Chapter 29
Sustainability and Public Finances in the Time of Austerity

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Abstract The scope of this study is to underline, within the current European context of economic and financial crisis, the importance and relevance of the sustainability of public finances, understood not only as an end in itself but also as a means of reaching that end, enabling the further development of society in general. Methodologically, because the subject has taken on a supranational significance, the present work will pay special attention to the EU legal framework in the first stage and then analyse the measures that have been taken in at-risk countries such as Portugal, in order to repair public finances at the local and national level. Concerning these measures, a critical attitude will be adopted, not only to highlight the importance of the increase in financial control and fiscal responsibility, but also to analyse the compatibility of some such measures with the national legal order.

Keywords Sustainability of public finances • Economic and financial crises • Austerity • Financial control and fiscal responsibility

Sustainability of Public Finances: Conceptual Precision, Timeliness and Importance

In recent years much argument has arisen at a global level surrounding the topic of public finances and their sustainability. Such debate has gained particular importance in Europe, largely stemming from a serious crisis (at the economic and financial level and also in the area of public debt), wreaking havoc (and is still doing so) on this continent and, in particular, on European countries with

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problems in terms of the consolidation of public accounts, as is the case with the so-called PIGS (Portugal, Italy, Greece and Spain).

Nevertheless, before delving into this theme, it is necessary to define the meaning and reach of public finances. As such, the theme of sustainability of public finances will be considered in two parts: on the one hand, in regard to public finances (as an object), and on the other hand, in regard to sustainability (as an adjective, related to the first definition, of public finances).

Starting with the concept of public finances, notwithstanding its multiple meanings, it can be defined as the "*economic activity of a public body inclined to allocate assets to satisfy the needs with which it has been entrusted*" (Franco 2001, p. 3). Here, then, is a concept which, as a result of its own labelling, is grounded in the public domain, whether from an objective viewpoint on emerging activity for the allocating of goods in order to meet certain needs, or from an organic perspective as the public body responsible for managing available resources to satisfy social needs, keeping in mind the broadest sense of this concept, in order to encompass the financial situation of national bodies as well as all subnational levels of government such as regions, municipalities and even the public business sector.

Abstractly defining what the sustainability of public finances consists of is not such an arduous task. Generically speaking, sustainability translates as the "*ability of a government to assume the fiscal burden of its debts in the future*" (European Commission 2012, p. 1). More concretely, it is possible to say that "*fiscal policy is not sustainable if it implies an excessive accumulation of government debt over time and ever-increasing debt service*". In the same way it can be said that "*sustainability means avoiding an excessive increase in government liabilities—a burden on future generations—while ensuring that the government is able to deliver the necessary public services, including the necessary safety net in times of hardship, and to adjust policy in response to new challenges*". The task of defining the limits of sustainability in a precise and universal manner, that is to say, the line that separates sustainability from unsustainability of public finances, is much more problematic and difficult. Accordingly, from our point of view since a limit is at stake that should not be defined abstractly, or with the least amount of precision, it thus requires being evaluated minutely case by case, since its boundaries are dependent on a wide set of variables, especially in terms of time and space.[1]

[1]According to the European Commission (2012, p. 11), "*limits to sustainability differ across countries and over time. The capacity to run high debts depends inter alia on the degree of development of financial markets, perceived risks, and trust in the capacity of a government to implement structural reforms and consolidate deficits. It also depends on the degree of global risk aversion and the attractiveness of investments alternative to government bonds*". Despite this understanding, we must not fail to point out that austerity policies were largely shaped by two Harvard economists, Reinhart and Rogoff (2010, p. 2), in which they argue for a relationship between public debt and growth, particularly when public debt exceeds 90 % of the GDP. According to these authors, "*whereas the link between growth and debt seems relatively weak at normal debt levels, median growth rates for countries with public debt over 90 % of GDP are roughly one percent lower than otherwise*".

In light of this, we can see that the sustainability of public finances, besides being a current topic of discussion, is also of relevance outside of its own scope, that is to say, beyond public administration (understood *lato* sensu) and its own financial concerns. In reality, the goal of sustainability of public finances is not merely an end in itself, that is, sustainability of public finances for the sake of sustainability, but rather should be seen as a means of reaching a concrete end, which is economic and social development (cf. point 1 of Council Regulation (EC) No. 1466/97, of 7 July 1997). What is meant by this is that there is a link between public finances and development in general, in that healthy and balanced public finances both enable and/or reinforce favourable conditions for growth as well as social and economic development, while at the same time the opposite is true—which, as will be shown later, is recognized by the European Union (EU) and embodied in its own legal orders.

Sustainability of Public Finances and European Union Law

The goal of sustainability of public finances, in line with its importance, naturally constitutes a national plan shared by different States and is incorporated in the legal orders of each one. Nevertheless, the importance of public finance sustainability goes much further than a strictly national scope, constituting a supranational plan. It is exactly this that is observed at the level of the EU, whose law adopted the rule and the objective of sustainability of public finances.[2]

As we know, the EU can be seen as a "*two-speed legal system*": (1) on the one hand we have spaces or areas of centralization and uniformity such as that of monetary policy, with a single legal framework, a single currency (the Euro) and a single authority (the European Central Bank—ECB), and (2) on the other hand, we have spaces of decentralization and mere coordination, as in the case of financial policy. Here, in view of the great difficulty (or even impossibility) of establishing a common legal structure and a supranational financial authority, the maximum point reached is the attempt to approach the different legislations of each member state (MS). So, for now it is impossible to talk about a common public finance policy, a common budget, a common tax system or a common control system and, consequently, each MS approves and executes its own measures concerning public money.

However, not only theory but also reality provides some evidence that the Euro zone cannot survive without a substantial degree of financial alignment, because

[2]See article 126.º of the Treaty on the Functioning of the European Union, the Protocol no. 12 on the excessive deficit procedure, the Council Regulation (EC) No. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, and, more recently, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the member states.

the stability and solidity of the whole depends in large measure on the stability and solidity of the parts, which, when isolated, are not always good performers.

It was in this context that, early on, the EU took measures aimed at self-control and budgetary discipline within member states or, in other words, that each and every MS strives to avoid excessive budgetary deficits. Put simply, we can say that the restrictions put into place—built upon two criteria (budgetary deficit and public debt)—fundamentally break down into the following: (1) budget deficits may not exceed 3 % of the gross domestic product, and (2) public debt may not surpass 60 % of the gross domestic product.[3]

In this respect, it is worth pointing out that the EU did not restrict itself to establishing these limitations, also having foreseen the process of excess deficits and, for this purpose, the sanctioning of measures in case such rules are not respected.

This procedure essentially consists of two phases:

(i) It begins with a supervisory moment by the Commission (the Guardian of the Treaties), which must follow the financial situation of each MS closely in order to identify possible deviations. If this is the case, a report must be made and the MS in question is notified and the Counsel is informed[4];
(ii) If that MS persists in its deviation and does not carry out the necessary measures to correct the situation, the procedure continues with the intervention of the Counsel. Here, a *multistage voting procedure* takes place, beginning with the declaration of the excessive deficit situation, after which the MS is notified to carry out appropriate measures and finally, if the situation still persists some “sanctions” can be applied (for example, publishing additional information before issuing bonds and securities, to make a non-interest-bearing deposit of an appropriate quantity for the Union or to pay fines of an appropriate amount).[5]

Despite the approval of this measure and this sanctioning strategy, the truth is that critical appraisal of such measures is far from positive, namely in the light of:

(i) the bureaucratic nature of the procedure;
(ii) the vagueness and subjectivity of the rules concerning sanctions;
(iii) the lack of enforceability as a consequence of the protection agreements between MS;
(iv) the risk of treatment disparities.

More recently, as a result of recognizing that insufficient implementation had been achieved, further accentuated by the European public debt crisis, a tendency to reinforce the economic and monetary pillars of the EU has since been observed,

[3]The budget deficit and the public debt must be faced *lato* sensu (as prescribed in the European System of accounts 1995—ESA 95), including not only the financial situation of the national bodies (specifically, the State itself and the central administration) but also all subnational levels of Government, as Regions, Municipalities and even the Social Security system.

[4]See, article 126. no. 3 and 5 of the Treaty.

[5]See article 126, ns. 6 to 11 of the Treaty.

through the adoption of a set of rules aimed at, above all, promoting budgetary discipline. Additionally, there is specific emphasis not only on "*the need for governments to keep their public finances healthy and sustainable as well as to avoid excessive deficits*", but also on the importance that this represents for achieving the objectives of the EU. This reinforcement, especially as it pertains to the "*golden rule*" of limiting and restricting public debt, is clearly visible in the recent Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, from which the following essential aspects arise:

(i) Demand that national budgets remain in a balanced or in a positive state[6]; this rule is considered to be adhered to if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0.5 % of the gross domestic product at market prices[7];
(ii) The rule of budget balancing has to be incorporated into national law within one year of the entry into force of the treaty, using provisions that are guaranteed to be adhered to throughout national budgetary processes.[8]
(iii) In the event of significant observed deviations from the medium-term objective or the adjustment path towards it, a correction mechanism shall be triggered automatically. The mechanism shall include the obligation of the Contracting Party concerned to implement measures to correct the deviations over a defined period of time.[9]
(iv) The contracting parties whose currency is the Euro commit themselves to adopting Council decisions within the framework of the excessive deficit procedure unless opposed by a qualified majority (article 7.º).[10]

The Sustainability of Public Finances and Economic and Financial Assistance Programmes

The goal of sustainability of public finances is also deeply ingrained in the economic and financial assistance programmes signed by Greece, Ireland and Portugal.

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[6]See article 3.º, n.º 1, al. a.

[7]See article 3.º, n.º 1, al. d. Article 3.º also stipulates "*where the ratio of the general government debt to gross domestic product at market prices is significantly below 60 % and where risks in terms of long-term sustainability of public finances are low, the lower limit of the medium-term objective specified under point (b) can reach a structural deficit of at most 1 % of the gross domestic product at market prices*".

[8]See article 3.º, n.º 2. In case of non-compliance of this duty, the EU Court of Justice may apply sanctions on MS, at a level no less than 0.1 % of their GDP (article 8.º, n.º 2).

[9]See article 3.º, n.º 1, al. e.

[10]See article 7.º.

In a period of little more than a year, these three countries (each a MS of the EU), for not entirely parallel reasons [on the causes that form the basis for requests for external financial assistance of each one of these countries, see European Commission (2010, pp. 3–9; 2011a, pp. 6–18; 2011b, pp. 9–15); for further developments about the Portuguese case, see Reis (2013)], all turned to external financial assistance. Each entered into agreement with the so-called *Troika* (made up of representatives of the European Commission, the European Central Bank and the International Monetary Fund), at different moments in time, agreeing to a Memorandum of Understanding on Specific Economic Policy Conditionality.[11]

Under these documents, as a condition of receiving financial assistance, these countries took on a broad and meaningful set of obligations to international creditors, in a wide variety of areas:

(i) public finances and budgetary policies;
(ii) public administration (central, regional and local);
(iii) public health and education systems;
(iv) legal systems;
(v) regulation and supervision of the financial sector;
(vi) public services of transports, telecommunications, energy and national postal service; and the
(vii) job market.

It must be pointed out that the financial assistance that these three States received was made available in instalments, whose disbursements were made under the condition of observing accepted commitments. Thus, those States subjected themselves to a tight set of control schemes and financial reporting that has taken place during regular evaluations of accordance over the course of the programme.

Despite the diverse grounds which form the basis of requests for external financial assistance by each of these countries, a comparative analysis of the three *Memoranda* allows for observing that the approved model of intervention has a common matrix based on adopting austerity policies. [12], [13] In accordance with the

[11]Greece's *Memorandum* dated 3 May 2010, Ireland's 3 September of the same year and, finally, Portugal's was ratified on 17 May 2011.

[12]Austerity is defined by Blyth (2013, p. 2), as "*a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices, and public spending to restore competitiveness, which is (supposedly) best achieved by cutting the state's budget, debts, and deficits.*"

[13]The similarity (materially and formally) between the three aforementioned *Memoranda* is not limited, however, to the adoption of a common matrix, going so far as to incorporating the text used. According to the notice published in the Portuguese newspaper "Público" 8 August 2013, "*the agreements signed by Ireland and Portugal share 75 % of* [the same] *text, those signed by Greece and Ireland coincide on 77 % and those signed by Greece and Portugal 82 %*". Despite the similarities (which in fact exist), the three documents also display some differences between each other, namely in regard to the dimension of the measures aimed at the financial sector, which are more prominent in the *Memoranda* of Ireland and Portugal than in that of Greece.

model set forth in the *Memorandum*, the way of reaching the objectives, especially as far as consolidating public finances is concerned, is through adopting a policy of deflation, based on reducing deficit, public debt and spending, in addition to increasing tax revenue. According to the defenders of the policy of austerity, it was believed that adopting that type of measure (especially in the public sector) would prevent the "*crowding out*" effect and, at the same time, would have the positive effect of creating confidence in the private sector, all of which would together lead to expansion and economic development (Krugman 2013, p. 6; Cavero and Poinasamy 2013, p. 38).

Focusing on the Portuguese case as a reality now under way, it is possible to note that there have been several measures for reducing expenditures and for increasing tax revenue during the programme of financial and economic assistance and in compliance with the commitments made to the *Troika*, bearing in mind the ultimate goal of consolidating public finances and, similarly, the slimming of the State. As it stands, in regards to reducing expenditures, the Portuguese government has achieved a very significant set of cuts, namely in public salary benefits, retirement benefits, social assistance benefits as well as in the sectors of education, culture and sports.

Just as in the case of revenues, a broad set of measures was implemented which including putting State property up for sale and privatizations, an exponential increase in the tax burden, largely through tax rate increases (of personal income tax, VAT and of fees related to delivery of public services such as, for example, co-payments in the national health system) or through the reduction of tax benefits—although later these were somewhat alleviated by a progressive reduction in the tax burden on corporate bodies.

The application of these measures has generated a heated discussion within Portuguese society:

(i) not only regarding the effects they have triggered (which will be noted shortly) and, related to this, the correction of policies that have been adopted, but also on
(ii) their democratic legitimacy, given that they have been imposed by a series of non-elected parties, of doubtful compatibility with two fundamental constitutional principles, those of democracy and sovereignty, and finally,
(iii) from a strictly legal point of view, since measures restricting legal rights, freedoms and guarantees are at risk, in their compatibility owing to constitutional limits in place—to the extent that it becomes questionable whether a process of dismantling the Social State is not under way.

Regardless of the debate that has arisen, nearly three years after the agreement to the Memorandum the outcome of applying deflationary measures—mainly aimed at budgetary consolidation—will undoubtedly be negative. And it will be negative first and foremost due to the social impact that these measures have, especially in increased unemployment, as well as the reduction in disposable income available to people which, as a consequence, brings about a decrease in the standard of living. The same conclusion can be reached in analysing the outcome

arising from public finances, which are far from corresponding to those outcomes initially foreseen. In fact, since 2011 to the present, an increase in public debt has been observed and, moreover, an increase in this compared to the GDP, such that these both are much higher than the objectives initially established.

Nonetheless, according to the *Memorandum*, the purpose of budgetary consolidation cannot be reached simply through cutting expenses and increasing revenue. Alongside such measures, mechanisms for implementing and strengthening a system of ongoing control and accountability of decision-makers have been prioritized, spanning across all sectors and administration, contributing to these goals in one way or another.

Internally speaking, in accordance with the *Memorandum*, the implementation and strengthening of financial control has translated into the adoption of various measures, of which the most salient ones are:

(i) Firstly, and as a way of fighting so-called *de-budgetization*, expanding the reach of public administration through introduction of so-called national accountancy rules, including entities that traditionally were excluded from the public administrative sector but whose accounts have relevance for public finance;

(ii) Secondly, dissipation in terms of control functions brought about through the creation of new institutional control structures (such as the Council of Public Finances, the technical surveillance units both for Public and Private Partnership Projects as well as for the Monitoring of the Public Business Sector), which were attributed special functions in "*areas of budgetary risk*";

(iii) Thirdly, a new trend has been detected in regard to the moment of exercising control—concretely, to a trend of exercising this control in advance. In fact, whereas previously a posteriori inspection of offenders[14], was preferred, it is currently possible to say that this practice is being called into question and replaced with and/or complemented by another that, without neglecting posterior inspection and properly holding financial decision-makers responsible, values control during the period prior to taking on and/or incurring expenditures. This new trend is justified for reasons that have to do with questions of efficiency of control itself—and naturally the inefficiency of the previous model—and a certain lack of (self) confidence in public administration;

(iv) Fourthly, with the objective of making financial control more efficient, there has been a marked increase in information disclosure duties placed upon varying sectors and administrations (on the importance of financial information for multiple purposes, including fiscal control, Lundqvist (2013); for more information on the Portuguese local financial system, see Freitas da

[14]A trend which, it should be noted, also was found in other legal orders—in French law, see Bouvier et al. (2008, p. 867), Bouvier (2010, p. 229), Levoyer (2007, p. 109); in Spanish law, see García-Alos (2009, p. 105); for further reading on the general tendency, see Bilbao (2009, pp. 248–250).

Rocha (2011, pp. 455–488)), coupled with an increase in the level of penalties, focussed on the importance and instrumental role that information plays in exercising control.

Nevertheless, as was previously mentioned, it is not only at the level of financial control that this trend towards reinforcement has been noted. At the same time, there has been considerable movement in the direction of greater demands on and accountability for financial decision-makers, translating on the one hand into a significant broadening of duties which various administrations are assigned, as well as into applicable penalties on the other.

It is worth noting that when saying that a tendency towards strengthening of control and financial responsibility has been witnessed, this is not to say that there is truly a new trend evolving, in the sense that prior to the memorandum, financial control and responsibility were undervalued realities or even ignored. Such a viewpoint does not correspond to reality, since, even though on different levels, prior to the memorandum there was already a sense of the weakness of national public finances and, related to this, a sense of the need and importance of strengthening those control mechanisms and of financial responsibility itself. What the *Memorandum* did, was because of necessity and the external link taken on by the Portuguese State and as a condition for ensuring the financing necessary for the national economy to accelerate, intensify and, perhaps, improve this very movement.

From all that has been shown, it is quite apparent that financial accountability and control are current and essential realities for the reinstatement of sustainability of public finances.

Conclusions

The sustainability of public finances is clearly a question of great concern and relevance in the present day. The timeliness of the topic is further accentuated by the European public debt crisis and, in particular, due to the difficulties experienced by several European states in securing financing. Far from being confined to the public sector, the goal of sustainability of public finances should be seen as a way of attaining social and economic development.

The goal of sustainability in public finances, besides being deeply rooted in EU law, is present in the economic and financial assistance programmes entered into by Greece, Ireland and Portugal. Through these programmes as a counterpart to financial assistance, those States agreed under the terms of their creditors to follow a vast set of obligations on economic policy, especially on the matter of budgetary consolidation. In all of these programmes, despite some differences, the model of intervention adopted was based on a common matrix—austerity. In accordance with the defined model, restoring public finances can be carried out through a

deflationary policy based on the reduction of the deficit, of public debt, the reduction of spending and the increase of tax revenues.

In the Portuguese case, the balance we have made in terms of public finance and its sustainability reveals negative aspects as well as some positive ones.

The negative aspects are many and significant: bearing in mind the social impact of austerity measures and the suffering of citizens as a consequence of these measures, the fact is that, despite certain measures adopted in the area of revenue (especially in terms of taxes), an increase in public debt has been observed (in addition to an increase in relation to the GDP), meaning that the increase was greater than was foreseen in the programme. This phenomenon is, from our point of view, a direct result of the strict application of a programme centred on the successive implementation of austerity measures (austerity on top of austerity), which by not being accompanied by measures aimed at stimulating growth has lead to a pronounced economic recession. To make our standpoint completely clear, we are not against the adoption of austerity measures. We believe that in the Portuguese case, much could be (and should be) done at the level of rationalizing the State and public spending. What went wrong, from our point of view, was not having tried to strike a balance between austerity and growth.

Nevertheless, the implementation of the economic and financial assistance programme, in the area of budgetary consolidation, did not bring out only negative aspects. Among them, several positive aspects should also be noted. One of these, as we pointed out earlier, concerns the strengthening of control mechanisms and of financial accountability, which, in their essence, seek to introduce greater strictness, discipline and also responsibility in public financial management. However, beyond this aspect which has a normative nature (that is, it results fundamentally from legislative changes), another stands out which is much more appealing and which we can label as arising from a collective civil conscience related to public finances. From this we can say that now more than ever, as a product of the financial and economic crisis which Portugal has been experiencing and the costs which have come with it, people are concerned with public finances and the need for these to remain at a sustainable level, not only for the present generation (a self-centred concern) but also for future generations (an altruistic concern). In fact, when considering public finances people express a range of viewpoints, among which are: (i) firstly, a sense of belonging and of ownership of public finances; (ii) secondly, as a result of raised awareness of collective "ownership" of public finances, a sense of responsibility has emerged, made clear by the fact that citizens have progressively resisted distancing themselves from public financial management but rather perform an active role of continuous surveillance (and being increasingly demanding, even from a qualitative point of view, which goes beyond mere compliance with law, calling for good administration of public money through effectiveness, efficiency and economy in the measures put into place) in the hands of those agents upon whom the management of public monies is bestowed.

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