



Ministério da Fazenda

# Fiscal Responsibility in Brazil

Coordenação-Geral de Monitoramento da Política Fiscal – COMFI  
Subsecretaria de Estudos e Governança Fiscal

## Seae

Secretaria de Acompanhamento Econômico

# Brazil in a snapshot

## *Brazil in a snapshot*

26 states, the Federal District and 5,570 Municipalities

5th largest population (206 mn people); 5th largest area; 7th largest GDP (USD 3,192 bn)\*



Each state has its own constitution.  
Each municipality has its own municipal organic law.

Economic Pillars:  
inflation targeting,  
floating exchange rate  
and fiscal responsibility

\*Source:

Population: IBGE (2015)

GDP: IMF - World Bank Databases (data for 2015)

# Complex Institutional Framework

## *Complex Institutional Framework*

Locally managed taxes lead to “Fiscal War” among States

Independent branches, with tendency to present high personnel expenditure



Autonomous planning, budget and public administration management for distinct levels of government

High and persistent deficits and a history of debt renegotiation by the Federal Government until the 1990s

## *Fiscal Responsibility Law – Features*

- » A Fiscal Responsibility Law (FRL) is in place since May 2000. It establishes compliance with revenue and expenditure targets, observing limits and satisfying conditions regarding tax breaks, generation of personnel and social security expenditures, consolidated and security debt, credit operations, including those involving revenue anticipation, guarantees issued and outstanding liabilities.
- » Comprehensive framework: all public administration, including funds, foundations and state owned enterprises which depend on treasury resources; the 3 levels of government (Federal Government, States, Federal District and all municipalities); the 3 branches (Executive, Legislative and Judiciary) and the Prosecutor`s Office.
- » 3 levels of rules:
  - (a) General rules;
  - (b) Specific rules for the end of tenure in office (political cycle);
  - (c) Escape clauses for exceptional economic conditions and natural disasters, only invoked with Congressional approval: decline of economic activity or negative growth in GDP, state of war, internal disturbances or calamity and drastic alterations in monetary and exchange policies.

## *Fiscal Responsibility Law – Features*

- » The law sets out a number of numerical fiscal indicators:
  - (a) personnel expenditure is limited to 50 percent of net current revenue for the federal government, and 60 percent for states and municipalities. Within each level of government the law further specifies limits for the executive, legislative, judiciary and other offices, where applicable;
  - (b) permanent spending mandates cannot be created without permanent revenue increases or spending cuts;
  - (c) Senate sets debt limits for all levels of government. However, there was never an agreement reached on the limit for the central government; thus the only limits currently in place are for States and Municipalities (respectively 2.0 and 1.5 of the Net Debt / NCR ratio).
  - (d) There are also limits set by the Senate for annual borrowing for States and Municipalities.

# Fiscal Responsibility Law

## *Fiscal Responsibility Law – Features*

- » The government sets numerical multiyear targets for the budget balance (for the current year and indicative targets for the next two years), expenditure and debt.
- » In case of noncompliance, corrective measures need to be taken and can result in sanctions (the Fiscal Crimes Law details penalties for mismanagement, ranging from fines to loss of job).
- » There is also the "golden rule" principle set in the Constitution (new borrowing should be at most equal to public investment).

## *Fiscal Transparency*

- » Bimonthly and quarterly publication of fiscal reports.
- » Consolidation of national accounts (which do not match with fiscal reports).
- » Quarterly audiences on fiscal targets on each Legislative branch and biannual audiences on Central Bank's fiscal costs in the Congress.

## *Fiscal Responsibility Law – Sanctions*

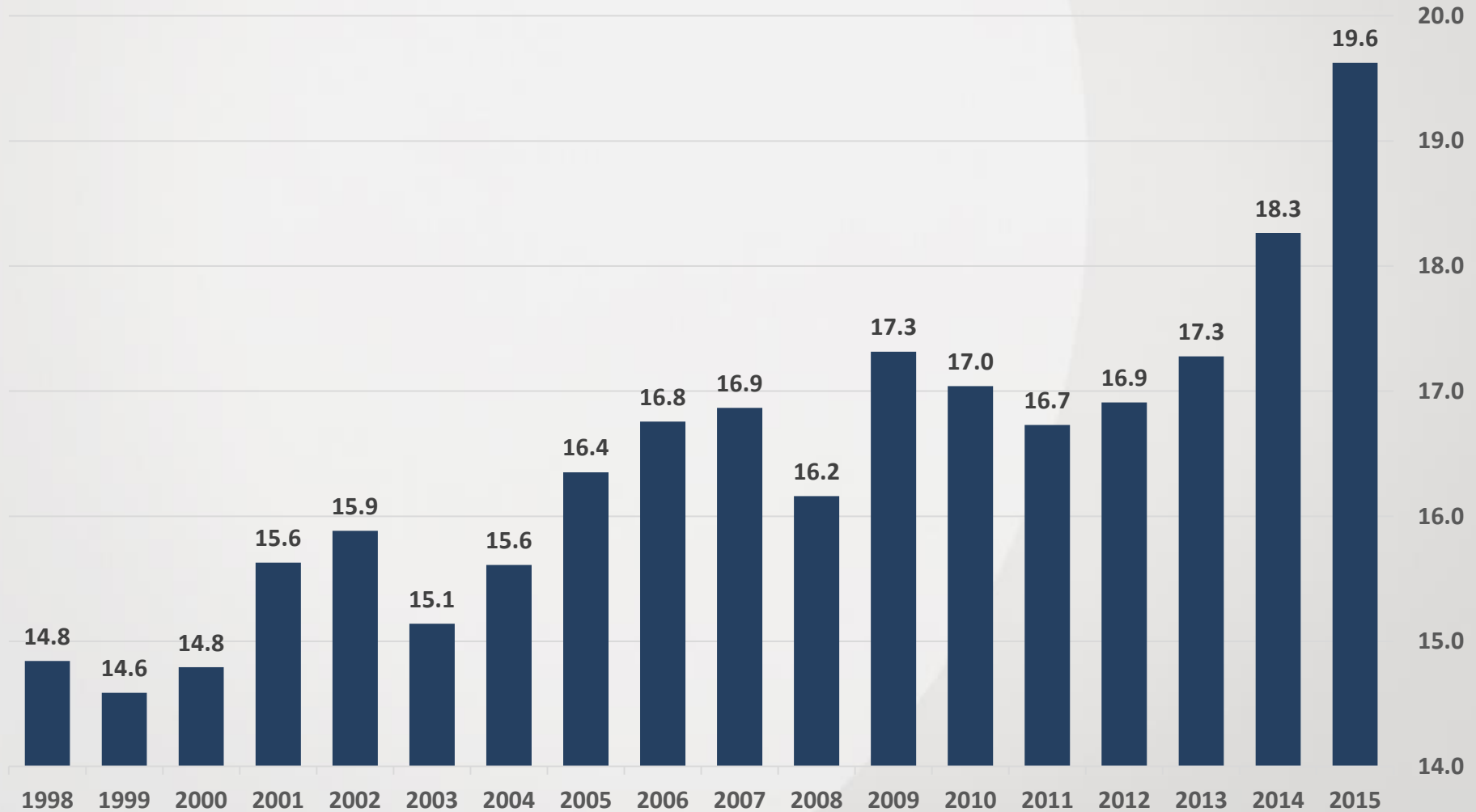
- » If there is not compliance, some sanctions apply:
  - (a) federal and state voluntary grants will be suspended;
  - (b) new borrowing is forbidden;
  - (c) new federal and state guaranties will not be granted;
  - (d) there is a fiscal crime bill, with penalties (loss of position; arrest, fines; etc).

## *Fiscal Responsibility Law – Challenges*

- » Concept harmonization on the structure of reports.
- » Distinct auditing procedures within the Federation.
- » Convergence of rules applied to public accounting and professional training.
- » Improvements being discussed in Congress through Bill 229/2009: budgetary process integration; debt limit for the central government; creation of the Fiscal Management Council; expanded fiscal target appendix; enhanced definitions for personnel expenditure and more strict mechanism for the creation of permanent expenditure.

# Central Government Expenditure

## Central Government Expenditure (% GDP)

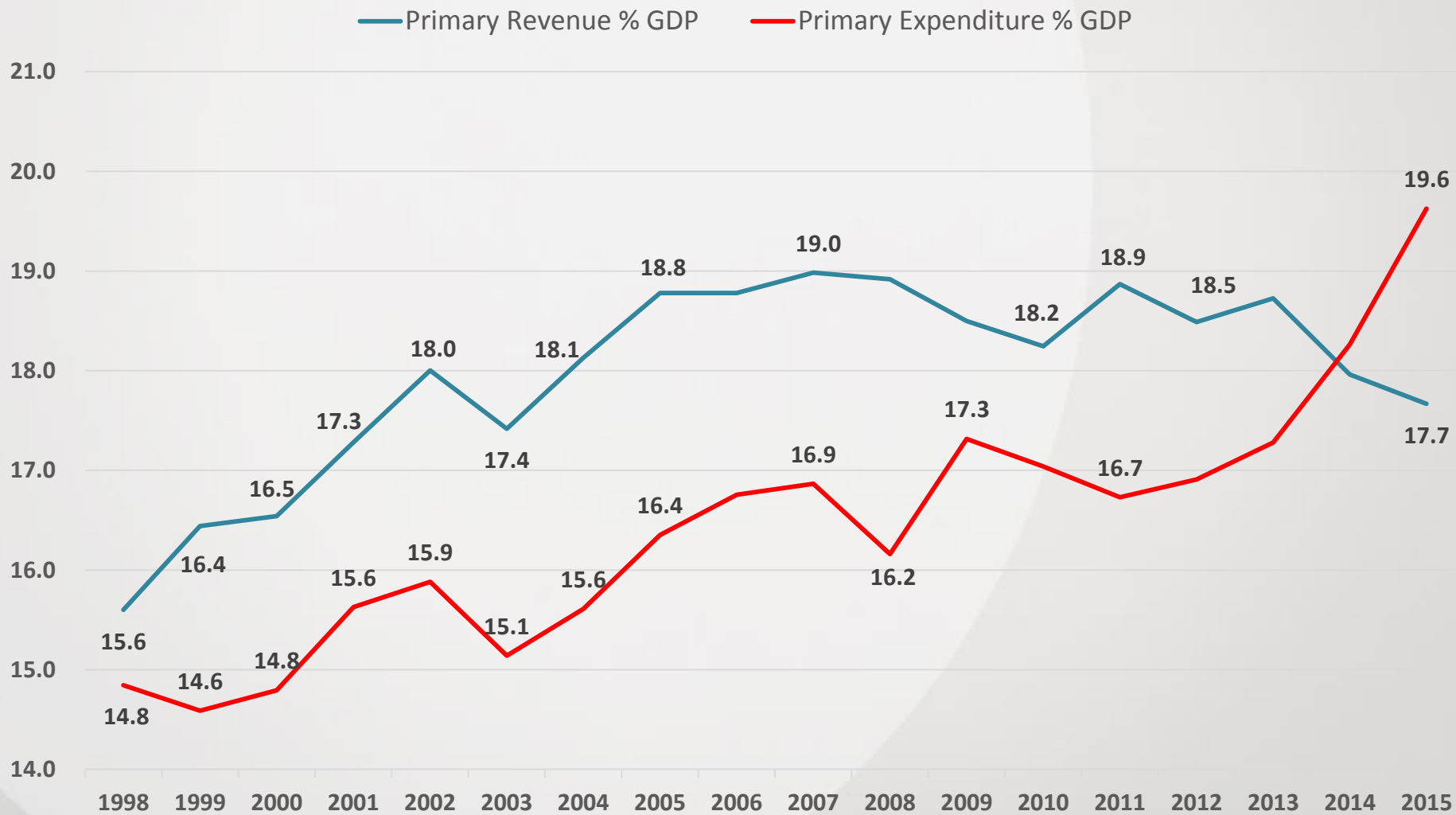


Source: STN. Effects from Petrobras capitalization were not considered in 2010.



# Central Government Revenues and Expenditure

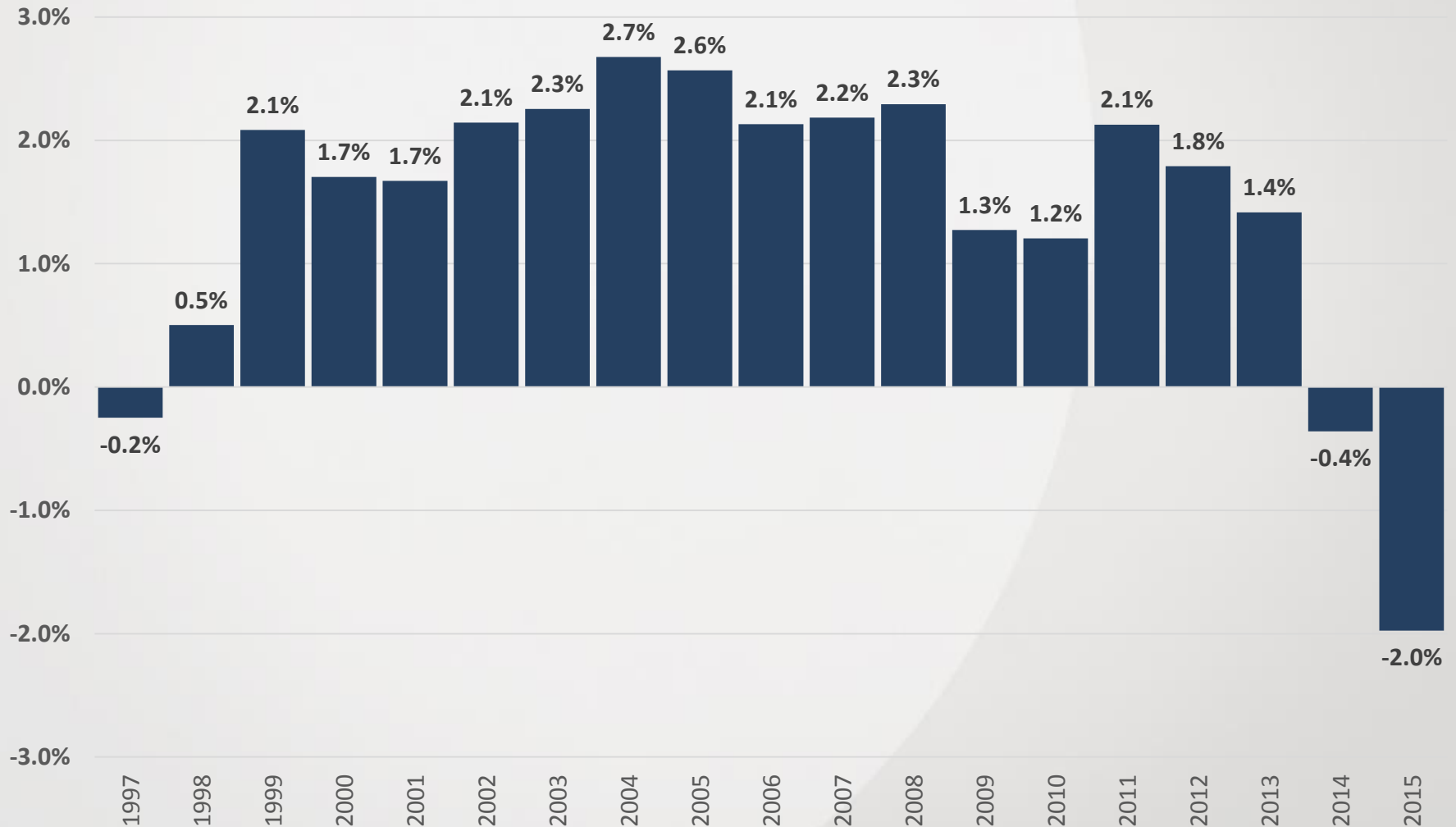
## Primary Revenue and Expenditure - 12 months (% GDP)



Source: STN. Primary Revenue net from constitutional grants. Effects from Petrobras capitalization were not considered in 2010.

# Central Government Primary Balance

## Central Government Primary Balance (% GDP)

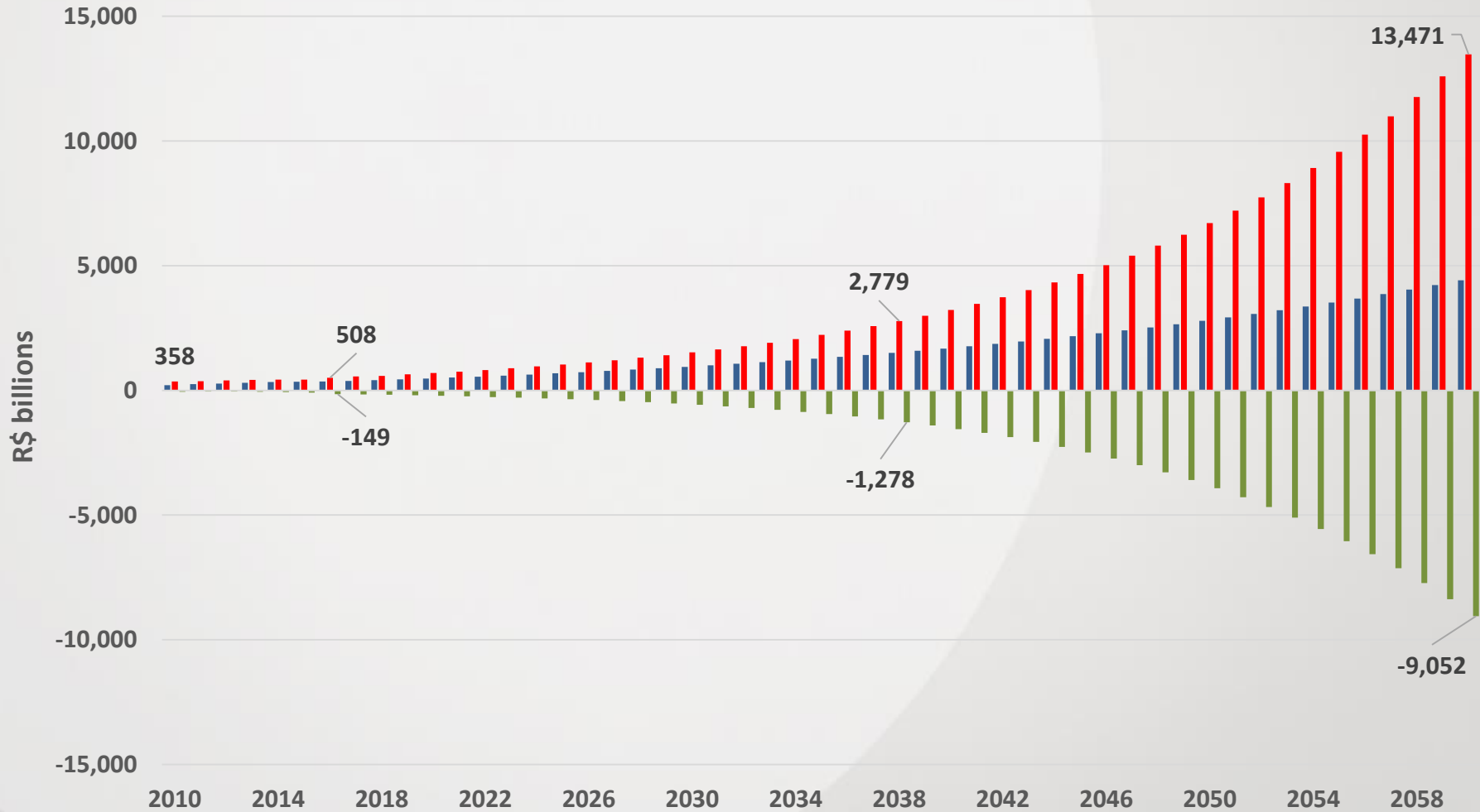


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# Social Security Projections

## Social Security Projections

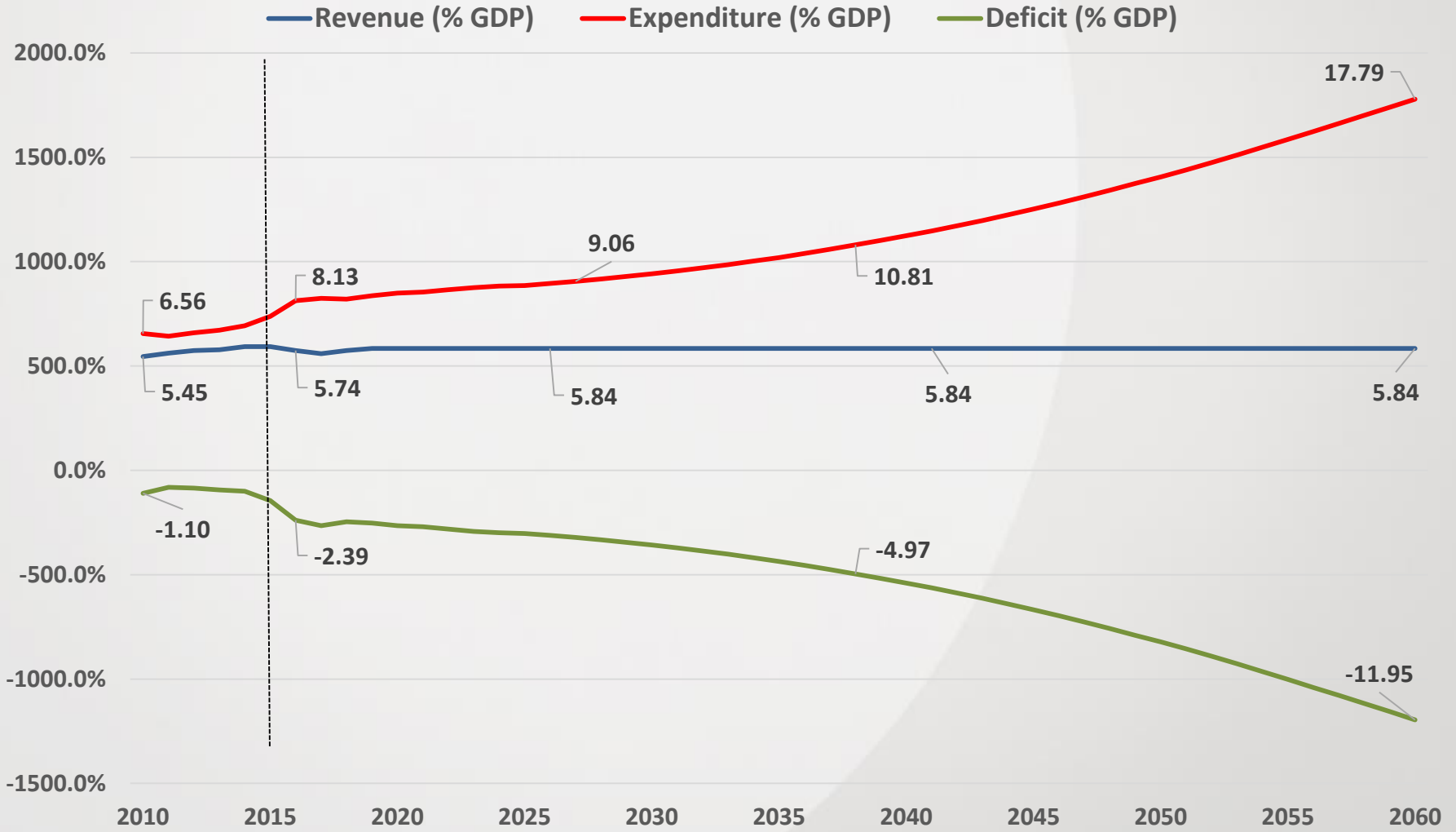
■ Revenue ■ Expenditure ■ Balance



Source: STN – RREO Dec/2015.

# Social Security Projections

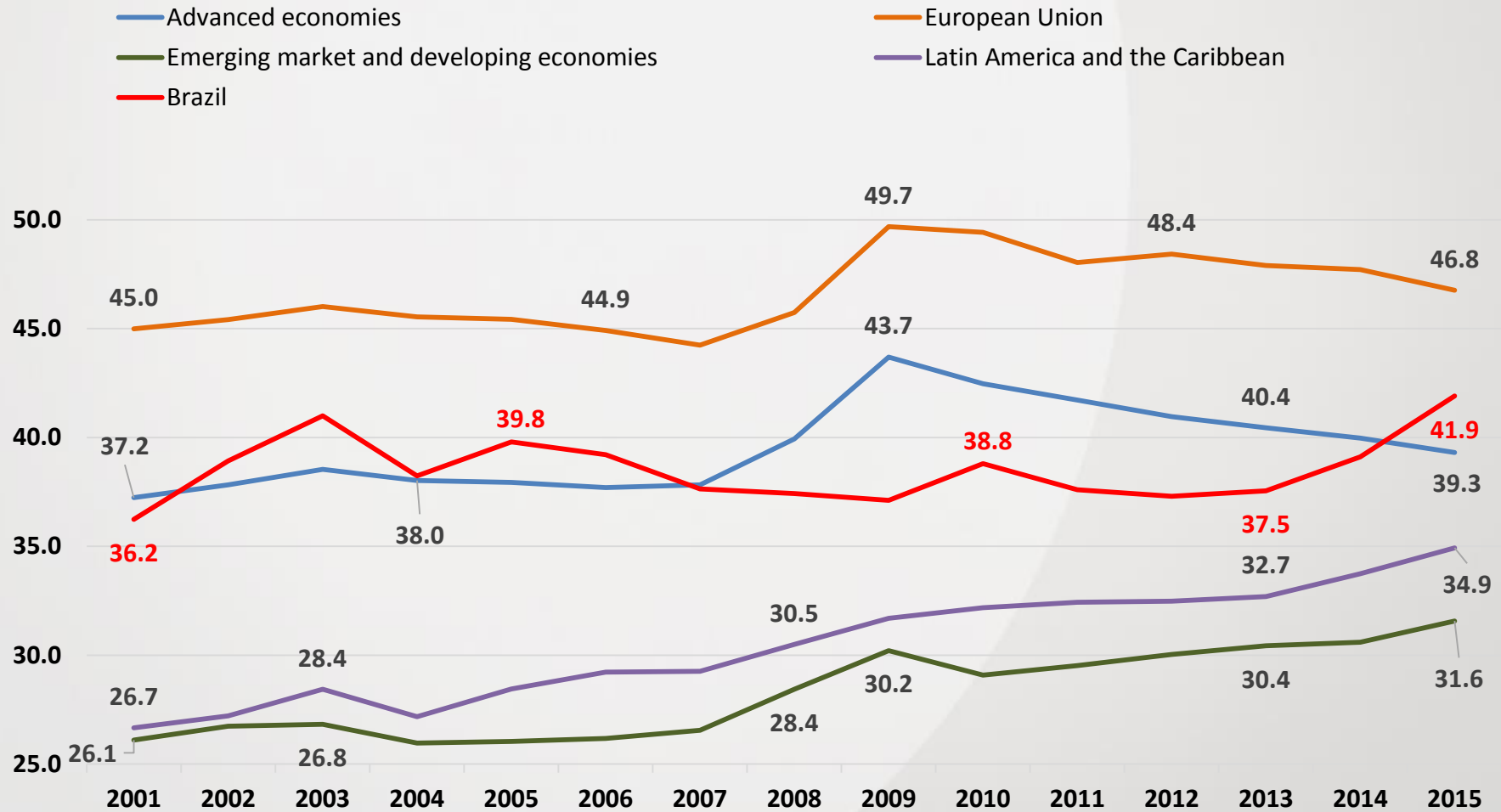
## Social Security Projections



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# General Government Expenditure

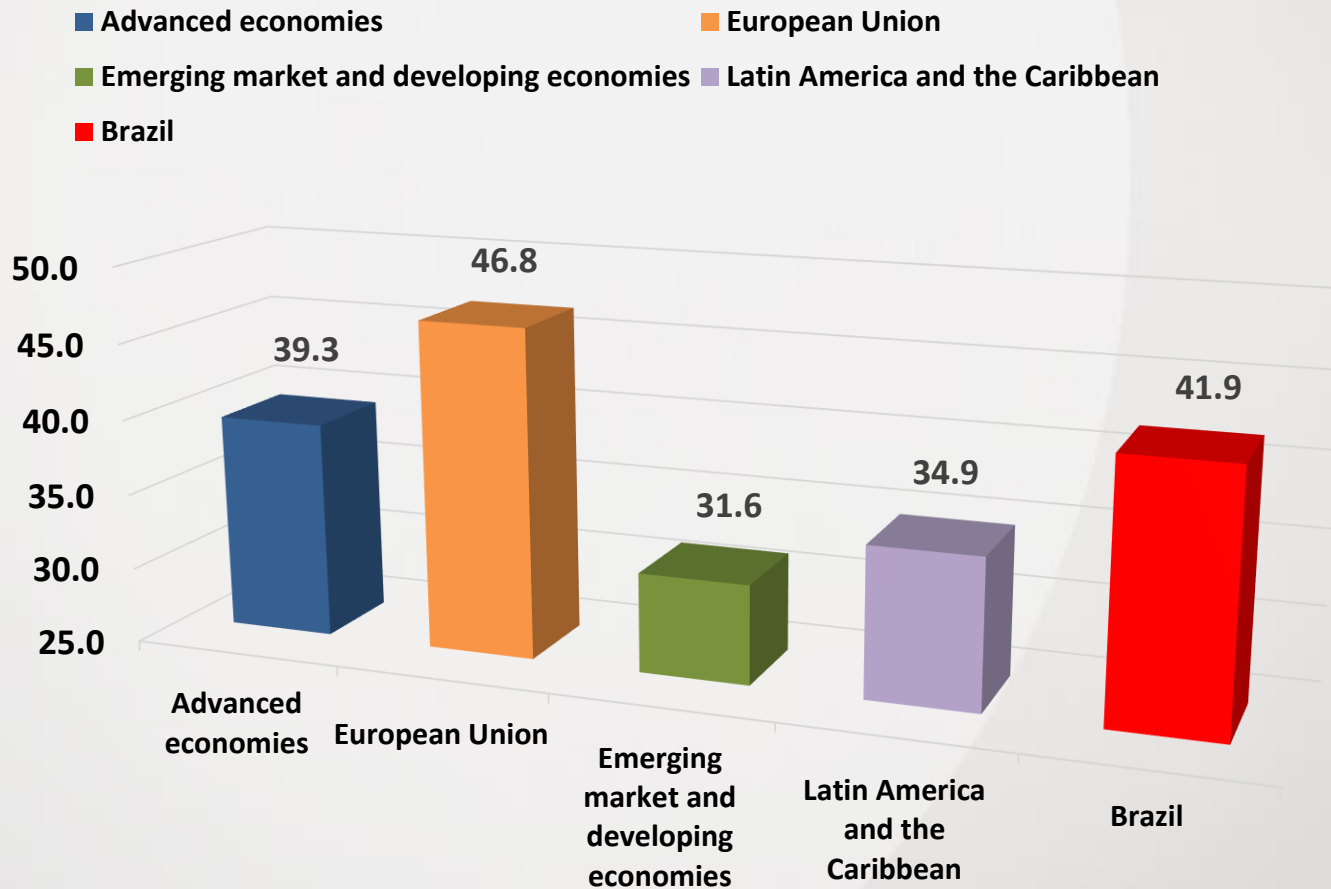
## General Government Total Expenditure % of GDP



Source: WEO (IMF).

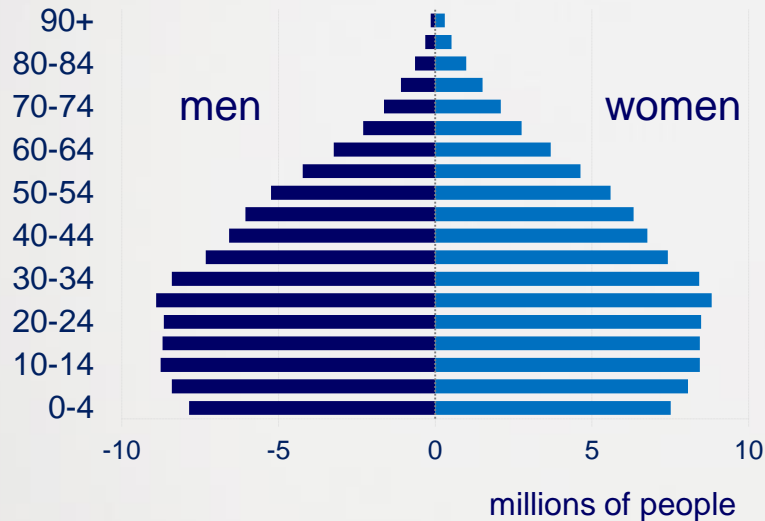
# General Government Expenditure

## General Government Total Expenditure % of GDP (2015)

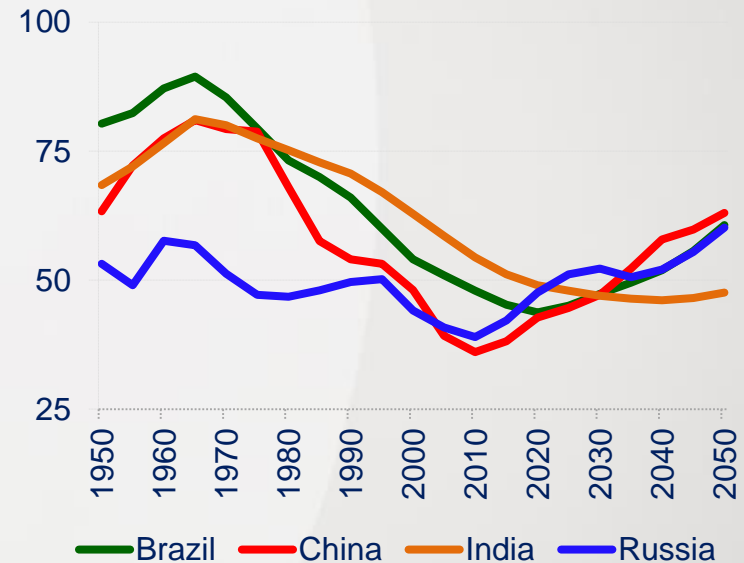


Source: WEO (IMF).

## Population Pyramid (2012)



## Dependency Ratio



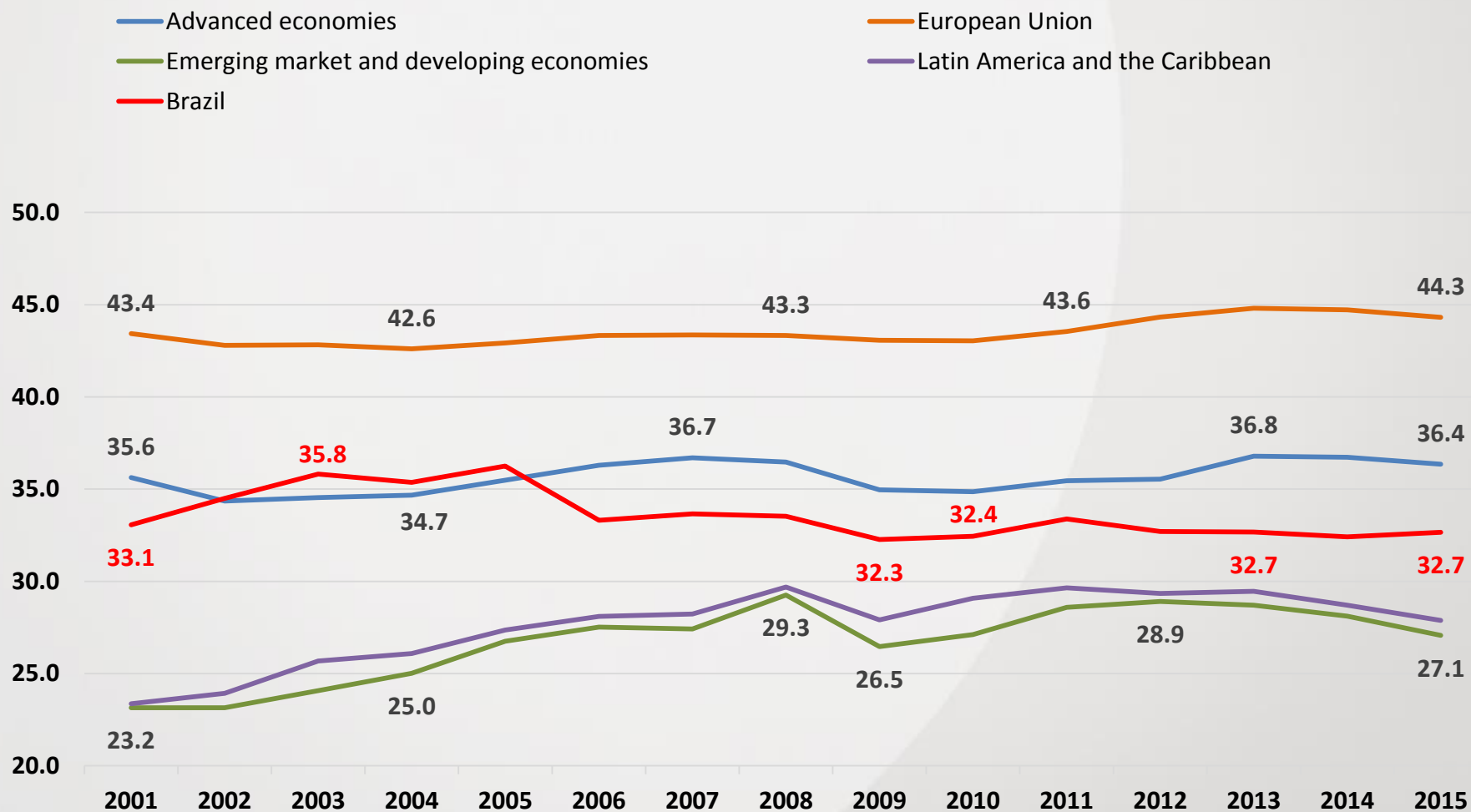
- **Brazil's population is highly concentrated within the Economically Active Population range**

- **Brazil's dependency ratio is still declining, while other countries already face an upward trend**

Note: The dependency ratio is the ratio of the sum of the population aged 0-14 and that aged 65+ to the population aged 15-64

# General Government Tax Burden

## General Government Tax Burden % of GDP

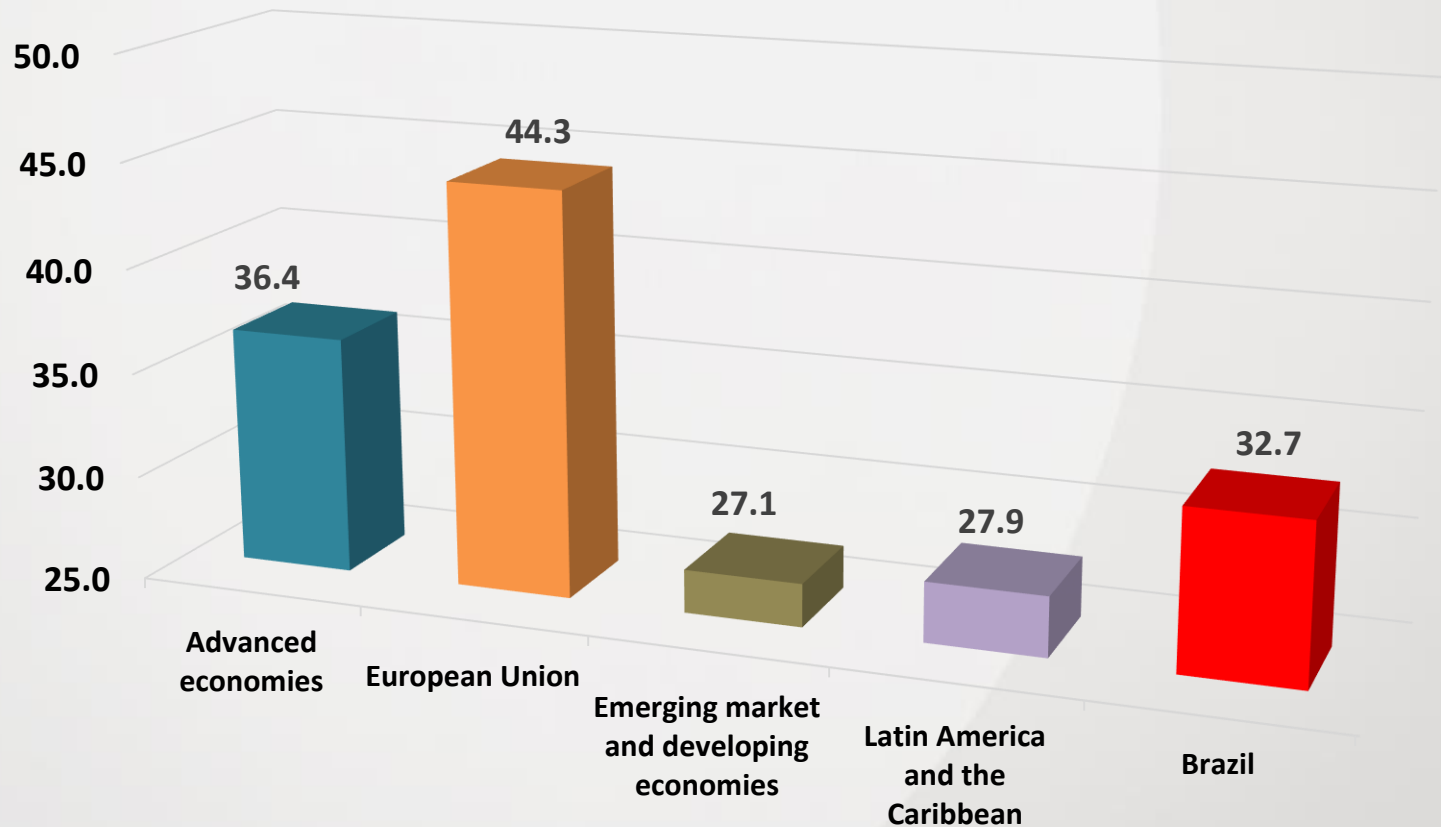


Source: WEO (IMF) and the National Revenue Authority.



# General Government Tax Burden

## General Government Tax Burden % of GDP (2015)



Source: WEO (IMF) and the National Revenue Authority.

# Constitutional Amendment Proposal 241

## *General Evaluation*

- » From 1998 to 2015, central government expenditure increased from 14.8% to 19.6% of GDP.
- » There has been a structural imbalance in public accounts, worsened in recent years by recession and increase of public expenditure.

## *Constitutional Amendment Proposal 241*

- » In line with the national FRL, international literature and international experience.
- » “Zero” real increase of central government expenditure.
- » Rule might be changed on the 10<sup>th</sup> year, depending on Presidential proposition.
- » The Amendment just changes the formula for the calculation of floor expenditure for Health and Education.
- » To be consistent over time, it shall be accompanied by a social security reform.
- » Projections indicate that central government expenditure will decrease consistently in % of GDP.

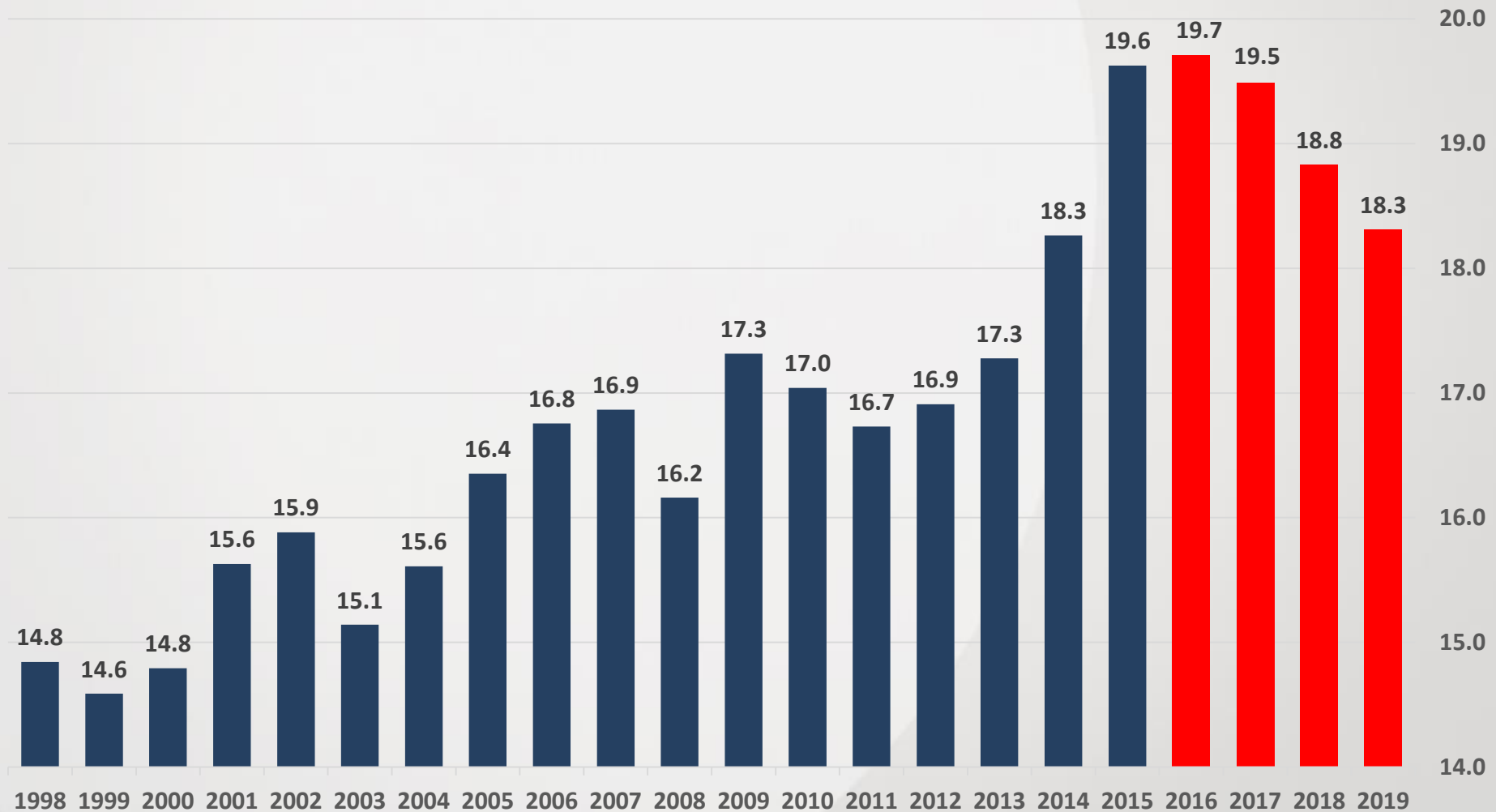
# Constitutional Amendment Proposal 241

## *Constitutional Amendment Proposal 241*

- » Brazil has to transform a R\$ 169.3 billion primary deficit (2.7% of GDP) into a primary surplus, in line with the reduction of the net debt to GDP ratio.
- » Fiscal adjustment on the expenditure side is always gradual, which means it will take some time to overcome deficit and recession.
- » Adjustment speed will depend not only on the Constitutional Amendment, but also on the increase of central government revenues. Revenues decrease almost 2 p.p. of GDP from 2011 to 2016.
- » Reform pillars: Constitutional Amendment 241 and social security reform.
- » The agenda of reforms is essential for inflation and interest reduction as well as investment increase.

# Central Government Expenditure

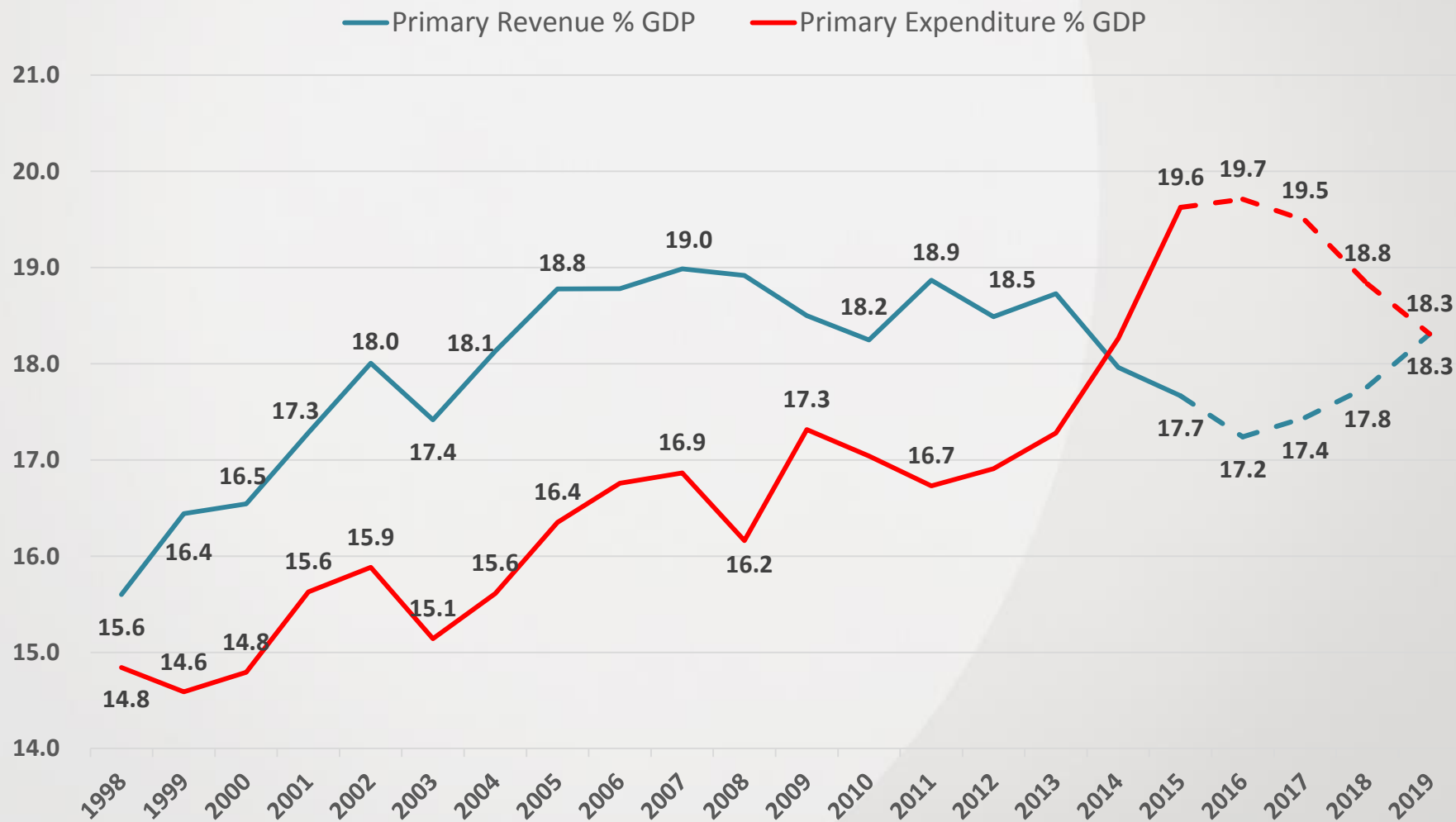
## Central Government Expenditure (% GDP)



Source: STN. Constitutional Amendment effects were considered from 2017-2019. Petrobras capitalization was not considered in 2010.

# Central Government Revenues and Expenditure

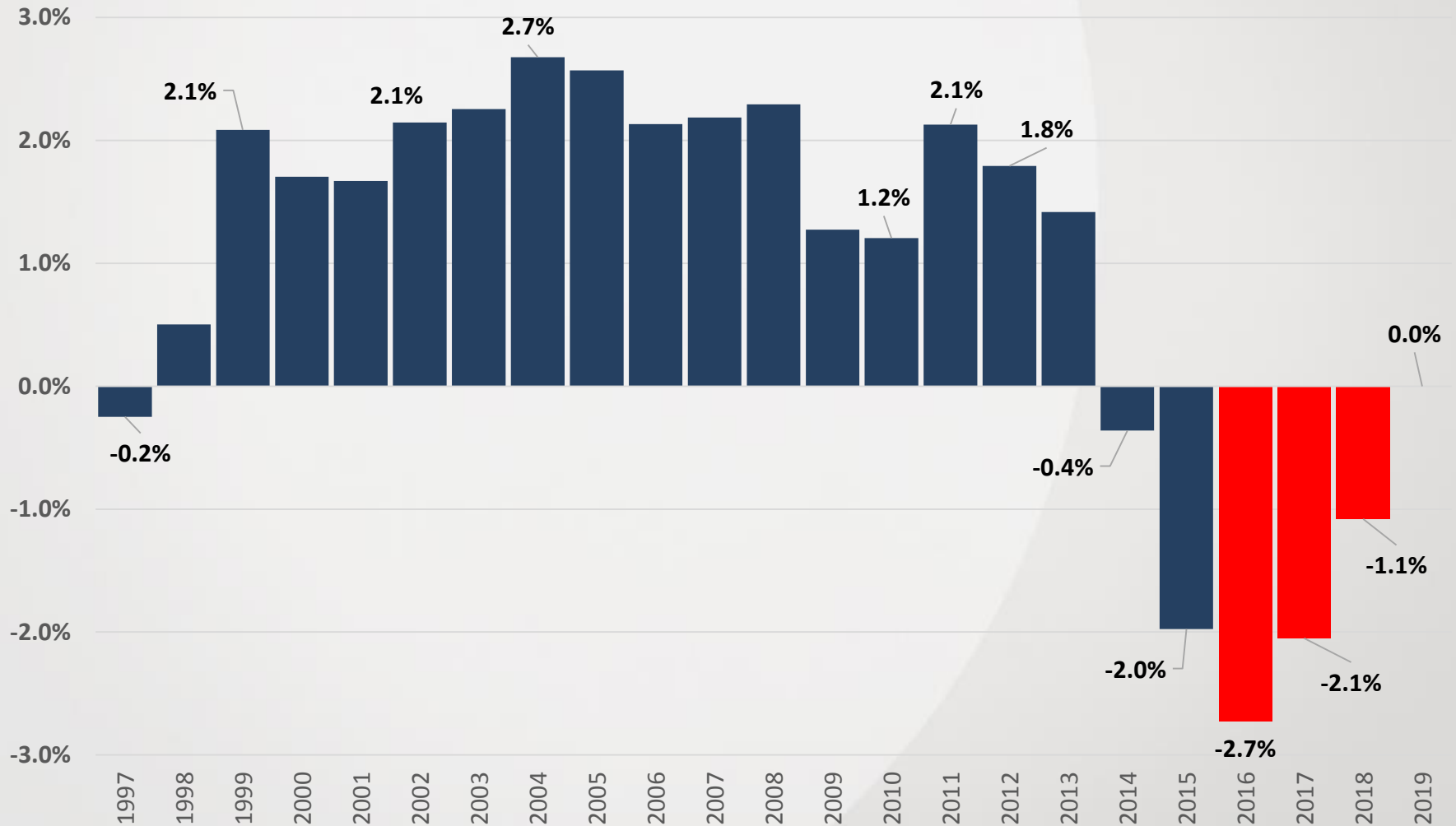
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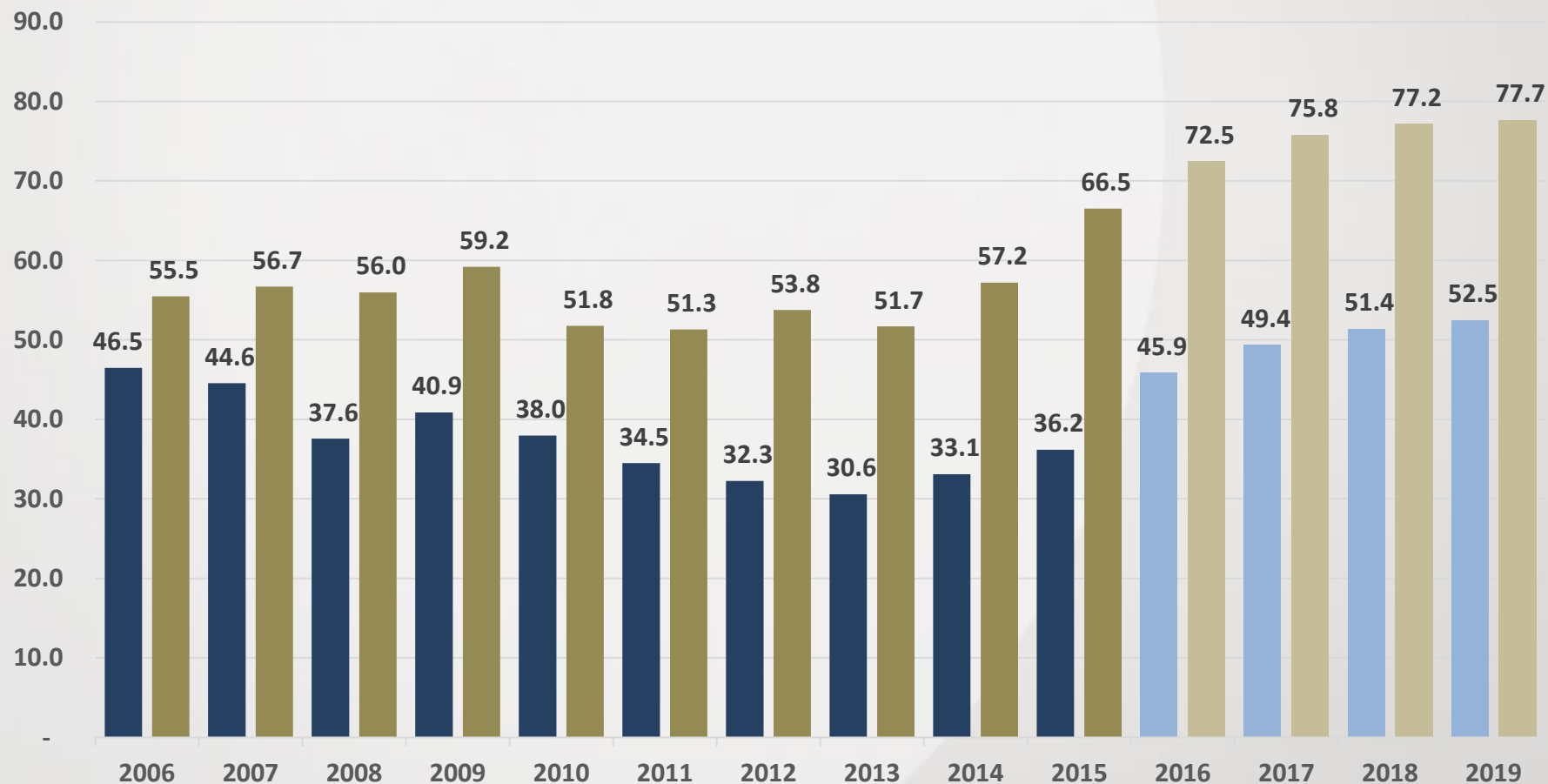
## Central Government Primary Balance (% GDP)



Source: STN. Constitutional Amendment effects were considered from 2017-2019. Petrobras capitalization was not considered in 2010.

## Public Sector Net Debt & General Government Gross Debt

■ PSND (% GDP) ■ GGGD (% GDP)



Source: CBB. **Constitutional Amendment effects were considered from 2017-2019.** It does not consider adjustments, such as virtual payments from BNDES within the next years.

**Seae**

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