

## **V EUROSAI/OLACEFS SEMINAR**

### **FISCAL SUSTAINABILITY, PRESENTATION OF ACCOUNTS AND ACCOUNTABILITY**

#### **SUBTHEME 3**

#### **THE FISCAL SUSTAINABILITY IN THE MODERN STATE – PERSPECTIVES**

Summary:

1. Foreword
2. The fiscal sustainability problem in the modern States
3. The SAIs role in the promotion of the fiscal sustainability
4. Conclusions
5. Recommendations

## **1. Foreword**

States are nowadays confronted with a complex reality, usually designated as globalization.

Under the auspices of the World Trade Organization, barriers have been knocked down, at world level, for the trade exchanges.

In Europe, the economic and monetary integration has been deepened and from this process the Economic and Monetary Union has emerged.

In other parts of the world, other economical integration movements have been implemented.

These events and others often pointed out as examples of globalization, came to confront modern States with their limitations and expose them to competition risks at a world scale.

An unfavourable demographic evolution has also come to emphasize the pressure exercised on the States regarding public finance.

After some decades, in which modern States have assumed themselves as welfare States, without great concerns with costs, nowadays these same States are confronted with the need to maintain the citizens' social protection level but in a reduced economical growth scenario, high unemployment rates and inter-State competition to attract and retain investments.

From these circumstances a core issue that disturbs States emerges: how to conciliate a pre-determined social protection paradigm with the funding constraints that moderns States are facing?

## 2. The fiscal sustainability problem in modern States

The question formulates the issue of fiscal sustainability of modern States.

The countries belonging to the Economic and Monetary Union (EMU) are bound by rules of the Stability and Growth Pact, which limits their action in relation to the budgetary policy.

The adoption of the Stability and Growth Pact results in the recognition of the need for budgetary consolidation policies as an indispensable condition for the efficient operation of the Economic and Monetary Union.<sup>1</sup>

The EMU countries continue to be, concomitantly, bound to the prosecution of a set of tasks with constitutional dignity, namely in the economic, social and cultural areas. Consequently, a conflict arises between the constitutionally shaped models of the welfare State and the budgetary constraints resulting from the Euro zone rules.

However, one shouldn't think that such constraints exist exclusively in the European countries that, like Portugal, have adopted the single currency. The rest of the European countries compete among themselves to attract and retain investments, which results, right from the start, in tax competition and in the difficulty of increasing tax revenues, either due to the willing to pay limits or due to the mobility of some revenue sources, namely the financial capital.

Besides these factors, there is also, in Europe, a demographic problem that threatens public fiscal sustainability and which puts at risk the welfare State paradigm in force.

The countries, to which the development aid programmes are crucial, also have to worry about the submitted public accounts reliability and with its fiscal sustainability.

The increasing importance and technical capacity inherent to the fiscal sustainability practices advise the reinforcement of the SAIs role in the different States.

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<sup>1</sup> Cfr.. ERNESTO CUNHA / JOÃO PARENTE / PAULO NOGUEIRA DA COSTA, *Sustentabilidade Financeira: O Papel das Instituições Superiores de Controlo neste Contexto*, Lisboa, 2006, p.2, available in <http://timor/C3/C17/PC-INTOSAI/default.aspx>.

As an example we can look at the recommendations from some international organizations in this field.

In accordance with the IMF, State budgets should be accompanied with documentation where the budgetary policy objectives, the macro-economic structure, the policies on which the budget is based and the main identifiable fiscal risks are specified.<sup>2</sup>

Despite the budget being elaborated in an annual perspective, it should be accompanied by documentation that contextualizes it within the wider budgetary policy objectives and the long term fiscal sustainability.<sup>3</sup>

Also the OECD guidelines about best practices recommend the issue of a pré-budgetary report, at least one month before the submission of the annual budget, where the medium term economic and fiscal objectives should be exposed, highlighting the total revenues, expenditures, deficit or surplus and debt. OECD also recommends that a long term report should be published assessing the current budgetary policies sustainability, every five years or at shorter intervals if there are significant changes in policies related to public revenues or expenditures. The forecasts supporting the analysis should be submitted, as well as alternative scenarios. It is advised that, at long term, besides the public debt, any commitments that will have a fiscal impact in the future are taken in consideration.<sup>4</sup>

We can assert that there is global pressure on the States for them do adopt sustainable public policies, which has resulted, in several States, in the implementation of several reforms.

In fact, the need to reorganize the public sector, with the aim of implementing a more rational and efficient management, has led to the adoption of strategies that require, namely:

- The application of significant reforms in the social security, health and education systems and mechanisms;
- The adoption of new ways of funding, managing and providing public nature goods and services (by resorting to public-private partnerships, for example);

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<sup>2</sup> Cfr. FMI, *Manual Revisto de Transparência Fiscal*, 28 de Fevereiro de 2001, pp. 53 and following.

<sup>3</sup> Ibidem

<sup>4</sup> Ibidem

- The introduction of reforms in the public sector budgeting models, stressing the pluri-annual programming and the orientation by performance objectives and by the assessment of its achievement, instead of focusing on means;
- The development of accessible, transparent and swift economic and fiscal information systems, which include statistical data and indicators based as much as possible in harmonized criteria, in internal and external terms;
- The adoption and application by public organizations of public accounting systems more consistent with the national accounting harmonized systems, in order to enable the economic evaluation, the international comparability and the “multilateral supervision” (as an example, we can refer, the fulfilment of the stability and growth programmes by the Member States of the EMU).<sup>5</sup>

From the point of view of the measures taken within the Portuguese Public Administration in relation to the fiscal sustainability, we can quote some of the strategies and measures adopted;

- Alteration of the retiring rules in the public and private sectors, namely comprising the increase of the retiring age and new calculation methods for the retirement pensions;
- The alteration of the public hospitals nature and management model, transforming them into companies;
- More generalized use of public-private partnerships as an alternative to the traditional funding and management modalities of the public sector;
- Implementation of parliamentary debates on the priorities for the orientation of public expenditures before the Budget submission each year and the development of programme based budget-process and results oriented management;
- Approval of rules on indebtedness limits applied to all the sub-sectors of the Public Administrative Sector (including the Regional and Local Administrations);
- Changing of the accounting systems used in Public Administration, making them closer to the accrual basis accounting system, and thus allowing the assessment of the compliance of internal and external bindings

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<sup>5</sup> Cfr. ERNESTO CUNHA / JÃO PARENTE / PAULO NOGUEIRA DA COSTA, *Sustentabilidade Financeira...*, quote, p. 16

- to fiscal stability <sup>6</sup>;
- Audit of the financial situation of the entities financed by public resources, independently of their statutory nature.

In these scenarios, it is easily understood that the demand for good governance is unavoidable, as this implies the management of public funds in accordance with the technical criteria of economy, efficiency and effectiveness, the transparency in decision making, an adequate risk management and the submission of the accounts by all involved.

The citizens contribute, through their taxes, for the financing of the constitutionally tasks imposed on the State, but they, concomitantly, demand that the public resources (originally private) are effectively applied in the prosecution of public interest. The Supreme Audit Institutions have the mandate to assure that it is so.

### **3. The SAIs role in the promotion of fiscal sustainability**

The SAIs plays a crucial role in modern societies, auditing the management of public resources, informing the parliaments and the citizens about the merit of that management and auditing its legality and regularity. SAIs that operate like Courts of Auditors are also empowered to judge and sanction accountables whenever public funds have been used in violation of the law.

Within the context of the Economic and Monetary Union, the Stability and Growth Pact and the ESA 95 (European System of Integrated Economic Accounts) came to reinforce the importance of the Supreme Audit Institutions, in the extent that the level of exigence, technicality and complexity involving public management and the presentation of public accounts cannot put aside the technical audit developed by them.<sup>7</sup>

Also in an inter-States competition scenario to attract and retain investment, the reliability of the financial audit system is of the utmost importance. This is assured,

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<sup>6</sup> In this sense, we quote the adoption of the Official Accounting Plan of the Public Sector (Plano Oficial de Contabilidade do Sector Público), which, whenever fully adopted, will facilitate the elaboration of accounts and indicators related to the Public Administrations according to the National Accounting criteria (European System of Accounts – ESA 95) in force in the European Union to which the States are particularly bond through the Stability and Growth Pact.

<sup>7</sup> JOSÉ CASTRO CASTRO DE MIRA MENDES / ELEONORA PAIS DE ALMEIDA / PAULO NOGUEIRA DA COSTA, *Auditoria Externa das Finanças Públicas e Controlo Político*, Lisboa, 2006, quote p.18.

mostly, by the credibility and effectiveness of the Supreme Audit Institution activity that influences, namely, the calculation of the entrepreneurial trust rankings and ratings of each country.<sup>8</sup>

An independent and credible Supreme Audit Institution is also fundamental so that the developing countries may have access to certain support and development aid programmes sponsored by international organizations such as the IMF or the World Bank.<sup>9</sup>

Besides these factors there is also, as we have seen, the conciliation attempt between the promotion of the economic growth with the assurances of a welfare State, implicating that good governance and public fiscal sustainability are main issues in modern States.

It seems that the SAIs organization and activity cannot but reflect the demands of deep reforms in the Public Administration of respective States, being the same, nowadays, indissociably connected to the set of problems of fiscal sustainability.<sup>10</sup>

Having said this, we are confronted with the following fundamental question: is it or not the SAI's task to give their opinion on the fiscal sustainability of the public sector?<sup>11</sup>

The Portuguese Court of Auditors has reflected upon this question and has been increasingly reinforcing its intervention in issues connected to the fiscal sustainability of the State.

In Portugal, the Budgetary Framework and Stability Act (*Lei de Enquadramento e Estabilidade Orçamental*) charges the Court of Auditors with the jurisdictional supervision of the budgetary execution, including the fiscal sustainability dimension.

As examples of the Court of Auditors' action in this field, we can point out the following:

- The alteration of the structure of the Opinions on the General State Account, from 2004, onwards, which that started to include issues regarding the involving economical issues as well as sustainability issues;<sup>12</sup>

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<sup>8</sup> Idem, p. 19

<sup>9</sup> Idem

<sup>10</sup> Cfr. ERNESTO CUNHA / JÃO PARENTE / PAULO NOGUEIRA DA COSTA, *Sustentabilidade Financeira...*, quote, p. 18-19

<sup>11</sup> Idem p.18

Within this scope, the reports included a projection of future effects of the public deficit containment measures, especially in what concerns the transfer of tax credits and pensions funds and liabilities. An analysis of the State charges with public-private partnerships in the roads and railways concessions and in the health sector has also been carried out as well as the assessment of the non-financial debts of the State, with the identification of its main creditors.

- The great importance that the Court of Auditors has been giving to public indebtedness issues, giving its opinion, regularly, about the obtainment of loans, other contracts generating future responsibilities and assignment of credits by local authorities.
- The assessment and formulation of recommendations about the Public Official Accounting Plan (*Plano Oficial de Contabilidade*) application, which is a fundamental instrument for a better appraisal, at each moment, of the organizations' financial sustainability and that of the State, in a consolidated way.
- The recent alteration (in August 2006) of the Audit Act of the Tribunal de Contas (Court of Auditors) which reinforces its capacity to demand accountability from all the intervening parties in the public resources management, even within public or private enterprises.

But, once an affirmative reply is assumed regarding the question that we placed before, a set of other questions naturally follow:<sup>13</sup>

- What role, in fact, can the SAI assume in the promotion of modern States fiscal sustainability?

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<sup>12</sup> Since 2004 the Opinion includes a title specifically dedicated to the fiscal sustainability – cfr. Título III do Volume I do Parecer da CGE/2004.

<sup>13</sup> Cfr. ERNESTO CUNHA / JÃO PARENTE / PAULO NOGUEIRA DA COSTA, *Sustentabilidade Financeira...*, quote, p. 18-20



- Does such task derive from the mandate granted to them by the respective Constitutions or audit acts?
- Or will it be necessary to change those laws in order to enable SAIs give their opinion about the public sector fiscal sustainability?
- Will a typification of new forms of financial infractions be justified to cope with the development of a new financial accountability concept connected to the sustainability problems and to its assessment criteria?
- Should the SAIs concern with fiscal sustainability be reflected in the financial audits? In the regularity audits? In the performance audits? What kind of audits should be given priority?
- Should these concerns be reflected in the internationally consecrated audit standards?
- Or should the SAIs give their opinion on fiscal sustainability in “ad-hoc” reports?
- Or should the alternative be to follow the path that leads to the certification of accounts (which implies that SAIs should give their opinion about public deficit)?

Here is a set of questions that seem relevant to us, although they do not drain up all the questions and problems raised by the theme we are now discussing.

These questions are particularly relevant in the social areas.

In fact, the promotion of the modern States’ public fiscal sustainability implies, from the start, the need of promoting the fiscal sustainability of social policies and programmes, especially in the education, health and social security areas, hence emerging issues related to the control strategies and methodologies adopted by the SAIs.

In this area, it seems quite important to us to share experiences among the different SAIs in order to enable them to find, together, a set of common principles in this matter, without questioning each one’s specificities.

#### **4. Conclusions**

- 1- There is a global pressure on the States for them to adopt public sustainable policies.
- 2- The analysis of the adopted strategies and the formulation of recommendations, in matters such as the indebtedness, public-private partnerships or accounting systems, are an important instrument that SAIs have at their disposal to promote good governance and, thus, public fiscal sustainability.
- 3- The Portuguese Court of Auditors has already been including, in some of its reports, assessments and statements about the fiscal sustainability of the State, namely in the Opinion on the General State Account.
- 4- The promotion of the modern States' public fiscal sustainability implies, from the start, the need of promoting the fiscal sustainability of social policies and programmes, especially in the education, health and social security areas, hence emerging issues related to control strategies and methodologies adopted by the SAIs.

#### **5. Recommendations**

- 1- The SAIs organization and activity cannot but reflect the demands of significant reforms in the Public Administration of States, being the same, nowadays, indissociably connected to the set of problems on fiscal sustainability.
- 2- Each SAI should define, in fact, what is the role it plays in the promotion of their respective States' fiscal sustainability.
- 3- SAIs should monitor the measures adopted by Public Administrations to ensure fiscal sustainability.
- 4- It seems quite important to share experiences among the different SAIs in order to enable them to find, together, a set of common principles in this matter, although respecting each one's specificities.