



Economics and Public Finance – This session outline

Chapter 5: The State Budget

5.3 Budget discussion and vote in Parliament

- 5.3.1 Majority and minority governments.
- 5.3.2 Logrolling (or exchange of votes) and interest groups.
- 5.3.3 Decision making in parliament

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Economics and Public Finance – Readings

Readings in English

- Summary Chapter 12 (Book *Economia e Finanças Públicas: da Teoria à Prática*), including the logrolling section of Chapter 4.
- Slides.
- Readings in Portuguese:
Book *Economia e Finanças Públicas, Escolar Editora 5ª edição*
1. Chap. 12 (5ª Ed.) p. 427-429 and 449-455; (6ª Ed.) p. 454-483.

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Economics and Public Finance – Core topics

- Budgetary rules (conclusions):
 - Equilibrium:
 - Formal balance and substantive balances (global budget balance or primary balance)
 - Political decision making in Parliament:
 - Logrolling
 - Interest groups
 - Consequences of not approving the Budget.

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Economics and Public Finance – The equilibrium rule (1/3)

- **The Equilibrium Rule** (budget revenue and payment appropriations must be in balance):
 - The effects of this equilibrium rule are considered the most important in the budgetary discipline of the **State Budget**.
 - Every Budget (either in the form of **Budget Law Proposal** or **afterwards in the form of the Budget Law** equals total public revenues to total expenditures.
 - As such, there is always an **accounting** or **formal correspondence** between revenues and expenditures.
 - However, at the same time severe fiscal imbalances may still subsist.
 - and this apparent contradiction can be understood by the notion of **substantial balances**.

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Economics and Public Finance – The equilibrium rule (2/3)

The **Equilibrium Rule** implies the following (continued):

- **Formal budget balance**
 - **Total Revenue = Total Expenditure**
 - The State Budget always conforms with this principle, since there must exist revenues to cover expenditures, in accordance to the **Constitutional Law**.
 - “**State budget** shall provide for the income needed to cover expenditures“ (article 105, 4th paragraph of *Constitutional Law*). The total income can be financial (loans, Treasury bonds, etc.) and non financial income (taxes, social contr.)
- **Substantial balances**
 - Substantial balances depend on balancing **certain revenues and certain expenditures**
 - Examples: The **budget balance** (non-financial revenues and expenditures) can present a deficit. But the **primary balance** (non-financial revenues and expenditures excluding interests) **can have a surplus**

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Economics and Public Finance – The equilibrium rule (3/3)

- **The equilibrium rule implies the following:**
 - **The Budgetary Framework Law** characterises the “*balancing criteria*” to be observed by each Public Administration subsector
 - The entities in **Central Government**- the **budget balance should be non-negative** unless the macroeconomic conditions do not allow it.
 - The exception is **corporate public sector** within Central Government that should have the **primary balance non-negative**.
 - The **Social Security budget balance should be non-negative**.
 - Note: The equilibrium rule defined for EU Member states will be discussed in chapter 6.

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Budget Discussion and Vote

The State Budget is an important law Parliament, with a legal, economic and political dimension.

In **political terms**, it is important to distinguish three situations:

- 1- The existence of a government with **majority parliamentary support** in of a **single political party**.
 - 2- The existence of a **coalition government with majority parliamentary support** in Parliament.
 - 3- The existence of a **one-party government with minority representation** in Parliament.
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Budget Discussion and Vote

The political context will be decisive in the process of discussion, amendment and approval of the State Budget in Parliament.

With a majority, of a single party or coalition governments, negotiations are made almost exclusively in the preparation of the State Budget Law Proposal (PPL OE). Proposals to amend the Budget by opposition parties in the parliamentary discussion and approval phase are overwhelmingly defeated.

With minority party governments, negotiations can be done both on the elaboration stage of the Budget Proposal, or the parliamentary stage, but the later is much more relevant. Here the role of Logrolling and interest groups influence is much more relevant and the government may be defeated by “negative coalitions” of the oppositions.

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Logrolling or the “Exchange” of votes (I)

Assume, there is a **proposal X** to be voted on, by three parties with an equal number of Members of Parliament: A, B, C. The social support base of each party is homogeneous, so we may consider three representative individuals. The expected variation of utility for each individual, expressed in monetary units, if X is approved is the following:

	X	Benef	Costs
A	-2	1	3
B	5	8	3
C	-2	1	3
Sum	1	10	9

Voted separately this proposal X by majority rule will be **rejected**, although in a utilitarian logic, its **approval** would **improve social welfare**.

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The “Exchange” of votes: logrolling (II)

Now consider a **proposal Y** that affects social welfare differently. Like proposal X, it also generates concentrated benefits, but now for the supporters of another party (C). If proposals X and Y are voted simultaneously or sequentially (with “exchange” of votes) what can happen?

	X	Y	Sum
A	-2	-2	-4
B	5	-2	+3
C	-2	+5	+3
Sum	+1	+1	+2

There may be logrolling (exchange of votes) between parties B and C to vote in favor of both proposals to approve both proposals.

Note that, from a **utilitarian point of view**, this agreement between B and C improves social welfare.

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The exchange of votes “logrolling” (III)

Can we conclude that logrolling always increase social welfare? Case II Assume that now the X and Y proposals have this impact:

	X	Y	Soma
A	-2	-2	-4
B	3	-2	+1
C	-2	3	+1
Soma	-1	-1	-2

It is easily seen that it does not. In this situation several things can happen.

- 1) Voted individually, proposals are **rejected**.
- 2) With logrolling they can **both be approved**, although the effect on **social welfare (utilitarian) is negative**.

Important conclusion. In democracy the rule of one man/woman one vote does not allow to reveal the diversity of intensity of preferences. If this **intensity is equal**, the rule of absolute majority, **is democratic** and produces **a desirable result in terms of social welfare (utilitarian)**.

If this **intensity is different** (as it usually is), the **decision is democratic** but the consequence in terms of **social welfare is uncertain**.

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The role of interest groups (I)

Interest groups, can have a **public** nature, or a **mixed** or **private** motivation.

They, can develop their activity of **political pressure** in the **two phases** of the budget process, either with the government in the **first phase** of the elaboration of the State Budget law proposal by the government, or in the **second** parliamentary phase.

In Parliament they can ask for hearings in the Budget Committee; in the Sectoral Committees (Health, Education, etc.), or with MPs from parliamentary groups most "receptive" to their requests.

Hearings given to interest groups are very often informative as they bring and present a lot of information.

As in the case of logrolling, a positive political response to interest groups' requests can have a positive or negative effect on social welfare.

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The role of interest groups (II)

- Associations representing certain sectors of activity that wish to reduce a tax rate (VAT, for example) or intend to avoid increasing it, will act first with the Ministry of Finance and then in Parliament with the Budget Committee.
- Tobacco companies interested in modifying tobacco taxation can request hearings, first from the government in the preparation of the Budget and then in Parliament.
- **Political entities** (other than interest groups) can also put pressure on political power. **City councils** that want a new hospital or a new educational equipment will work with the Ministries of Health and Education, respectively in the first phase of preparation of the PPLOE, or in Parliament next to the

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Voting amendments in Parliament

Consider that we are dealing with a **minority government** and that there are “negative” coalitions* of the opposition parties to approve proposals to change the state budget.

Depending on the budgetary impact of these approved proposals, there will be different **political impacts**:

- If the impact is small, political stability will not be at stake.
- If there is a significant budgetary impact of increased spending or decreased revenue, this could lead to a political crisis.

** Note: it is often the case that these coalitions are called “negative”. However, they are completely democratic in the sense that it is majority that supports a point of view diferente from the (minority) government.*

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Voting the final State Budget proposal

After the process of discussion and voting in the detail article by article (in the Commission and in the plenary) of all the proposed amendments, there is the final global vote of the State Budget.

In Portugal, an **eventual rejection of the Budget proposal** does not lead to the fall of the government. If on January 1 there is no approved budget, the previous Budget will be the one that will come into force in twelfths (resources released 1/12 each month)

However, there are possible **political consequences** that can include: Government resignation (PM initiative). Dissolution of the Assembly of the Republic. (PR initiative)