MEDIUM TERM BUDGETARY FRAMEWORK EXPERIENCE IN PORTUGAL

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SOME BACKGROUND INFORMATION

- Portugal is a unitary state composed of two autonomous regions, 308 municipalities and 3092 parishes
  - Local and regional government expenditure represented 12.5% of total general government (S13) expenditure in 2016
  - Local government has a multiannual framework, but it is not fully regulated and in practise is not used
- Public expenditure (%GDP)

1995	2005	2010	2016
42.6	46.5	49.1	45.1

- Portugal concluded in 2014 its third financial assistance programme since the restauration of democracy in 1974
  - 1st programme – IMF 1977
  - 2nd programme – IMF 1983/84
  - 3rd programme – IMF, EC, ECB (formerly known as 'troika') – 2011-2014

SOME BACKGROUND INFORMATION

- The budget process centred only on the annual budget until the addition of the Stability Programme in 1999
- Only in 2011, with the 5th amendment to the Budget Framework law (published in May, just before the start of the adjustment programme) introduced a MTBF

Assessment by the IMF (2014)

Table 0.2. Portugal: Impact of Reforms on Selected Transparency Principles

Principle	Before Program	Reforms Undertaken	Current Situation	FTE Priorities	End Point
Medium-term Budget Framework (MTBF)	Nothing except for SGP forecasts		MTBF prepared weak track recording following		Credible and complete MTBF
Fiscal Legislation (Budget Frame Law)	Incomplete guide to budget process		More complete BFL with some weaknesses		Sound BFL

Source: IMF, Portugal - Fiscal Transparency Evaluation, IMF Country Report No. 14/306, September 2014

2011 MULTI-ANNUAL FRAMEWORK

- Law no. 22/2011 of 20 May (5th amendment to the 2001 BFL) created the **Multi-annual Framework of Budgetary Planning – MFBP** (*Quadro Plurianual de Programação Orçamental* – QPPO in Portuguese)
  - Approved on 6 April 2011 [exactly same date of the request for financial assistance]
- The MFBP shall define the **ceilings on expenditure by the <u>central government</u> that is financed by general revenues**
  - Excludes expenditures financed by own revenue (earmarked).
  - Note: CG expenditure financed by general revenue is approx. 60% of total GG expenditure (cash basis accounting)
- Ceilings are defined **in line with the objectives established in the Stability Programme and are binding for the subsequent four years**
  - MFBP shall also define the ceilings on expenditure for each budgetary programme, each group of programmes and all programmes as a whole; these ceilings are binding for the first year, the second year, and the third and fourth years respectively.

➢ MFBP shall be **updated on an annual basis for the four subsequent years in the State Budget Law**, in line with the objectives established in the Stability and Growth Programme

How binding are the ceilings?

PROBLEM: HOW BINDING?

Conceptual problem: the expenditure **ceilings are binding** for the subsequent four years, **but** the entire four years of the multiannual framework **are updated on an annual basis for the four subsequent years in the State Budget Law**

- In the end of year t, when the State Budget for t+1 is approved, the ceilings are defined for t+1, …, t+4
- Yet, in the following year (that is t+1), the Budget law for t+2 (to be approved in the end of t+1) instead of being subject to the ceiling for t+2 approved in the previous year can modify the ceilings for t+2,…, t+4 besides adding t+5.

- Non-compliance: contrary to the legal requirements the projection of general revenues and own revenues are not provided for the subsequent four years

In practice the ceilings have been subject to annual revision *(see next slides)*

2011 MULTI-ANNUAL FRAMEWORK

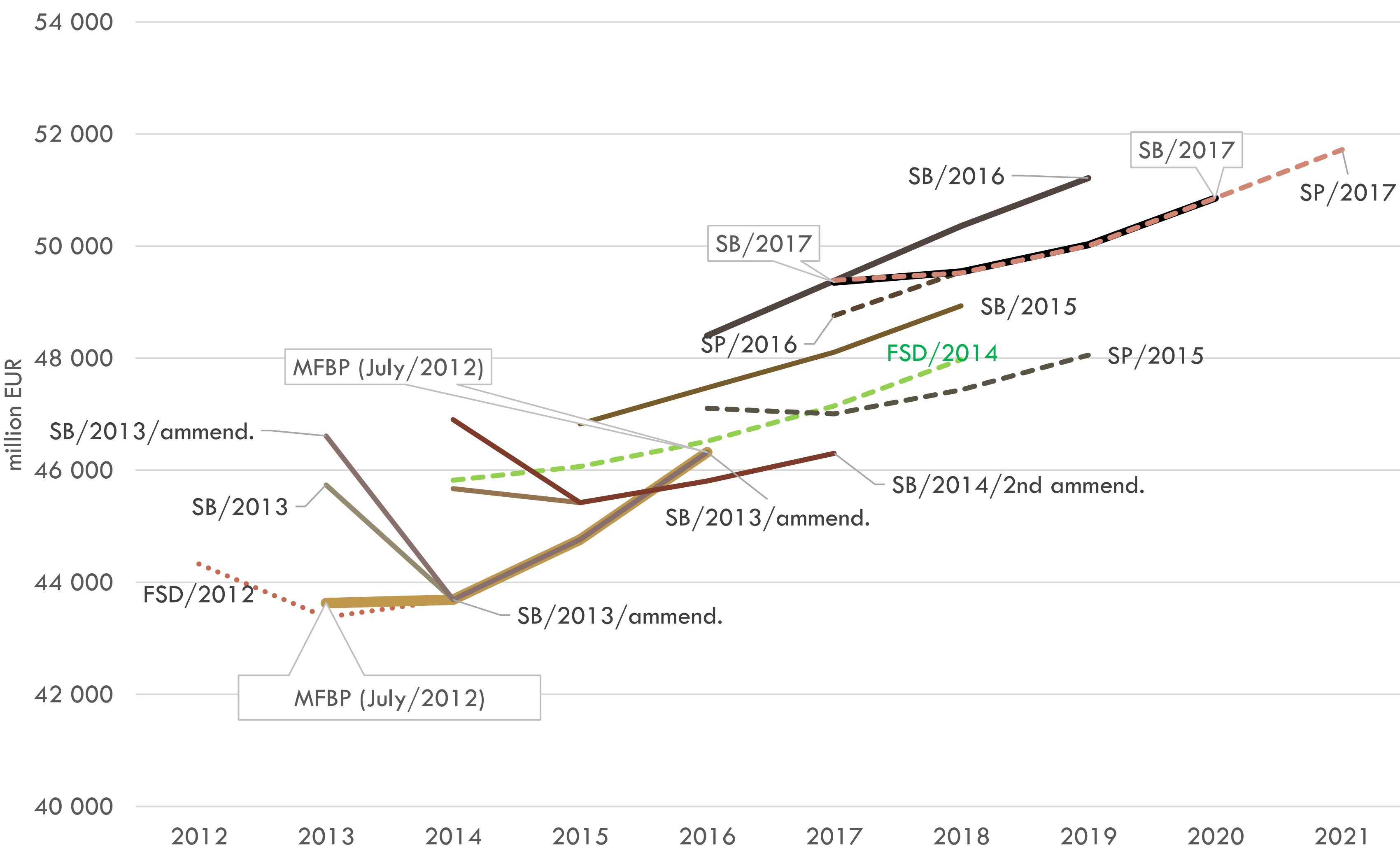
European Commission, Public Finances in EMU 2014:

«In 2012, Portugal introduced an MTBF that obliges the government to annually submit (simultaneously with the draft budget) to the parliament a draft law on a budgetary multi-year planning setting expenditure ceilings for the central government expenditure for the subsequent four years in accordance with the targets contained in the latest Stability Programme. The government, the parliament and the independent fiscal institution (*Conselho das Finanças Públicas* - Public Finance Council) are involved in setting the objectives. »

- Actually, CFP monitors compliance, but is not involved in setting the ceilings, except examining whether the ceilings are compatible with the deficit target (and only for t+1, due to lack of information on the outer years t+2,…,t+4))

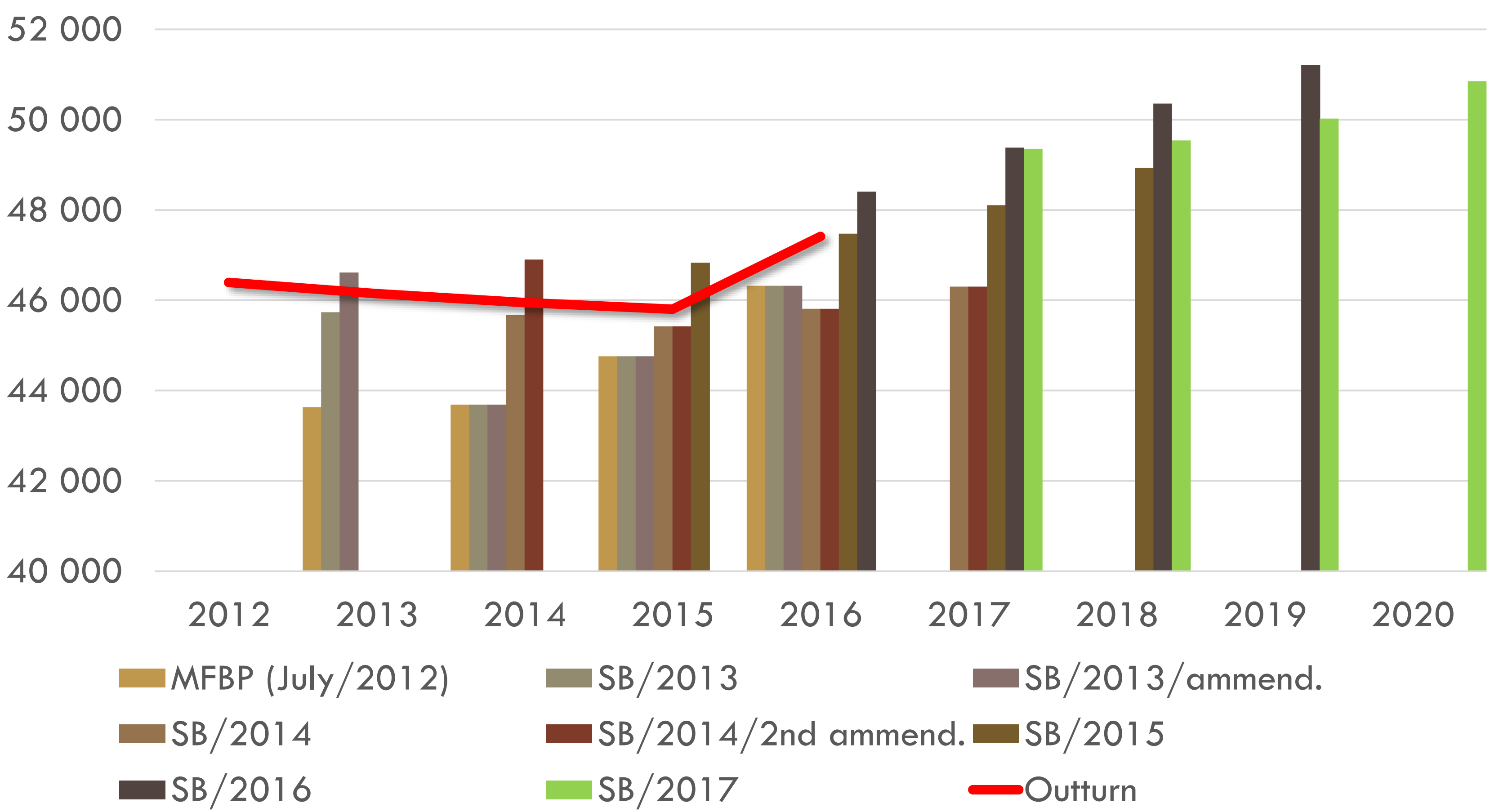
TRACK-RECORD MFBP

Approved MFBP: solid lines
Draft updates (not approved): dashed lines ---

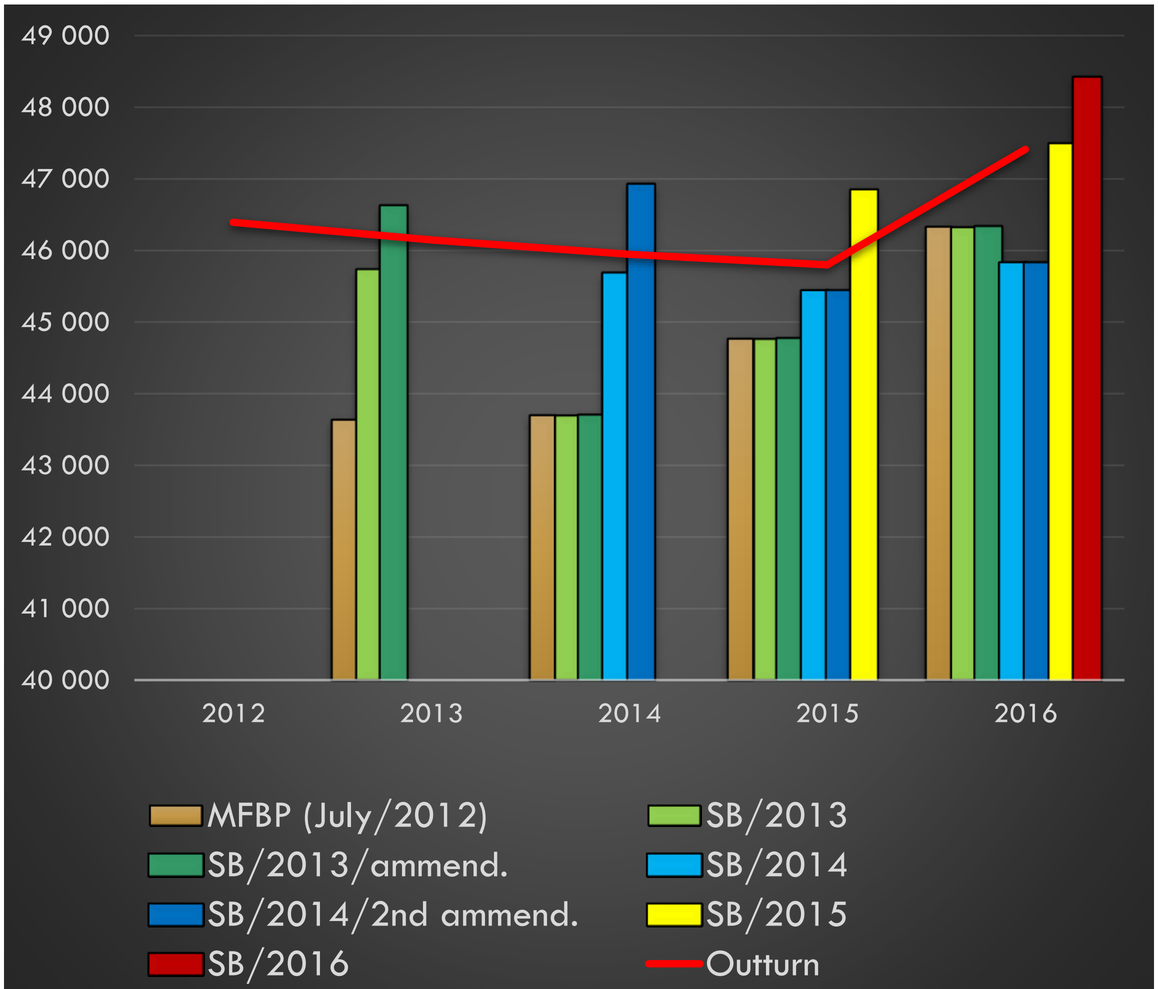


TRACK-RECORD: APPROVED MFBP

The (revised) ceilings have always been formally complied with



TRACK-RECORD



Revised ceilings have always been complied with

2013: ceiling increased twice: with SB/2013 and an amendment to SB/2013

- Constitutional Court ruled unconstitutional further civil service compensation cuts included in SB/2013; further social security expenditure (recession)
- Compensated for by tax increases
- Oddity: SB/2013 & 1st amendment to SB/2013 only increased the ceiling for 2013, leaving the ceilings for 2014-16 unchanged

2013-2016: compliance just ensured by raising the ceiling in the respective SB

TRACK-RECORD

- 2013-2016 compliance just ensured by (raising) the ceiling in the respective SB
  - No compliance with ceiling set in previous update to the framework
  - Could raise the question whether there was really an improvement vis-à-vis the previous situation characterized by a focus on the annual budget
  - Yet, its too soon to conclude that. This behaviour could be the result of the introduction of the framework during a period of extreme fiscal stress, during an adjustment programme, in the context of a deep recession, and with policy instability on account of constitutional boundaries being crossed
- More recently, the SB/2017 actually reduced the ceiling for 2017 set in the SB/2016 (from 49381 to 49358 million €), which is good news in this regard!
  - additionally 2018 and 2019 ceilings were also reduced
- Non-full-compliance: *contrary to the legal requirements the projection of general revenues and own revenues are not provided for the subsequent four years*

RECONCILIATION: DIFFERENT ACCOUNTING STANDARDS

- National accounting (ESA2010)
- General Government (GG)

SP objectives

MFBP

- State Budget
- Cash basis accounting
- Central Govt. (CG)

RECONCILIATION: DIFFERENT ACCOUNTING STANDARDS

State Budget for 2017 | Million EUR	
1. General Government budget balance (EDP)	**-3 016**
2. Ajustments to the cash basis accounts balance	**-1 745**
Accrual (Commitments adjustments - Cash)	-515
Taxes and Social contributions	-244
Difference between interested paid and accrued	154
Other accounts receivable (-)	0
Other accounts payable (+)	-425
Differences due to General Government perimeter	107
Other adjustments	-1 338
3. General Government Balance (cash basis) [(1)+(2)]	**-4 761**
a) Regional and Local Government Balance	891
b) Social Security Balance	1 092
4. Central Government Balance [(3)-(a)-(b)]	**-6 743**
c) Revenue	58 313
Tax revenue	42 049
Other current revenue	14 551
Capital transfers received	1 713
d) CG maximum Expenditure Limit [(c)-(4)]	**65 056**
e) Financed by own Revenues	15 698
5. CG limit for expenditure financed by general revenue (MBFP) [(d)-(e)]	**49 358**

Source: MF. CFP calculations. | Note: CG – Central Government.

Note: Reconciliation table published by CFP and not by the Ministry of Finance

Departure point for t+1 CG expenditure ceiling is GG net lending objective (national accounts)

→ adjustments to obtain the GG balance in cash basis accounting

→ deduct local government and social security funds cash balance to reach the central government balance (cash basis)

→add revenue forecast (cash) to CG deficit yields CG expenditure ceiling

→deduct financing via own revenues to get the ceiling on CG expenditure financed by general revenue (cash basis)

NEW BUDGET FRAMEWORK LAW (BFL)

Approved in September 2015

To be implemented in 3 years' time: 2019 State Budget should be fully prepared and executed according to the requirements of this new BFL

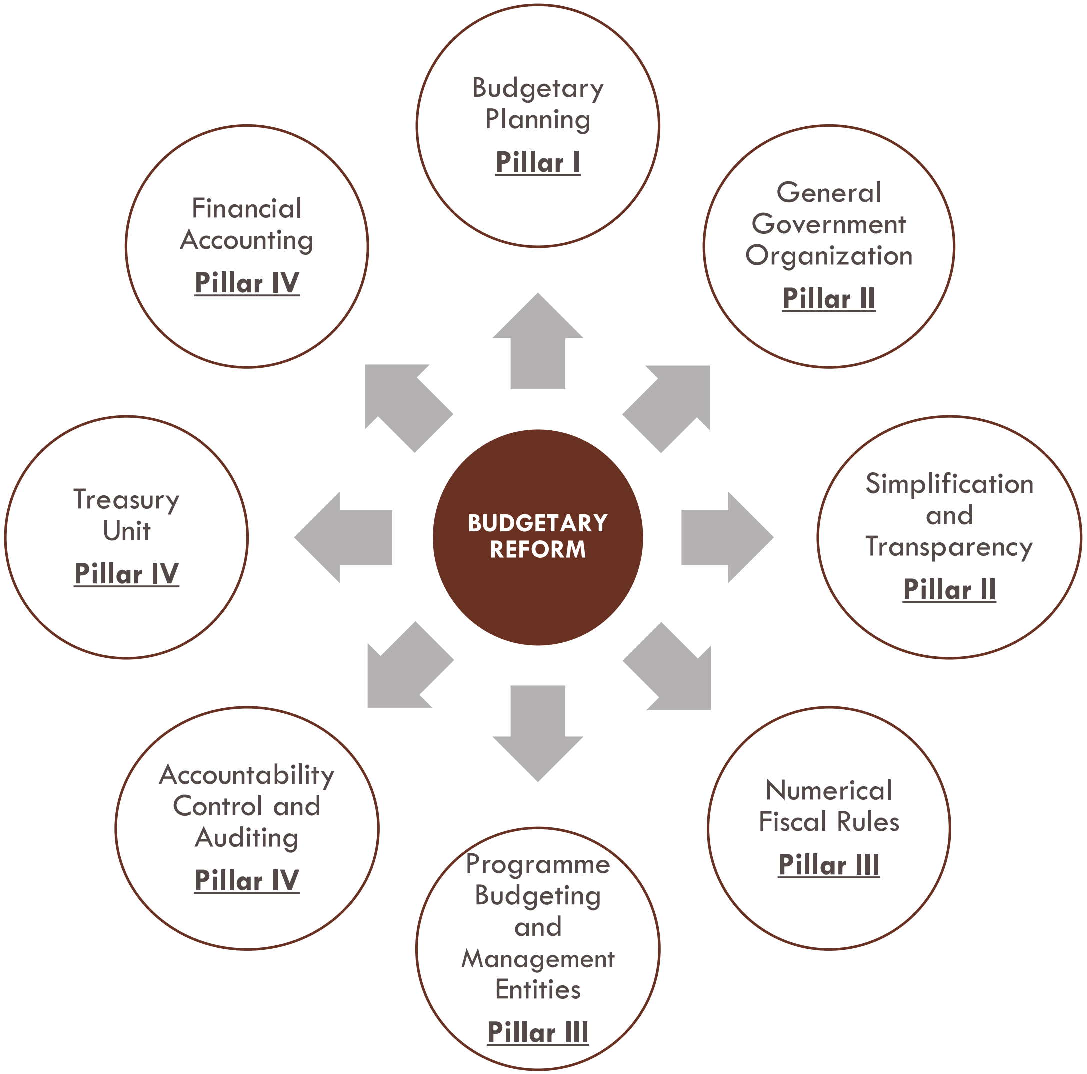
Accompanied by a **reform of public accounting standards towards an accrual system based on IPSAS** was also legislated in late 2015, is being implemented, although with some **delay**

The law envisages a *new way to design and implement fiscal policy*. The change aims to effectively integrate fiscal policy in a medium term economic policy framework, and promote a modern and efficient public financial management, reinforcing accountability

Enhances public expenditure control mechanisms

New IPSAS based Accounting System to align Budgetary, Financial and Management accounting standards, thereby promoting transparency and accountability

NEW BFL HAS FOUR PILLARS



Sources: MoF, CFP

NEW MULTIANNUAL EXPENDITURE FRAMEWORK

New designation: **Multiannual Expenditure Framework**

- *[Quadro plurianual das despesas públicas- QPDP]* replaces QPPO

Will be linked to programme budgeting

More responsibility to line ministers that will determine management units responsible for programmes

- **Defines expenditure ceilings from year t to t+4** compatible with Stability Programme targets
- **Applies to central government & Social Security**
- **Applies to total spending** (irrespective of the source of financing, i.e. it will also include expenditure financed by own revenues)
- Includes revenue projections

NEW MULTIANNUAL EXPENDITURE FRAMEWORK

Yearly, the Government presents the multiannual framework, which includes the current year and the four subsequent years

The ceilings are binding for the following economic year State Budget and have an indicative nature for the programming period that matches the remaining period of the legislature

Escape clauses for binding ceiling – Government can establish a higher ceiling when:

- Redefinition of the MTO
- Significant deviation from the MTO (!!)
- Social security can exceed them in the case of social benefits where these constitute rights of beneficiaries
- In case of amendments to the State Budget within the exclusive remit of Parliament

NEW BUDGET FRAMEWORK LAW

Implementation will be key, but implementation delays observed:

- **in the public accounting reform** [postponed from 2017 to 2018]
- **in the set up of technical entity** to monitor the law's implementation during the transition period [now in place; created in November/2016 instead of March/2016]
- **in complementary legislation,** including the guidelines and specifications for the implementation of Budgetary programmes
  - *State Budget for 2019 should be fully prepared and executed according to the requirements of this new BFL*

New expenditure framework could require fine-tuning before implementation

- Not clear if it is subject to Parliamentary approval
- Not clear how the desirable freezing of ceiling for subsequent budget is compatible with an yearly presentation
- Escape clauses too extensive and incomprehensible how in the case of a significant deviation from the MTO the expenditure ceiling can be raised

POLITICAL COMMITMENT AND PUBLIC DISCUSSION?

Successive ceiling revisions, accommodating spending overruns; but also implementation during fiscal stress

Number of articles in the national press regarding the QPPO:

- 2014: zero
- 2015: **2**, but only referring that the analysis of the QPPO is part of the remit of the fiscal council
- 2016: **4**
  - quoting the approval of the draft QPPO by the Government (but no information on its content); description of the structure of a the ISEG budget watch report

Reference in Parliamentary debates (excluding the law designation):

2012: 1st QPPO: MoF Vítor Gaspar mentions it twice; 1 MP from the majority mentions it once.

Very difficult to find any other reference!