

Session #14

Chapter 4: The public sector: scope, structure and accounts

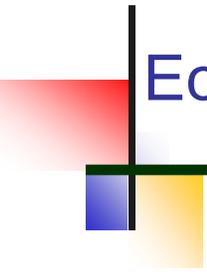
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4.2. The accounts and balances of General Government

4.2.1. The account and budget balance of General Government

4.2.2. The economic classification of revenues and expenditures

4.2.3. The budgetary balances



Economics and Public Finance – Readings

ENG: Summary of chapter 11 of Pereira,P.and Nunes, F.(2016) Economia e Finanças Públicas: da Teoria à Prática.

PT: chapter 11 of Pereira,P.and Nunes, F.(2016) Economia e Finanças Públicas: da Teoria à Prática.

Economics and Public Finance – Core topics & Glossary

- Accounts and budget balance of General Government (Public Administrations)
 - *(Contas e saldos das Administrações Públicas)*
- Accounts and balance of each General Government subsector
- *Total* versus *Effective* revenues and expenditures (*receitas e despesas efectivas*)
- The economic classification of revenues and expenditures (*classificação económica*)
- General government balance: net borrowing (-)/net lending (+)
 - *(saldo global das administrações públicas)*
- Current and capital balances (*saldos correntes e de capital*)
- The primary balance (*saldo primário*)
- The “golden rule” of Public Finance (*a regra de ouro das finanças públicas*)

EPF – The overall accounts balance of Public Administrations

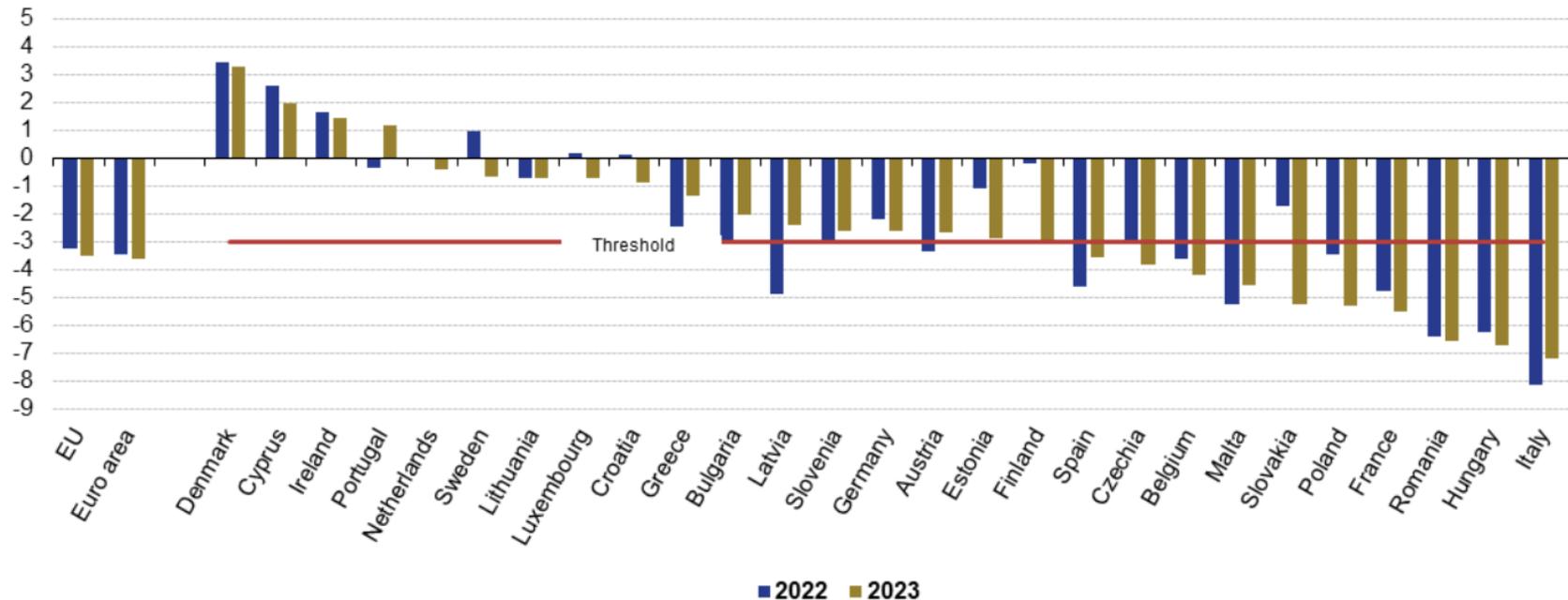
- **Definition**

- The expressions **budget deficit** or **surplus** refers to the value (negative or positive) of the **budget balance of General Government or Public Administrations (“PA”)**.
- The global balance is the **sum of the balances of each sub-sector (Central government (State, Autonomous Services), Regional and Local Governments, and Social Security)**, which constitute the necessary baseline for a good and well-informed management of public finances.

EPF – The overall accounts and balance of Public Administrations

Public balance, 2022 and 2023 (1)

(Net lending (+) or net borrowing (-) of the general government sector, % of GDP)



(1) Data extracted on 22/10/2024
Source: Eurostat (gov_10dd_edpt1)

eurostat

After a deep financial crisis (2011-2014) and COVID (2020-21), Portugal has now almost balanced budgets.



EPF – The overall accounts and balance of Public Administrations

In **Federal countries** the Budget balance is the sum of the balances of federal government, state and local government and social security.

In **unitary countries** the Budget balance is the sum of the balances of central government, local government (which in Portugal includes regions and municipalities) and social security.

EPF – The overall accounts balance of Public Administrations

- Important aspects to take into consideration when calculating the budget balance of General Government (Public Administrations)
 1. The accounting can be made:
 - Using the approach of **National Accounts (“NP”) incorporated in the European System of Accounts (“ESA2010”)** for the purpose of budgetary policy supervision following the European Economic and Monetary Union (“EMU”) framework, given that the Stability and Growth Pact (“SGP”) sets an upper limit to the budget deficit of the overall General Government.
 - Using the approach of **Public Sector (“CP”) Accounting (“PSA”) Standards** for the purpose of elaborating the State Budget.

EPF – The values of all Public Administration subsectors

2. Only **effective revenues and expenditures** are considered (excluding financial assets and liabilities) **of all Public Administration subsectors**
 - The **general governments' balance** of **all** subsectors
 - is the sum of all accounts' balances of the State, Autonomous Funds and Services, Local and Regional Governments and Social Security.
 - The **overall balance** of **each** subsector
 - is given by the **effective** revenues less effective expenditures without the effective and non-consolidated expenditures.
 - **Note**: It doesn't matter how the overall budget balance of all/each Public Administration subsector is determined, whether consolidated or non-consolidated values.

EPF – Effective and non-effective revenues and expenditures

- 3. **Non-effective (financial) revenues and expenditures** are excluded from the **calculation of general government balance of Public Administrations**, *i.e.*, financial assets and liabilities
 - **Financial assets**: credit accounts balance
 - **Financial liabilities**: debit accounts balance
- This typology of effective and non-effective revenues and expenditures is obtained from the **economic classification of expenditures and revenues**.

EPF – Economic classification of revenues (1/3)

Current revenues	Capital revenues
1. Direct taxes	9. Sales of investment assets
2. Indirect taxes	10. Capital transfers
3. Social security contributions	11. <i>Financial assets</i>
4. Fees, tariffs, fines and charges	12. <i>Financial liabilities</i>
5. Property income	13. Other capital revenues
6. Current transfers	
7. Sales of goods and services	
8. Other current revenues	

EPF – Economic classification of revenues (2/3)

- **Effective revenues**
 - **Items 1 to 10 and Item 13**
- **Non-effective revenues**
 - **Item 11: Revenues from selling financial assets (*ativos financeiros*)**
 - **privatisation** normally means giving up, by general government, control over a public enterprise by the disposal of shares and other equity on this enterprise. The associated revenues are included here. Typically these revenues are used to **decrease government debt**.
 - **Item 12: Revenues from assuming financial liabilities (*passivos financeiros*)**
 - by issuing government bonds and other forms of borrowing
 - **Note:** a relevant part of the budget deficit is covered by revenues from **financial liabilities**. Revenues from financial assets or financial liabilities do not change the net assets of the public sector.

EPF – Economic classification of revenues (3/3)

- Relevant information

1. the importance of tax revenues
2. the importance of borrowing
3. the importance of **state-owned enterprises** (property revenues)

EPF – Economic classification of expenditures (1/2)

Current expenditures	Capital expenditures
1. Expenditures with civil servants (e.g. wages)	7. Acquisition of capital goods
2. Acquisition of goods and services	8. Capital transfers
3. Current expenditures with outstanding debt (interest payments)	9. <i>Financial assets</i>
4. Current transfers	10. <i>Financial liabilities</i>
5. Grants and subsidies	11. Other capital expenditures
6. Other current expenditures	

EPF – Economic classification of expenditures (2/2)

- **Effective expenditures**
 - **Items 1 to 8, Item 11**

- **Non-effective expenditures**
 - **Item 9: Expenditures with financial assets (*ativos financeiros*)**
 - with purchasing bonds and securities and with lending activities.
 - **Item 10: Expenditures with financial liabilities (*passivos financeiros*)**
 - with debt redemption and the execution of financial guarantees.

Economics and Public Finance – Budgetary accounts balances

- The analysis of the Public Administration accounts allows us to identify four major types of budgetary balances:
 - **current balance** (*saldo corrente*)
 - **capital balance** (*saldo capital*)
 - **global (or effective) balance** (*saldo global*)
 - **primary balance** (*saldo primário*)

EPF – Current and capital accounts balances

- **Current balance =**
 - Current (effective) revenues - Current (effective) expenditures=
 - = current revenues - current expenditures

- **Capital balance =**
 - Capital (effective) revenues - Capital (effective) expenditures

- **Global balance = Current balance + Capital balance**
 - = Current and capital effective revenues**
 - current and capital effective expenditures**

EPF – The “*golden rule*” of Public Finances

- **Definition**

- **The current budget balance should not be negative,**
 - *i.e.*, current expenditures should not be paid with capital revenues.
- **Alternative formulation:**
 - ***“The value of the budget deficit should not exceed the value of investment expenditure.”***

EPF – General Government balance

- **General Government Balance** (or Public Administrations' balance) =
 - **Effective revenues - Effective expenditures (all subsectors)**
 - If +: *surplus* or financing capacity (**net lending**).
 - If -: *deficit* or financing needs (**net borrowing**).
 - **In terms of % of GDP, the most important budgetary criterion for the Stability and Growth Pact with an upper limit set at 3%.**
 - It is the *most important balance*, given that
 - it indicates the need to increase (deficit) or the capacity to decrease indebtedness (surplus).

Economics and Public Finance – Primary budget balance

- **Primary balance =**
 - Effective revenues (current + capital) - Primary expenditures
 - Primary expenditures: (Current expenditures - Interests from public debt) + Capital expenditures
 - **What does it mean?**
 - It clarifies what the budget balance would be if there was no public debt (hence, without *interest payments*)
 - Note: *Interests paid are part of current expenditures.*

Economics and Public Finance – The nature of fiscal policy

- **Despite the importance of fiscal balances herein presented, there is a *limitation*:**
 - None of the mentioned budget balance measures allows to fully exemplify the **nature** (*expansion or contraction*) of **fiscal policy**.
 - This limitation is usually overcome by applying a **different type of budget balance** calculation **to be discussed in Chapter 6 (fiscal policy)**.