

## *Public Finance Management* in Portugal: The One and Only True State Reform

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Following the approval of the Law Reform of the State Budget Framework (Law no. 15/2015, of 11 September), Portuguese public finances should slowly develop to take the form of a model of *Public Finance Management* system (hereinafter, PFM), in which the accounting dimension is largely overcome by the management concerns.

Under this purpose, the budget model should be organized around the State Accounting Entity, building up for the first time the State Balance Sheet, in which all the operations of the various subsectors will be aggregated according to international standards (IPSAS and EPSAS), a operation similar to 2009, regarding the introduction of the Portuguese chart of accounts (SNC) to the private sector; in this case applicable to the public sector, and therefore being called as SNC-AP.

The advantages of this model are clear. All state budgetary and financial management will be based on a single information management system, which allows real-time analysis of the effective performance of the various public sector entities. However, as usual in our country, the foam of the day tends to cloud structural reforms, delaying essential needed changes.

Nowadays, the States are facing huge challenges. While in the past, the existence of a State was incontestable, this reality is no longer certain. The market has been redefining this concept, and the productive functions that were in the past attributed to the public sector are no longer guaranteed. The privatization trend, in the first place, followed by the digitization movement, are challenging the fundamental basic foundations of public authority, which is put into a test on a daily basis.

The challenges are obvious. The new economy is based on a single principle: the elimination of intermediaries. The State is the intermediary par excellence. In this context, the challenge is evident: its existence as an intermediary is no longer taken for granted, and therefore it must assume a positive and dynamic role in the social productive

equation. How does this work? The State must replace its authority posture in order to become a partner in the creation of social value. In other words, The State should evolve from a bureaucratic Napoleonic authority model to an efficient partnership model.

This problematic undermines the most basic essentials. In order to achieve a better understanding of the present phenomenon the following ideas should be explored:

- i) What is the State today? Structural economic changes are increasingly accelerating, and public service obligations are increasingly blurred.

It is essential the replacement of the authority model by a model of partnership - this is the real meaning of a real and proper State Reform. The market incapacities that had previously occurred had ceased due to the technological sophistication. The utilization of roads can be taxed through the use of locators or car registration scanning, the transport and accommodation providers may no longer be regulated in the presence of automatic feedback models. These simple examples demonstrate that the concept of public good is clearly in crisis. Notwithstanding, society remains unequal: digital illiteracy will accentuate social cleavages at rates never seen before. The key to overcome this trend is clear: the State must be focus on ensuring the efficient functioning of the market, constantly reforming itself in order to be a supplier of added value to market players and not a blocking agent due to the imposition of mere bureaucratic measures. At the same time the State must strengthen its action in the increasingly critical area: ensuring the principle of equality, with the elimination of social, economic and territorial disparities. **Better Public Management is a critical factor to insure the Social Welfare State – the additional resources achieved will have a great impact in the social cohesion policy.**

- ii) Where is the State? With the digitalization movement, the State intends to assume a dualistic presence: to be everywhere, and nowhere. That is how to behave under the digital cloak. A local physical absence at the instrumental level, more than compensated by a global and cozy virtual presence. The risk is clear. If the State digitalization is misdirected or, poorly perceived, the State will not be found nowhere, and people will not feel the State. Populist

movements aggregated by basic psychological motivations, such as nationalist feelings, or merely anti-system positions, will emerge in social networks through unfiltered communications, where rumors will dispel the facts. Thus, the State should proactively develop its digital agenda, eliminating the administrative obstacles that, can work as barriers to the activity of the individuals, and at the same time resisting to the temptation of demonstrating existence through the denial of pretensions. **Better Public Management is a critical factor to insure the State Territorial Cohesion – the additional resources achieved will have a great impact in the territorial cohesion policy.**

- iii) Who is the State? The disintermediation inherent to the digital transformation viscerally challenges the actual economic *status quo*. The intermediaries are disappearing at a terrifying pace. Earlier flourishing businesses such as travel agencies, banking and others, need to reinvent themselves towards a peer to peer relational logic. In the future, every individual will be an independent professional with a potential client base of seven billion (rushing to the eight billion). The State is also an intermediary. And, for that reason, it will also have to reform itself. Yet, this whole structural situation reminds us of an idea occasionally forgotten: the State is all of us. Under this assumption the entire Public Administration Reform must be carried out. Beyond public services or smart cities, what really matter is to being able to build a State of intelligent citizens who exercise an intelligent citizenship. **Better Public Management is a critical factor to insure the Legitimacy of the Government of the State – the additional resources achieved will have a great impact in the quality of public policy.**

The existence of an efficient State is essential, since it guarantees the development of a social policy able to ensure the elimination of disparities and simultaneously to guarantee the national, territorial and social cohesion. If the state is not efficient, all these matters will be called into question, which will mean the destruction of the social model as we know it.

How does PFM contribute to this scenario?

The PFM provides the foundations for the smooth functioning of this new State, more efficient and balanced. Why? Because it emphasizes the management aspects of all levels of public administration and will force all the agents to make, at any moment, the best decision in financial terms. Its range is total and comprehensive. For instance, by constructing the State Balance Sheet (so far nonexistent), the limitations of the cash-management models will be overcome, dropping the mere cash management ideal and achieving the true management dimension. Nowadays, the income inherent to the asset is more relevant than the asset itself. This premise in the long term leads to the exhaustion of the asset, disregarding, at every moment, its own value. Therefore, this management of affairs is intolerable in the 21st century.

Illustrating this idea, nowadays a good public manager is the one who spends precisely what he has been given in the budget to achieve, in the following year, a budgetary increase and simultaneously an enlargement of the public department employees structure. The good public leader of the future will be the one who creates the most value for society by its decisions, who invests in the right moment and who improves the efficiency of his services; in other words, the good public leader of the future will be the one who will be able to produce more welfare units for citizens according to his available resources.

The differences are evident: whereas, at present, the equation that defines the good financial decision-maker is only defined by the model of internal management to the public organization (namely by measuring the quality of his relation with the ruler), in the future the performance measure will lay on his relation with the citizen and with the market, which will define the goodness of his performance.

The PFM and its underlying accrual logic will make it possible to overcome the current limited analyses that destroy any sustained effort to optimize the State.

Thus, and for instance, the current cash flow logic, which is a step backwards from the double-entry bookkeeping model adopted by Marquês de Pombal in the 18<sup>th</sup> century, originates the following:

- i) A conceptual confusion between public expenditure and investment (please note that in a cash logic both realities are similar);

- ii) Irrelevance of the decisions made to increase the value of the public assets (since those do not generate immediate revenue and for that reason are immediately disregarded);
- iii) The structural decisions are sidelined in favor of immediate measures;
- iv) The general regulatory activities essential to safeguard public assets are neglected (the tragedy of the land registry is largely the result of this);
- v) Over consideration of the importance of public debt when, in any business logic, non-financial liabilities should also be considered for any reasoned solvency analysis, being both weighted with financial and non-financial assets;
- vi) The development of a budget policy centered on the governmental ministries, therefore limited by the organic barriers, which discourage the development of transversal policies;
- vii) Current financial accountability is essentially legalistic, based on highly formal assumptions that ignore the material effects of the policies developed and, consequently, the managerial aspect based on indicators of efficiency and effectiveness.

In other words, our current model of public accounting, based on the cash logic, follows into the use of pre-industrial technology from the early 19th century in a digitization era of the 21st century. The results, in terms of national competitiveness, could not be more devastating.

PFM, by its own dynamics, goes beyond all these weaknesses:

- i) Investment in capital goods is a different concept from current expenditure; both of which are financial outflows, however have a diametrically opposite impact on the value chain. In this context, it will no longer be discussed whether a capital increase in a public bank will constitute budgetary

expenditure - which is irrelevant in a scenario of necessity - but rather what increase in value to the State is associated to this investment decision;

- ii) The good manager will be the one capable to increase the public value, and not the one who manages the mere cash flows. Thus, the Ministry of Finance will no longer have the freedom in the policy of the budgetary blocking measures, since the budgeted allocation will be the one to which the public body is entitled, and for that reason that entity will be accountable for the creation of value matters (whether social, financial or economic);
- iii) The structural decisions will regain political importance, devaluing immediacy measures that do not create value in the long term. As an established program budgetary model, the organic shackles of the state will be broken, and for the first time there will be room for true cross-cutting policies developed from the bottom up and not solely based on a transient measure of the ruler that manages the public department until the next elections;
- iv) Public bodies will have an incentive to develop a value-creating regulatory economic policy so that their assets are valued. For example, a natural park will have an intrinsic value, which will be accounted, and will justify the conservation action of the public nature protection bodies, and that can justify the creation of an overall contribution to support the inherent costs of its maintenance;
- v) The financial equilibrium of the State will be analyzed under some comprehensive and sustained criteria, going beyond the analysis of a single variable - the financial liability - which in Portugal is around 36% of the balance sheet. Therefore, a deeper and more serious analysis of the country's economic performance will be required;
- vi) Intelligent financial self-sustainability models can be built, assigning the competence to carry out the expense and to collect the corresponding revenue to the same entity, which will substantially improve the terms to which the financial decision relies;

- vii) Financial accountability is no longer essentially legalistic, based on formal assumptions, and will be based on indicators of material results, which will accentuate the managerial aspect translated into indicators of efficiency, effectiveness and cost-effectiveness.

Moreover, in formal terms, the new model presents several virtues:

- i) Requires harmonization of the accounting standards in the various sub-sectors following the best international practices;
- ii) Allows a permanent analysis of the budgetary performance through the creation of an information system with cross-sectoral coverage;
- iii) Enhances the transparency of budgetary management, which is a critical factor in measuring the quality of our financial policy;
- iv) Increases the accountability for budgetary management;
- v) Improves the quality of the information available to the market, which is essential to remove any unfounded rumors from the financial markets, protecting our public debt from potential misunderstandings.

In Portugal this transition process can be considered relatively simple. The SNC-AP is purely an adaptation of the SNC. The challenge that the former Portuguese accounting system held (at that time called ATOC, promoted to OTOC because of this positive outcome) in 2009 was minor, and the SNC was extremely successfully implemented. It is important to note that in this case the difficulties were far more significant. In the referred situation most of the Portuguese companies were concerned about the transition to a non-tested model in Portugal. Nonetheless, certified accountants did not hesitate to embrace this challenge and, few years after, without any disruption or major difficulty, the entire accounting model in Portugal was fully adapted to the best

international practices. If this transition was possible in the private sector, why cannot it also occur in the public sector?

In this current time the Portuguese accounting professionals are well trained and the technical knowledge is manifestly plentiful. Therefore, in this situation, should be take into consideration the fullest capacity - at a technical, formative and associative level – of the Portuguese accounting professionals, in an initiative of this scope and importance.

The Portuguese transition can be the model example in this field. For this matter will be enough to follow the best existing practice - New Zealand - which made its transition about 20 years ago. What can be the outcome? From a deprecatory denomination: Pacific Albania has now been classified as triple A by most rating agencies, and at the same time the best classified country in human development.

Public finances health is, in the formal and material sense, an indicator of development. The Portuguese accounting reform must be considered, in this sense, the true structural reform.

Under this framework, there are no excuses for any delay in implementing this structural reform.

And since we are in a network era, all the movements must be shared by the most participants possible. That is the measure of success of a public policy trend. Today we face some strong opposition for this reform based in some well stablished nations. This conservative push is justifiable. Since that nations are winners in the current state of art, they are afraid to change to the new framework. They don't need more transparency because they win with opacity. They don't want that the other nations improve their finance performance because they cannot control them in the future. PFM is a critical factor for independence. PFM is crucial for confidence and trust.

This is a opportunity for a new move in History: Greece was the founder of the Modern Civilization; Portugal was the founder of the Globalization. Why not embrace together this new opportunity do make history again?