Fiscal Consolidation and Institutional Reforms in Brazil

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Outline

1. Recent developments and challenges to the Brazilian fiscal policy
2. Reforming fiscal institutions
3. The importance of the Social Security Reform
4. Recovering growth: initiating a new virtuous cycle
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Brazil is facing one of the worst economic and social crises in its history

GDP per capita (in thousands R$, 2016)

Combined with:
- Double-digit inflation (improving recently)
- Double-digit Unemployment
- Worsening fiscal position

Source: IBGE
The lack of structural reforms have led the expenditure to the unsustainable path. Brazilian fiscal problems are not only temporary, but structural.

Central Government Primary Revenues and Expenditure (as % GDP)

Source: IBGE
The size of these imbalances requires a medium-term consolidation plan

Overall balance reached 10.7% of GDP deficit in 2015.

Restoring confidence, since then, has reduced the cost of the debt.
1 Fiscal imbalances have increased indebtedness levels rapidly

Public Sector Gross Debt (as % GDP)

Need to address a fiscal consolidation strategy

Source: Banco Central do Brasil
There is limited room to raise taxes in order to correct fiscal imbalances

Source: IMF
There is also limited room to raise indebtedness and to postpone fiscal adjustments

Brazil has one of the highest indebtedness levels among developing countries

Source: IMF
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The role of the Constitutional Amendment 95 (approved in 2016)

- **Objectives**: start the process of fiscal consolidation by limiting growth rate of expenditures. The expenditure cap will make the public sector able to achieve better fiscal balances and to stabilize the growth rate of debt without the need to increase tax burden.

- **Expenditure limit determination**:

  - **Basis 2016**
  - **Limit 2017**
  - **Limit 2018**
  - **Limit 2019**
  - **Limit 2020**

  \[
  \text{Basis 2016} \rightarrow (1 + 7.2\%) \rightarrow (1 + CPI_{2017}^{\text{junho}}) \rightarrow (1 + CPI_{2018}^{\text{junho}}) \rightarrow (1 + CPI_{2019}^{\text{junho}}) \rightarrow \ldots
  \]

- Applied only to the Central Government

- Minimum constitutional amount of expenditure related to health and to education sectors will be observed.

- There are exceptions to this limitation:
  - Subnational transfers
  - Unexpected expenditures (Créditos Extraordinários)
  - Elections
  - Raise capital through state companies
2 The benefits of the expenditure cap to the fiscal framework

- Reduce pressure to raise taxes and create distortions in the tax system
- Reduce debt and interest payments
- Being the anchor of the Brazilian Medium-Term Fiscal Framework
- Improve the role of the Congress in defining the allocation of the budget and in making the multi-year fiscal space clear to the public
- Restore the discussions of improving effectiveness of the public programs
- Create political room to implement structural reforms
2 Ongoing effort needed to implement the New Fiscal Regime (Expenditure Cap)

✓ Approve structural reforms in order to control mandatory spending and budget rigidities

✓ Enhance strategic and medium-term focus of fiscal policy and budget process

✓ Improve macro-fiscal forecasting (baseline and alternatives)

✓ Promote procedural changes in the budget process to support the rule (New Public Finance Law)

✓ Develop a expenditure review focusing on the large and fast-growing programs

✓ Improve transparency
Developing the Federal Government Monitoring and Evaluation (M&E) System

- Presidential degree will regulate this system
- Establish procedures to be followed by line ministries in order to create new programs
- Define guidelines and procedures to make ex-ante and ex-post evaluations of programs
- Develop public investment projects database managed by the Ministry of Planning
- Improve information sharing related to program evaluations among government agencies
- Integrate the Monitoring and Evaluation System to the budget process
There are clear signs of potential efficiency gains among government programs.

Source: World Bank
There are clear signs of potential efficiency gains among government programs

Incidence Index of Social Programs in Brazil (in %)

Source: World Bank
There are clear signs of potential efficiency gains among government programs

Education sector incidence indicators

Source: World Bank
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3 Social security reform: demographic perspectives

Population Aging
65-year old or more population/working-age population

- In 2015, 8 working-age adults in relation to each 65+ person
- In 2040, 4 working-age adults in relation to each 65+ person

Fonte: IBGE
3 Social security reform: international comparison

Fonte: IBGE
Private Sector Social Security System Expenditure (as % of GDP)

Social security: baseline expenditure projections (no reform)

Fonte: Ministry of Finance
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Economic growth recovery in Brazil: initiating a virtuous cycle

Sustainable growth path:

- Fiscal consolidation
- Confidence
- Interest rates
- Investment and credit
- Growth
Economic growth recovery in Brazil: initiating a virtuous cycle

Fiscal Consolidation
Strengthening fiscal institutions: control spending growth, compliance, transparency, fiscal risk mitigations.

1. **Expenditure Ceiling (EC 95/2016)**
   - Ensure fiscal long-term fiscal sustainability and reduce the pressure to increase tax burden.

2. **Social Security Reform**
   - Convergence to international standards and guarantee solvency of the system.

3. **Expenditure Review**
   - Improve expenditure allocation and public policy effectiveness

4. **New Public Finance Law**
   - Review and update all the procedures related to the budget process.

5. **Strengthening Fiscal Responsibility Law and Regulate the Federative Fiscal Council**

6. **Review the system of guarantees related to subnational governments indebtedness**

Productivity Improvement Agenda

1. **Tax Reform**
   - Simplify, increase efficiency and reduce justice litigations

2. **Strengthening infrastructure regulatory framework**

3. **Bureaucracy reduction and administrative Reform**
   - Focus on essential activities of the public sector in order to provide services to citizens
   - Reduce operational rigidities and provide instruments to public managers
   - Result oriented administration

4. **Improve business environment**

5. **Strengthening governance and compliance among state companies and public pension funds**

6. **Concessions and privatizations**

7. **Labour law modernization**

8. **Increase foreign trade**
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¡Gracias!