Conselho das Finanças Públicas
Portuguese Public Finance Council

Public Finance Sustainability and the Role of Independent Fiscal Institutions

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All opinions expressed here are my own and do not reflect the official position of any institution.

Porto, 11 November 2019

Summary

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- Public finance risks
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Parte B - The IFIs (Independent Fiscal Institutions)

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- The Portuguese Public Finance Council

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Part A

Public Finance Sustainability

Sustainability – what is it?

Public Finances are sustainable:

if the expenditure plans, i.e. if the expenditure assumed in the present including all commitments in the future, can be effectively realised, without failing to comply with the obligations relating to the public debt assumed in the meantime

Some important implications:

1. the expenditure assumed shall correspond to a revenue plan enabling a stable, non-explosive trajectory for public debt

2. The internalisation of the notion of sustainability implies guidance of the political decision for the calculation of cost impacts and intertemporal benefits

3. the financial sustainability of the State is something that depends on the past, contemporary decisions, but also on what will happen in the future

Public debt time path

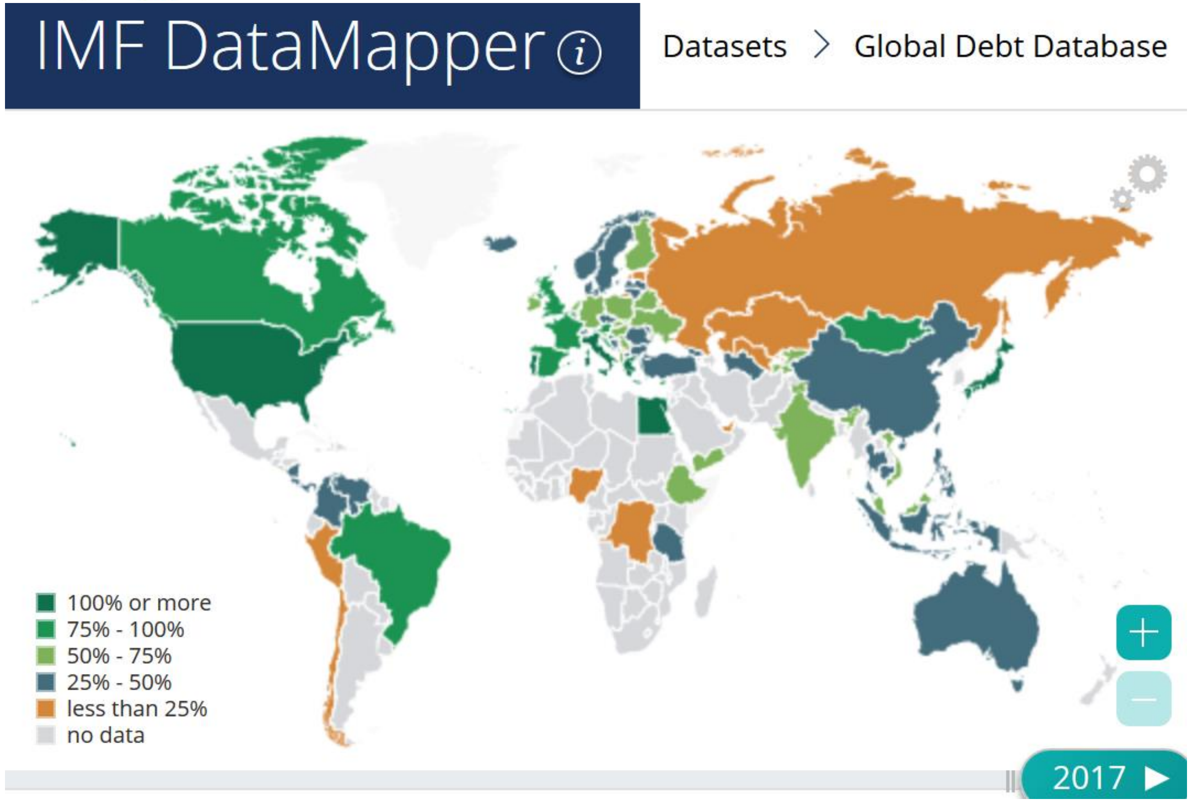
Debt at the end of the year = Debt at the beginning of the year + $\underbrace{\text{Expenses - Revenues}}_{\text{- Budget balance}}$ + Deficit/Debt adjustments

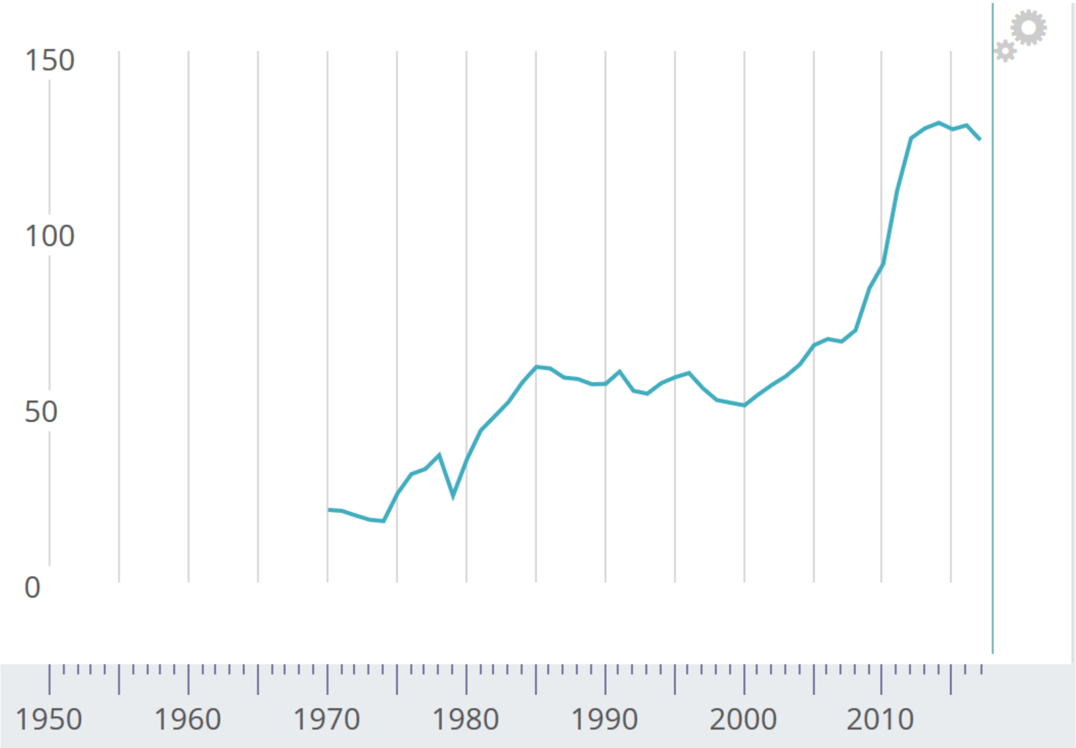
Debt change = - Budget balance + Deficit/debt adjustments

Debt change = $\underbrace{\text{Interest-free expenses + interest paid}}_{\text{Total spending}}$ - Revenues + Deficit/debt adjustments

Interest paid ≈ interest rate x debt

Public debt sustainability





https://www.imf.org/external/datamapper/GG_DEBT_GDP@GDD/PRT

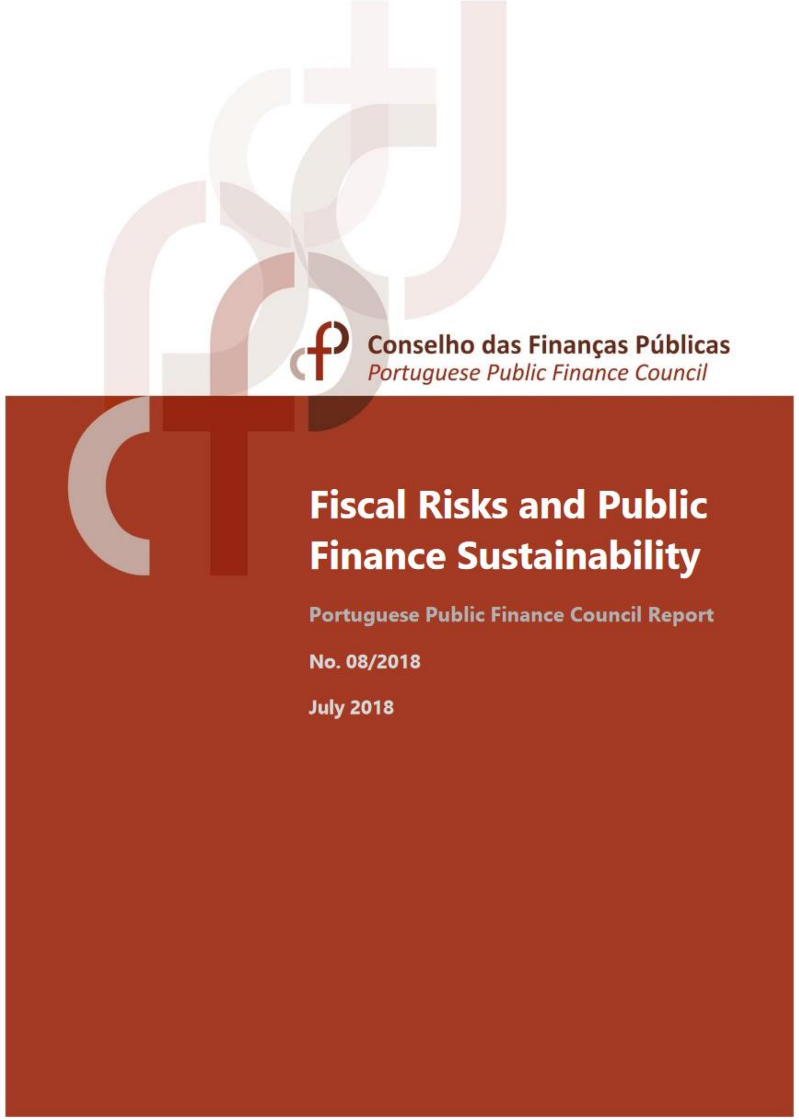
Public debt sustainability

The trajectory of public debt is usually expressed as a percentage of GDP.

Variables that affect this trajectory:

- GDP growth rate
- interest rate
- the initial value of public debt
- revenue and public expenditure (primary budget balance)
- deficit-debt adjustments

Public finance risks and sustainability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Fiscal Risks and Public Finance Sustainability

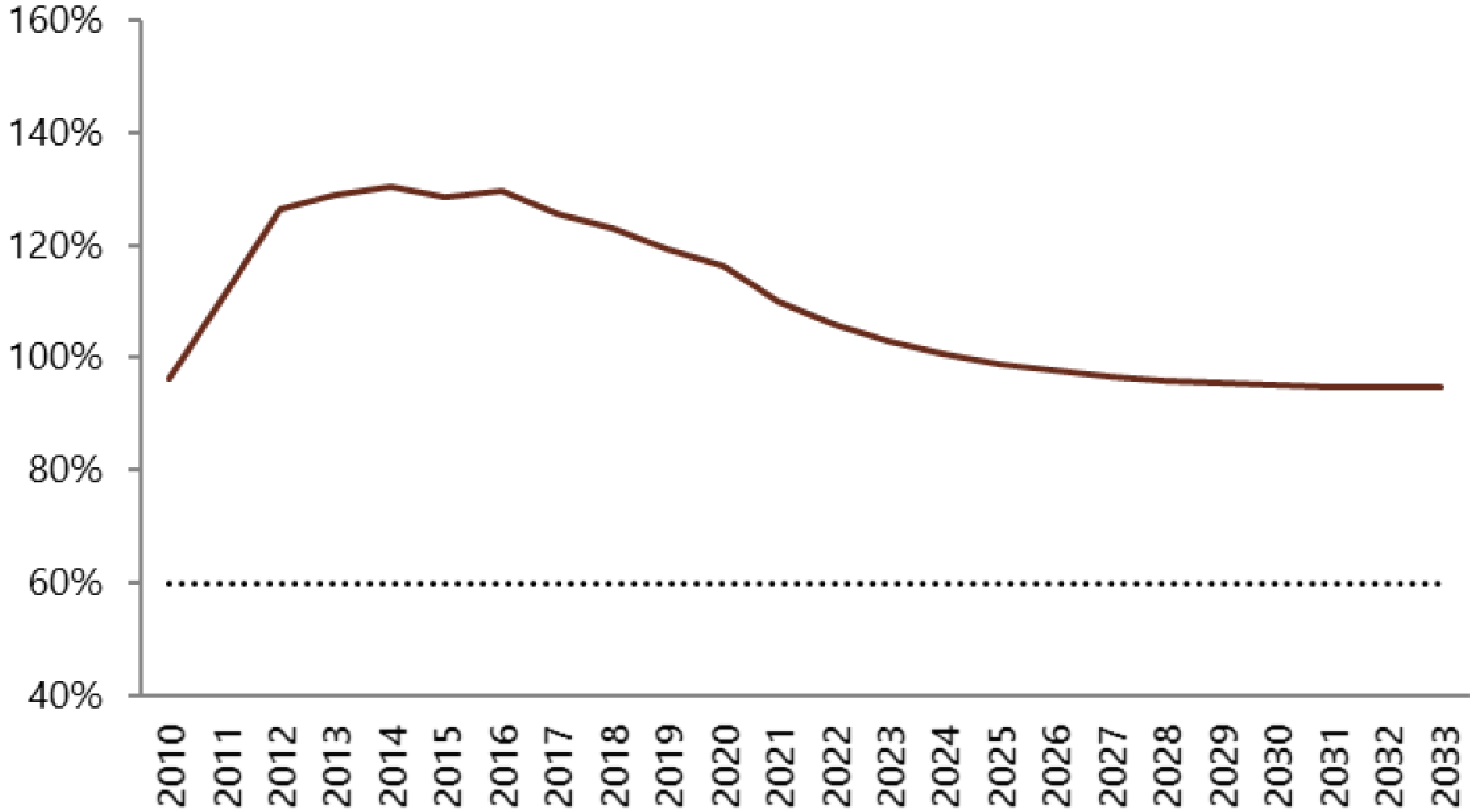
Portuguese Public Finance Council Report

No. 08/2018

July 2018

Public finance risks and sustainability

Chart 61 - CFP and EC no policy change scenario, Maastricht debt (in % of GDP)



Source: Bank of Portugal, European Commission, CFP, INE and MF. CFP calculations.

Public finance risks and sustainability

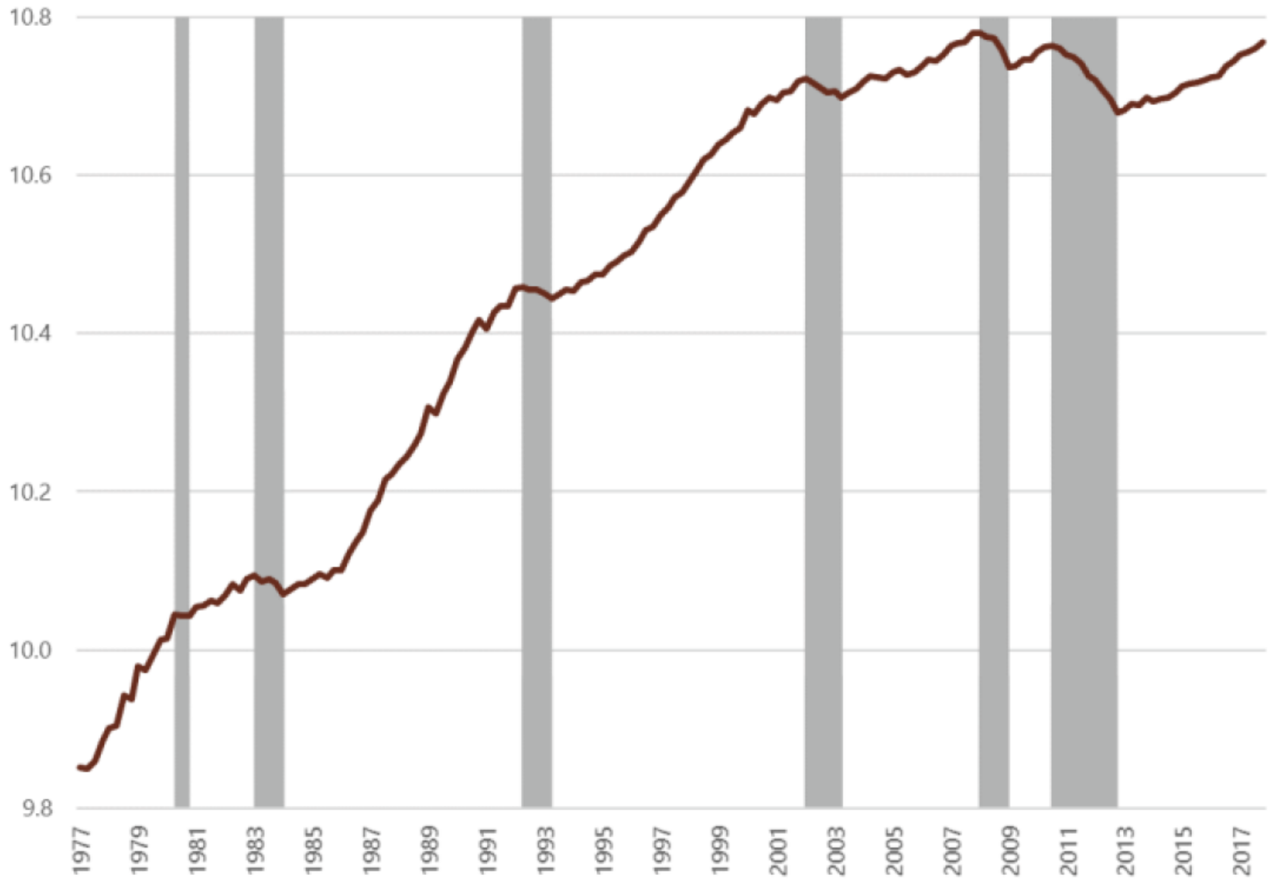
1) Macroeconomic risks
   - economic growth
   - economic cycles (recessions)

2) Revenue risks
3) Risks on expenditure
   - Pension
   -Health

4) Contingent responsibilities
   - financial sector
   -guarantees granted, public-private partnerships and the public companies

Public finance risks and sustainability

Chart 12 – Quarterly real GDP (logarithm), 1977-2017



Note: The shaded areas represent recession periods in Portugal.
Sources: Bank of Portugal (long quarterly series) and CFP calculations.

Public finance risks and sustainability

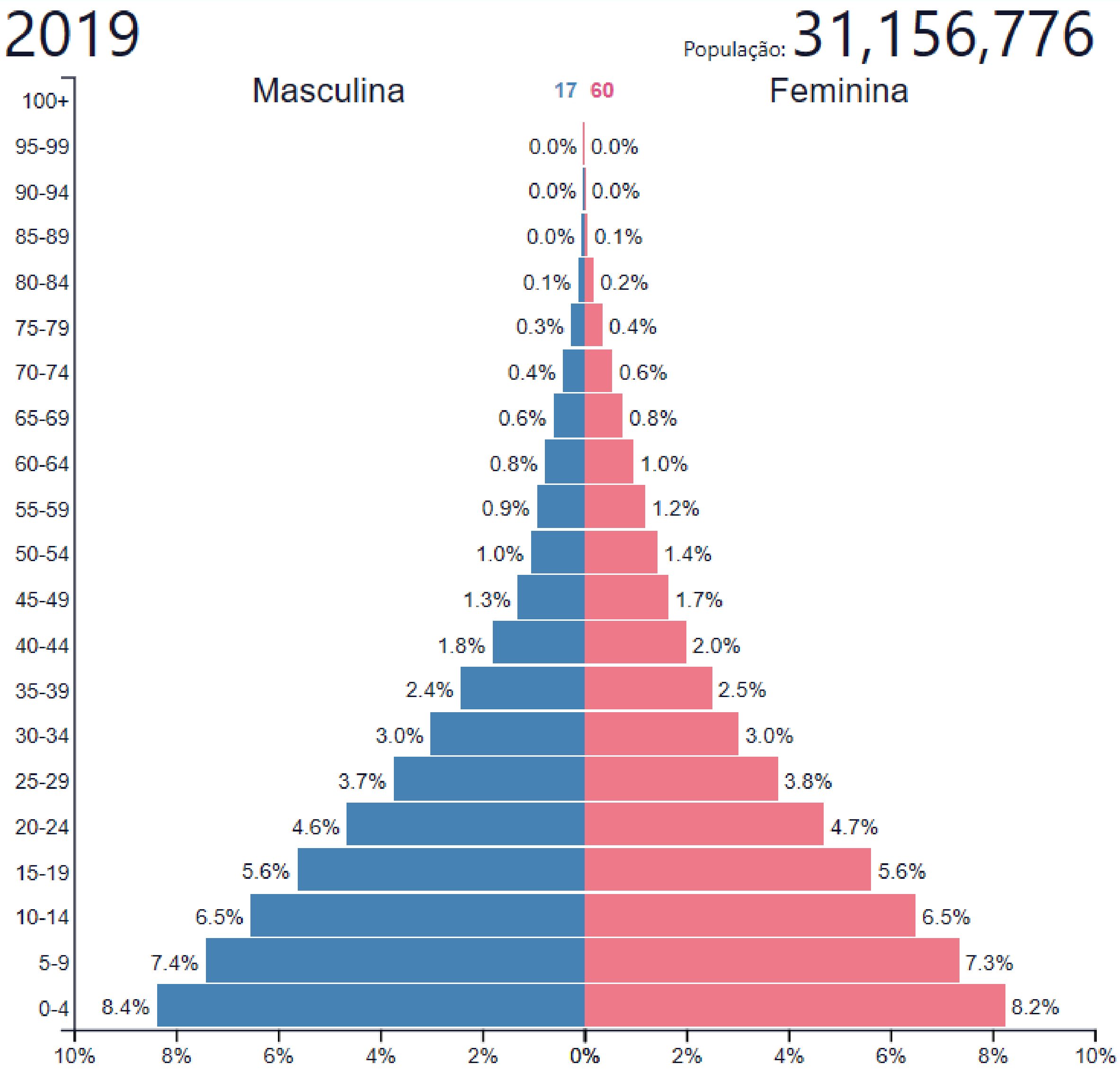
Table 2 – Recessions in Portugal since 1977

Peak	*Trough*	*Consecutive quarters of falling output*	*Peak-to-trough fall in output (%)*	*Quarters for output to regain pre-recession peak*
1980 Q2	1980 Q4	2	0,2	1
1983 Q1	1984 Q1	4	2,3	5
1992 Q2	1993 Q2	4	1,5	4
2002 Q1	2003 Q2	5	2,4	4
2008 Q1	2009 Q1	4	4,3	-
2010 Q3	2012 Q4	9	8,1	20
Average		5	3,1	

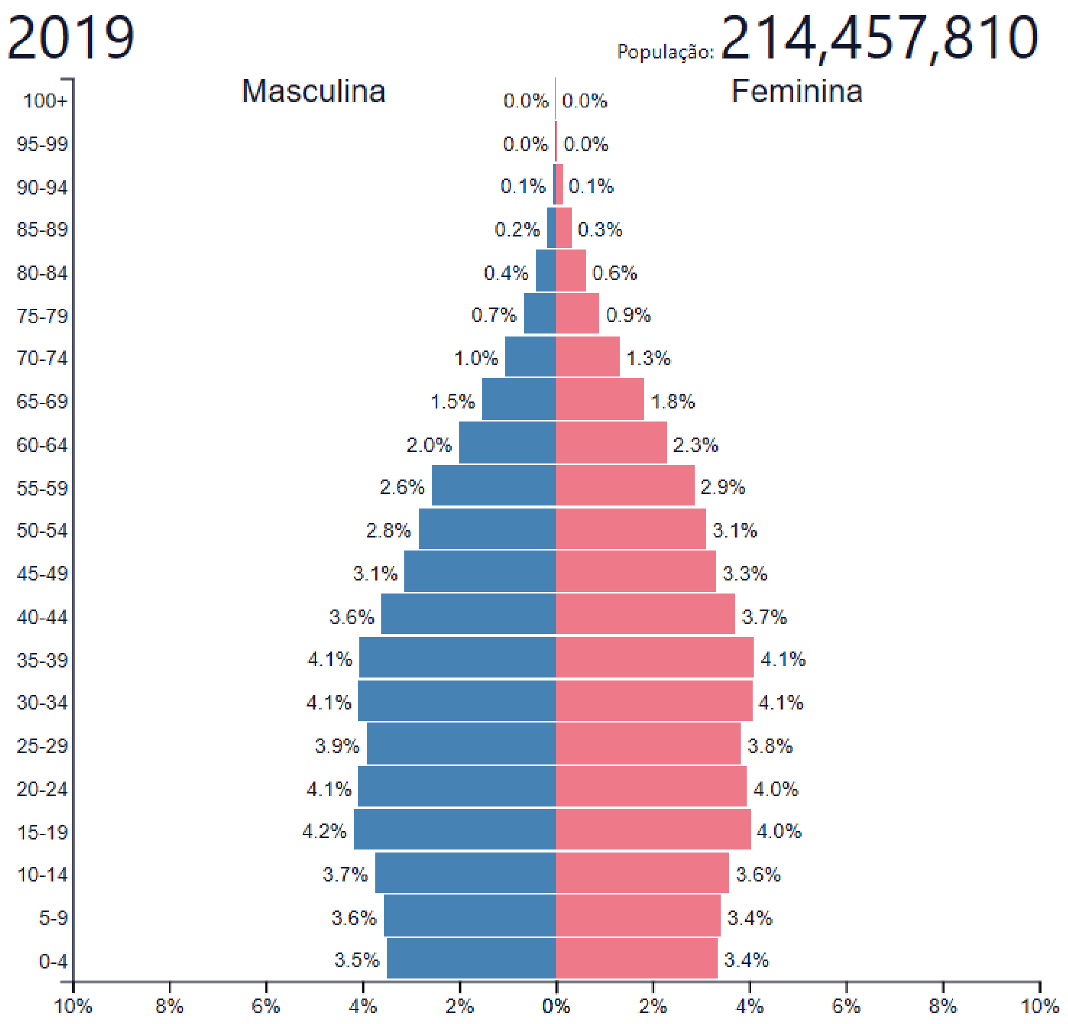
Sources: Bank of Portugal (long quarterly series) and CFP calculations.

Using a binomial distribution and assuming that the probability of recession is independent each year, it is concluded that the probability of the Portuguese economy being in recession at a given point in any five-year period is approximately 55%.

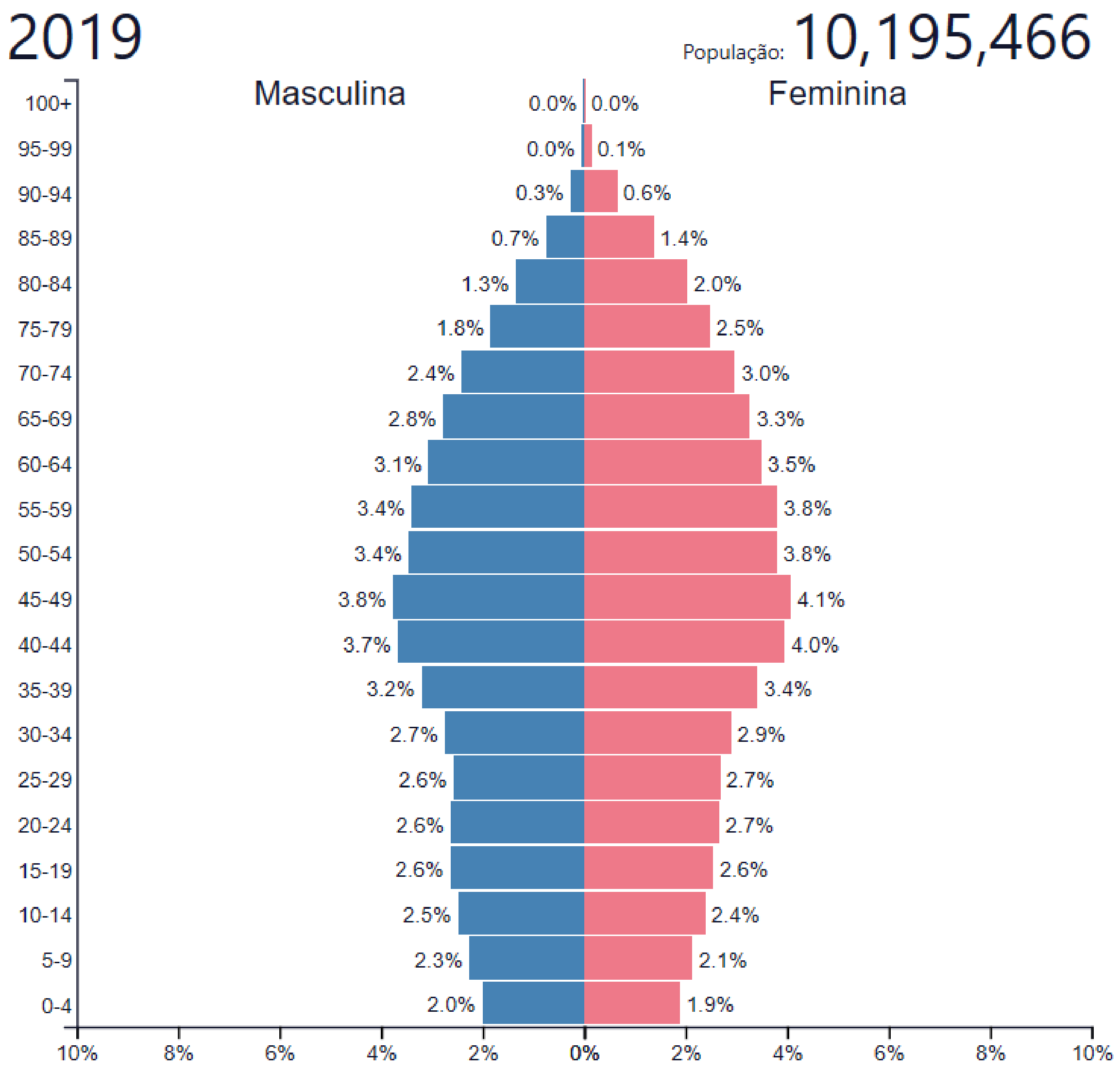
Mozambique - population age structure



Brazil - population age structure

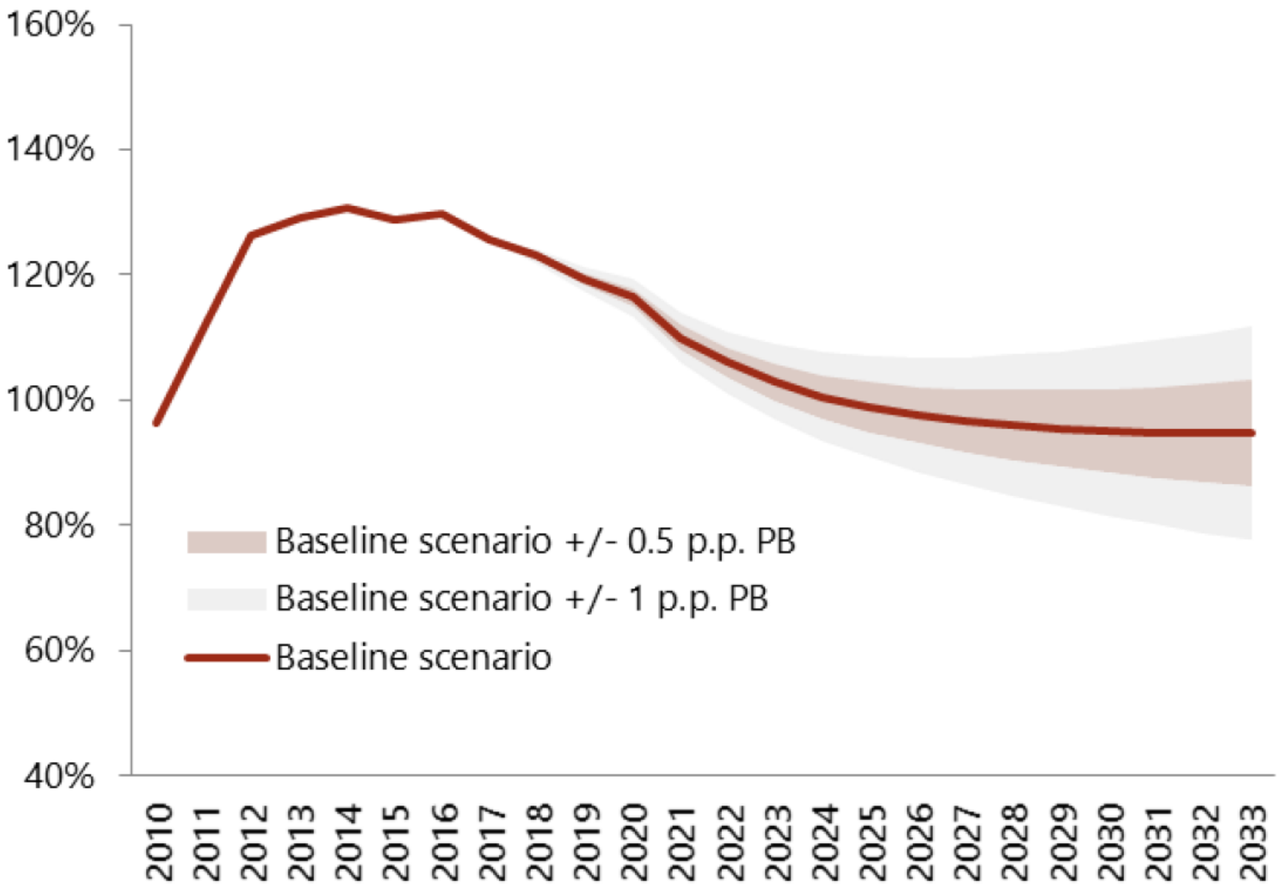


Portugal - population age structure



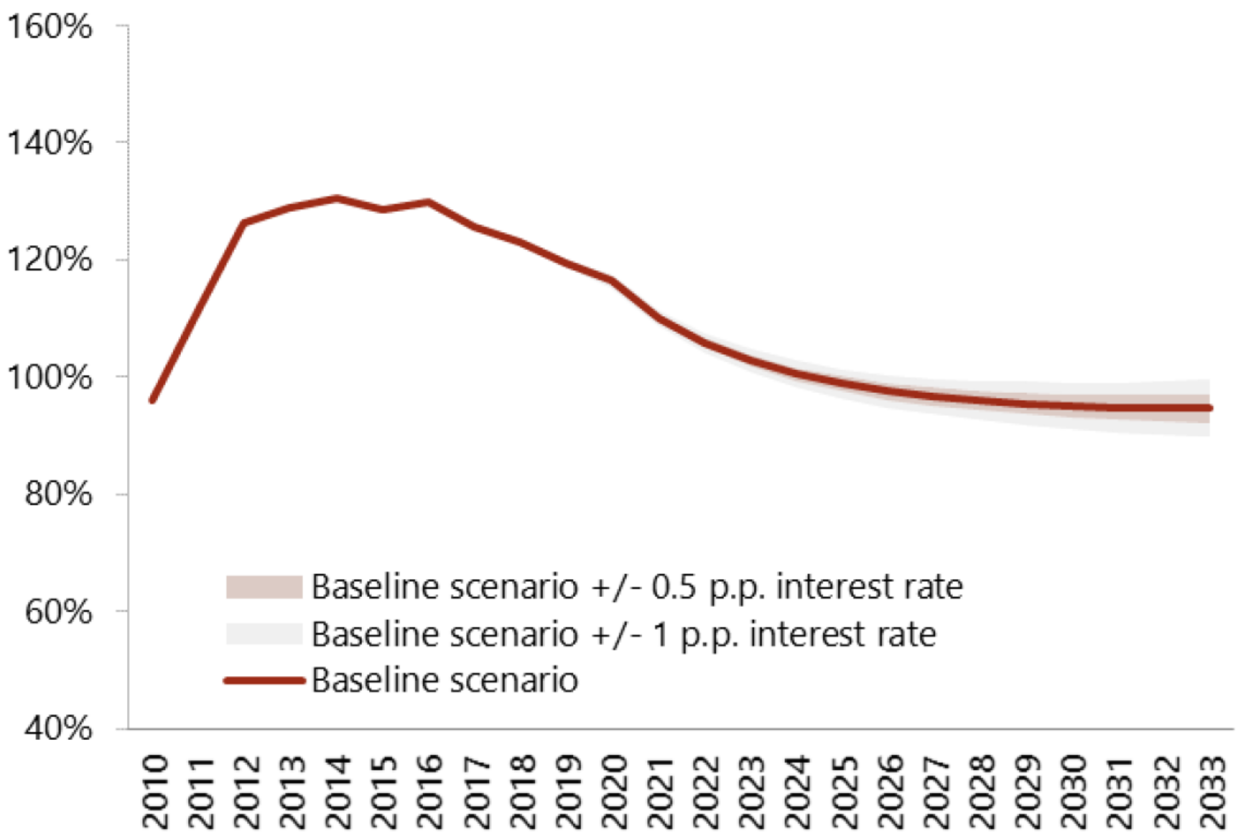
Public finance risks and sustainability

Chart 63 – Sensitivity analysis to changes in primary balance (in % of GDP)



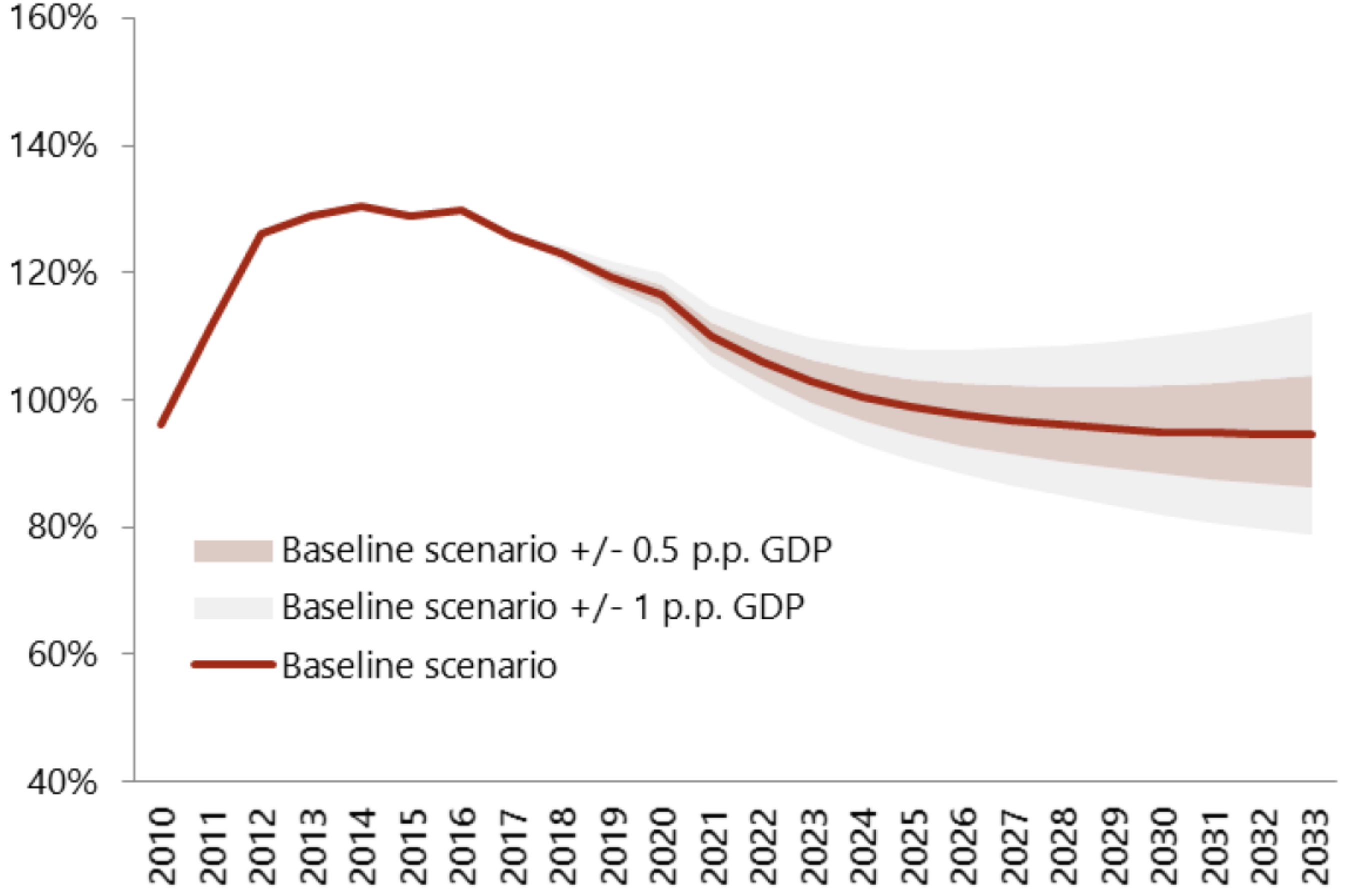
Sources: Bank of Portugal, European Commission, CFP and INE. CFP projections and calculations.

Chart 64 - Sensitivity analysis to changes in implicit interest rate (in % of GDP)



Sources: Bank of Portugal, European Commission, CFP, IGCP, INE and MF. CFP projections and calculations.

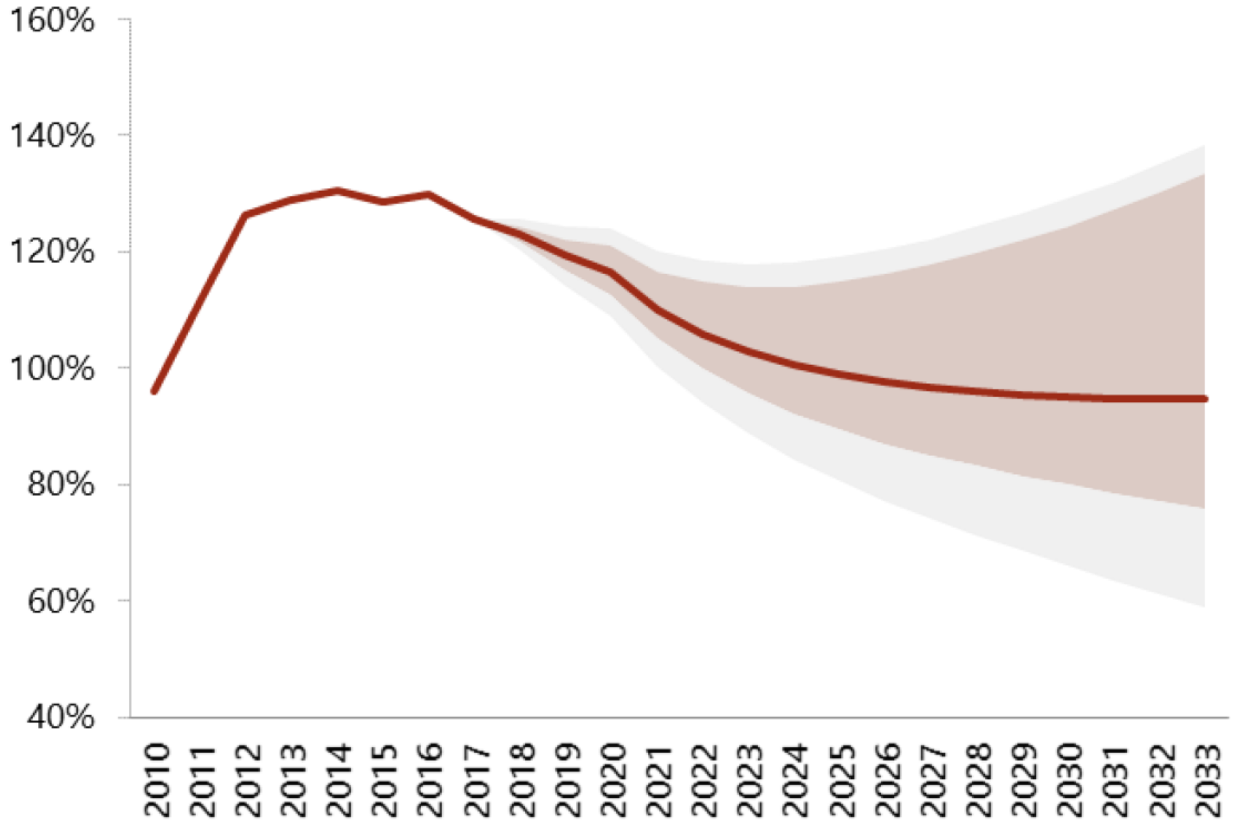
Chart 65 - Sensitivity analysis to changes in GDP growth (in % of GDP)



Sources: Bank of Portugal, European Commission, CFP, INE and MF. CFP projections and calculations.

Public finance risks and sustainability

Chart 66 – Sensitivity analysis to a simultaneous shock (GDP, interest rate and PB) (in % of GDP)



Sources: Bank of Portugal, European Commission, CFP, IGCP, INE and MF. CFP projections and calculations.

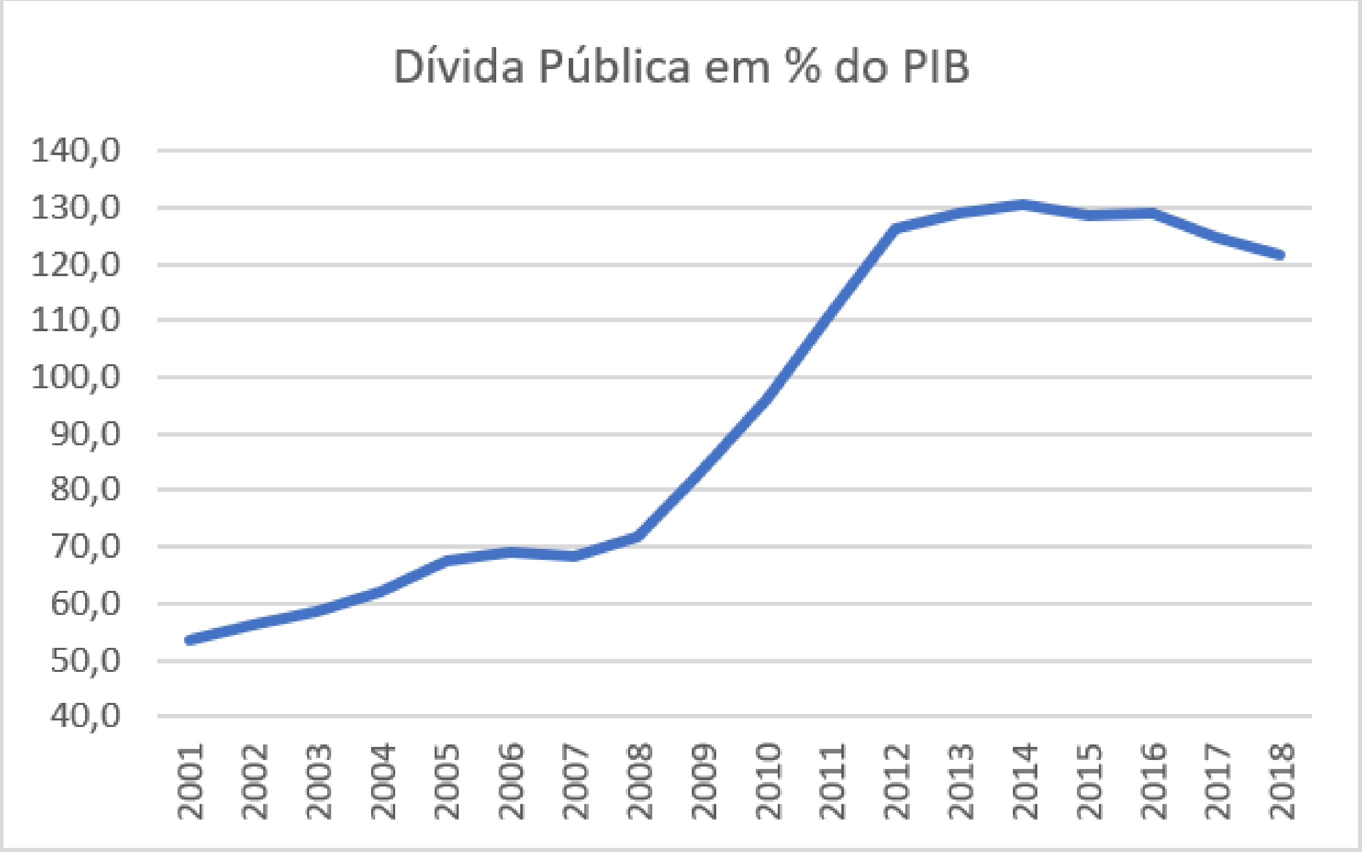
An ideological question?

Two erroneous ideas on the sustainability of public finances:

1) Concern about sustainability leads to the reduction of the state's social role and the choice for private supply

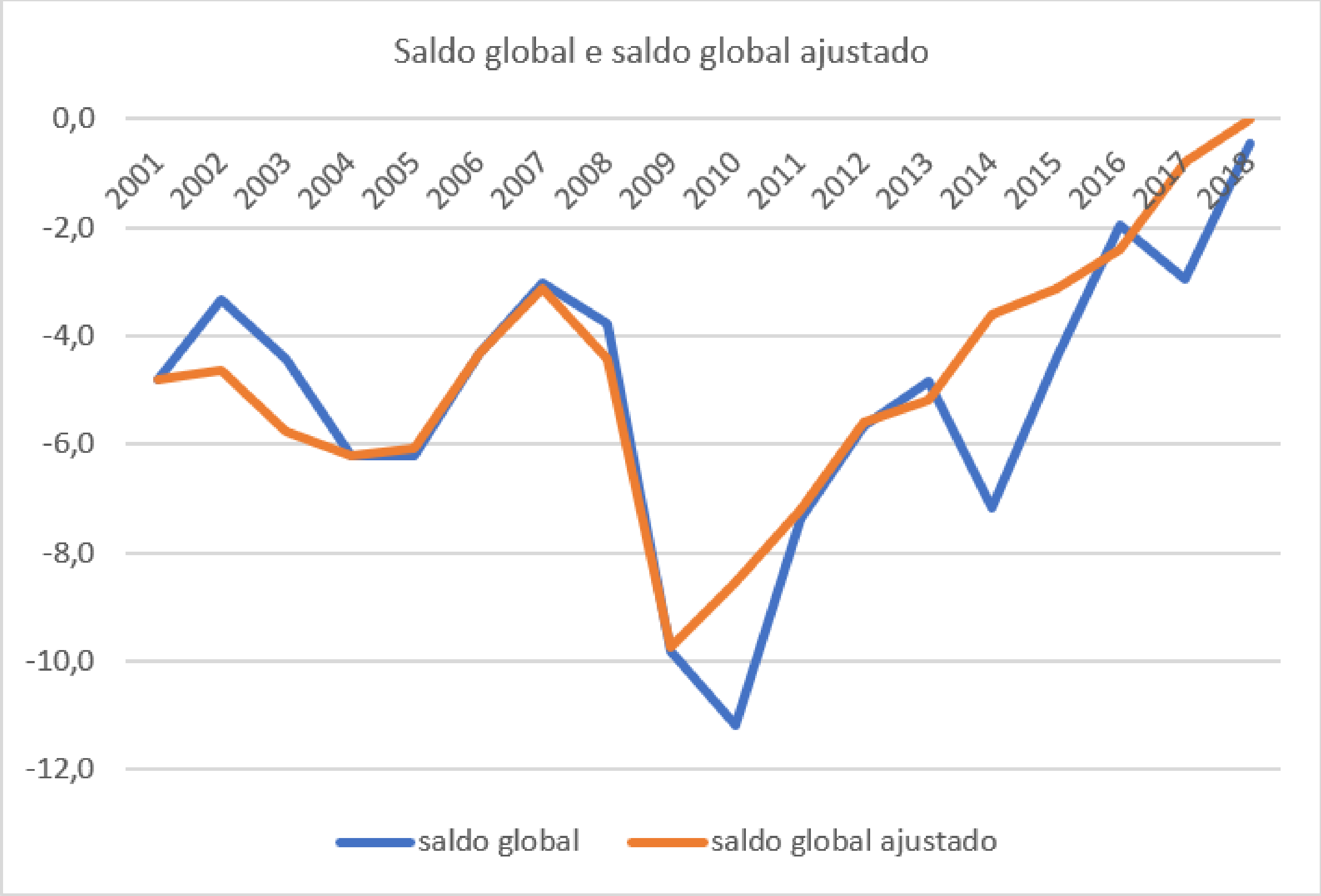
2) Concern about sustainability does not allow the use of fiscal policy to deal with recessive periods

Experiência portuguesa de consolidação orçamental



Fonte: Conselho das Finanças Públicas, www.cfp.pt

Fiscal consolidation in Portugal



Fonte: Conselho das Finanças Públicas, www.cfp.pt

Fiscal consolidation in Portugal

	Despesa primária (% do PIB)	Receita total (% do PIB)
2001	41,1	39,3
2002	40,9	40,4
2003	42,7	40,9
2004	43,5	39,9
2005	44,1	40,5
2006	42,5	40,9
2007	41,5	41,5
2008	42,2	41,6
2009	47,2	40,4
2010	48,9	40,6
2011	45,7	42,6
2012	43,6	42,9
2013	45,1	45,1
2014	46,9	44,6
2015	43,6	43,8
2016	40,6	42,8
2017	41,8	42,7
2018	40,5	43,5

Fonte: Conselho das Finanças Públicas, www.cfp.pt

The budgetary process and sustainability – the short and the long term

There are incentives that can lead to the bias towards the deficit and the growth of public debt (temporal inconsistency of fiscal policy):

- immediate gain, future costs
- annual character of budgetary decisions
- election cycle
- short termism

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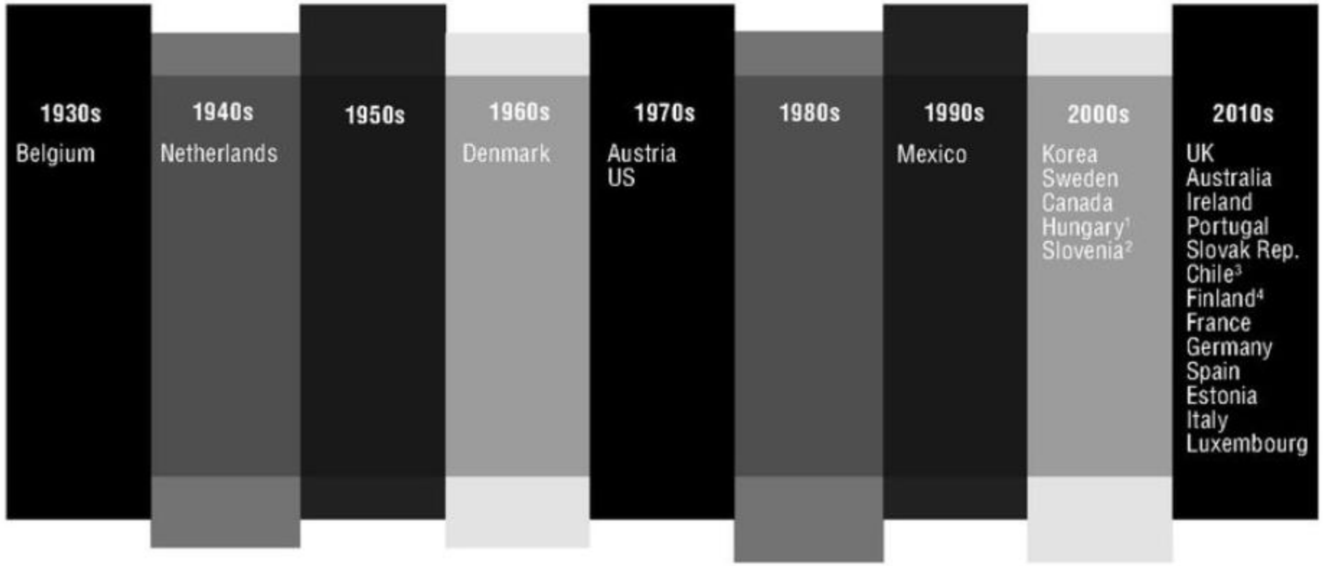
Part B

The IFIs (*Independent Fiscal Institutions*)

Some characteristics of IFIs

Figure 1. **The growth of IFIs in the OECD**



1. Hungary: The Office of the Fiscal Council in Hungary (established 2009) saw its resources significantly reduced at end 2010.
2. Slovenia: A first fiscal council with minimal resources ceased operations in 2012. A new fiscal council is in the process of being established.
3. Chile: A Fiscal Advisory Council was established in April 2013. Its members were replaced following elections. There have been proposals for reform to bring the council more in line with international standards.
4. Finland: In addition to the National Audit Office Fiscal Policy Evaluation Unit, a new Economic Policy Council was established in 2014 with a mandate to give *ex ante* policy advice.

Source: Designing effective independent fiscal institutions, Lisa von Trapp and Scherie Nicol, OECD

What do IFIs do?

1. Long-term sustainability analysis
2. Responsibility for macroeconomic budgetary forecasts
3. Responsibility for monitoring compliance with budgetary rules
4. Direct support to parliament in the budget analysis
5. Policy cost assessment
6. Assessment of the cost of electoral programs

Independence of IFIs: the Portuguese case

Article 4

Mission

The mission of the Council is to undertake an independent assessment of the consistency, compliance and sustainability of fiscal policy, while fostering its transparency so as to contribute for the quality of democracy and economic policy decision-making, as well as for reinforcing the Republic's financial credibility.

Independence of IFIs: the Portuguese case

Article 5

Independence

1 — The Council and the members of its governing bodies act independently while performing the functions assigned to them by law and through these statutes, and cannot request or receive instructions from the Assembly of the Republic, the Government or any other public or private entity.

2 — Financially, the independence of the Council and its capacity to fulfil its mission are guaranteed through State budget appropriations.

Independence of IFIs: the Portuguese case

Article 8

Access to information

1 — The Council shall have access to all the economic and financial information necessary for the accomplishment of its mission and all public entities are duty bound to supply this information in good time, as well as additional clarification in response to requests.

2 — The Council shall indicate the set of information to which it must have regular and automatic access, in accordance with a pre-defined calendar.

3 — The access to information mentioned in the above clauses 1 and 2 shall be subject to the legal restrictions in terms of State secrecy, judicial secrecy and banking secrecy.

4 — For the purposes of the assessment set out in paragraph a) of Article 6, the Government shall provide the Council with the macroeconomic models used and their underlying assumptions.

5 — Should any public entity not fulfil the duty of providing the information in good time, this shall be stated on the Council's webpage.

6 — Should the Council consider such non-fulfilment serious, the President of the Republic, the Assembly of the Republic, the Tribunal de Contas and the Banco de Portugal shall be duly informed.

Independence of IFIs: the Portuguese case

Article 12

Composition

1 — The Senior Board is a collegiate body and comprises five members.

2 — The members of the Senior Board shall be personalities of acknowledged merit, with experience in the economics and public finance areas and a high degree of independence.

3 — The Senior Board shall have a maximum of two non-national members, preferably from other Member States of the European Union.

4 — The members of the Senior Board are the President, the Vice-President, one executive member and two non-executive members.

5 — The President and the executive member shall perforce be resident in Portugal.

6 — The Executive President shall be a Portuguese citizen.

7 — The members of the Senior Board shall not be all of the same gender.

Independence of IFIs: the Portuguese case

Article 13

Appointment

1 — The members of the Senior Board are appointed by the Council of Ministers, on a joint proposal of the President of the Tribunal de Contas and the Governor of the Banco de Portugal.

2 — Up to sixty days before the end of the term of the members of the Senior Board, new members shall be appointed.

3 — Within thirty days after the end of the term of a member of the Senior Board, under the provisions of paragraphs b) to h) of clause 1 of Article 15, a new member shall be appointed.

4 — The appointments referred in the previous clauses shall be published in the 2nd series of the *Diário da República* (Official Journal) within five days of the Council of Ministers' decision.

5 — The members of the Senior Board shall take office before the President of the Assembly of the Republic within thirty days of the end of the term of office of their predecessors or of publication of the respective appointment, pursuant to clause 3 above.

Independence of IFIs: the Portuguese case

Article 16 [1]

Guarantees of independence and incompatibilities

1 — Except for the reasons provided in paragraphs b), c), e), f), g) and h) of clause 1 of Article 15, the members of the Senior Board cannot be removed from office.

2 — The following persons cannot be appointed members of the Senior Board: those who in the previous two years have been a member of the European Parliament, a member of a national Parliament, a member of the Government, a member of the Regional Governments, a member of the executive bodies of local governments, a member of the national executive bodies of a political party or a public manager.

3 — During their term of office, the members of the Senior Board cannot perform other public or private functions in Portugal or in any other entities that may conflict with their functions in this Board.

4 — The provisions of the previous clause do not apply to teaching duties in higher education institutions and research activity, although priority shall be given to work performed for the Council.

Independence of IFIs: the Portuguese case

The CFP delivers an opinion on the macroeconomic projections underlying the budget programmes. It recently issued a qualified endorsement concerning the macroeconomic forecasts of the draft budget plan for 2020.

https://www.cfp.pt/en/publications/state-budget/cfp-issues-a-qualified-endorsement-to-the-macroeconomic-forecasts-underlying-the-draft-budgetary-plan-for-2020

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Obrigado
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