Public Finance Workshop on Fiscal-Structural Reforms

Opening Remarks by Banco de Portugal Governor, Carlos da Silva Costa[1]

Lisbon, 3 July 2017

Good morning ladies and gentlemen,

It is a great pleasure to be here today to open this workshop on 'Fiscal-structural reforms: towards economic growth and the sustainability of public finances'. On behalf of Banco de Portugal and the organising team, a very warm welcome to you all!

As you are aware, this workshop, hosted by Banco de Portugal, was organised in the context of the annual meeting away from Frankfurt of the Working Group on Public Finances of the European System of Central Banks. The workshop gathers here today an outstanding group of fiscal experts coming from central banks, fiscal councils, and other national and international institutions.

Let me take this opportunity to reaffirm in particular the importance of fiscal councils and other independent fiscal watchdogs for the pursuit of sound public finances in our countries.

Global economic activity is gradually recovering. However, structural challenges persist in many countries, including low productivity growth, high unemployment, insufficient levels of investment, high public and private indebtedness as well as weaknesses in the financial sector.

How can structural reforms help?

These reforms are key to improving long-term economic growth prospects and to reducing our economies' vulnerabilities to future adverse shocks. However, it should also be taken into consideration that they may be associated with some negative effects in the short and medium term, as reform implementation is not without economic and social costs.

Structural reforms may be linked to fiscal policies through various channels. This workshop will focus on a specific subset of structural reforms, namely fiscal-structural

[1] Version prepared for presentation.

reforms. Fiscal-structural reforms encompass areas like taxation, social security and pension systems, healthcare, education, justice, the institutional framework and public finance management, among others. They should be distinguished from the standard use of discretionary fiscal policy to fulfil short- to medium-term objectives.

The post-crisis period has witnessed a reduction in fiscal imbalances in Europe. However, debt ratios remain at record highs and risks to the sustainability of public finances persist in several countries. Fiscal space for expansionary policies is limited and further consolidation is needed.

Against this background, fiscal-structural reforms gain prominence as an approach to improve the efficiency and quality of public finances. Indeed, if well designed and implemented, they can support inclusive economic growth, ensuring their long-run sustainability.

Notwithstanding their potential benefits, the implementation of effective fiscal-structural reforms faces several tough challenges.

First, they should preferably be part of a broad package of other necessary structural reforms. As such, the assessment of the potential impact on the economy is usually complex and requires a comprehensive approach. The technical expertise to make a correct assessment of the likely effects of reform is paramount for an efficient design.

Second, and closely related to the previous point, the planning of such reforms has to take into account the institutional and legal framework in each country. Indeed, the political decision-making process, the type of government, the existing domestic laws, in particular at constitutional level, and external rules like those included in the Stability and Growth Pact for European Union members, are important aspects to be taken into account. Sometimes, the improvement of this institutional and legal framework is in itself an important prerequisite for the feasibility and success of other reforms.

Third, the technical expertise required for the planning of reforms should have a strong base in the country implementing them, along with ‘national champions’ supporting the reforms on their own merits. Domestic “ownership” is critical. Reforms should never be understood by society as an imposition from abroad, either from the IMF or from the European institutions.

Fourth, careful attention needs to be paid to the communication strategy and redistributive mitigation measures. Both are key to ensuring adequate support from the public and to containing populist appeals targeted at those parts of society that are potentially most adversely affected by the reforms. Indeed, some of these reforms may involve long implementation periods, with transitional arrangements, and often lead to changes in the distribution of income and wealth. This may create pockets of discontent in spite of the clear overall benefits for the society. Lack of understanding of these challenges by decision-makers may seriously jeopardise the expected outcomes.

Last but not least, the length of the political cycle often proves insufficient to provide the right incentives for the effective implementation of fiscal-structural reforms. Therefore, broader agreements across the political spectrum, if possible, significantly increase the likelihood of reform success. However, by their nature and especially in those countries most in need of them, such agreements have been quite hard to achieve lately.

All in all, I am convinced that sustainable public finances and better long-run economic performance pose significant challenges that should be tackled without delay. The long-term benefits of structural reforms decided today will far outweigh their short- and medium-term costs, in particular if reforms are appropriately designed in order to mitigate the latter while not jeopardising the former.

Today we have gathered here all the ingredients for a rich and fruitful debate on the topics I have touched upon.

I thank you all for your participation and wish you a very pleasant and constructive workshop.