

## Technical note

### Portugal: António Costa's Government delivers proposal for the 2020 State Budget. Negotiations with opposition to start soon

Lisbon

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The recently re-elected PS (Socialist Party) Government led by António Costa is set to face its first political challenge in the current legislative term following the unveiling of the initial proposal of the 2020 State Budget to the President of the Portuguese Parliament. The Government sets a historic goal for the upcoming year: reach a **fiscal surplus for the first time in Portuguese democratic history**. While reducing the deficit and public debt, this proposal increases tax burden: the Government expects to add more than 2 billion euros in tax revenues.

Contrary to what happened in the previous four years, the Government will not have guaranteed support from former allies CDU (Portuguese Communist Party and Green Party) and BE (Left Block) due to the lack of a formal deal between the parties and disagreements on key policies State employees, public services, tax policy and other areas. António Costa and his cabinet seemed to bring the Government closer to the Left-Wing parties through a recently announced 800 million-euro investment in the NHS (National Healthcare Service), but important differences remain in other areas. Negotiations between the Government and the opposition parties are expected to begin before the end of the year, which could lead to changes in several State Budget measures before the **final vote in February of 2020**.

PS doesn't have enough Members of Parliament to form a majority, which means that **other parties will need to vote in favour or abstain for the budget to pass**. This **relative uncertainty** has led to a document with a wider margin for changes during the negotiations with opposition parties. A failure to pass the Budget is unlikely, as a political crisis would also affect the reputation of the Left parties. The question is how far the Government is willing to go in the name of perceived stability, guaranteeing votes in favour.

#### FINANCIAL AND ECONOMIC OUTLOOK

The 2020 State Budget proposal includes the Government's predictions, expectations and goals for the national economy during the year.

- For the first time since the Democratic revolution of 1974, the

State Budget projects a 0,2% surplus at the end of the year

- The Government is expecting a 1,9% growth in GDP, above EU average for next year.
- The unemployment rate at the end of 2020 is expected to be 6,1%, slightly above the previous Government prediction.

## KEY MEASURES FOR COMPANIES

**The set of measures presented to impact SMEs** are considered to be a Government compromise to convince the employers' associations to agree to the previously announced increase in the National Minimum Wage for 2020.

**Corporate Income Tax**, known in Portugal as IRC, will be the Government's main weapon to attract investment and increase the economic competitiveness of the country. Small and Medium Enterprises will have a chance to pay less tax if they meet certain conditions.

### Key measures and incentives

- Companies with taxable profits of up to 25.000 euros will now pay 17% in Corporate Income Tax (IRC), instead of 21%. This revision falls short of the 50.000-euro cap demanded by employers' associations, but it's a significant increase of the previous cut-off point of 15.000 euros.
- To encourage decentralization, companies headquartered in inland regions or regions with a particularly low demographic concentration will pay the minimum IRC tax rate of 12,5%.
- Companies will be able to deduct IRC payment in 20% of the expenses in salaries above the National Minimum Wage.
- Companies who pay for their employees' public transportation will be able to receive a State repayment of 130% of the value spent, instead of the current 100%.
- The maximum value for deductible profit invested in SMEs will be increased to 12 million euros, from the current 10 million. Companies will also have four years instead of

three to reinvest profits before they have to pay tax.

- Cars bought by enterprises will pay the minimum 10% IRC rate if the acquisition cost is under 27.500€, instead of the previous 25.000€.
- Companies will be able to deduct the entirety of the VAT paid in electric car battery charging.
- Companies who are forced to pay a tax for excessive staff rotation will have the opportunity to defer the payment or divide it into several instalments.
- The Government will study possible tax cuts for companies with a high volume of exports over the next year, although no specific measures are included in the State Budget.
- Online gambling will have flat tax rates of 25% of GGR in games of chance and 8% of turnover in online betting. Betting exchanges will have a 35% tax rate on commissions.
- Taxes on unhealthy foods, tobacco and environmentally damaging behaviours should be adjusted.
- Regarding the real estate sector, the Government will also be looking to encourage the creation of affordable housing through measures that will penalize touristic accommodations and real estate deals in areas with "high demographic pressure", rewarding real estate owners who decide to rent their houses to city dwellers at lower than average prices.

## POLITICAL LANDSCAPE AND REACTIONS

The President of the Republic, Marcelo Rebelo de Sousa, has already started the hearings with the parliamentary parties: PS, PSD, BE, CDU, CDS-PP, PAN, Chega!, Liberal

Initiative and Livre in order to understand each party's position on the State Budget proposal before the start of the official discussions, providing a first chance for compromise.

**PSD**, the largest opposition party and the most important political force in the Right-Wing, appears to be outside the Government's radar for negotiations, despite PSD's significant number of MPs. According to some reports, António Costa may be looking to draw support from PSD Members of Parliament elected by the Autonomous Region of Madeira to guarantee important votes, creating another internal division in PSD.

So far, the biggest Far-Left political force, **BE**, has been the most vocal about the proposal, claiming that the State Budget is "insufficient", "lacks commitment" and "is created around the Socialist Party's obsession with the surplus".

**CDU**, the coalition of the Communist Party and the Green Party, has avoided any commitment to approve the State Budget, asking for policies to defend workers, improve the conditions of State employees and support Small and Medium Enterprises. It is unlikely that CDU agrees to vote in favour of the State Budget without significant changes to the initial proposal.

Closer to the Government, **PAN** (Party of People, Animals and Nature) finds in the State Budget several measures that answer the party's concerns: an increase of the VAT for bull-fighting and related activities, taxes on single-use plastic and taxes on highly polluting cars and industries. However, PAN leader André Silva has called for more proposals and structural changes in the Government's environmental policies.

Expectedly, **CDS-PP** and **Iniciativa Liberal**, representatives of the Centre-Right in

Parliament, have already announced that they will vote against the State Budget due to profound differences between their ideological views and some of the key measures included in the document. This, guarantees six unfavourable votes.

**Chega!**, a Far-Right, anti-establishment party, has already indicated the intention to vote against the State Budget. Despite being a single-MP party, Chega! Is rising fast and could be an important opposing voice during the Parliamentary discussions.

**Livre**, the smallest Let-Wing force in the Parliament, may be an important ally for the Government despite having only one MP. Joacine Katar Moreira showed disappointment for the lack of attention given to the citizenship law and racism issues, but the negotiations with António Costa's team will be the deciding factor for Livre's final vote on the State Budget.

## Next steps

Following the hearings with the President of the Republic, the Government is expected to begin the first round of negotiations with Left-Wing and environmentalist parties before the end of 2019. The Parliament will officially discuss the 2020 State Budget on the 9<sup>th</sup> and 10<sup>th</sup> of January, before the first general vote on the 11<sup>th</sup> of January. If the document passes this first stage, each provision is discussed in the Parliamentary Committees.

## Possible political scenarios to approve the State Budget

Due to PS' relative majority in Parliament, the Government needs at least 8 votes in favour from other parties or 15 abstentions to approve the State Budget in each vote. Considering that the Parliament has 230 Members, these are relatively small margins, but there aren't many potential partner choices for António Costa. The

most likely scenarios for the Government would be:

- Reach an agreement with all the Left-Wing and environmentalist parties to ensure a comfortable vote in favour of the State Budget: this solution would require challenging and lengthy negotiations not only with the Government's previous allies, CDU and BE, but also with PAN (Party of People, Animals and Nature) and Livre (Free Party). António Costa and his Ministers would likely have to fold on multiple areas, especially public services, a price that may reveal to be too steep for the Government.
- **Negotiate an agreement with PAN, Livre, and the three Members of Parliament elected by PSD in the Autonomous Region of Madeira:** this is a recently reported alternative solution to approve the State Budget that makes mathematical sense, but it could jeopardize the Government's stance with former allies BE and CDU. The MPs from PSD could be persuaded to vote in favour of the budget in return for measures with a particularly positive impact in their region, including a new public hospital that is waiting for State funds. PAN seems to be the most likely candidate for a deal, and Livre may be easier to swing due to its single-MP status. This solution would require absolute commitment, seeing as it guarantees the exact number of votes that the Government would need to approve the budget: eight.
- **Abstention from one of the two largest Far-Left political forces:** this scenario is plausible, but it would raise doubts on the Government's stability and ability to guarantee support over the next three years of governance. If either BE or CDU abstain, every other party except for PS could vote against and the State Budget would still be approved.
- **A Central Block formed with PSD to ensure stability:** Despite a fight for party leadership and plenty of internal disagreements, PSD still leads the Right-Wing and holds a significant number of 79 MPs. Given Rui Rio's relative proximity with some of António Costa's views, and regardless of the historical rivalry between PS and PSD, the two parties could look to strike an agreement to pass the State Budget in a last-ditch effort from the Government to prevent failure. The consequences for the Government and the budget itself would be difficult to predict, but it would be a guarantee that the Government would stay in power in case of a complete inability to reach agreements with the remaining parties.

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