



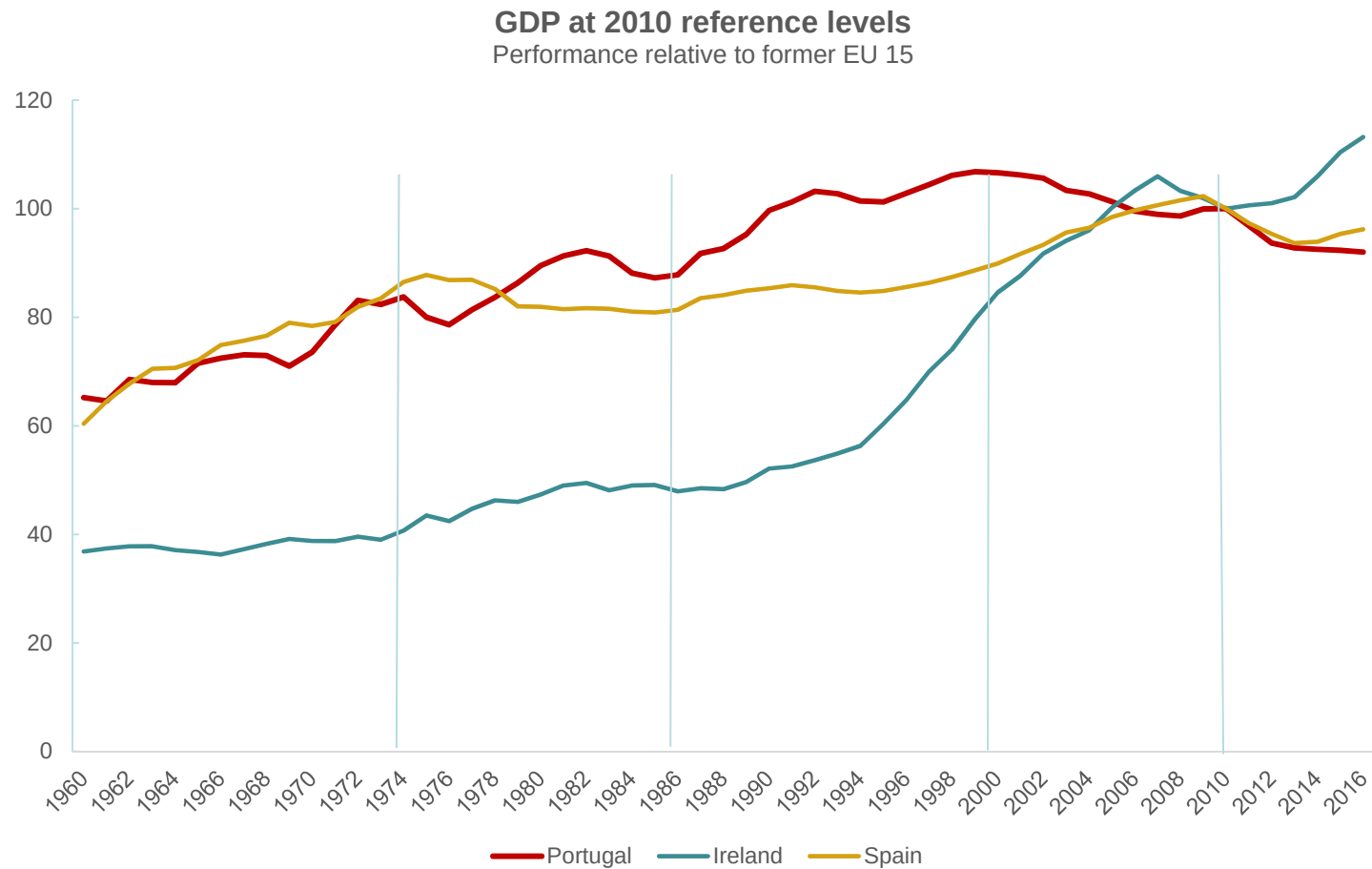
Conselho das Finanças Públicas
Portuguese Public Finance Council

REFORMS DRIVING RECOVERIES: SOME MISSING FOUNDATIONS

Teodora Cardoso

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Learning from the experiences of Portugal, Ireland, Latvia and Spain",
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Portuguese economic performance leading to the crisis



Source: AMECO, February 2016 update.



Structural weaknesses

- Good performance hid structural fragilities temporarily offset by expansionary fiscal and credit policies while accumulating macroeconomic imbalances
 - From the beginning of the 1990s, competition from new EU entrants and emerging countries called for policies to improve productivity in both traded and nontraded sectors
 - build up human capital and raise labour productivity
 - encourage competition and the mobility of the labour force
 - stimulate the adoption of new technologies
 - eliminate regulatory barriers hampering the process of resource reallocation towards more productive firms
 - Policies during the 1990s had mostly taken advantage of “low hanging fruits”: construction and real estate, public expenditures
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Stagnation and growing macroeconomic imbalances after 2000

- Budget deficits led to the country coming under the excessive deficit procedure
 - Effectively complying with European rules required a genuine medium-term budgetary framework and an effective public expenditure management infrastructure
 - Instead one-off operations and budget freezes were used to comply with the deficit rules and led to a chronic problem of structurally weak public finances, political instability and economic near stagnation
 - Together with the unprecedented increase in credit to the private sector, this allowed the build up of major imbalances that led to the need for the international assistance programme in 2011
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Programme achievements and failures

- The programme was successful in correcting the main macroeconomic imbalances within the foreseen time limits
 - The recovery path remains disappointing and risks bringing the economy back to the very unsatisfactory performance that characterised the preceding decade
 - Important reforms were made but a comprehensive reform programme is still missing
 - Fiscal consolidation and rationalisation of public spending are necessary foundations for such a programme
 - They must provide the intertemporal consistency without which reforms become a succession of measures and countermeasures that end up in increased instability leading to stagnation and eventual discredit
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Effective fiscal consolidation

- An effective policy of fiscal consolidation goes beyond cutting deficits or adopting strict rules that soon need to be made more flexible and end up being circumvented
 - It requires
 - awareness of the costs of eluding consolidation and
 - institutional changes to make it happen
 - In a consolidation context reforms come to be seen as means to improve resource allocation and to enhance consumer and investor confidence, instead of simple but inherently unstable redistribution mechanisms
 - In order to be successful fiscal consolidation must be set in the context of a **medium-term budgetary framework** rooted in a **new understanding of the role of the State in the economy** and complemented by **deep PFM reforms**
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PFM reforms and the new budget framework

- Rebuilding the PFM infrastructure cannot be rushed and demands new skills and a different political and administrative culture
 - Information requirements involve the complete overhaul of accounting systems and IT infrastructure
 - Sequencing and prioritisation are essential parts of the reform
 - The same is true of communication and understanding of the analysis underlying the proposals
 - The new budget framework law of September 2015 can provide the cornerstone for reform but its implementation is now at stake and will require close monitoring that has not yet been provided for
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Need for interaction between the Stability Programme and the National Reform Programme

- The critical priority of reforming the national fiscal framework is not enhanced by the way the Stability Programme and the National Reform Programme account for reforms and their impact
 - The practices they accommodate mean that the Stability Programme ignores the economic impact of measures and only takes into account direct budgetary impacts and the expected effect on aggregate demand of the increase in investment spending
 - The Stability Programme may even turn into an obstacle to reform in cases, like PFM measures, that require upfront investment and need to be integrated into a medium-term programme with well defined and strictly monitored outcomes and expenditure targets
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Numerical rules and reforms

- The European framework in practice treats fiscal consolidation merely in the context of numerical rules that neglect institutional constraints and become too complex to be effective
 - Short-term compliance with numerical rules becomes the focus of attention while reform issues remain broadly outside the Ministry of Finance remit
 - As a consequence, the consistency of reforms with financial constraints and their role in easing (or reinforcing) such constraints is easily neglected
 - Implementing reforms then becomes at best a matter of passing laws, the enforcement and economic impact of which is not overseen and even less evaluated
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Conclusions

- The implementation of a policy framework consistent with fiscal consolidation and economic reform still requires important adjustments at the national level
 - It also entails close monitoring and awareness that compliance with programme outcomes and evaluation is as important as numerical rules and is essential to qualify their achievement
 - Evaluating the impact of reforms on observed – or even potential – economic performance is difficult
 - However, ignoring it easily leads to a preference for measures that produce short-term growth while accumulating intractable future problems
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THANK YOU FOR YOUR
ATTENTION
