economy and society, and to reduce the obstacles that have hitherto slowed down investment implementation and reduced its productivity. In line with the priorities of the NRRP in investments, reforms are focused mainly in the area of public administration, education and skills, product market and social policies.

In the PA framework, of relevance is the reform of the public financial management, which aims to increase transparency in the use of public resources and promote an integrated management system of real estate public assets In addition, the NRRP includes a reform of the judicial system that establishes the strategic framework for the digital transition of justice and the reduction of the administrative burden on companies. Notably, this reform introduces a legal framework promoting in and out-of-court settlements, the establishment of a legal framework for voluntary administrative arbitrage, and the creation of specialized chambers in superior courts.

In order to tackle the skills mismatch characterizing the Portuguese labour market, the NRRP includes two main interventions. The first one is focused on reinforcing the vocational and educational training whilst the second one proposes a strengthening of the cooperation between Higher Education, Public Administration and enterprises. With respect to educational policies, the plan includes the digital education reform that foresees the strengthening of the digital teachers' skills, the technological infrastructure of schools, including digital equipment, internet access, as well as the development of digital educational content.

The plan includes also a decent work agenda which aims at combating precariousness, promoting collective bargaining, active employment policies and training, with a special attention to the new form of work, e.g. digital platforms workers and telework.

With respect to product market, the plan includes a liberalization on highly regulated professions , e.g. lawyers, architects and engineers, and the reduction of regulatory and administrative burden imposed on both professionals and firms. Another relevant reform is the creation of the National Promotional Bank *(Banco Português de Fomento)* that has a twofold purpose: increasing the level of competitiveness of the economy and supporting the development of the national productivity. In addition, a review of the insolvency framework strengthens the role of insolvency practitioners and the rights of the lender introducing compulsory partial apportionment in specific cases.

Finally, in the domain of social policies, the NRRP includes a reform of the housing system through a national housing plan *(Plano Nacional de Alojamento Urgente e Temporário*) that aims to create a structured and transversal response for people who lack emergency or temporary accommodation solutions. The objective of this reform is to develop a legal and regulatory framework for signaling and monitoring people supported by the housing policy. The plan foresees also two main reforms in the healthcare area: the first one regards the governance model of public hospitals, i.e. reconfiguring hospitals network according to capacity planning in terms of volume of services, human resources and infrastructure. The second reform instead focuses on primary healthcare through the modernization and digitalization of the NHS, especially through investments in the Autonomous Regions of the Azores and Madeira. Table 5 summarizes the main reforms included in the Portuguese plan, divided in key policy areas.

Table 5. Key structural reforms

Area	Measure	Description	Timeline
Labour market	Decent Work Agenda	Fighting precariousness and segmentation though active labour market policies and the promotion of collective bargaining. One of the objectives is to increase the national minimum wage to 750 euros.	1Q2023
Education and skills	Reform for Digital Education	Reinforcing the population's digital competences as an integrated public policy action, updating and modernise both formal and non-formal education.	4Q2025
	Reform of vocational education and training	Strengthening the response capacity of the Portuguese education and training system in terms of youth and adult education and training	4Q2025
	Reform of cooperation between Higher Education and Public Administration and enterprises	Review the legal and institutional framework in force that governs the cooperation of higher education institutions, with the Public Administration and enterprises, in order to modernize the incentives for cooperation and support for the diversification of training provision and lifelong learning.	2Q2021
Justice	Economic Justice and Business Environment	Strengthening the relations of citizens and businesses with the State and reduce the burdens and complexities that inhibit business activity and thus impact on productivity.	3Q2025
Public administration	Modernisation and Simplification of Public Financial Management	The reform also aims at increasing transparency and efficiency in the use of public resources, through a more integrated management of administrative and financial processes across all entities within general government.	4Q2025
Taxation	-	-	
Product market	Reducing restrictions in highly regulated professions	Eliminating restrictions on access in some highly regulated professions and preventing infringements of competition rules in the provision of professional services, as under national and European Union law.	2Q2022
	Creation and development of the Banco Português de Fomento	The aim of this promotional bank is to (i) support the development of the economy through the provision of financing solutions, and (ii) support the development of the Portuguese business community, bridging the market gaps in access to corporate financing, with a focus on SMEs and midcaps.	4Q2020
Social Policies	Housing	Creating a structured and cross-cutting response for people in need of emergency housing solutions or transitional housing with a view to their protection, autonomy and social inclusion and the fight against inequalities.	2Q2021
	Primary health care reform	Modernisation of the entire health system, e.g. promotion of health and healthy lifestyles; integrated management of disease, investments in the qualification and modernization of primary health care facilities and strengthening proximity healthcare responses.	

Source: Own elaboration

Overall assessment of the Portuguese plan

At the early stages of the pandemic crisis, a positive economic performance and policy effort was helping Portugal to address some of its challenges. Yet, Portugal was still facing various problems, such as shortfalls in investment, a segmented labour market, high skills mismatch, a still inefficient PA as well as a rigid product market and ineffective social safety nets.

The plan has been largely built on the 2019 Country Specific Recommendations. It proposes an ambitious set of structural reforms and targeted investments that have many interdependent and complementary objectives.

This is in particular the case of two key social policies reform – the national strategy to combat poverty and the national plan for urgent and temporary accommodation that address most of the issues related to housing

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– and the product market reforms – notably the reduction of restrictions in highly regulated sectors and the creation of the Banco Português de Fomento. Equally relevant are the reforms regarding the education system, the economic and business environment justice and the public administration.

An additional positive contribution of the plan is the the alignment with the green and digital objectives of the RRF. In particular, on the green side, the Portuguese NRRP proposed relevant reforms on industries decarbonization as well as sustainable mobility, especially through the reform of the transport ecosystem. On the digital side, main reforms address the digital gap of the Portuguese public administration, businesses and educational system in order to establish a new strategic framework for the digital transition of the economy.

It is worth mentioning that despite tourism plays a key role in the Portuguese economy, it is not included in the NRRP. Yet, on May 21, the Ministry of the Economy announced a plan to reactivate tourism ("*Plano Reativar o Turismo|Construir o Futuro"*) foreseeing a first investment of 6 billion euros in the Portuguese tourism sector to reach the goal of 27 billion euros in tourist revenues in 2027. The largest share of the investment, 4 billion euros, will be provided by Banco Português do Fomento, which will channel 3 out of 4 billion to preserve the employment and productivity and the remaining part for financing the businesses of the tourism *sector.*

On a less positive note, labour market reforms, such as the decent work agenda, are not enough to tackle all the above-mentioned challenges, from high youth unemployment to the lack of effectiveness of public employment services (PES), and both quantitative and qualitative targets are not mentioned. The only exception is the increase of the national minimum wage up to 750 euros by the 4Q2023.

Concerns emerge also with respect to the qualification and skills area, whereby the plan assigns the majority of the funds to the modernization of the education buildings. Finally, the Portuguese NRRP falls short in addressing the challenges related to the lengthy duration of trials and the high VAT gap, i.e. the overall difference between the expected VAT revenue and the amount collected.

Finally, in terms of effectiveness of the proposed interventions, the plan timeline should be guaranteed by the creation of a centralized monitoring cabin, the so called "Recuperar Portugal". However, the fact that many of the key structural reforms, especially the PA and justice reforms, are postponed to 2025, might risk slowing down both the absorption of the funds and the economic recovery.