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Eurozone Debt Crisis: A discussion of the Implementation of TSCG in Ireland

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Abstract

The recent Eurozone debt crisis led to the adoption of the Treaty on Stability, Coordination and Governance in the European Monetary Union (TSCG) or the "Fiscal Compact" in December 2011 by the 26 of the 27 EU member states [1]. The objective of the treaty is to prevent future debt crisis by imposing a strict set of budget rules on the signatory nations [2]. The republic of Ireland is a signatory state of the TSCG. This essay discusses the thoughts of Ireland on the TSCG.

Keywords

Eurozone debt crisis, TSCG, Westminster model, Napoleonic model.

1. INTRODUCTION

As a signatory state of the TSCG, Ireland is required to introduce the budget rules of the treaty into domestic law, stipulating that the structural budget of the government has to be balanced or in surplus [1-2]. Specifically, the budget outcome of the government needs to meet the Medium-Term Objective (MTO) that limits the structural deficit to -0.5% of GDP, or -1% of GDP provided that the country's public debts are not greater than 60% of GDP and sustainability of public finances is not under threat over the long term [2]. Under the TSCG, there is a collection mechanism which will trigger when the European Commission reports a deficit warning or the Irish government identifies a significant deviation from the budget rules. And when the corrective mechanism is triggered, the Irish government will then have to prepare a detailed action plan containing specific corrective measures for the lower house of the parliament within two months [2]. Moreover, only in certain exceptional circumstances such as severe economic downturn or other events beyond the government's control that deviation from the budgets are permitted [2].

Since the introduction of the treaty, it has received extensive debates among the treaty's stakeholders in Ireland as well other member states of the EU. One of the most important issues raised from the treaty is the democratic legitimacy of the treaty. The treaty was introduced by the European Commission, an unelected body that does not have the democratic mandate to impose budgetary discipline on the member states of the EU [3]. Giving new powers to the European Commission on the budgetary matter of the country and the establishment of a common economic policy would need the approval of the general Irish public, not only the parliament [4]. While the TSCG does not necessarily involve constitutional change in the country, it is maintained by the opposition parties of the Irish parliament that the fiscal rule of limiting deficits to 0.5% of the Irish GDP would have constitutional law or equivalent status [4]. Indeed, it is exactly because of the political difficulties of introducing the treaty into domestic law that a referendum was held on 31 May 2012.

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Prior to the referendum, the Joint Committee on European Union Affairs and the Sub-Committee on the Referendum on TSCG presented a report to both Houses of the Oireach-Tats on the general public's opinions regarding the adoption of the treaty. Overall, the public pinions on the adoption of the treaty was mix, with compelling arguments on both sides of the debate. Supporters of the treaty argued that the treaty would help the country maintain financial stability and address the flaws in the euro that there is a lack of a consistent and disciplined fiscal regime. Under the treaty, the supporters believed that Ireland would be able to reduce its large public debt-to-GDP ratio and budget deficits over time. This, in turn, would restore the confidence in the Irish financial market, in particular the confidence of the potential market lenders to Ireland.

On the other hand, opponents of the treaty held a cynical view about the intention and the economic effects of the treaty. Specifically, proponents of the treaty believed that its true intention is to protect the financial institutions and powerful investors at the expense of the society. While they all agree that it is important for the government to maintain fiscal stability, the contend that the underlying causes of the sovereign debt crisis was not too much due to failures in budgetary policy at the national level, but rather it is due largely to irresponsible banking practices of investing surplus funds in the financial world and the property markets that have spanned over a decade [5].

Rather than directly addressing the root causes of the sovereign debt crisis, opponents of the treaty believed that the treaty addressed the wrong issue. Rather than helping Ireland maintain financial stability, they believed that the treaty or fiscal compact would delay economic recovery and would force the government to cut public spending such as education and healthcare that would undermine the wealth-fare and the livelihood of the Irish public. As a result, much of the analysis underpinning the fiscal compact is flawed. Some of the stakeholders in the committee's public consultation project believe that it would make no difference to the Irish economy whether or not to adopt treaty.

Summarising the discussion, there are apparent reasons both for and against the fiscal compact and it is not within the remits of this short essay to have a thorough assessment of arguments presented by both side. On 31 May referendum, the Irish public voted in favour of the adoption of the treaty by majority vote of 60.3% on a turnout of 50% and the treaty was signed into law by the resident on 27 June 2012. The referendum result suggests that the Irish public generally believe that fiscal compact would bring a positive contribution to the country and the society, regardless of the claim that the fiscal compact would reduce public spending.

2. THE LINK BETWEEN ACCRUAL ACCOUNTING AND ACCOUNTABILITY

For the sake of efficiency and accountability of public services, the public sector has been reforming over the past 20 years [5]. The purpose of most public sector reforms is to introduce market mechanisms as a method of enhancing its governance and control [4]. Moreover, these reforms stress the "management" instead of "administration of services", which requires the traditional role of accounting shift to cost management. Thus, accrual accounting has been increasingly emphasized, more and more governments begin to shift from cash accounting to accrual basis accounting [6].

GAAP (Generally Accepted Accounting Principles) and IFRS (International Financial Reporting Standards) stipulate accrual accounting, this is because the accrual accounting can better reflect the performance and financial status of a business [7]. Accrual accounting is a principle of adjusts accounts, which determine the income and expense based on the behavior of power and responsibility. According to this principle, all income realized and the costs incurred in the current period shall be treated as income and expenses for the current period, regardless of whether the amount is received or expended. On the contrast, those income and

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costs are not belong to the current period can not be treated as income and expense for the current period, even if they have been received or paid [3]. The role of accrual accounting is to summarize the past transactions of the company in order to preserve the important information for investors [4].

As Evans (1995) asserts, the use of accrual accounting in the public sector will bring some benefits, such as improve the social accountability of public managers, achieve more efficient resource management, better demonstrate the sustainability of government policies, help the public sector better compare annual costs and profits, pay more attention to output instead of input, provide additional flexibility for public sector managers, and improve the competitiveness of the public sector. In addition, accrual accounting plays a major role in decision making because it responds and provides some important financial information. By the way, accrual accounting needs treat as a means instead of an end [3].

Accountability, especially financial accountability and transparency are important in governance policies. Accrual accounting makes accounting information more transparent, through publishing the financial statements to the public to meet the financial accountability and public accountability of public sector [2][8]. In this regard, accountability requires managers to be motivated, flexible and informative, so that their decisions on resource allocation are consistent with the basis of accountability. If accrual reporting has changed, but management continues to use cash budgets, then it will become another form of compliance report and may reduce the benefits [3].

In general, the use of accrual accounting could help the public sector management and enhance accountability process. And accrual accounting is the government and audit offices used to look for good governance, accountability and transparency as symbolization of modernization [5]. For instance, the central government adopts accrual accounting to manage the local government, which the central government acts as the principal and the local government acts as agents. Thus, the central government can better monitor the local government's finances and performance [1].

In addition, accrual accounting makes the financial report more transparent and makes the total cost of the activity more clearly. For example, the implementation of the accrual accounting in the Iranian public sector has led to a greater transparency in the total cost of Iranian government activities, and further increases the level of accountability in the public sector [9]. Another example is the implementation of the accrual accounting in New Zealand's public sector. New Zealand is the first country in the world to introduce accrual accounting in government accounting and budgeting. It is also a country that fully adopts accrual accounting and the accounting system reform is relatively entirely [6]. According to Schedler (1995), the use of accrual accounting in New Zealand is successful and fiscal spending was significantly reduced. Before the use of accrual accounting, New Zealand has a fiscal deficit every year. But after adopt accrual accounting, the fiscal surplus is showing a growing trend. In addition, the government's fiscal transparency is significantly improved, which is favorable for the public to evaluate the government's fiscal transparency and performance. Furthermore, the efficiency of the government has also been greatly improved and further improves the accountability of the public sector.

On the other side, the culture of accountability and answers seeking play a significant part in the practice of the accrual accounting in the public sector, accountability rate could be enhance by the answers seeking culture. Therefore, the public sector should adopt the accrual accounting and correctly assess the performance of the management. Moreover, according to Riahi (2008), the use of accrual accounting in the public sector not only improves accountability, but also allows the profit, costs, assets, liabilities, and budgets of the financial report to be well interpreted. Besides, accrual accounting can also improve managerial accountability, facilitate

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the preparation of operating budget, make the total cost more transparent, and enhance the manager's decision-making ability [2].

However, although the accrual accounting has become the central content of the current accounting system, but in the changing economic environment, accrual accounting also has some drawbacks. For instance, Chic (2009) against the US public sector adopt accrual accounting, this is because accrual accounting can not solve some complex problems in the financial statement. For example, the final accounting information in accrual accounting is net profit rather than cash flow, and it also not reflect the actual situation of the cash flow. In this case, the cash flow and paper gains are segregated, which would mislead the public, resulting in less accountability and transparency [10]. Moreover, there are many accounting treatments in accrual accounting. For instance, there are more than ten methods of the depreciation of fixed assets, such as straight line, units of output, sum of the yeas digits and so on. Thus, different people may have different results for the same business, which will reduce the consistency and comparability of accounting. In addition, accrual accounting has a large number of complex assumptions about future events, and these assumptions exist to judge and manipulate the risk. Therefore, the framework of the accountability system can not provide correct and useful information for decision makers to solve the problem [11].

To sum up, the accrual accounting is the core and the fundamental standard of accounting system. And it plays a vital role in the handling of accountants. Public sector adopt accrual accounting could improve accountability and the transparency of financial report, but use accrual accounting still have some drawbacks. Therefore, the public sector should dialectical to adopt accrual accounting and effectively combine cash accounting and accrual accounting. So that makes the accrual accounting in economic activities to fully play as well as enhance accountability and transparency in the public sector.

3. THE ROLE SUPREME AUDIT INSTITUTIONS (SAIS)

The aim of this paper is to discuss the role of supreme audit institutions (SAIs) and critically examine the challenges of maintaining independence from the executive. It is understood that SAIs are governmental authorities responsible for the auditing of government revenue and spending (Shah, 2007). Depending on different governance systems and government policies as well as their legal mandates and reporting relationships of a jurisdiction, the auditing systems of the SAIs across the world broadly fall into three types - the Napoleonic system, the Westminster system and the board system [9-10].

In the Napoleonic system, the SAI is given both judicial and administrative authority and is independent of the legislative and executive functionalities of the government. In the Westminster system as that adopted in many Commonwealth countries (e.g. the UK, Canada, Australia, etc.), SAI is an independent governmental body consisting professional auditors and technical experts and is directly reporting and accountable to the parliament making up of democratically elected law makers [9-10].

In contrast to the SAIs under the Napoleon system, SAIs in the Westminster system serves no judicial function but whose findings and decisions can be passed to the legal authorities of the country for further action. Lastly, in the board system commonly adopted in Asian countries such as Japan and South Korea, SAIs are organised in a board structure, typically consisting an audit commission that is responsible for the decision making, and an executive bureau that is responsible for the actual audit work [10].

Regardless of the types of SAIs, all SAIs are undertaking one or more of the following auditing practices, including 1) checking the accuracy of government revenues and expenses, 2) checking whether government spending has been authorised and used for the agreed purposes, 3) checking whether government departments and functionalities have complied with

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government policies, as well as relevant laws and regulations, and 4) assessing the performance of the services delivered by government bodies to determine whether tax payers receive value for their taxes[10].

4. THE DIFFICULTIES OF MAINTAINING INDEPENDENCE FROM THE EXECUTIVE

In performing their auditing services, SAIs are facing with a number of challenges. The difficulty of maintaining independence form governmental executives is widely considered as one of the biggest challenges facing SAIs [6-7] [10]. Indeed, as the role of SAIs is to audit governmental departments and agencies, the autonomy and independence from governmental executives is essential to perform the auditing role effectively. Without autonomy and independence from public executives, it is unlikely for SAIs to provide effective oversights on public finances and the performance of public authorities, and to hold public executive accountable for any mistakes or misconducts in public administration.

In the developed economies in Western Europe and Northern America, the autonomy and independence of SAIs are guaranteed by institutional design that ensure the check and balance of the power of different governmental bodies, as well as the monitoring of media and active civil society [8]. However, such institutional mechanisms are exactly lacking in the less developed regions of the world. As revealed by Ram (2008), in those regions with the weakest strength of SAIs, public executives can influence the auditing process through a variety of means such as maintaining controls over the resources and budgets for public auditing and using executive powers to remove the head of the SAI from office without the consent of either the legislature or the judiciary bodies. And in those regions, SAIs may also face with the difficulty in ensuring that the government will effective address audit report due to the lack of adequate compliance requirements [7][10]. Moreover, it is commented by World Bank (2015) that impunity within their judicial systems can lead to significant delay in corrective sanctions, thereby undermining the works of SAIs.

Summarising the discussion, SAIs serves a number of important roles such as checking the accuracy of public finance, checking whether public expenditure has been authorised and assessing the performance of the public bodies and agencies. Autonomy and independence is crucial for the performing of these roles however they are frequently lacking in the world's less developed regions.

5. WESTMINSTER MODEL AND NAPOLEONIC MODEL

The work of SAI (Supreme Audit Institution) is to review public resources in an independent opinion. The goals of public sector auditing is: to make the use of public funds appropriate and effective to develop the sound financial management; to execute administrative activities properly; and to communicate with the public and the government through reports. There are four SAI models in contemporary in this section, Westminster model and Judicial model would be illustrated. It would also refer to the problems of these models.

Westminster model also known as the Anglo-Saxon or parliamentary model. Westminster is a place in London. Thus, It is clear that this model is created and used in the United Kingdom [12]. In UK's Westminster model, tasks of Supreme Audit Institution are closely related to systems of parliamentary accountability. The process of UK's Westminster model is that at the beginning, parliament authorizes all funds, in the next, the government and other public departments produce annual accounts. Then SAI would audit those accounts [13]. Finally, the head of SAI do a report to parliament or to the parliamentary committee responsible and Public Accounts Committee review the audit reports and do recommendations. Government responds to Public Accounts Committee recommendations.

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There are some obvious characteristics of UK's Westminster model. Supreme Audit Institution is National Audit Office. The National Audit Office (NAO) supervise public spending for Parliament. It also help to hold government departments and the public bodies it audits to account for how the government departments and the public bodies use public money. it helps public service managers to improve performance and service delivery in national and local. There are only two roles in National Audit Office. One is Comptroller and Auditor General who is the only leader of National Audit Office and has right to authorise finance requisitions to send central funds to departmental accounts within approved financial limited. The other are some professional accountants and auditors. In National Audit Office, all powers belong to Auditor General. In other words, under UK's Westminster model, the SAI organization is monocratic [8][12]. Nowadays, the Auditor General of UK National Audit Office is Amyas Morse who was appointed by the Queen in June 2009.He is an Officer of the House of Commons. He has own access and reporting rights. All staff in National Audit Office are independent of government. Auditor General has all rights, powers and responsibilities who can appoint own staff and decide on own work. Though the SAI is response to parliament, the parliament has no power to decide on the things in National Audit Office. It has a hierarchical structure. In UK's Westminster model, The work of National Audit Office includes financial audit, certification audit, and value of money or performance audit. The professional accountants and auditors pay more attention to the financial audit and the value for money rather than compliance with legislation and regulations in detail [9]. The last step of UK's Westminster model is Public Accounts Committee review the audit reports and do a recommendations. Public Accounts Committee is typically chaired by one on the opposition. The main work of Public Accounts Committee is to focus on the reports presented by Auditor General. The UK's Westminster model is effective and economic and it shows a true and fair view on annual accounts [4]. The account is also properly prepared in accordance with the relevant Accounting Framework and regular in income or expenditure, or both, in line with Parliamentary intention.

The most serious weakness of UK's Westminster model is monocratic. The Auditor General has a powerful right. However, no one or organizations supervise this power. It requires the Auditor General has a high level of trust among all stakeholders and has a high personal integrity. The oversee of Public Accounts Committee is limited. The power of Auditor General appointment and removal is not belong to Parliament.

The other SAI model is Judicial model, also known as Napoleonic model. This model is used in the Latin countries in Europe, Turkey and some countries in Africa, Asia and Latin American. In this part, it is talking about the Italy's Judicial model. In Italy's Judicial model, Supreme Audit Institution is a constituent part of Judicial system. The Supreme Audit Institution in Italy called 'Corte dei conti' [14]. The 'Corte dei conti' was set up in 1862, in the newly-created Italian State. It was to control the public administration and prevent and avoid waste of money and unsound management. The process of Italy's Judicial model is that firstly, in an annual budget, parliament authorises all spending. Then, the Finance department has two tasks. One is to set rules for public accountants and other officials. The other is to oversight whether these rules are being dealing with. This means the finance play a role of internal audit for government. Next, the SAI audits individual accounts and dismisses officials or imposes penalties. Finally, SAI audits national accounts and do a report to Parliament and Parliament can rely on this report in granting a 'discharge' to government [13].

The characteristics of Italy's Judicial model are particular. The 'corte dei conti' is are court and the staff in it are judges who can dismiss officials or impose penalties to correct auditors actions. Thus, the SAI background is legal rather than accounting or audit. The relationship between parliament and SAI are limited. It is lack of parliament involvement. The follow of court's reports are also limited. For the Italy SAI, it pays more attention to the compliance with

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detailed rules and regulation rather than focus on financial management. When SAI imposes penalties, the finance would be accepted by court, not the original department [15].

There are a lot of problems of Italy's Judicial model. Though it prevent the situation of corruption and make rules for each accountant, the system is complex and may be difficult to operate effectively. It would cause a waste of human capacity and other resource. The Italy's Judicial model concentrated on compliance with detailed rules and regulation rather than focus on financial management.

The details of UK's Westminster model and Italy's Judicial model has been introduced above. The UK's Westminster model are more effective but the SAI is a monocratic organization and the Italy's Judicial model are more fair but it would waste a lot of human and other resources.

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