

## 11. The public sector in Portugal: scope, structure and accounts<sup>1</sup>

### Summary

This chapter examines the scope and structure of public sector in Portugal, as well as the accounts of the various sub-sectors of general government including transfers that operate between them.

One difficulty in the analysis of public finances in Portugal is a certain conceptual confusion because the same term has different meanings depending on the context in which it is used (for ex. State). A second difficulty is the different forms of accounting and accounting systems used. The main concepts used here are economic rather than legal, and we clarify the distinction between them. Finally, frequent changes in organizational structure of governments, as well as changes in the actual universe of institutions of government difficult, sometimes comparative analysis.

The **public sector** includes all entities that are controlled, directly or indirectly, by some political institution be it the government of the Republic, regional governments (Azores and Madeira) or local governments. So the public sector includes on the one hand the **general government** and **public sector corporations** outside general government with a market nature (selling their goods or services at roughly market prices). These are those where there is a majority of public capital and therefore that the major stakeholder is the State, a Regional Government or a municipality. Additionally, to be outside general government the public corporation should cover at least 50% of its costs through own revenues (prices, tariffs, fees, user charges in exchange of services provided) and not public funding.

What characterizes the entities within **general government**, is that they are *non-market* producers of goods and services to individual and collective consumption or entities operating redistribution (pecuniary or not). In both cases being mainly financed by compulsory contributions. These public funding can cover total expenditures or at least they must represent 50% of production costs. The principle is that they are mainly publicly financed.

The **general government** (or public administrations) comprises three levels of government (i) the "State": including central government and social security (ii) the regional governments of Azores and Madeira (iii) and local governments. However, since Portugal is a unitary country in statistical terms (EUROSTAT) it appears as with only two levels of government.

EUROSTAT, the Statistical Authority in the European Union has developed the European System of Accounts ESA2010, where countries have the same structure of accounts distinguishing the central government (S.1311), state (S1312), local (S1313) and social security funds (S1314).

The intermediate State level (S1312) is primarily used in federal countries (e.g. Germany, Belgium, Austria) and not in unitary countries (e.g. Portugal and the UK). Portugal shows the aggregate accounts of central government (S1311 which consolidates the accounts of the central government (direct and indirect); Local government (S1313 which consolidates the accounts of regional and local government (ARL)) and finally Social Security (SS in S1314). In federal countries (such as Germany or Austria), federal government accounts (S1311) state government accounts (in S1312), and local governments in (in S1313).

The general government in Portugal is therefore composed of three sub-sectors, namely: **central government (divided in direct and indirect administration)**, Social Security and Regional and Local Governments. Since two of them (Central Government and Social Security) are under the political direction of government, the degree of **political decentralization** may be

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<sup>1</sup> (c) Paulo Trigo Pereira. This is a slightly revised version of the summary included in the book (Pereira, P. and Nunes, F. (2016) *Economia e Finanças Públicas: da Teoria à Prática*) in order to adapt to the needs of Erasmus students and the diversity of their countries' public finances. Updated April 2021.

measured by the ratio of the expenditure on regional and municipal governments (the ARL) over the consolidated expenditure of public administrations.

The use, in the broadest sense of the term "State", in "State Budget" (*Orçamento do Estado*) or "General State Account" refers to the budget or the account of the two subsectors sub-sectors (Central government and SS).

**Central government** includes **direct administration** institutions and **indirect administration** institutions. The former are those under direct control of the Ministry or Secretary of State. Direct administration includes the integrated services of each ministry (ie Directorate-General ou *Direções-Gerais*), without a legal form and with just an **administrative autonomy** for the current management of appropriations from the State Budget. They have no autonomous revenues or own assets. In turn institutions within **indirect administration** (e.g. hospitals, public universities, public institutes) are entities with **administrative and financial autonomy**. They have a legal status, leaders have more autonomy for management of current and capital expenditures, they have their own assets, ability to have their own income and possibility of access to credit (with permission). The sub-sector of **social security** includes the institutional units which are mainly responsible for the payment of social benefits (unemployment, sickness, pensions, etc.) and are financed by compulsory contributions.

We can understand the **structure of general government** using two concepts of **decentralization**. *There are two types of decentralisation in Public Administration, namely:*

- **Political decentralisation**
  - towards smaller territorial units in terms of political and budgetary autonomies. It is a **vertical movement top down from central government towards** local and Regional Authorities
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- **Administrative decentralisation**
  - whenever the State creates its own subordinate public entities with administrative and financial autonomies
    - **Horizontal movement:** from direct administration to indirect administration (public universities, hospitals, public institutes)

The **central government direct administration** is in some cases **administratively de-concentrated**, *in* several institutional entities generally having **administrative autonomy** yet without legal personality usually on a territorial basis.

- Officials from public entities with **administrative autonomy** are allowed to make **day-to-day on-going management decisions** as long as they were previously earmarked in its budget.
- Public entities with administrative autonomy have their revenues **which consist on appropriations on the State Budget** (transferred in provisional **twelfths**).
- Public entities with administrative autonomy **lack legal personality**, *i.e.*, have no assets or revenues of their own, re unable to resort to external funding for additional revenues and having limited contractual flexibility.

When considering the accounts of public administrations, it is important to distinguish whether to use **national accounts or public accounts**. The **national accounts (NA)** are used for the European Union to monitor member states' fiscal policy (EUROSTAT, the excessive deficit procedure etc..) It has an economic basis, based on defining the universe of entities that belong to the government as *non-market units* and adopts a logic of commitments (revenues and expenses are recorded when the commitment is made and not when there is a cash flow). On the other hand **public accounting (PA)** is used initially in the accounts of general government entities (SPA) has a more legal definition of the entities that belong to the public administration and adopts a more imprecise logic of cash (receipts and expenses are recorded when entering or leaving the box).

In order to compute the **balances of general government** accounts, we use the economic classification of revenue and expenditures (i.e. non-financial). The **effective revenue** is total revenue less revenue from financial liabilities (e.g. loans) and financial assets (eg income from sale of shares or other financial assets). **Effective expenditure** is the total expenditure less expenditure on liabilities (eg repayment of loans) and financial assets (eg purchase of all or part of capital by public corporations). The **current balance** (in PA) and gross savings (in NA) is the difference between effective (non financial) revenues and expenditures. It can be calculated for each sub-sector alone (central government, ARL and SS) or for public administrations (general government) as a whole. In this latter case it is necessary to **consolidate the current revenues** which are the sum of current revenues from all sub-sectors, less the inter-governmental transfers (revenues) that come from other sub-sectors. The **balance of capital** is also the difference between effective capital revenue and capital expenditure and can be calculated with or without consolidation for each sub-sector, but has to be consolidated for the general government.

The sum of current and capital balances (in NA) for all three sub-sectors gives the overall **budget balance of general government**, which is nothing more than the difference between effective revenues and effective expenditures. If it is negative, it represents a **public deficit** and generates the need for **net borrowing**, i.e. the need for government to issue new public debt. If it is positive, there is a surplus and generates the possibility to decrease (repay) part of the public debt.

Another important balance is the **primary balance** which is the difference between actual revenue and primary expenditure (actual effective expenditure less interest payments). It gives the value of the overall balance that would exist if there were no public debt (and therefore no interests).

Since interests that are excluded from the primary balance, are part of public expenditure, the *arithmetic* relation between the budget balance (BB) and the primary balance (PB) is:  
 $PB = BB + \text{Interests}$ .

The interpretation of the balances of each subsector should be cautious given the **transfers** between sub-sectors. We can make an analysis of **non consolidated** accounts of each subsector. For example we can analyse all effective revenues and expenditures of Social Security. Part of the effective revenues are transfers from Central Government and we can analyse the structure of revenues of Social Security and the weight of own resources (social security contributions) versus transfers from government. In this case we are using nonconsolidated values.

However, if we would like to compute the effective revenues and expenditures of central government we should **consolidate revenues and expenditures of each subsector**.

The consolidation is done just *not considering*, both on the revenue and expenditure sides of the accounts *transfers to or from other subsectors*. Accounts for General Government are always consolidated. But, for each subsector the analysis can be done either with consolidated or non consolidate data according to the purpose of the research.

**Budget Balances (unconsolidated)** represent a simple relationship between revenues and expenditures. A sub-sector may have a surplus only because it receives transfers from other sub-sector. In this case the balance (consolidated) of the sub-sector will be negative. If transfers are the result of a law (basic law on social security, finance, regional or local, etc.) they are a legal obligation of the State. If they are not a consequence of a specific law, but they are discretionary (e.g the need to cover any deficit of Social security) the situation is different.

Also **transfers between general government (AP) and the market public sector corporations (SPE)** should be considered carefully since they may involve *off-budget* phenomena or outsourcing with the aim of reducing "artificially" the budget deficit. A financial flow between the two can be a current expenditure (case of compensation for "social prices"), can be a capital expenditure (capital transfer) or an increase in the equity of a public corporation. The latter, unlike the first, is clearly not an effective expenditure since it increases the financial assets of the state and in principle should not count for the deficit. However, if the company concerned is considered a *non-market* institution, it should count for the deficit.

