Conselho das Finanças Públicas
Portuguese Public Finance Council

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Teodora Cardoso[1]

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Introduction

The Portuguese Public Finance Council (hereafter CFP, the acronym for Conselho das Finanças Públicas) is one of the fiscal watchdogs recently created in Europe. The initiative for its creation preceded the European guidance in the area. The need for such an institution had long been invoked and was eventually accepted by the main political parties[2] that, in 2010, made its creation part of an agreement towards the approval of the 2011 State Budget. An independent working group was then appointed with the task of drawing up the Council's statutes, which were approved by Parliament in October 2011. The CFP started its activities following the appointment of its senior board in February 2012.

Legal setup

Portugal has an established tradition of independent agencies in the case of the Court of Auditors (Tribunal de Contas) and the Central Bank (Banco de Portugal). The CFP statutes took advantage of these by determining that the members of the Council's 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. They shall be personalities of acknowledged merit, with experience in the economics and public finance areas and a high degree of independence. According to the statutes, the senior board shall have a maximum of two non-national members, preferably from other Member States of the European Union[3]. Their term of office is seven years and they cannot be removed from office except for specified reasons of incapacity or misconduct.

The Council is financed by the State Budget. Its budget is prepared by the senior board and is subject to a favourable opinion issued jointly by the President of the Tribunal de Contas and the Governor of the Banco de Portugal. Further guarantees of independence are provided by the fact that, during their term of office, the members of the Senior Board cannot perform other public or private functions in Portugal or in any entities that may conflict with their functions in the Council.

[1] Portuguese Public Finance Council Chair. The opinions expressed are the author's. Text prepared for the OECD High-Level Parliamentary Seminar, at the Swedish Parliament, Stockholm, 17-18 June 2013.
[2] The Socialist Party (PS), then in office, and the Social Democratic Party (PSD), then the main opposition party, now in office.
[3] In fact, two non-national members were appointed, namely, Jürgen von Hagen (vice-chair) and George Kopits, as well as three Portuguese nationals: Teodora Cardoso (chair), Rui Nuno Baleiras (executive board member) and Carlos Marinheiro.

The statutes also grant the CFP access to all the economic and financial information necessary for the accomplishment of its mission, all public entities being *duty bound to supply this information in good time, as well as additional clarification in response to requests*. All the Council's analyses and reports must be made available to the general public on its webpage, in Portuguese and in English.

Preceding the relevant debates in Parliament, the CFP must present reports on: the Stability Programme and other procedures within the regulatory European framework of the Stability and Growth Pact, the multiannual budgetary framework and the draft State Budget.

Important tasks to be fulfilled by the Council are the

a) assessment of the macroeconomic scenarios adopted by the Government and the consistency of budget projections with these scenarios;

b) assessment of compliance with fiscal rules;

c) analysis of the dynamics and sustainability of public debt;

d) analysis of the dynamics of existing commitments, with special emphasis on the pension and health systems and on public-private partnerships and concessions;

e) assessment of the financial position of the autonomous regions and local governments;

f) assessment of the economic and financial situation of public enterprises, and their potential impact on the consolidated public accounts and their sustainability;

g) analysis of tax expenditures;

h) monitoring the budget outturn.

Background

Before the present crisis, Portugal had long been coping with budgetary problems that had led to several stabilisation programs sponsored by the IMF in the 1970s and 1980s. Those difficulties were alleviated by the period of strong growth that followed EU integration in 1986. However, as the following years would show, the basic problems had not been solved. Starting from a low level of debt and a young population after the 1974 revolution, and suffering from severe inadequacies in education, health and social security, the country then entered a period of expansionary fiscal policies, based on a strictly annual framework, that led to a rapid increase in public expenditure and fiscal deficits, initially financed by money creation.

On joining the EU in 1986, the economy's structural problems started to be dealt with, though productivity remained low and competitiveness continued to be achieved mainly through exchange rate depreciation. However, taking into account the good performance that followed integration into the single market and the need for further institutional changes to stabilise the public finances and enhance international competitiveness through increased productivity, integration in the single currency appeared justified. Indeed this was seen as putting pressure on structural reforms, while providing better financial conditions and promoting the adoption of a more efficient fiscal framework, based on a medium-term and sustainability outlook in the context of the Stability and Growth Pact.

The abundance of cheap finance that followed the adoption of the euro, and was reinforced by the international financial bubble, would, however, frustrate these hopes. The availability of finance led to growth and employment policies based on low productivity sectors (construction, retail trade), delaying the structural reforms needed to increase total factor productivity[4]. Fiscal policy fed these developments with consecutive headline and primary structural deficits. These accelerated the accumulation of public debt, with the ratio to GDP rising from 50.7% in 2000 to 93.5% in 2010. In the meantime, the private sector also borrowed heavily to finance current consumption, all translating into large current account deficits financed by foreign borrowing by the State and the banking sector.

This became an obviously unsustainable situation once the financial crisis erupted, finally leading to the Eurozone sovereign debt crisis. In Portugal, the Government still tried to circumvent the economic downturn of 2009 by strengthening the fiscal expansionary stance, but only succeeded in increasing the economy's vulnerability that culminated in the loss of access to financial market financing in 2010.

Developments since 2010

It was in this context that the CFP was created, as an element of a revised fiscal framework that also introduced a medium-term budget framework, as well as an expenditure ceiling to be fixed in a Fiscal Strategy Document presented to Parliament in spring and defining the fiscal strategy for the following four years. The CFP must present reports on these documents and on the annual draft budget, assess the macroeconomic scenarios on which they are based, and the compliance with the rules set. The CFP has complied with these obligations, as well as producing reports on subnational financing, that were presented as contributions to the ongoing reform in the area[5]. These have been subject to auditions in Parliament, as well as being widely discussed in the press, together with a number of other interventions by senior board members.

So far experience shows that underlying public finance management problems still remain that constrain the implementation of a fully effective medium-term budget framework in Portugal. The urgency of the adjustment following the loss of market access did not facilitate

[4] See, on this point, Fernández-Villaverde et alli (2013), *Political Credit Cycles: The Case of the Euro Zone*.
[5] All these Reports can be found in the CFP website, in Portuguese and English.

reforms in underlying areas that are only slowly being addressed. The Troika program contemplated these needs, but was also focused on the need for fast reduction of the public sector borrowing requirement. It is now clear that it both underestimated the program's impact on the economy and did not sufficiently work through its interlinkages with the sequencing of necessary reforms. As a consequence of the initial optimism of the program, recourse continued to be made to temporary and one-off measures in order to bring the deficit in line with targets, an old device in urgent need to be eliminated, as its lack of credibility postpones the benefits, but not the costs, of the adjustment, which continues to require further restrictive measures. The CFP Reports on the 2013 Draft Budget and on Budget Execution for 2012 clearly underlined these problems.

The Council has also consistently supported the need for an in-depth reform of the budget process, which is now foreseen for the end of the current year. In the CFP opinion, this is a clear priority for a successful and lasting adjustment. An amendment to the current budget framework law was recently approved, aimed at transposing to Portuguese legislation the new European rules. In its report on this amendment, the CFP stressed the need to go ahead with a deeper reform that also takes into account the changes required to guarantee compliance with those rules. Complementary measures defended by the CFP concern the improvement in the quality, consistency and transparency of public accounts, the introduction of an appropriately defined and monitored expenditure ceiling and the introduction of a regular spending review procedure.

Of particular interest to the CFP is the problem of macro-fiscal forecasts. According to its statutes, the CFP is responsible for assessing the macroeconomic scenarios adopted by the Government and the consistency of budget projections with these scenarios. This, however, does not mean that the Council has any role in producing such projections. The Council only knows the budget proposals and the projections on which they are based when they are made public, subject to strict delays for evaluation and Parliament approval. Under these circumstances, its opinion can still help a better informed discussion of the Government proposals, but this area would benefit from further consideration, given the absence in Portugal of an independent, professional institution, with a remit to monitor, analyse, conduct research and produce short-, medium- and long-term forecasts for the economy.

At present, the CFP is still going ahead with the recruitment of technical staff, a process that has been made difficult by a clause in the statutes that inhibits CFP staff from university teaching or research. The CFP now counts on four staff members, recruited from other public sector agencies. From the ongoing recruitment process, we expect to hire up to ten new staff members that, apart from the general tasks involved in assessing forecasts and preparing the budget reports, should gain expertise on specific sectors or areas that are instrumental to the Council's work (e.g. economic modelling and forecasting and public accounts) or that the Council is supposed to analyse (e.g. health, pensions, subnational finances, public enterprises, tax expenditures, and public debt sustainability). Taking into account the need for reinforcing the treatment of these subjects as a basis for better budgeting, we think these are promising areas of work that can improve the quality of the economic and fiscal policy debate in Portugal.

As a complement to its activities, the CFP is leading, together with Banco de Portugal and the Gulbenkian Foundation, a number of initiatives to discuss the reform of public sector governance in Portugal. A conference under the title *Towards a Comprehensive Reform of Public Governance* took place in January 2013 (its Proceedings can be found here). From September onwards it will be followed by a cycle of monthly seminars on specific themes under the same heading. Portuguese and foreign experts are invited to present their experiences and advice, to be subject to open discussion with the audience.

Conclusion

As a new institution, the CFP has been building its credibility by focusing on a number of areas that need to be addressed in order to bring about a durable fiscal consolidation in Portugal. These imply institutional, organisational and managerial reforms leading to greater transparency and accountability, the need for which the Council has been advocating and is helping bring about within its remit. Its opinions are widely discussed and subject to debates in Parliament, forming a basis for a better understanding of the role of fiscal policy in Portugal.