

Session #16

Chapter 5: The State Budget

- 5.1. The State Budget and the budgeting cycle
 - 5.1.1. Definition, scope and importance of the State Budget
 - 5.1.2. The budgeting cycle
- 5.2 The preparation of the Budget and budgetary rules
 - 5.2.1 The preparation of the Executive Budget Proposal
 - 5.2.2 The rule of Specification

Bibliography

- **In English:**
 - Summary of Chapter 12 “The State Budget”, *Economia e Finanças Públicas*
 - Slides of lectures 16 and 17
- **In Portuguese:**
 - **Book *Economia e Finanças Públicas*, 5ª edição, Cap. 12**, p. 417-421 budget and budgetary cycle, p. 426- 435 – budgetary rules: specification. **6ª edição, Cap. 12 p. 435-440, 445 e 448-454**
 - Orçamento Cidadão 2021 do Institute of Public Policy (Citizen Budget (Orçamento Cidadão) in Portuguese here:
 - http://www.ipp-jcs.org/wp-content/uploads/2021/04/OC-2021_vf.pdf

Economics and Public Finance – Core topics

- The State Budget
 - Basic notions and concepts
 - The Scope, substance and contents
- The budgetary cycle
 - The four-stage budget cycle: 1) preparation 2) discussion and vote 3) implementation and monitoring 4) final accounts.
 - Time frames and functions

The Budgetary Rules: specification of expenditures (economic, functional, organic and programs).

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Economics and Public Finance – introduction to the State Budget

- The **State Budget** can be seen as a document with **3 relevant dimensions**:
 - **Economic**: it embodies a forecast of the (annual) financial activity of certain Public Administration subsectors directly run by the General Government.
 - **Political**: it reflects government priorities in terms of the structure and extent of financial resources (income and revenues) earmarked to specific public policies (expenditures).
 - **Legal**: it is a legal instrument enforceable by the **Budget Law**, approved by the Parliament, which nevertheless imposes numerous *limits to the financial powers* of the government.

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Economics and Public Finance – Portuguese legal framework of the State Budget

- In **Portugal**, and most countries there are two legally binding levels, which are:
 - **The Constitutional Law** (the Constitution of the Portuguese Republic, 7th Revision, 2005)
 - **The Budget Framework Law** (Lei de Enquadramento Orçamental), and **other** related legislation.
- In Europe, the **Treaty of the European Union (EU)** and other legally binding documents, also frame the Budget:
 - Several treaties signed by Portugal (Treaty of Maastricht, Treaty of Nice, Treaty of Lisbon).
 - The **Stability and Growth Pact (SGP)**, the European Council regulations and also the European Commission regulations and more recently the “**Fiscal Treaty**” (analysed in chapter 6).

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Economics and Public Finance – general principles of the Budget

- The **Portuguese Constitutional Law** sets out several principles for the Budget:
 - **the scope and substance** of the State Budget, and the structure of the (annual) Budget Law;
 - **the organisation and presentation** of the State Budget in terms of revenues and expenditures;
 - **the definition and nature** of the role of the Parliament and of the Government in each stage of the budgetary cycle in accordance with legal time frames and limits.
- The **Budget Framework Law** sets out principles in terms of:
 - The provisions and dispositions governing the **preparation, discussion, approval, implementation and controlling** of the State Budget;
 - The **superseding legal value** of the State Budget to be observed by other laws and legal instruments directly results from the legislative responsibilities of the Parliament.

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Economics and Public Finance – Basic notions and concepts about the State Budget

- The State Budget is presented and organised as a single document in the form of the **Budget Law**, that
 - **comprises a detailed description of all revenues and expenditures,**
 - is **proposed** by the **Government** and discussed, changed and **approved** by the **Parliament,**
 - **forecasts (in advance) each subsequent yearly fiscal period** (calendar year in most countries, in Anglo-Saxon countries the financial year starts in April).
- The Government submits a **draft Budgetary Law** to the Parliament that is put to (favourable) vote and later approved in its (final) form.
- Afterwards, the **Budget Law** has to be officially enacted by the President of the Republic in order to be properly put into effect.

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Economics and Public Finance – The scope of the State Budget

- The **State Budget*** encompasses the budgets of
 - **Central Administration;**
 - **Social Security.**
- The **State Budget does not include** the budgets of
 - **Local and Regional Governments (Madeira and Azores).**
- * the equivalent to federal budget in federal countries

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EPF – The contents of the draft Budget Law Proposal

- The **draft Budget Law** is structured as follows:
 1. **Structure and body** (*Articulado da Lei*) which includes the articles of the law.
 2. **Budgetary Tables** (*Mapas orçamentais- see Appendix*)
 3. **Budgetary Report** (*Relatório do Orçamento do Estado*)- Explains the budget measures taken by government
 - Refer to article 33 of the Budgetary Framework Law and also to the proper **Budgetary report**.
 4. **Budgetary developments** – more detailed data
 - Article 32, 1st paragraph, item b) of the Budgetary Framework Law and also to the Budgetary reports of the AFS.
 5. Information details (including, short, medium and long-term indicators)
 - Article 34 of the Budgetary Framework Law.

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Economics and Public Finance – 4-stage budget cycle

- The **budget cycle** of each **State Budget** comprises four separate but *interdependent* stages, namely:
 - **Stage I:** preparation of **State Budget** and its **Budget Law Proposal**,
 - **Stage II:** discussion, amendment and voting of the **Budget Law Proposal**,
 - **Stage III:** execution and controlling of the enacted **Budget Law**,
 - **Stage IV:** preparation, voting and reviewing of the **State's General Account**.

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Economics and Public Finance - 4-stage budget cycle: Stage I (1/2)

- The terms and nature of **Stage I** of the aforementioned **budget cycle of each State Budget** are set as follows:
 - **It is the sole responsibility of the Government** (in accordance with its public and administrative functions) the initiative of **presenting the draft Budget Law** (in accordance with article 197 of the Constitution of the Portuguese Republic) until **10 October of each year**

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Economics and Public Finance - 4-stage budget cycle: Stage I (2/2)

- The budgetary procedure begins with the presentation to the European Commission (until 15 April) of the annual update of the Stability Program (See Chapter 6).

The preparation of the Budget is done in phases (see Figure 12.1 of the VET Book) which culminates in the approval by the Council of Ministers of the proposed law to be submitted to parliament:

1. Elaboration of the **macroeconomic scenario** –
 2. Based on the previous one: estimated actual revenue (R).
 3. Defining the **target for the Budget Balance** ($SO = R - E$)
 4. Forecast of the ceiling for effective and total expenditures ($E = R - SO$)
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Economics and Public Finance - 4-stage budget cycle: Stage II (1/2)

- Given its political and legislative responsibilities, the Parliament has to approve a law on the **Main Planning Options** (“*Lei das Grandes Opções*”) and the **State Budget**, upon proposals from the Government.
 - Voting takes place within 45 days after submission of **Budget Law Proposal**.
 - Final approval (by Parliament) and official enactment (by the President of the Republic) by **year-end**.
 - In case of rejection, a new draft Budget Law has to be presented (by the Government) and approved. In the meanwhile the budget of last year comes into being on 1st January. Alternatively, the Government may step down..

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Economics and Public Finance - 4-stage budget cycle: Stage II (2/2)

- The discussion and voting of the **Budget Law Proposal encompasses two phases:**
 - **debate on the general principles** (in Parliamentary plenary sessions);
 - **debate on the details**
 - in plenary sessions of the Parliament for matters relating to the *tax system and limitations on public debt*;
 - in the Budget Committee.
 - *Note: next lecture we will develop the parliamentary stage*

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Economics and Public Finance- 4-stage budget cycle: Stage III

- The execution (**State Budget** lapses at the end of the fiscal year, 31 December) and controlling of the **Budget Law** encompasses two principles:
 - Principles on the execution of income and revenues:
 - Legality and compliance (it had to be previously recognised as income and revenues)
 - **Note: Estimated revenues may be exceeded.**
 - Principles on the execution of expenditures
 - Legality and compliance (**amounts are ceilings to expected expenditures**).
 - Earmarking.
 - Execution by provisional twelfths (in the State-Ministries).

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Economics and Public Finance - 4-stage budget cycle: Stage IV

- The preparation of the **State's General Account** (*Conta Geral do Estado*) is done by the Government, and is later on scrutinised and voted by the Parliament.
- The State's General Account is a summary of the **execution** of the **State Budget** during its yearly fiscal period (and subsequent verification in the following yearly fiscal period):
 - **Scope:** *similar* to that of the **State Budget**,
 - **Contents:** Reports, general and consolidated accounting maps and other relevant information and details.
- The State's General Account needs to be approved by the Parliament before 31 December of year **t+1**, after the **Audit Court** has made an evaluation of the report, hence closing the budget cycle of **year t**.

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The **Specification Rule** and the classification system of expenditures and revenues

- One of the best-known rule of organising a State Budget, namely *the **specification rule***, requires the preparation and presentation of **expenditures and revenues** reports along international standards given by classification systems duly established and recognised.
- Each country should maintain stable criteria related to its budgetary classification system making it possible to perform temporal analysis of fiscal policy as well as to produce historical surveys of government spending, to compare data from different fiscal years and to identify **annual objectives and priorities**.

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EPF – The classification system of expenditures

- In every State Budget, public expenditures should be classified for different purposes, according to the specific needs for policy formulation, reporting and budget management.
 - In Portugal, each expenditure is classified according to the following criteria:
 - **Economic** classification,
 - **Functional** classification,
 - **Organic** classification,
 - Classification by **program**.

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EPF – The economic classification of expenditures

- The **economic** classification *makes a distinction between:*
 - Effective and non-effective revenues and expenditures (mentioned before),
 - Current and capital revenues and expenditures.
- **Benefits:**
 - It allows for compliance controls, auditing, monitoring.
 - It allows for economic analysis of the budgetary accounts and balances of the various subsectors.

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EPF – The functional classification of expenditures

- **The functional classification** of expenditures allows for historical analysis and policy formulation along the different **functions** of Central Government (Direct and Indirect) and Social Security.

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|---|
| 1. General functions of sovereignty such as the National Armed Forces |
| 2. Social functions , like education and healthcare |
| 3. Economic functions , namely farming and agriculture, industry and manufacturing |
| 4. Other functions , such as public debt management |

The functional classification system "*Classification of the Functions of Government (COFOG)*" developed by the OECD and published by the United Nations represents a normative framework at international level that each country may adopt, in whole or in part, enabling international comparability between State Budgets from different countries. Portugal adapted this classification



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EPF – The organic classification of expenditures

- **The organic classification** of expenditures enclose the following **benefits**:
 - It allows transparent budget information on revenues and expenditures for every public service and department (e.g. Directorate-General of Consumer; ISEG, etc.).

- **Note**
 - Each time the governmental structure or organisation is changed within Central Government Administration (direct or indirect), the organic classification of expenditures must be accordingly adjusted.
 - For example, changing the number of ministries or merely changing its designations in relation with its related functions and responsibilities.

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EPF – The organic classification of expenditures

- **The organic classification** of expenditures fitting the different **entities of Central Government (Direct and Indirect)**.

Organic designation	Chapters
01 General State Expenditures	0101 Presidency of the Republic
	0102 Assembly of the Republic
	0103 Constitutional Court

02 Ministry of Foreign Affairs	0201 Government Cabinet Members
	0201 Diplomatic and consular services

03 Ministry of National Defence

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EPF – Classification of expenditures by program

- **Program:** A program is a set of activities, expenditures, actions and measures that meet the same set of objectives, goals and results. Hence, this classification by program takes into account public policy objectives.
 - Programs may be within a line ministry or be across ministries and may also refer to a multi-annual basis. As such, reported expenditures beyond the 2nd year onwards are only tentative.
 - **Example:** "Promotion of safety"
 - Expenditures made on several key areas (foodstuff, pharmaceutical, infrastructures, and so forth), involving several ministries, namely Agriculture, Healthcare and Public Works.
 - **Benefits:**
 - It allows the identification of objectives and policies.
 - It allows the assessment and accountability of the allocated financial resources.

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EPF – The classification system of revenues

- In Portugal, public revenues are classified according to the following criteria:
 - **Economic classification:** for the General Government, Autonomous Funds and Services and Social Security.
 - **Organic classification:** overall revenues from Autonomous Funds and Services
- Some notes on the economic classification:
 - Revise the notions of **effective (non-financial) revenues** and **non-effective (financial) revenues**.
 - Tax revenues are the dominant source of public funding followed by income from public lending activities (financial liabilities).
 - The importance of this classification is given when analysing: i) the weight of the taxation system to cover public expenditures, ii) lending activities and its effects on public debt, iii) the importance of state-owned enterprises as sources of income (for instance, income from property and other assets).

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APPENDIX 1: – COFOG

Classification of the Functions of Government



- 01 - General public services
- 02 - Defence
- 03 - Public order and safety
- 04 - Economic affairs
- 05 - Environmental protection
- 06 - Housing and community amenities
- 07 - Health
- 08 - Recreation, culture and religion
- 09 - Education
- 10 - Social protection

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APPENDIX 2: Fiscal rules (1/3)

- **The European institutions have stressed the need for quantitative national fiscal rules. One can envisage several fiscal rules:**
 - **Budget deficit** (overall ceiling - nominal or as % of GDP; structural budget balance, % of GDP);
 - **Debt** (nominal ceiling or as % of GDP);
 - **Spending** (maximum value, nominal, real; growth rate, nominal, real);
 - **Revenue** (tax burden, limits to tax rates, reallocation of revenues above the forecasted revenues).
- **Such efforts try to deal with:**
 - **the sustainability of public finances;**
 - **fiscal policy adequacy to economic business cycles.**
- **Still, sometimes pro-cyclical fiscal policies occur (more on Chap. 6).**

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APPENDIX 2: Fiscal rules (2/3)

The EC reports that fiscal rules have been adopted progressively after the 1990s, notably in the period 2000-2008.

- Examples: Germany, Ireland, U.K., Sweden.
- In 2008 only three countries did not have any kind of fiscal rule (Cyprus, Greece, and Malta).
- In the 1990s rules were more targeted for the Local and Regional Administration, after 2000, for Central Government and Social Security as well.
- Rules with a legal binding, and subject to sanctions, deliver more efficacy than rules based on political commitment.

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APPENDIX 3: Fiscal rules (3/3)

Country	Rule	Definition	Sub-sector *
Germany	Deficit	Value (nominal)	CG
	Spending	Growth rate (nominal)	CG, RG, LG
	Debt	Value (nominal)	LG
Belgium	Deficit	Value (nominal)	LG, SS
		Growth rate (real)	RG
	Spending	Growth rate (real)	CG, SS
	Revenue	Growth rate nominal (function of GDP nominal growth)	CG
Denmark	Deficit	Structural balance (% of GDP)	GG
	Spending	Growth rate (real)	GG
	Revenue	Limits to tax rates	GG
Finland	Deficit	% of GDP	CG
		Value (nominal)	LG
	Spending	Value (real)	CG
	Revenue	Reallocation of extraordinary revenues	SS
France	Debt	% of GDP	CG
	Deficit	Golden rule	LG
	Spending	Growth rate (real)	CG, SS
Netherlands	Revenue	Reallocation of extraordinary revenues	CG
	Spending	Value (real)	CG
Portugal	Deficit	Value (nominal)	CG, LG
	Debt	Debt limits	RG
U.K.	Deficit	% of GDP (average in the cycle)	GG
	Debt	% of GDP	GG

(*) GG – general government; CG – central government; RG - regional government; LG - local government; SS - social security

Source: EC, Public Finances in EMU (2006, 2009).

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