



Brazil Institute – Woodrow Wilson International Center for Scholars

"Challenges of the Administrative State: Brazil and the United States in Comparative Perspective"

The budgetary process and the challenges to recover debt sustainability and economic growth in Brazil

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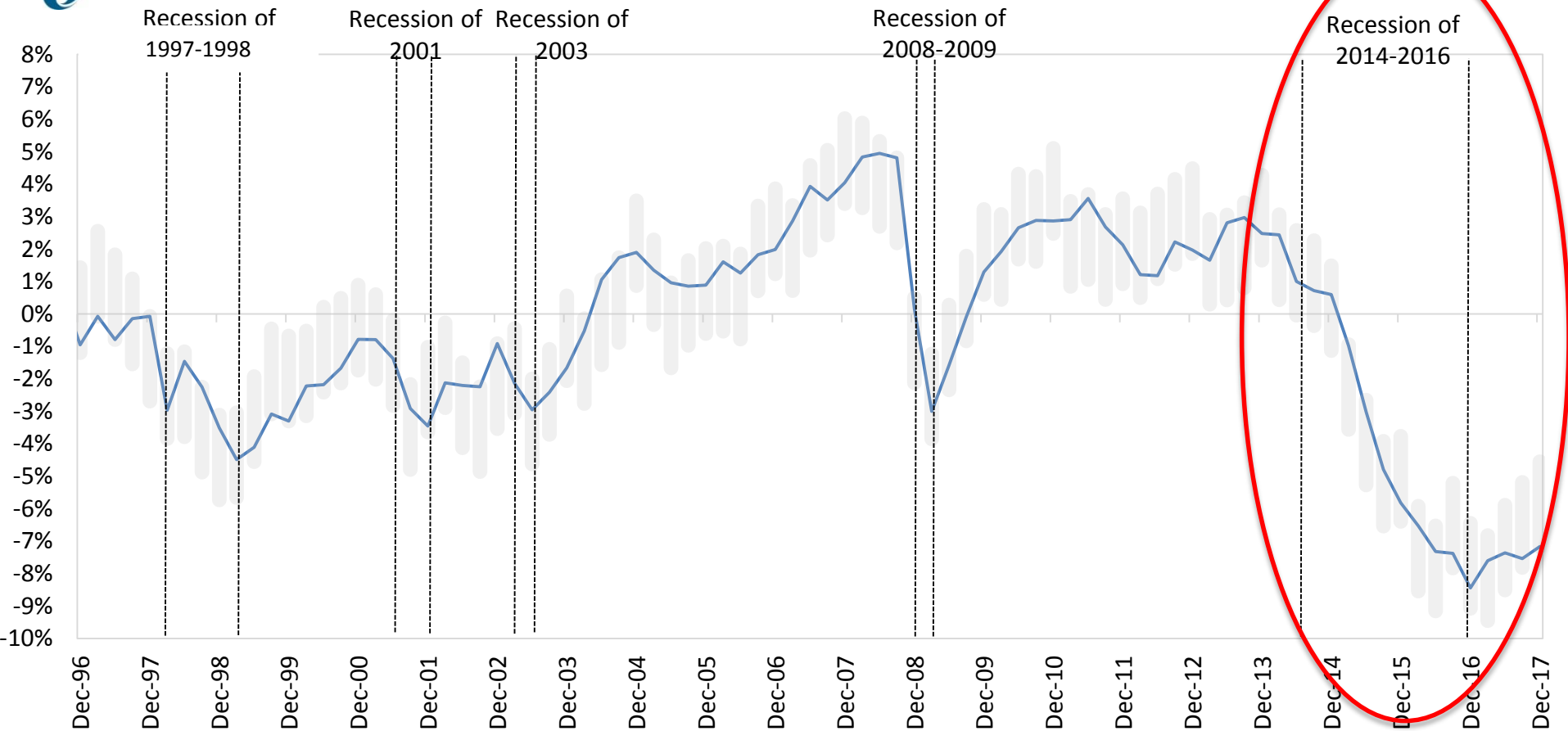
Washington, DC | May 23th, 2018

1. High budgetary rigidity and the new expenditure ceiling
2. Institutional improvements and excess of rules
3. The quality of public spending and debt sustainability are the main challenges in Brazil's public finance
4. The institutional framework is sufficient to resolve the fiscal problem, but there is a lack of "spirit of fiscal responsibility"



Intro: Macroeconomic context

Output gap (and confidence interval)

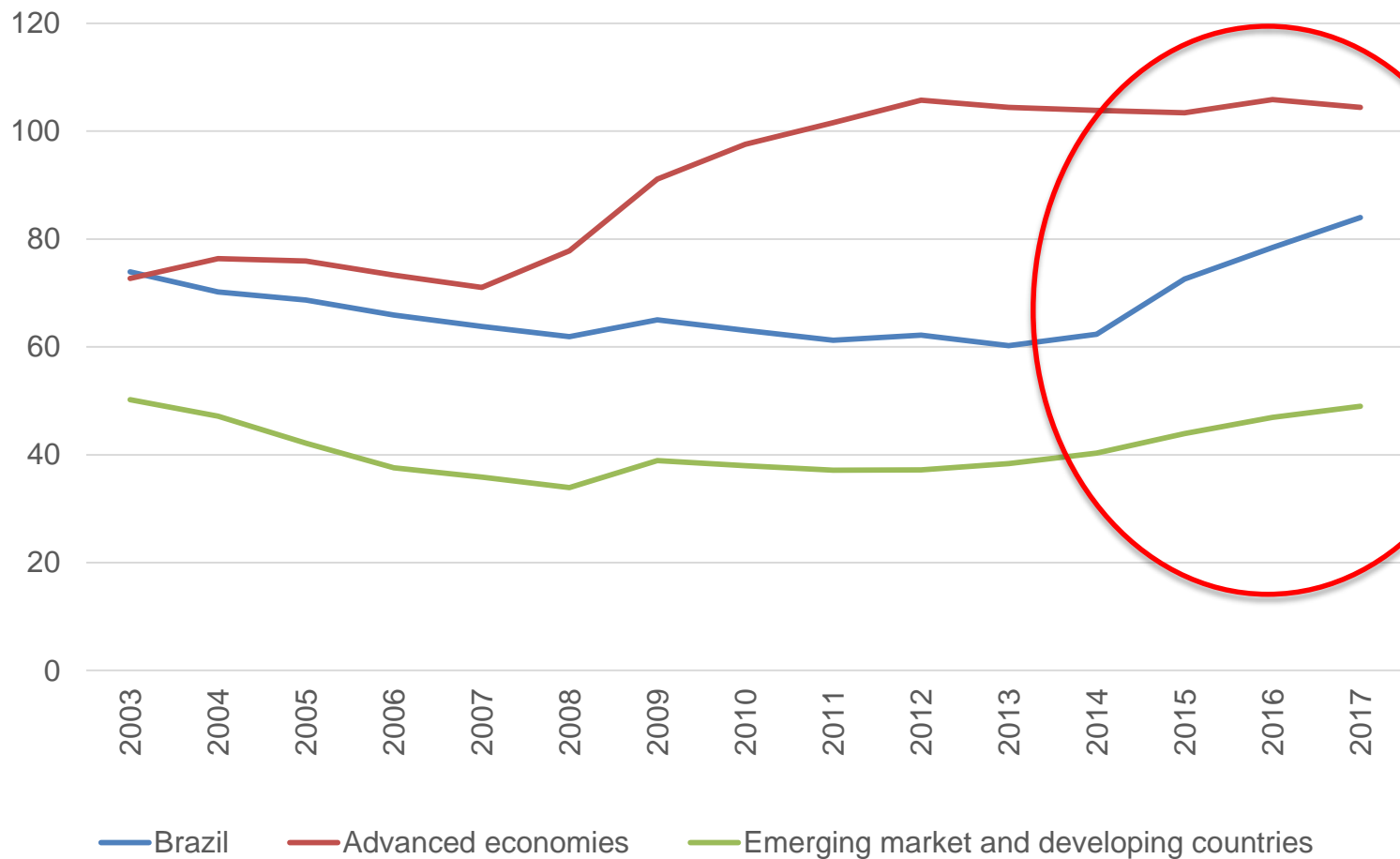


GDP (per capita) - PPP (2011 dollar)	1980	2017
Brazil	11,146	14,212
Advanced economies	23,665	44,905

Source: Independent Fiscal Institution (IFI) of Brazilian Federal Senate. <https://www12.senado.leg.br/ifi/dados/dados>

Intro: Brazil x Emerging and development countries

Gross debt - % of GDP

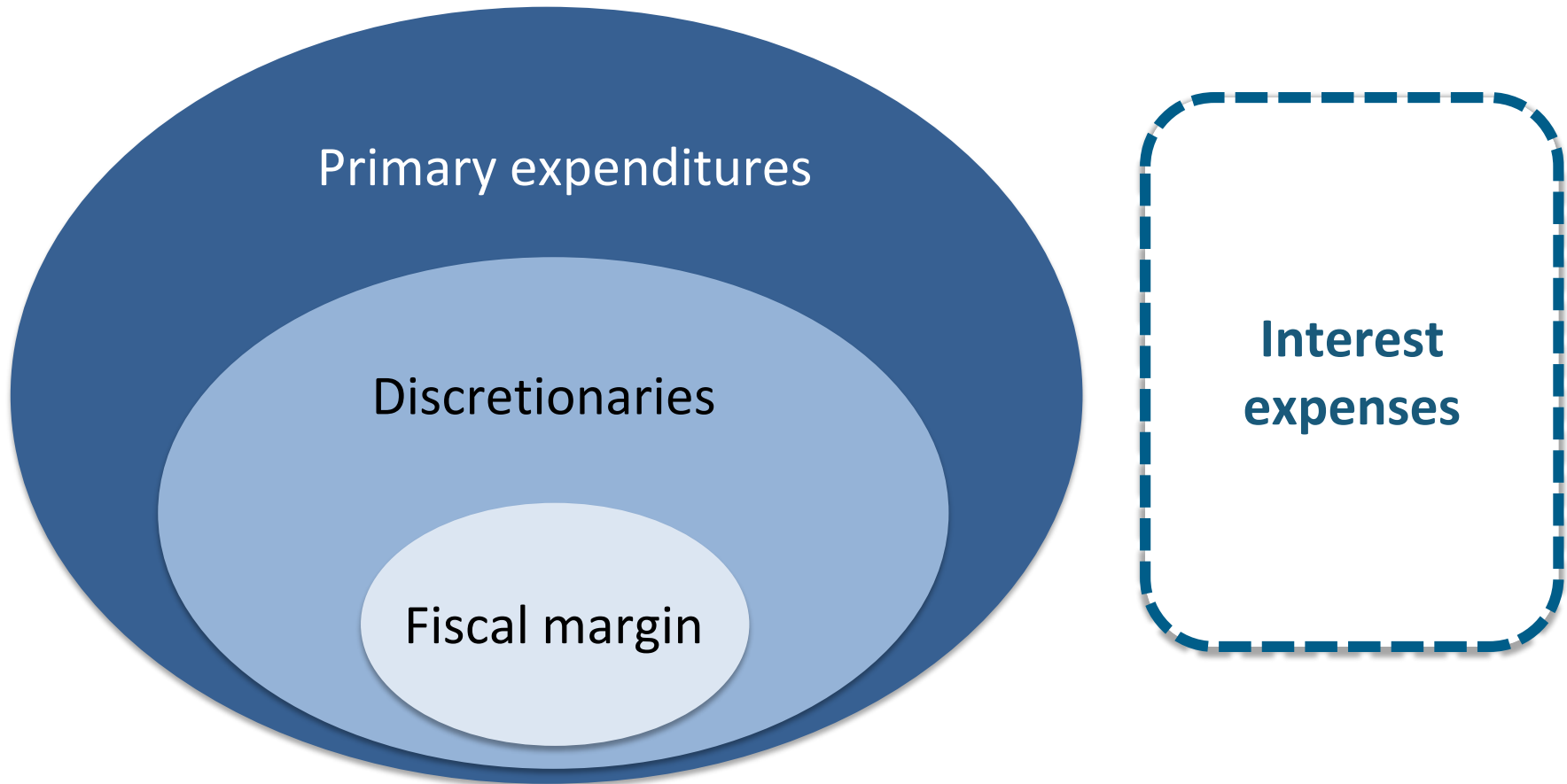


Intro: IFI scenario

Basic scenario (1)	2015	2016	2017	2018	2019	Average 2020-2030
Real GDP growth - %	-3.5%	-3.5%	1.0%	2.7%	2.5%	2.3%
Real interest rate - %	3.2%	7.0%	3.9%	2.7%	3.5%	4.3%
Optimistic scenario (2)	2015	2016	2017	2018	2019	Average 2020-2030
Real GDP growth - %	-3.5%	-3.5%	1.0%	3.2%	3.5%	3.5%
Real interest rate - %	3.2%	7.0%	3.9%	2.8%	2.5%	3.1%
Pessimistic scenario (3)	2015	2016	2017	2018	2019	Average 2020-2030
Real GDP growth - %	-3.5%	-3.5%	1.0%	1.9%	1.5%	1.3%
Real interest rate - %	3.2%	7.0%	3.9%	3.8%	4.3%	5.7%



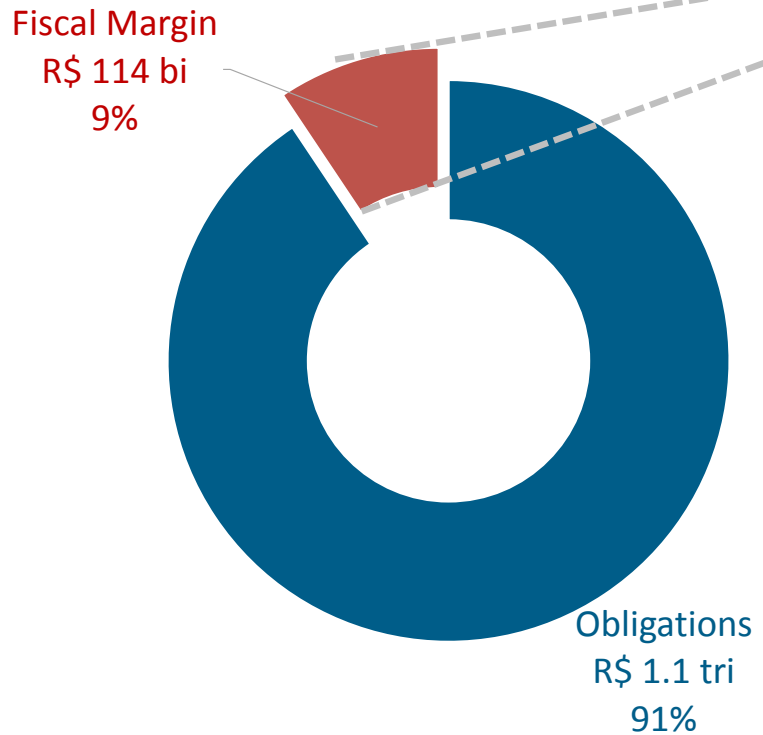
1. High budgetary rigidity and the new expenditure ceiling



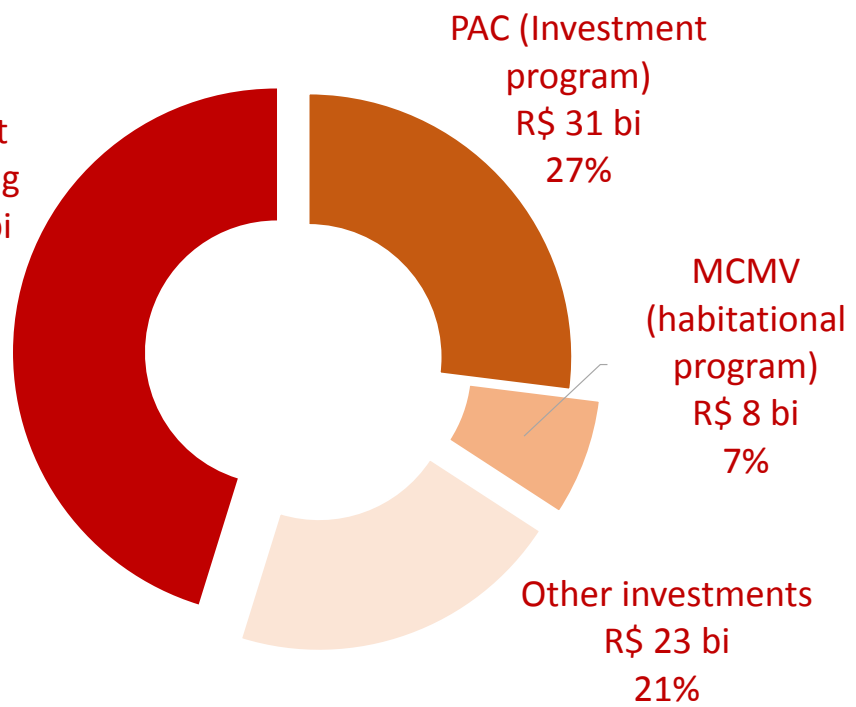
1. High budgetary rigidity and the new expenditure ceiling

Expenditures under the ceiling

Fiscal margin



Current spending
R\$ 51 bi
45%



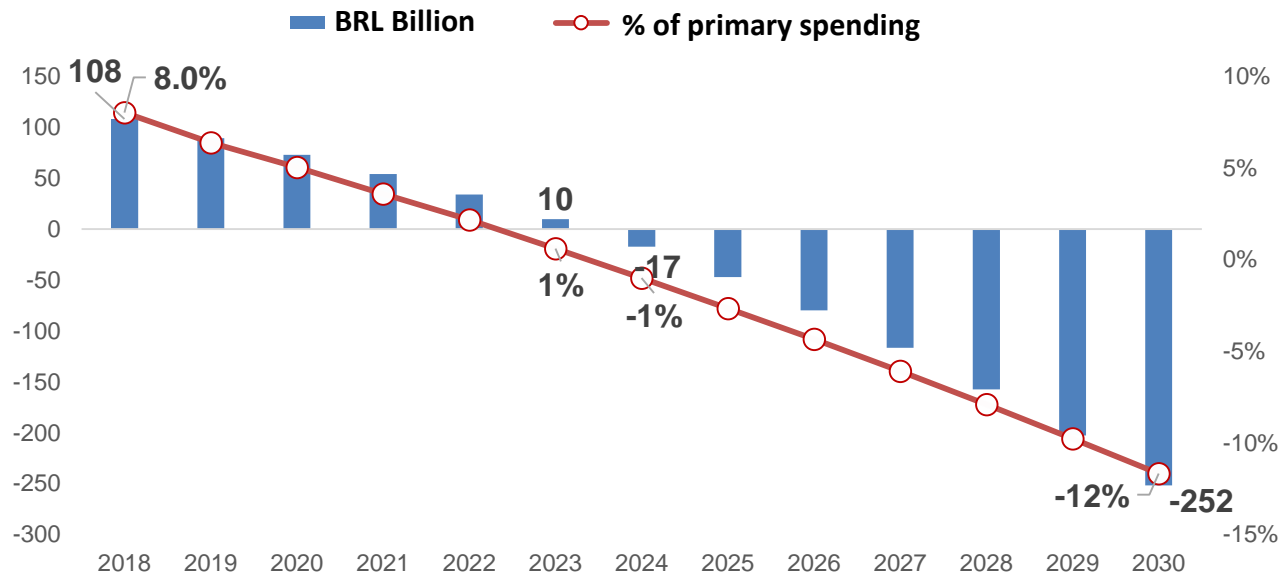
2016



1. High budgetary rigidity and the new expenditure ceiling

1. Public budget in Brazil is very rigid. The expenditure ceiling (created by the Constitutional Amendment number 95/2016) determines that total primary spending does not grow above inflation
2. On a budget of R\$ 1.4 trillion (or USD 400 billion), less than 10% is manageable without changes in ordinary legislation or even the Constitution
3. We created a concept to demonstrate this high degree of rigidity in Brazil: “fiscal margin”

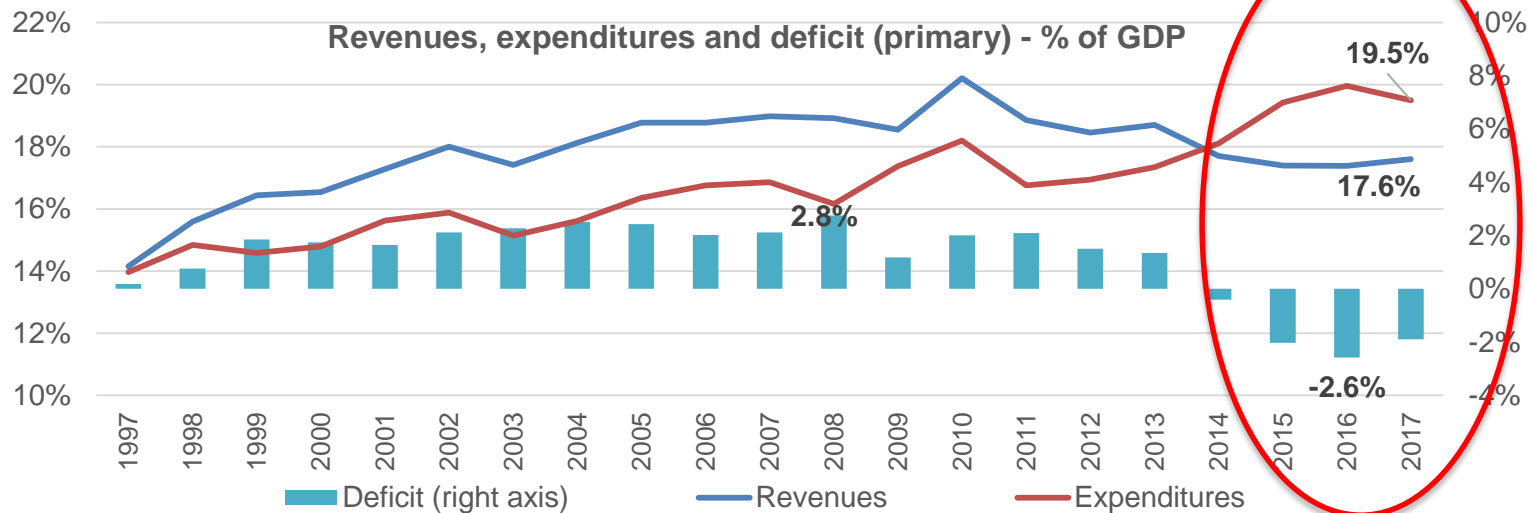
Fiscal margin



Source and Forecasts: Independent Fiscal Institution of Brazilian Federal Senate (IFI). Forecasts: IFI.

1. High budgetary rigidity and the new expenditure ceiling

1. In the last 20 years, public expenditure was very close to revenues (fiscal policy is procyclical)
2. Fiscal adjustment in Brazil has been made by increases in tax burden
3. Recent reduction in revenues coupled with an increase in expenditures, generating fast growing deficits



Growth of revenues and expenditures (primary) as % of GDP

	1997 to 2002	2002 to 2007	2007 to 2012	2012 to 2016
Revenues	3,85	0,98	-0,53	-1,05
Expenditures	1,92	0,98	0,08	3,05



1. High budgetary rigidity and the new expenditure ceiling

1. Room for fiscal adjustment is decreasing sharply
2. Stabilizing the gross public debt-to-GDP ratio requires a drop in federal spending of 4.4% of GDP until 2030

Forecasts to revenues, expenditures and balance (deficit or surplus) - % of GDP

% of GDP	2017	2024	2030	Difference between 2030 and 2017
Revenues	17.65	17.73	17.75	0.10
Expenditures	19.45	17.23	15.03	-4.42
Balance	-1.81	0.51	2.71	4.52

2. Institutional improvements and excess of rules

1. Separation of “Banco do Brasil” (the main public bank of Brazil) and Central Bank
2. Creation of the National Treasury Secretary to manage the public debt
3. Creation of a Financial System (SIAFI) to register each public expenditure
4. Fiscal Responsibility Law (LRF)
5. Negotiation between federal government and subnational governments to equilibrate the debt of municipalities and states
6. Closing of states’ public banks
7. Targets to the primary balance
8. Expenditure ceiling

2. Institutional improvements and excess of rules

1. 11 fiscal rules...

- Golden Rule (Constitution)
- Expenditures ceiling (Constitution)
- Target to primary balance (Fiscal Responsibility Law)
- Exemptions (Constitution)
- Threshold to civil servants payroll expenditures (Constitution)
- Threshold to gross debt (Constitution)
- Others...

In 2019, 2 important rules are about to be breached

3.1 Quality of public expenditure

Central Government public budget – % of GDP

Functions	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Growth - 2008 to 2017 (in percentual points of GDP)
Pensions/Social security	7.8%	8.7%	8.4%	8.2%	8.3%	8.3%	8.4%	9.0%	9.7%	9.9%	2.2
Education	0.9%	1.0%	1.2%	1.2%	1.4%	1.4%	1.6%	1.6%	1.7%	1.7%	0.8
Health	1.5%	1.6%	1.6%	1.6%	1.6%	1.6%	1.6%	1.7%	1.7%	1.7%	0.1
Social assistance	0.9%	1.0%	1.0%	1.0%	1.1%	1.2%	1.2%	1.2%	1.3%	1.3%	0.4
Unemployment benefits	0.7%	0.9%	0.8%	0.8%	0.9%	1.2%	1.2%	1.1%	1.1%	1.1%	0.4
National defense	0.7%	0.8%	0.8%	0.7%	0.7%	0.7%	0.7%	0.7%	1.0%	1.0%	0.4
Justice	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	-0.1
Administration	0.5%	0.5%	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.0
Agriculture	0.3%	0.4%	0.3%	0.3%	0.3%	0.3%	0.2%	0.5%	0.4%	0.3%	0.0
Transportation	0.3%	0.4%	0.5%	0.4%	0.4%	0.3%	0.4%	0.3%	0.3%	0.2%	-0.1
Public security policies	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.2%	0.2%	0.0
Others	1.2%	1.1%	1.1%	0.9%	0.9%	0.9%	0.9%	0.8%	0.9%	0.8%	-0.4
Total	15.5%	17.2%	16.9%	16.4%	16.6%	17.0%	17.4%	17.9%	19.3%	19.1%	3.6

3.1 Quality of public expenditure

Revenues and expenditures of Central Government – % GDP – 2017

I. Revenues	17.6%
II. Expenditures	19.5%
II.1 Pensions/Social security (just private retirees – “INSS”)	8.5%
II.2 Civil servants payroll	4.3%
II.3 Other	2.8%
II.3.1 Unemployment insurance	0.8%
II.3.2 Social transfers (BPC)	0.8%
II.3.3 Other	1.2%
II.4 Discretionary spending	3.8%
II.4.1 PAC (investment program)	0.5%
II. Other	3.3%

14.4% of GDP or more than 73% of the total spending!

Investment corresponds to just 0.5% of GDP

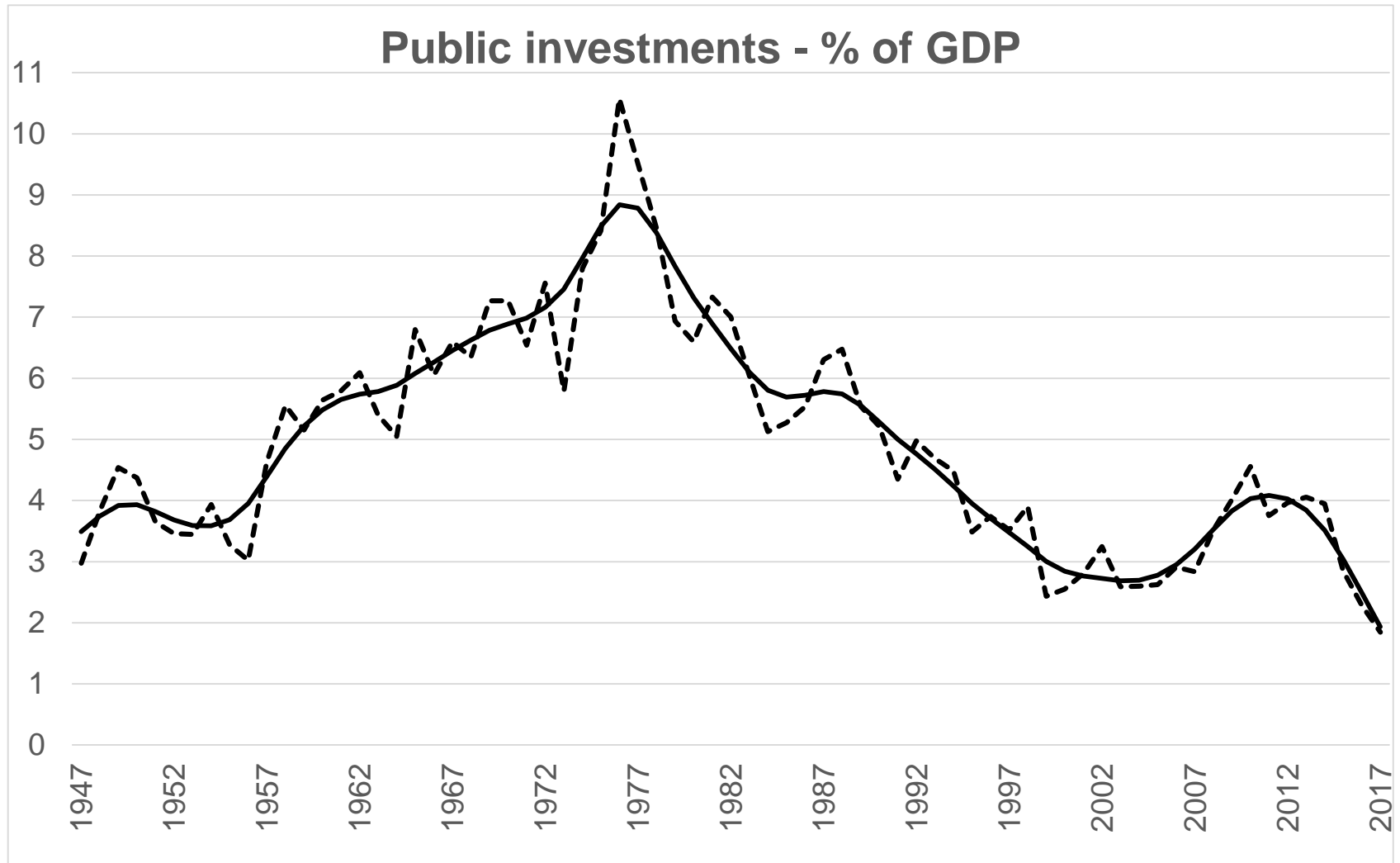
3.1 Quality of public expenditure

Social security and salaries – General Government – selected countries – % GDP – 2016

	Social security benefits expense (% of GDP)
Sweden	14.1
Turkey	9.9
Colombia	9.5
Brazil	9.1
Switzerland	9.0
Australia	8.1
United Kingdom	7.7
Korea, Republic of	6.6
Chile	3.3
Paraguay	3.3
Peru	1.1

	Wages and salaries (% of GDP)
Paraguay	11.2
Sweden	10.6
Brazil	9.9
Australia	8.5
United Kingdom	7.1
Turkey	7.0
Chile	6.7
Switzerland	6.3
Peru	5.9
Korea, Republic of	5.5
Colombia	4.2

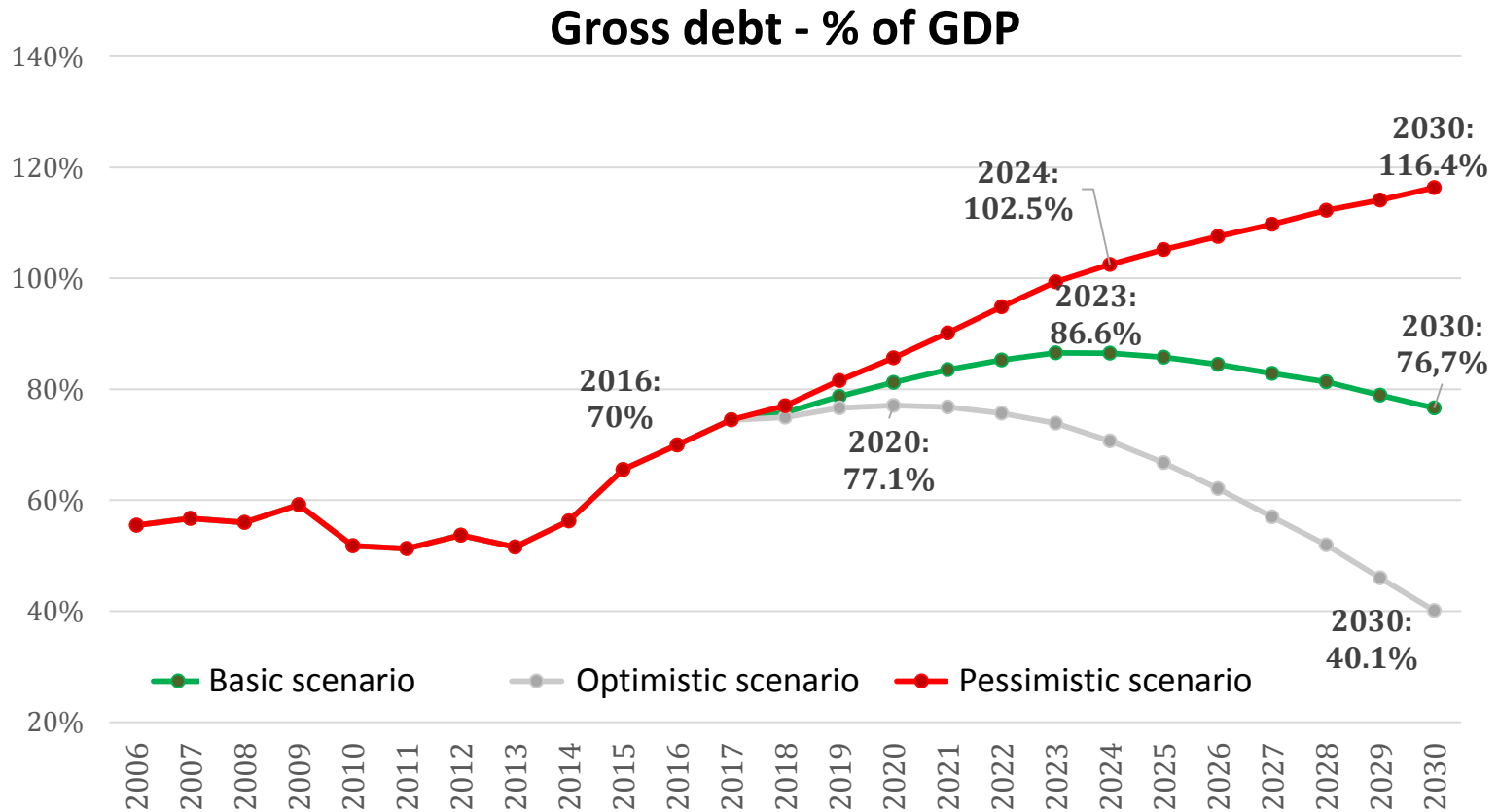
3.1 Quality of public expenditure





3.2 Debt sustainability

1. In IFI's basic scenario, the gross debt will increase until 2023 and just if authorities maintain the compromise with fiscal adjustment
2. In IFI basic scenario, we consider an average economic growth of 2,2% (2020-2030) and an interest rate above 4%
3. The risk is to migrate toward the pessimistic scenario, where gross debt increases to 100% of GDP between 2023 and 2024



Source: National Treasury and Independent Fiscal Institution of Brazilian Federal Senate (IFI). Forecasts: IFI.

<https://www12.senado.leg.br/ifi/publicacoes-1/relatorio/2018/maio/raf-relatorio-de-acompanhamento-fiscal-mai-2018>

4. Spirit of fiscal responsibility

1. In spite of the existence of many fiscal rules, Brazil has not yet an effective commitment to fiscal responsibility...
2. The expenditure ceiling is about to be breached in 2019 and constitutional triggers will have to be pulled
3. To recover the debt sustainability, Brazil should make deep changes in revenues and/or spending
4. Economic growth is essential in this process...
5. Finally, the electoral process, this year, is an opportunity to discuss with society these problems and show the real situation of public accounts and economy, indicating the necessity of rescuing the “spirit of fiscal responsibility”



Thank you
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