

This article is part of a book on Public Finances to be edited by CEPAL. It should only be cited by authorization of the authors (5-31-99)

PRINCIPLES AND RULES IN PUBLIC FINANCES: THE PROPOSAL OF THE FISCAL RESPONSIBILITIES LAW IN BRTAZIL

Martus Antonio Rodrigues Tavares
Álvaro Manoel
José Roberto Rodrigues Afonso
Selene Peres Nunes*

SUMMARY

Resume

1. Proposal motivation
2. Principles and rules for fiscal policy
3. Principles and rules in the Brazilian Fiscal Responsibilities Law
 - 3.1. Establishing rules in a federation
 - 3.2. Establishing inter-operational rules: the budgetary process as a planning tool
 - 3.3. Establishing limits to debt stock and the contracting of credit operations
 - 3.4. Establishing limits to expenditures on active and inactive personnel
4. Final Considerations
5. Appendix
6. Biography

Economists. Respectively, the Executive Secretary of the Ministry of Budget and Management (martusar@mpo.gov.br), Special Advisor to the Minister of Budget and Management (alvaroma@mpo.gov.br), Head of the Fiscal Issues Secretariat of the BNDES (jafonso@bndes.gov.br) and Economics Advisor to the Minister of Budget and Management (selenepp@mpo.gov.br).

This article is a modified version of the paper "A proposal for a new fiscal regime in Brazil: that of fiscal responsibility". Presented at CEPAL's XI Regional Seminar on Fiscal Policy, Brasilia, January 1999. The references stated herein related to the Fiscal Responsibilities Law are respective to the Bill of Law sent to the National Congress in April 1999. Said Bill of Law may suffer alterations in the approval process. In December 1998, a Preliminary Version of the Bill of Law was submitted to public consultation. The Ministry of Budget and Management, with a decisive participation of BNDES's Fiscal Issues Secretariat coordinated its elaboration. It has also incorporated contributions of the various ministries and federal bodies. The authors thank the collaboration of Heloisa C. Moreira, Laira V. L. Conçalves, Beny Palanik, Lia M. G. P. Lopes, Ricardo F. Silveira and Sérgio N. França.

RESUME

The debate on the role of the fiscal policy and its instruments indicate the need to (a) define the principles that avoid excessive and recurring deficits; and (b) the imposition of restrictions on public expenditures, i.e., by means of rules, and by means of social control through transparency. The proposal of the Brazilian Fiscal Responsibilities Law (FRL) defines principles, establishes rules and requires greater transparency by means of responsible fiscal management. To abide to these rules, the FRL adopts some of the already renowned mechanisms: automatic expenditure cuts, and the need to undertake compensations in the event of the creation of long term expenditures. Due to the characteristics of the Brazilian economy, the FRL gives special treatment to: (a) the federative relations, respecting the autonomy of the federation's entities; (b) inter-temporal deficiencies of the budgetary process, as the determinant of part of the structural unbalances of the public sector; and (c) debt and personnel expenditure levels, due to its high level of the total amount of the public expenditure.

1. PROPOSAL MOTIVATION

The characteristics of the crises, sometimes recession and unemployment, sometimes fiscal deficits and inflation determine a need to theoretically rethink the limits to State action and the use of the several economic policy instruments. The 1930s depression could be more efficient in seeking a conscious balance, due to dealing with lower levels of uncertainty and of decision asymmetry than that of the market. The role of the expansionist fiscal policy as promoter of economic growth however has been questioned based on the restrictions on the financing capacity.

From the 1970s, the appearance of large deficits, chronic inflationary processes and debt crises increased the importance of the monetary impacts of the fiscal policy in terms of inflationary potential. This, in turn, determined a return to the non-intervention concept. At the same time, the need to establish limits became ever more urgent, due to the recognition of the coexistence of positive and negative effects of the public deficits. Besides the form of financing the expenditure, the volume relative to other economic variables needed to be considered.

On the path to impose more rigid controls on the fiscal policy, around the world political movements promoting the thesis of central bank independence, as the way to avoid the monetary financing of the public deficit began to appear. At the same time, the transition from authoritarian regimes to democratic governments in Latin America determined that the societies should exercise more control on the destiny of the expenditures – from the budget itself – and the limits to the execution of the economic policy.

The strengthening of democracies and the Legislative Branch prompt the need to give more value to the Budget as an instrument to control public expenditures, as well as the definition of the national priorities. Such should reflect the society's aspirations, in terms of defining the volume and destiny of the expenditure, and also the means of financing such expenditures.

In the 90s there has been an evolution in this practice, from the North American, the European Monetary Union (EMU) and that of New Zealand. In the US, the Budget Enforcement Act (BEA), of 1990, introduced automatic cuts in the federal government expenditures every time that the forecasts indicate the non-achievement of the fiscal results targets established by the Congress in the budgetary process¹.

In Europe, the 1992 Maastricht Treaty established general norms to be obeyed by all the Member States, with the basic principal that “the Member States have to avoid excessive government deficits”. In other agreements in the EMU sphere (European Council Resolutions and other regulations brought down by the competent organisms), targets were defined for:

- a) the annual inflation rates: at maximum 1.5% over the average of the three countries with lowest inflation;
- b) the long term interest rates: not superior in 2% over the long term interest rates of the three countries with lowest inflation;
- c) the budget deficit: 3% of the GDP; and
- d) the maintenance of the exchange rate, over the last two years.

The Member States obey the principles of a confederation, conducting their own policies with relative independence, to converge towards agreed criteria. Deviations are admissible, so long as the adjustment tendencies are maintained. On the contrary punitive measures are foreseen in the protocols².

The North American and European experiences have a lot to teach about the possibilities of implementing fiscal policy in a federative structure. The institutional complexity, in this case, tends to be potentially generated by the division of functions among the levels of the federation. These execute fiscal decisions that frequently hamper a clear separation between the economic policies and the earmarking of those that are responsible for them.

In the EMU, norm formulation and application reaches a group of autonomous and sovereign countries. On the contrary to the United States, the legislation contemplates only the federal government, due to the fact that each unit of the federation has its own rules. Even though the focus of the EBA is restricted to the federal government, this instrument represents a good example of control on expenditure expansion.

1. For a deeper analysis on the North American legislation on this issue, one should search on the Internet for references on the Congressional Budget Impoundment Control Act of 1974 and the Balanced Budget and Emergency Deficit Control Act of 1985.

2 For a recent analysis of the EMU, see Eichengreen & Wyplosz and the several studies published by OECD/PUMA. For an analysis of the problems in the implementation of the EMU, also see Nunes & Nunes (1997). A virtual library on all this regulation is accessible at the European Community sites – for example, at <http://europa.eu.int/eur-lex/en/lif/dat>.

In New Zealand, the 1994 Fiscal Responsibility Act, established guidelines for the maintenance of the debt and the patrimony at prudential levels.³ The Parliament determines generic performances criteria and the Executive Branch has liberty to budget and spend, although with broad and strict society control. In such case, social control overrules the rigidity of the rules themselves, which makes this experience an international benchmark in terms of transparency. This has led Kopits & Craig (1998) to state:

“New Zealand represents a benchmark for public sector transparency. The Fiscal Responsibility Act of 1994, which contains a series of principles for fiscal management and transparency, is the culmination of a decade of reform designed to improve the efficiency, effectiveness, and accountability of what had been a large and interventionist public sector.”

In Brazil, the unsatisfactory coordination among monetary, fiscal, and public debt policies, as an important part of the diagnosis of the Brazilian crisis, had already determined, since 1986, the adoption of a series of measures to alter the relationship between the National Treasury and the Central Bank. Among these, one may highlight:

- a) budget unification, with the extinction of the Monetary Budget (agriculture and exports subsidies and financing, done before by the Central Bank);
- b) unification of the Monetary Authority, with the closing of the Central Bank’s “movements current account” (*conta movimento*) at the Bank of Brazil (it was an almost automatic financing mechanism of the fiscal expenditures by the monetary authority);
- c) setting up of the National Treasury Secretariat;
- d) the constitutional prohibition of the Central Bank in financing the National Treasury;
- e) creation of the National Treasury unified account at the Central Bank and the implementation of the Integrated Financial Administration System (*Sistema Integrado de Administração Financeira*) of the Federal Government – SIAFI.⁴

The Real Plan, in 1994, inaugurates a new phase for fiscal policy in Brazil. It makes it possible to visualize the remaining problems of the separation between the accounts without the inflationary bias. Although there have been advances, on the other hand, the change of the public deficit financing standard, from inflation to debt, has reflected in an expressive growth of the public debt. During the inflationary process, it was possible to accommodate the pressures. That is, due to the fact that an important public sector financing mechanism constituted by inflation, which works as an inflationary tax, or to the fact that it functioned as an invisible real term expenditures compression mechanism for expenditures. This worked due to the reason that in Brazil the revenues have always had better indexing than the expenditures.

3 For a specific analysis on the New Zealand experience, see Scott (1996) and Carvalho (1997). One may also access the New Zealand Government home-page at: www.govt.nz. Mainly at the “Legislation” link, it’s possible to verify the whole text of the *Fiscal Responsibility Act 1994*, as well as the *1998 Amendment*. For the Details of the financial and budgetary management norms, see the *Public Finance Act 1977-1994* and its different *Amendment Acts*.

4 To analyze the verified changes in this relationship after 1986, as well as the remaining problems, see Nunes (1999).

After the Real Plan, one may not state that the fiscal unbalances have been solved, but that they have certainly become more transparent, seeing that all the public sector spending decisions began to have a real impact on the budgets. As a consequence, the causes of such unbalances have become more evident, especially in relation to inter-temporal deficiencies of the budgetary process. They range from the open-ended accounts brought about by the 1988 Constitution to the Brazilian federative problems, and, mainly, on the absence of pre-established targets and budgetary mechanisms capable of guaranteeing their accomplishment. The end of the inflationary process brought transparency to the lack of consistency of the macroeconomic model. This signals the need to make choices and foresee the consequences.

Therefore, the historic public accounts unbalance problems of the Country, increased by the recent reduction in the flow of external financing – due to the Asian and Russian economic crisis – that has traditionally financed it, have required that the Brazilian authorities, at all levels, seek a new posture in the administration of the resources trusted to them by the society. The Public Sector needs not only to state its intention of good resource management, but also has to legally assume the compromise to do so.

The Fiscal Responsibilities Law – FRL goes into this context. This is due to the fact that differently from short term fiscal adjustment measures already implemented, it represents a structural change in the fiscal regime. It introduces new concepts, such as responsibility, transparency and harmonizes different norms to organize and balance public finances. It is, therefore, a real good conduct code in public finances, which may be applied to the three levels of government and the three Branches. It also goes in consonance with the constitutional guidelines of federative autonomy and independence among the Powers. Its scope, not only in terms of issues, but also of public sector conceptualization, in temporal terms, is the broadest possible.

This structural characteristic of the FRL had already been recognized by the Fiscal Stability Program, made public on 10.28.1998. In it, there were immediate measures and other of structural characteristics. Among these, the enacting of the law under analysis was also included, as an instrument “capable of instituting a definitive order to the public finances of the group of Branches and levels of governments”.⁵

⁵ The whole text and other information of the Fiscal Stability Program are available at the site of the Finance Ministry: www.fazenda.gov.br.

The motivation of the FRL comes, however, well from before. The 1988 Constitution had already foreseen, in article 168, a Complementary Law⁶ that would treat the public finances, external and internal public debt, guarantees, and financial institutions supervision issues. Such law would transcend accounting and control issues, seeing that these would be the object of another Complementary Law, also foreseen by the Constitution, in article 165. The second one should regulate instruments and the budgetary process, as well as impose specific norms on financial and patrimony management.⁷ Even though one expects that the decisions around both bills of law are in harmony and coherent, their passage through Congress will be separate. Besides this, after 10 years of the Constitution's promulgation, during which time the Complementary Law foreseen by article 163 hasn't been approved,⁸ Congress has, through a Constitutional Amendment, approved the Administrative Reform (June 1998), and has established a deadline of six months for the Executive to send the bill of law to regulate it.

In consonance with the transparency spirit of the FRL and to foment the debate and generate a national consensus around the importance of the matter, the preliminary bill of law was submitted to a process public consultation, having been made public, at the beginning of December 1998. This was done not only by means of the traditional publication by the official press, but also by the means of the internet.⁹ The consultation process also involved the organization of public hearings, with the participation of representatives from the sub-national governments and the private sector. Their suggestions were incorporated to the bill of law sent to Congress in April 1999.

This paper has the objective of bringing light to the debate on the establishment of guidelines and rules for fiscal policy, analyze the recent Brazilian contribution in the form of the FRL. The paper is organized in four chapters. After a brief introduction, chapter two analyzes some theoretical aspects that determine the tendency, observed after the 80s in several countries, of the seeking fiscal balance through the establishment of rules. Chapter three analyzes these issues adapted to the Brazilian reality, emphasizing (a) the federative relationship, due to the respect related to the autonomy of the entities of the federation vis-a-vis the establishment of rules; (b) the inter-temporal deficiencies of the budgetary process, seeing that they were responsible for the structural unbalances of the public sector; and (c) the debt and personnel expenditures levels, due to the fact that they are representative in the explanation of the public debt, indicating the need to impose limits. The fourth chapter concludes the article.

6 In the Brazilian legislative process, the Complementary Law works as a type of detailing of the Constitution, by means of Congressional approval with a qualified quorum (absolute numbers).

7 For such reason, there are already several bills of law in the National Congress, all of them through the initiative of the congressmen, that revise and improve Law nr. 4320, of 1964. The main one is nr. 135/96, in the House of Deputies. For more information, it is suggested that one consult the sites of the Congress' budget and control divisions (see block on *Union Budget – Documents* at: www.camara.gov.br) and of the Executive (see bill of the technicians group in the block *Legislation* at: www.sfc.fazenda.gov.br).

8 For the history of the work of National Constitutional Assembly of 1987/88, around the public finances issue and an analysis of the changes in the constitutional text and the main issues to be confronted in the complementary regulation, see Afonso and Giomi (1992).

9 During the public consultation process, 5,000 consultations were registered at the homepage: www.mpo.gov.br. At this address, besides the legal text and a “virtual library”, composing studies, legal papers, bills and useful links consulted by the technicians that prepared the bill of law (see the site: <http://federativo.bndes.gov.br>), a standard form was presented for the forwarding of critics and suggestions, which were afterwards incorporated in the final version of the bill of law.

II. PRINCIPLES AND RULES FOR FISCAL POLICY

In the economic literature, the efficiency of the fiscal policy as promoter of economic growth has been seen under a relative perspective related to its financing form. In Keynes, efficiency would be smaller if government financed its expenditures with the increase in taxes, reducing the income available to the private sector. This would impose an excessive tax burden. The financing of the fiscal policy by means of expanding the monetary base, in its turn, would have the same effect of an expansionary monetary policy: it would increase the product but would also have an inflationary potential. The financing of the fiscal deficit by means of the emission of bonds increases the effects of the public expenditures as generator of income and employment at present, leaving for future generations the burden of the interest payments.

Later on, Domar (1944) and Lerner (1944) gave a new formulation to the problem, showing that the debt generated by the public expenditure, in certain circumstances, converges to a “natural” limit. Domar (1944) argued that the debt/GDP relationship tended to a position of balance every time that there is economic growth. For Lerner (1944), the placing of bonds would start a virtuous circle in generating more income and employment, eliminating the origins of new deficits. This happens because it eliminates the insufficiency of the effective demand, or because it increases the tributary funding by the increase of the base for taxation, and, consequently, the financing limits of the government. In this context, the interest doesn't represent a burden on society, being seen as a mere transfer.

On the other hand, Friedman's well known argument that, contrary to the financing of the fiscal deficit by means of the expansion of the monetary base, the emission of bonds reduces the private sector's liquidity. This could generate a hike in the interest rates and a reduction in private investment, with recessive effects on the income level (*crowding out*). Besides this, so that the buying of public debt bonds becomes interesting for the private sector, the government may be forced to increase continually the interest rate, re-enforcing the described effect. And, even more, this type of financing would fatally increase the expenditures with the payment of interest, to avoid the explosive path of the debt. The Government, in the future, would need to increase tax collection or to decrease the transfer to other sectors, which would bring about a drop in income. These effects tend to compensate themselves, determining a long term fiscal policy neutrality.

The Rational Expectations School, of which Sargent (1979) is one of its most renown representatives, retrieved a more radical interpretation: that the neutrality is in place, even in the short term, because the agents anticipate the government's actions. That is, in case the agents anticipate such path as in the rational expectations models, it wouldn't even begin. The neo-classic conclusion in terms of economic policy is identical to that of the monetarist: there should be no fiscal policy [Barro (1974)] nor monetary [Sargent (1979)]. Thus, inflationary and public deficit crises are avoided. On this path, several other authors have also alerted about the problem of the financing of the public expenditure, more specifically of the debt burden, which would only permit the inter-temporal allocation

in favor of present consumption as to future consumption.¹⁰

On the other hand, the idea that economic policy should be conducted by means of fixed rules, in substitution to the discretionary power of the governments, has also been present, for a long time, in the economic literature. In the beginning, the main concern referred to the monetary financing of the fiscal policy. Authors, such as von Hayek (1973), Friedman (1968) and Lucas (1972), defended the adoption of fixed rules for the monetary aggregates, as a form of avoiding inflation and the growth of the debt. Friedman recognized that discretionary measures could be more adequate if they were capable of forecasting the evolution of the parameters of the economy, but as the losses due to the mistakes of the economic policy would also be great, it is preferable to substitute the discretionary by rules dictated by the law.

A byproduct of the debate of rules versus discretion refers to the association between the discretionary power and the political pressures. Authors such as Pissardes (1980) and Buchanan (1986) explained why governments insist on executing expansionary fiscal and monetary policies to try to increase the employment level. The fiscal policy and the publicity of the construction sites would be used as political action by the governments. Thus, they would aim at reaching popularity rates that would permit them to perpetuate themselves in power.

Even with rational expectations, it would be possible to affect the employment level in the short term, surprising the agents with unforeseen changes in the volume of currency and provoking medium and long term monetary disturbances. Seeing that the governments have a limited horizon, through the time span of their mandates, they give emphasis to decisions that generate rapid results as to that of price stability that offers long term benefits. The basic problem would be the inherent fragility of the policy as an economic decision taking process, which requires that priorities sustainable by consistent targets be established. According to Grossman (1988):

“the most basic problem... seems to be the inherent weakness of politics as a process for making economic decisions. Experience suggests that the political process has limited ability to specify consistent goals, establish priorities, and choose between competing objectives about economic matters, especially when these decisions require comprehension of complex technical issues and constant processing of complex information.” (pg. 8)

In this way, Kydland & Prescott (1977), Buchanan (1986) and Dorn (1987) suggest that the objective of price stability should be achieved by means of the establishment of norms that configure the desired policy, such as the public announcement of the objectives to be pursued, the adoption of pre-announced quantitative targets for several concepts of the monetary supply, the recommendation of mandatory restrictions in the generation of public deficits, and the imposition of constitutional limitations to taxing and the financing of government expenditures.

¹⁰ In respect to the debate of the burden of the debt, see Buchanan (1958), Meade (1958), Modigliani (1961), Diamond (1965) and Barro (1974).

Buchanan (1986) even defended the idea of incorporating such norms in the Federal Constitution. This in fact happened in several countries. The most common rules, adopted by a large number of countries, are related to the prohibition of the central bank financing the government. This is known as the “golden rule” (credit operations mustn’t finance current expenditures)¹¹ and the tax financing limitations (principal of date imposition, for example).¹²

Those that prefer the discretionary aspect of the rules use as argument the fact that the lack of flexibility, which is proper to rules, in general, end up making its maintenance unfeasible in the long. More than that, the idea that rules are too rigid to be obeyed, by itself, also induces the non-compliance, seeing that it takes away the credibility of the process.

Therefore, alternatively, the international organizations have been giving to the fiscal transparency precept the same importance given to that of fiscal responsibility.¹³ This is due to the fact that, lack of transparency of the statistics, in general, permits them to accommodate pressures and incorporate targets that in other ways would be non-reconciling.

In Brazil, for example, right after the promulgation of the new Constitution, Serra (1989) alerted to the little attention given to the dispositions that versed on control, transparency, and the government decision planning on the allocation of funding:

“The analysis related to the consequences of the 1988 Constitution on public finances has, generally, emphasized the fiscal prodigality and the increase in the rigidity to reform the public sector, implicit in the new text, as well as the characteristics, merits, and limitations of the changes to the tax collection system. Curiously, until now, the dispositions on the organization of the public expenditure, precisely the more positive ones (in which those who are worried about adequate rules, not only for fiscal balance, but also for control, transparency, and the government decision planning on the funding allocation) have been ignored....”(p. 93)

In federations, the debate of rules versus discretionary aspects gains new elements. If the reestablishment of consistency is fundamental, the path to do so should respect the peculiarities of each country. However, to establish rules without hurting principles of autonomy may be difficult. In reference to sub-national debt, for example, analyzing international experiences presents a diversity of focuses.

11 In this respect, see Kopits & Craig (1998).

12 In the case of Brazil, they are constitutional prohibitions.

13 The major example of this recommendation is the Good Practices in Fiscal Transparency Code, elaborated by the IMF, In this respect, see IMF (1998) and the site: www.imf.org/fiscal. An official version in Portuguese of this code of conduct may also be found at the Federative Bank (<http://federativo.bndes.gov.br>). CEPAL (1998), particularly, in its second chapter, that also highlights the transparency of the public finances as one of the main elements for the construction of a new Fiscal Pact. In this way, the World Bank and IADB dedicate growing attention to the matter. Also see World Bank (1997). Petrei (1997) and OECD/PUMA (1996 and 1997).

In general terms, according to Ter-Minassian & Craig (1997), four main guidelines may be distinguished, even though some countries may use techniques that encompass more than one of these guidelines. The first guideline is based on the discipline of the market to determine the limit to the states' debt. The second, corresponds to the cooperative guideline for the debt controls, whose limits result from the negotiation between the federal government and the sub-national governments. The third, is in respect to the sub-national debt control through specific rules in the Constitution or in the law. And, last, but not least, the fourth guideline refers to the direct central government controls on the sub-national debt.

Taking the path of the rules, like in the case of the United States and the EMU, or permitting broader discretionary powers and trusting the market to control, as in the case of New Zealand, the fact is that the success of these experiences have in common the idea that sustainability of the financing capacity should be sought by means of defining consistent macroeconomic targets, with adequate fiscal and monetary amplitude, including the inter-temporality. Starting from the budgetary restriction of the government, that unified deficits and the financing sources, and of the objectives of the economic policy – inflation, growth of the product, and real exchange rate – it's possible to determine the amount of deficit that may be financed.

Anand & Wijnbergen (1989) presented a model that enabled the explanation the change in the path of the public debt growth as a consequence of this specific among the economic policies. Fiscal deficits may be financed in three ways: emission of internal or external public debt bonds or monetary financing. The macroeconomic aims imply in restrictions on these financing sources, because they also affect the amount of currency that the private sector is willing to absorb at a determined interest rate.

As a consequence, it's possible to define a limit to the amount of deficit that may be financed and, if the deficit surpasses such limit, one of the macroeconomic objectives should be abandoned or the fiscal policy adjusted. It's clear that there are no prior guarantees that such objective will be attained, but only that the fiscal policy is not inconsistent with them. According to this analysis, the consistency between fiscal and monetary policies is achieved when, from the simultaneous attainment of these objectives, it is possible to generate a stable debt/GDP path.

In Brazil, however, as is the case of other developing countries, the incapacity of making choices at the adequate moment, distributing profits and loses according to the arrangement of the prevailing political forces, has determined, frequently, the pursuit of incompatible targets related to the desired levels of inflation, economic growth, meeting of social needs, fiscal results and external competitiveness aspect. Such fact reflects the difficulty in establishing consistent fiscal targets in the budget, in abiding to them during budgetary execution, as well as conferring to such instrument the necessary inter-temporal amplitude.

CEPAL (1998) highlights that, as the fiscal pact is a result of a historic process of the consolidation of the political and social institutions, one shouldn't expect it to be

easy to obtain immediate durable consensus or coalition on controversial issues such as the extension and intensity of State intervention in the economy and the distribution among the society of the fiscal policy financing. On the contrary, the changes are slow, difficult, demand political equation of pressures that many times are not deterred by budgetary restrictions and end up originating leaks right where flexibility is greater.

The limits of this process, then, are placed on the side of the sustainability of the financing capacity over time. Or takes place: (a) out of control levels of inflation, or (b) excessively considered tax burden; or (c) the growing debt/GDP relation; or (d) insufficiency of fiscal funding to attend to the social needs that belong to the State in the current model; or (e) high interest rates, to try to reestablish unsuccessfully the consistency; or last but not least, (f) a mix of these problems.

As a fact, the deficit would not be a problem if it were able to be financed, i.e., if there existed financing sources, in terms of availability and cost, which didn't imply in a future perspective of incapacity of financing. The contained idea in the models of keynesian inspiration is that, if the deficit has a fiscal characteristic and is used to increase income and, consequently, the tax collection base, at a compatible rhythm for its financing, the debt is maintained under control. A situation of public finances fragility would only be characterized by a debt growth rate superior to that of the funding needed to finance it.

In this context, the debt strategy may sacrifice the future budgetary balance, seeing that the present monetary restriction feed inflationary expectations even if favorable external chocks permit a reduction of the inflation. This creates a vicious circle of high interest rates, heavy debt service, budget deficits, inflationary expectations, and again high interest rates. As may be seen, the relationship between deficit and debt is not in one direction only.¹⁴

As a summary, the public finances experience of the last decades, as well as the several codes or laws that institutionalized these issues point out some themes that shouldn't be left out of any legislation in its respect:

- a) responsible fiscal management principles, aiming at consistency of macroeconomic policy in favor of stability;
- b) possibility of imposing limitations not only in the generation public deficits (fiscal result targets in the annual and multi-annual budgets), but also in its financing, be it by means of taxes (yearly principal), by debt ('golden rule' and limits for the debt/GDP relationship) or monetarily (legal restriction);
- c) due to the electoral cycle, the need to define stricter rules and prohibitions that inhibits the governors from getting away from fiscal balances at the end of term periods;
- d) in the federative cases, the need to define a clear relationship among the levels of government, specially in reference to sub-national debt, setting this relationship in the federative balance and in the financial decentralization;
- e) the need to introduce mechanism to reach flexibility in the rules to permit its accomplishment and guarantee its effectiveness;

¹⁴ For the debate on the deficit and debt relationship in Brazil, see Batista (1985).

- f) the possibility of, alternately, or in common with the adoption of rules, attribute greater weight to transparency and control through market mechanisms.

III. PRINCIPLES AND RULES OF THE BRAZILIAN FISCAL RESPONSIBILITIES LAW

In the last chapter, some theoretical aspects that have determined the tendency observed from the 80s in several countries, to try to achieve fiscal balance through the establishment of rules were analyzed. This chapter studies these issues adapted to the Brazilian reality, as proposed by the FRL, taking in four decisive aspects: the federative issue, inter-temporal deficiencies of the budgetary process, debt limits, and personnel expenditures limits.

A. ESTABLISHING RULES IN A FEDERATION

In Brazil, the fiscal federative structure has made it difficult to impose an effective control on the fiscal results of states and municipalities. This is shown to be ever more difficult the bigger the decentralization, and the less standard the spending process. On the one hand, the respect to the federative autonomy almost makes it unfeasible to implement the fourth guideline of the Ter-Minassian & Craig (1997) duality, mentioned in the last chapter. On the other hand, market cooperation and discipline has had less tradition than would be desirable. Consequently, seeing that macroeconomic consistency requires more amplitude in the concept of the public sector, even though the federal government has worked to generate primary surpluses, this has not been able to sustain by itself the fiscal adjustment.

The principles of fiscal responsibility suggested in the FRL follow, in the greater part, those adopted by New Zealand and represent the way to reestablish consistency and stabilize the debt/GDP relationship. Among the principles, the most important is to seek the balance between the society's aspirations for governmental action and the resources that it places at the disposal of the government to attend to them. It is expected, this way, to prevent the generation of heavy and persistent deficits, maintain the public debt at a prudent level, and have a foreseeable and stable tributary policy.

Even though defining principles, as in the case of New Zealand, is desirable, proposing a law that contains only principles is not usual in the Brazilian legislative process. This reflects the local culture, much more accustomed to rules. Therefore, in an essentially federative country, rule adoption may be needed to assure stability.

To not hurt the federative autonomy principle, option was made to first enumerate in the FRL the fundamental principles, and afterwards, detail them into general norms that may be applied to all units of the federation – Union, States, Federal District, and Municipalities. In the end, specific norms were established, with the inclusion of objectives and targets, to be fixed autonomously by each member of the federation.

The general or national norms encompass the already well known 'golden rule' (credit operations may not finance current expenditures) up to debt and personnel expenditure limits. In the case of own norms for each entity of the federation, the FRL determines that each government sets its fiscal policy objectives, with fiscal scenario of an

eight year time span, in the multi-annual budget (plano plurianual – PPA), and its three-year targets on the budgetary guidelines law (lei de diretrizes orçamentárias – LDO), enumerating revenues, expenditures, results, debt and patrimony. Therefore, when observing the principles of a responsible fiscal management, and the general norms that guide public debt, the creation of expenditures and the dealing with personnel expenditures, each government of the Federation must set its objectives and targets autonomously.

Besides this, recognizing that the political process tends to emphasize decisions that generate quick results over those of stability, the FRL introduced several rules for the end of office terms. In relation to personnel expenditures, in the Executive and Legislative Branches, in the six months that precede the end of the legislature or of the office term of the Chief of the Executive Branch, no action that provokes an increase in expenditures may be enacted, and, if the limits are exceeded or the monthly targets for reduction of the excess are not met, more severe penalties, than just suspension of the flow of funds, are imposed.

The credit operations for the anticipation of revenues (anticipação de receitas orçamentárias – ARO) must also be totally liquidated until the end of June during the last year of the office term of the Chief of the Executive Branch (in normal years, the deadline is December 15). And, also, on the last year of the legislature and the office term of Chief of the Executive Branch, no obligation which may not be paid during the same year may be assumed, unless there is equal or superior availability of funds in the current account.

There is still an argument in favor of discretion that can not be ignored: the lack of flexibility, which is proper to the rules, in general, will make them unfeasible over the long run. Therefore, as in the case of the EMU, it was decided to introduce into the FRL dispositions to achieve flexibility of the rules. In the budgetary process, temporary straying from the targets are admissible, so long as justified, temporary and that in the LDO the form and deadline, in which such deviation will be corrected, are stated. Besides this, for the debt and personnel expenditure limits, there are situations in which the deadlines to be targeted may be amplified.

Theoretically, the flexibility reveals also a very interesting posture relative to the role performed by public spending. As already mentioned, all the theoretical rethinking of the limits to the action of the State have oscillated between the emphasis on positive and negative aspects of the public deficit.

The FRL reflects both these preoccupations. On the one hand, one tries to strengthen the budgetary process and tries to reach consistency to enable the stabilization of the debt/GDP relationship for a reasonable period of time. On the other hand, flexibility means recognizing that, in certain circumstances, there are worst problems. Therefore, in the case of war, commotion, calamity or low growth rates, automatic cuts are not enacted. This way, one avoids that a recession, indicating that the non accomplishment of targeted result triggers public spending reduction mechanisms that would tend to depress even more the economic activity and the tax collection, in a vicious circle.

For the same reason, in such situations, the deadlines for the reaching of the debt and personnel expenditure limits are also increased. This may be in the case of reduced

economic growth, in which are identified three ranges of GDP variation and corresponding deadlines. In relation to the debt, due to the fact that it is also affected by the monetary and exchange rate policies, an additional flexibility was introduced, in case of extremely drastic changes in the monetary and exchange rate policies, as recognized by the Federal Senate. The FRL represents, thus, the recognition that with the enunciated principles, to avoid structural unbalances, one only needs to impose the limit to public spending to the average of the real revenues available for its financing.

As well as flexibility in rules, the FRL seeks to also exercise control on public spending through a typical market instrument: transparency. As important as the limits for spending and for the debt, or the rules to abide to them, is the need that they be widely known and correctly evaluated by society. That is why the FRL defines as other fundamental principles the wide access to information, transparency in the tax collection and funding application procedures for public resources and the making public of the results attained.

With the same spirit, the elaboration and approval processes of the bills of law of the multi-annual budget, the budgetary guidelines and the annual budget will be open to the society, as well as the yearly review of the accounts. The obligation that the main authorities of the three branches, in each level of government, make public monthly, quarterly and half yearly fiscal responsibility declarations is also foreseen, attesting the reaching of the limits, conditions, objectives and targets that have been established in the different budgetary instruments.

As highlighted by Lerda (1987), however:

“(...) an approximately ample deficit conceptualization (...) has crucial importance in determining: a) the effective cost of the debt (i.e., the average annual interest rate paid for the principal); and b) of the long term sustainability of a said standard of public debt.”

Thus, the FRL has a chapter for the creation of orientation norms for the elaboration of budgets, statements and other demonstratives, to be observed by each level and entity of the government. The necessary standards of concepts also passes through the obligation that the Union makes public annually, in an appendix of the budgetary guidelines law, the macroeconomic forecast that orient the fiscal targets to be pursued by the other entities of the Federation. Special attention is dedicated to the systematic of making public the public accounting, which will be brought to society's knowledge monthly by means of the Union, States, Federal District and the Municipalities elaborating a report on the respective fiscal, financial and patrimonial performance.

Apart from the dispositions related to the budgetary process, the intergovernmental relations deserve particular attention. The voluntary resources transfers may constitute in problems for the rigorous public spending control, if not duly regulated. Therefore, the bill of law contemplates the prohibition that superior levels of government render financial help or credits to pay personnel expenditures or earmark funds to attend to expenditures with own actions of the other entities. Another disposition, denies, still, the

concession of any new credit from one entity to another, even if for the refinancing or postponement of the debt. Relatively to the monetary financing of the budget deficits, constitutional prohibition is detailed by the FRL, so as to extend it to include the relationship between governments and state banks.

The FRL tries, therefore, to attend to some loopholes in the public spending control. Starting from the principles and general norms, the federation's entities ought to plan and establish their own fiscal objectives and targets. The effect of the FRL would be assured by compensation mechanisms and of deviation correction and by transparency that punished bad management through market discipline and the political process itself. That is, in Ter-Missanian & Craig's (1997) duality, as already mentioned in the last chapter, the FRL should situate Brazil simultaneously in the first and third guidelines.

Lastly, once fiscal irresponsibility is discovered, the FRL establishes institutional and personal responsibility sanctions on the administrators. The regulation of the responsibilities and crimes against public finances is stated through ordinary legislation proposal, that should be analyzed by Congress together with the FRL, as required by the tradition of Brazilian law making.

B. ESTABLISHING RULES FOR INTER-TEMPORALITY: THE BUDGETARY PROCESS AS A PLANNING INSTRUMENT

The international experience¹⁵ has demonstrated that, frequently, the revenues are over estimated in the budgetary process, be it due to the specific difficulty associated to its forecast, be it due to errors in foreseeing the economic scenario (economic growth expectations, and of inflation, for example). At the same time, the expenditures have a tendency to be under estimated, seeing that the annual budget has only the expenditures authorized for the corresponding period and, frequently, on the budget appear expenditures that surpasses a financial exercise. As examples, one finds, in general, investments that are executed over a long period of time (i.e., five years or more) and the current expenditures of continued nature, specially those that originate from past capital expenditures.

The existence of the flows of future expenditures, not foreseen in the first exercise in which the expenditure is budgeted, bring about fiscal unbalances that escape from an *ex-ante* analysis, only becoming visible when the facts have happened. Due to these inter-temporal budgetary limitations, the concept of fiscal result adopted represents a very optimistic indicator of the government's long term paying ability, because it incorporates the expected future costs of the obligations assumed by the government.¹⁶

15 See Alesina and Perotti (1996), on a variety of frequent practices used in the budgetary process.

16 For an analysis of the shortcomings of the commonly used deficit concepts, see Blejer & Cheasty (1990).

The State's machine quickly discovers, in the inter-temporality, a safe refuge to postpone fiscal adjustment and the balancing of the public accounts, planned to happen with a certain expenditure and surprised by non-foreseen spending, which have not been contemplated in the budget, and which have a multiplying, effect seeing that they are financed by bond issued debt, over which is paid interest. In Brazil, these inter-temporal deficiencies of the budgetary process and of the deficit concept were responsible for the appearance of the quasi-fiscal deficits and of debts that continue to not appear for a long period of time, reflected in the growth of the bond issued debt and the privatization currencies of the 90s.¹⁷

The magnitude of this problem points clearly to the need to have a more ample and rigorous formulation of the budget as pre-condition of fiscal discipline. Nunes (1998) suggested the inclusion of the continued expenditures in a sort of multi-annual budget, tagged to the PPA or the LDO, which would contain, besides targets and intentions, estimates of future spending already contracted so as to furnish a forecast of the debt/GDP relationship for a sequence of periods. This inter-temporal instrument would be object to follow-up and periodically submitted to revision.

The FRL, besides other advances, goes through this path and seeks to solve the inter-temporal deficiencies in the only possible form: retrieving for the budget its role as an effective planning instrument. The multi-annual budget represents a declaration of intentions of the Executive and the Legislative with the principle of fiscal responsibilities. It's up to the annual budgetary guidelines law to translate them into quantitative targets, make them explicit for the yearly financial exercise, to which the law refers to, and for the two subsequent exercises. Due to its annual periodicity, the LDO is transformed, therefore, into the public instrument to measure the accomplishment of the objectives expressed in the multi-annual budget. In it must be registered the reasons – in the hypothesis of deviation –, the manner in which it is intended to guarantee that the targets become consistent with the objectives, and the expected time for such to occur.

So that the measurement instruments become effective, its necessary, still, that they be accompanied by tasks that enable the avoidance or the correction of the deviations appointed by them. Thus, the FRL not only establishes the limits to be observed by the main fiscal variables, as well as offers several mechanisms to avoid and correct eventual deviations.

During the budgetary execution, in estimating that the yearly debt and results between revenues and expenditures determined by the budget guidelines law are not met, for example, a linear automatic cut is promoted on the expenditures, at the proportion needed to achieve those targets. Only the expenditures related to the constitutional sharing or legally those related to taxes, the remuneration of the active, inactive and pensions of personnel, and their related benefits and continued pecuniary installments of the general social security regime, the social assistance, the unemployment benefits, the unified health system, and the debt service, as well as the payment of the short term debt are kept.

¹⁷ For an analysis of the inter-temporal deficiencies of the Brazilian budgetary process, see Nunes (1998) and Nunes (1999). According to the Fiscal Stabilization Plan, dated October 28, 1998, the volume estimated of debts in the phase of securitization amounts to R\$ 15.2 billion in 1999, R\$ 6.8 billion in 2000 and R\$ 1.3 billion in 2001.

It's clear that little fiscal discipline isn't only attached to methodology issues and one does not intend to be thorough in this paper in the analysis of the factors that explain the fiscal deterioration in the recent period. In Brazil, in the spheres in which the central government has more control – Federal Government and State Companies – the privatization process and the adoption of austere measures has been relatively successful, but structural forces, such as budget rigidity and non-compressible expenditures (because required by law) with personnel and social benefits and social security, make it difficult to achieve adjustment.

Among the expenditures, the growth of the non-compressible expenditures, related to the payment of personnel, social security, constitutional transfers and others, legally determined, are highlighted. In the Federal Government, in 1998, the non-compressible expenditures represented 77% of the total non-financial expenditures. This means that, in recent times, an enormous effort in the generation of primary surpluses was made on other expenditures, basically items of current expenditures and investments, to compensate the growth on the fixed part of the expenditures.

Even among the structural forces, however, one may mention some that are associated to the difficulty in adopting inter-temporally consistent policies. This is the case of the actuarial unbalances of the several social security regimes, special those of the public sector, that result from the rendering of, or increase in, rights, including constitutional, without previous availability of fiscal results. The Brazilian legislation has always forecast backing to the worker, be it for assistance reasons (sickness, permanent invalidity, death, work accident, non-voluntary unemployment, pension for death of the surviving spouse and those of low income) or the social security, without considering the fiscal balance of the system.

Thus, besides the automatic cut, another important mechanisms to avoid deviations that the FRL takes from the EBA is the *pay-as-you-go*,¹⁸ here proposed for the compensation of the effects of all the acts that provoke reduction of revenues or the increase in the other continued expenditures, understood as those whose effects pass more than three consecutive exercises. Among these are included the contracting of public servants, that receive stability and the revenues renounce, due to non-taxing, amnesty, remissions and subsidies, as well as financial, tributary and credit benefits. The bill of law highlights that the increase in capital expenditures that may be financed by credit operations, donations, or voluntary transfers do not need to be compensated, nor those expenditures such as the debt service.

It's not too much to emphasis the importance of making a correct evaluation of the impact of these types of acts on the public finances and, right because of this, the bill of law foresees that the definition and the enumeration of the compensatory measures are be presented in the budgetary guidelines law by each entity of the federation. They should contemplate periods that include the specified one and surpass the year in reference. One's own acts, on the other hand ought to inform if the expected results will embrace a period inferior or superior to three financial exercises. In the second case, they should identify the disposition of the budgetary guidelines law that approved the compensation. If any

¹⁸ See Schick (1995).

expenditure has been created without the necessary compensation, it will be considered as non-authorized, irregular, and greatly harmful to public economy expenditure. It is up to the legislative to analyze its maintenance.

In specific reference to the continued expenditures, such as social security, in the 1998 constitutional reform, the use of funding from the contribution of the companies and the participants, originated from the paychecks, to finance non-related social security benefits expenditures had already been denied.

The FRL goes one step further on disciplining the increase of prohibited expenditures that are created by means of elevating any benefit or service that results in an increase in expenditures without a corresponding source of integral costing. That may be either an equivalent reduction in other social security benefits or services expenditures, the increase in revenues coming from the creation of another source of costing, or the elevation of the social security contributions.

Considering that it isn't the objective of the bill of law – and it could not do so – to take away or reduce any benefits that a citizen has the right to, the said compensation will not be required when the increase in expenditures is due to the simple elevation in the number of services rendered or the readjustment of the benefit or service is limited to preserving its real value.

To solve the inter-temporal deficiencies that end up in the assumption of debts, the bill of law determines that the budgetary guidelines law of each of the federation's entities, will incorporate an appendix in which the evaluation of the risks, to the respective treasury, of government decisions, that have relevant impact of non qualified degree of certainty on public accounts, as well as any other contingent passives, are registered.

The motivation for this control is related to the fact that seeing that the guarantees do not figure as public sector debts until the debtor does not pay, these values stay latent in the public accounts until they come to light.¹⁹ On the contrary of the private sector, that accumulates reserves related to losses with credit operations, the Federal Government doesn't have the habit of writing out provisions for non-payment and the cost ends up being absorbed in one go, when the fact effectively happens. As many of these potential debts don't impact the current budget, which is circumspect to one financial exercise, it becomes easy to open quasi-fiscal windows and “set” these expenditures for the future.

Therefore, one may verify that the budget doesn't incorporate any risk measurement for debts contracted at present, but that ought to be paid only in the future. The implications for future cash flow, however, are quite grave. What calls attention and is a dangerous precedent, is that the control of the expenditures is much more rigorous when the spending done in cash than when the Treasury gives contractual guarantees in bonds.

19 According to data from the General Demonstrations of the Union, in 1995, the guarantees given to international financing by the Federal Government added up to R\$ 15.648 billion. From then onwards, this amount should grow due to the contracting of credits with the international organizations for the States' Reform Programs.

Thus, the payment of debt guaranteed by, and of the debt assumed by the Union, due to the law represents, basically, the sum of the cost incurred by the government during the existence of the guarantee, and of the compensated passives of the state companies.

Finally, due to the importance and uncertainty characteristic, present in the Social Security issue and other likewise programs, the message of President of the Republic, which sends the Union's budgetary guidelines law to the Legislative Branch should contain, in an appendix, an evaluation of the actuarial, financial, economic and patrimonial situation of the following: (a) the benefits plan for the social security's general regime; (b) the unemployment benefits program, and the rest of the benefits paid for by the Worker's Support Fund (Fundo de Amparo ao Trabalhador); and (c) the other actuarial programs, as well as an equivalent of the benefits plan for the federal public servants' own social security. This last measure is extended to the chiefs of the executive branch of the States and Municipalities that have kept their own social security for their servants.

In Brazil, as well as in most of the European countries, the repartition regime is adopted, where the contribution of the active workers sustains the benefits received by the retired. The repartition system brings about crisis because it introduces an inter-temporal deficiency in the fiscal result concept. In the first stage: the number of those that contribute is superior to those that benefit, making the system generate surpluses. Incorporated into the fiscal result, the social security account transmits a false impression that it is possible for the State to spend more without incurring in future financial problems. Thus, spending that frequently is earmarked for other areas is pressured to appear. In a second stage, the number of beneficiaries becomes larger than those that contribute. Without savings, the State finds itself in the difficult situation of having to pay for the citizens' acquired rights, without the possibility of reducing indefinitely other expenditures to try to achieve fiscal balance.

Due to the impossibility of transitioning to the capitalization system, related to the elevated implicit deficit of the social security,²⁰ the FRL sides with some proposals that have suggested a mixed social security system, that harmoniously conjugates an obligatory public system, with benefits limited to a determined ceiling and related to the contributions made during the working life. This system, together with a complementary system, using the capitalization regime of additional contributions, preferably private and voluntary, based on the private sector and in the capacity of private savings is considered the most adequate.

C. THE LIMITS TO AMOUNT OF DEBT AND THE MAKING OF CREDIT OPERATIONS

A responsible management of public resources should necessarily emphasis the control of not only the spending but also the debt. The FRL defines the concepts of credit operations and of public debt and proposes very precise rules to control debt, for the contracting of credit operations related to the turn over of the floating debt and for the rendering of guarantees by the public entities.

²⁰ Around 20% of the GDP, according to CEPAL (1998, p. 199).

In reference to the debt, the fundamental precept that the product of the credit operations may not surpass the amount of capital expenditures in a determined financial exercise (golden rule) is highlighted,²¹ with the exception of the cases in which it is necessary to finance, in an integral way, the capital expenditures and the related spending associated to the investments. To avoid going down the wrong path, governments are denied the possibility of raising funds through entities that they control and to postpone payments to suppliers, service renders or construction companies, through the emission of credit bonds or guarantees.

If a credit operation has been undertaken in disagreement with the conditions defined in the FRL, the law will determine that said operation's effects should become null and void, be it by the canceling or total acceleration of the debt generated, or be it by the constitution of a reserve in corresponding or superior value. This will be used exclusively to amortize the debt in the subsequent exercise. It is also established that while the canceling or amortization of the debt does not occur, the borrower will be considered to be in default. The contracting of any new credit operation will be denied.

The action on the debt will be complete with the adoption of controls on the consolidated debt. The prudent maximum limits ought to be established by the Federal Senate for each level of government. This will be done in the form of reasons or proportions, deriving from a duly justified proposal of the President of the Republic. The administrators will be required to keep the amount of debt at prudent level, compatible to the tax collection and to the net patrimony. Besides that, they should guarantee security margins capable of avoiding that an eventual debt growth in subsequent periods contaminates, in a sensitive way, the other macroeconomic aggregates. For such reason, it's essential that spending be inferior to the revenues in each financial exercise during the contracting phase of the new debt.

If the amount of debt surpasses the maximum prudent level, it should return to that level during a pre-established period. Along such time, new credit operations are denied and the use of current availability is restricted. If the deadlines are not obeyed, the passing on of federal or state funding will be suspended for the exceeding period (not including constitutional sharing of tributary revenues). During a period that goes beyond the moment of the return to the prudential limit of the debt, the respective government will be denied the contracting of any credit operation (except to attend to the amortization of the floating debt principal) or voluntary sharing of funding.

D. THE LIMITS FOR SPENDING ON ACTIVE AND INACTIVE PERSONNEL

21 For a general view on the discipline of the public debt, specifically on limitations on its operations and amount, see Ter-Minassian (1998).

22 Data from the National Treasury Secretariat, General Coordination of the Relationships and Financial Analysis of States and Municipalities.

The expenditures with the pay sheet of the public servant salaries, and the benefits of the already retired will always constitute a critical issue for the structural adjustment of the accounts for a group of entities of the public sector in Brazil. Especially, the public sector social security has been marked, in the 90s, by strong actuarial unbalances, resulting from the rendering or elevation of the rights, including the constitutional ones without the existence of previous availability of fiscal resources.

The social security deficits have reached all the federation, where the benefits of the 1988 Constitution have been reproduced in the states' constitutions. This problem has become worse in the States and the Municipalities, where the preoccupation with stabilization policies is certainly lower. Besides the expenditures with inactive, the excessive expenditures with the pay sheet, related to working public servants, also plays an important role in the explanation of the fiscal unbalances.

Considering the excessive weight of the payment of public servants in the budget in all the government spheres, this has been the object of specific legislation in Brazil for some time. Still in 1995, to regulate a constitutional disposition, the Complementary Law nr. 82, known as Camata Law, in which the concept of current net revenues was defined, took as basis the limit of 60% of this expenditure to be used with the pay sheet. From then onwards, a gradual process of adjustment has been verified in the majority of the States, which is proven by numbers. In 1995, there were 23 States that didn't meet the limit, while in 1998 this number had been brought down to sixteen. The levels of non adjustment have also changed. While in 1995, sixteen were above 70%, in 1998, only ten were.²³

Even though one may verify the various and notable signs of the responsible standards of fiscal management at all levels of government, the Camata Law didn't produce integrally the results intended. This is due to the constitutional denial of firing public servants, in force until the end of 1998, and by not foreseeing penalties in the hypothesis of not observing the limits. To substitute the Law, a new Complementary Law (known as Camata Law II) was approved in May of 1999. It introduced innovations like the setting of a specific limit of 50% for the expenditures of the Union with the pay sheet, the definition of a deadline of two years for the attainment of the limits, at the proportion 2/3 on the first year and 1/3 on the second, and the imposition of sanctions in the case of not abiding to the adjustment schedule.

The FRL goes one step further in relation to Camata Law II, seeing that it establishes limits to be observed by each Branch, in each entity of the federation, which will be based on available tributary revenues.²³ If the expenditures with personnel have exceeded its prudential limits, the following will be suspended: the concession of any advantage or increase in remuneration, which is not foreseen by law or work contract; the revision, readjustment or adaptation of remuneration; the creation of posts, employment, functions, or the changing of carrier structure; the admission or contracting of personnel; and the concession of other non constitutional advantages.

²³ The appendix presents the distribution of the personnel expenditures among the branches of the entities of the federation, as well as a comparative of the limits adopted by Camata Law II and those proposed by the FRL.

If the expenditures with personnel have exceeded the maximum limits for three consecutive months, they should return to the them over a period of up to 24 months. This would be achieved by promoting successively until the limits are attained: a reduction in, at least, 20 percent with expenditures related to commissioned posts and functions, the exoneration of non-stable public servants and the firing of stable servants. If, after this deadline, the expenditures with personnel are not brought back into the limits, in the case of the Union, there will be an immediate suspension of the liberation of funds to attend to personnel expenditures that exceed the limit, and, in the case of the other entities of the federation, all the passing of federal and state resources.

IV. FINAL CONSIDERATIONS

The proposal of the FRL doesn't boil down to a simple cut in expenditures or the setting of temporary targets for the generation of fiscal surpluses, nor does it treat temporal aspects or of short term guidelines of the fiscal policy. On the contrary, it seeks to develop a new fiscal culture in Brazil. A new regime means instilling permanent principles and modern instruments that overlap and delineate the more immediate fiscal strategy, at the same time as it assures the long term fiscal balance.

On the one hand, the FRL regulates several norms contained in the Constitution, giving them consistency and coherence; on the other, it gets them going, permitting the achievement of a greater fiscal discipline. More than regulate the instruments related to the budgetary process and to public accounting (a subject more related to another Complementary Law, also under analysis of the Congress), the finances good conduct code states principles, specially, those of fiscal responsibility and transparency.

The fiscal reform respects to basic principles: that of democracy – all matters are disciplined by laws, approved by the legislative –, and that of the federation – obedience to the principles and general norms, which are equal to all levels (federal, state and municipal). Each government has to set its own targets and make public its rendering of results.

The FRL innovates when it requires the establishment of consistent targets in the budgetary instruments (multi-annual budgets, LDO and annual budgets). Therefore, the budgetary process begins to permit a continuous and permanent follow-up of the expenditures. This is without attributing a heavier weight to the formal and bureaucratic controls over those of results. Thus, it becomes a strategic instrument for planning and control.

Besides this, the budget acquires an inter-temporal focus and, therefore, becomes more effective as an instrument of control and of fiscal adjustment. For such reason, it should include estimates of expenditures already contracted or authorized that surpasses a budgetary year, thus configured as expenditures in future exercises, such as investments, debt payments, including those resulting from assumption, securitization, or permute of debts and expenditures with the Social Security. Therefore, it becomes possible to plan, in a permanent way, expenditures, avoiding that these expenditures in the future are assumed without the previous attendance to the fiscal balance condition.

This control, by the way, will be undertaken also by the society, as the making public and transparency of the budgetary process is improved, and a system of sanctions and punitive measures that foresee penalties for the public entities and for the governors that behave in disagreement with the principles and with the limits of responsible fiscal management are established.

V. APPENDIX

Brazil – PERSONNEL EXPENDITURES

*Present Effective Distribution, Camata II Law Limits (1999)
And Limits Proposed in the Fiscal Responsibilities Law (FRL)*

GOVERNMENT/BRANCH SPHERE	Effective Pay Sheet Distribution % of the Branches ⁽¹⁾	Limits	
		Camata II Law (1999) % of Current Revenues ⁽²⁾	F R L % of Available Tributary Revenues ⁽³⁾
UNION	100.0%	50.0%	60.0%
Executive	84.5%		50.0%
MPU (Attorney General Federal District and Ex-territories)	1.1%		1.0%
Others	4.5%		3.0%
Legislative	79.0%		46.0%
Judiciary	3.9%		3.0%
	11.6%		7.0%
STATES	100.0%	60.0%	80.0%
Executive	83.8%		68.0%
General Attorney	2.7%		2.0%
Legislative	4.1%		3.0%
Judiciary	9.4%		7.0%
MUNICIPALITIES	100.0%	60.0%	70.0%
Executive	90.0%		65.0%
Legislative	10.0%		5.0%

1 Sources: Union – SRF (Inland Revenues Secretariat), General Demonstrations of the Union and STN (National Treasury Secretariat);
States – data sent by the Finance secretariats of 16 States;
Municipalities – STN/SIAFI (Municipal Demonstrations).

2 According to the Law approved in May/99, the Net Current revenues include the Tributary Revenues, Net Current Transfers, Services, patrimony etc.

3 Available Tributary Revenues includes the Tributary Revenues and Net Tributary Revenues (Article 3 of the FRL bill of law)

ITS IMPORTANT TO HIGHLIGHT THAT THE LIMITS OF TH FRL ARE COMPATIBLE (EXACTLY EQUAL TO) THOSE OF CAMATA LAW II. THE DIFFERENCES ARE DUE TO THE FACT THAT THE REVENUES CONCEPT HAS CHANGED, BECOMING SMALLER IN THE FRL, GENERATING THEREFORE, A HIGHER PERCENT LIMIT.

VI. BIOGRAPHY

- AFONSO, José Roberto e GIOMI, Waldemar (1992). na Legislação Complementar sobre Finanças Públicas e Orçamentos - Subsídios e Sugestões para sua Elaboração H. *Cadernos de Economia* n° 8, Rio, abr./1992.
- ALESINA, Alberto & PEROTTI R. (1996) *Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects*. International Monetary Fund, IMF Working Paper WP/96170.
- ANAND, Ritu & van WINBERGEN, Sweder (1989) "Inflation and the Financing of Government Expenditure: an Introductory Analysis with an Application to Turkey, in *The World Bank Economic Review*, 3 (1):17-38.
- BANCO MUNDIAL (1997). *Informe sobre el Desarrollo Mundial*. Washington, 1997.
- BARRO, Robert J. (1974) "Are government bonds net wealth?", in *Journal of Political Economy*, 82 (6).
- BATISTA, Paulo Nogueira Jr. (1985) "Dois diagnósticos equivocados da questão fiscal no Brasil", in *Revista de Economia Política*, Vol 5, n.º 2, abr-jun.
- BLEJER, Mario I. & CHEASTY, Adrienne (1990) *Questões Analíticas e Metodológicas na Medição dos Déficits Fiscais*. IMF Work Document, manuscript not published.
- BUCHANAN, J. M. (1958) *Public Principles of public debt*. Homevood, Irving.
- BUCHANAN, J. M. (1986) *Liberty, Mariet and State: Political Economy in the 1980s*, Brighton: Harvester Press.
- CARVALHO, Wagner (1997). "A reforma administrativa da Nova Zelandia nos anos 80-90: controle estratégico, eficiência gerencial e accountability". *Revista do Serviço Público*, Brasília, ano 48, n. 3, p. 5-35, set-dez/1997.
- CEPAL (1998). *El pacto fiscal: fortalezas, debilidades, desafios*. Santiago do Chile: Cepal, 1998.
- DIAMOND, P. A. (1965) "National debt in a neoclassical growth model", in *The American Economic Review*, 55(5), part 1: 126-50.
- DOMAR, E. D. (1944) "The burden of the debt and the national income", in *The American Economic Review*, December: 798-827.
- DORN, J. (1987) "The Search for Stable Money: A Historical Perspective", in *The Search for Stable Money: Essay on Monetary Reform*, edited by James A. Dorn & Anna J. Schwartz, University of Chicago.
- FRIEDMAN, Milton (1968) "The Role of Monetary Policy", in *The American Economic Review*, vol. LVIII, no. 1.
- GROSSMAN, P. J. (1988) "Government and economic growth: A non-linear relationship", in *Public Choice* 56: 193-200.
- IMF (1998). *Code of Good Practices on Fiscal Transparency - Declaration on Principles*. Washington, IMF, apr/1998.
- KOPITS, George and CRAIG, Jon. (1998). "Transparency in Government Operations". Washington, IMF, *Occasional Papers*, n° 158, jan/1998.
- KYDLAND, F. E. & PRESCOTT E. C. (1977) "Rules rather than discretion: the inconsistency of Optimal Plans", in *Journal of Political Economy*, 85(3).
- LERDA, Juan Carlos (1987) "A dinamica da dívida pública: de Domar-Lerner a Tobin-Simonsen", in *Pesquisa e Planejamento Economico*, 17(2), ago.
- LERNER, A . P. (1944) *The economics of control: principles of welfare economics*. New York, Macmillan.

- LUCAS, Jr. Robert E. (1972) "Expectations and the Neutrality of Money", in *Journal of Economic Theory*.
- MEAD, J. E. (1958) "Is the national debt a burden?", in *Oxford Economic Papers*, 10(2), feb.: 163-83. (1959) "Is the national debt a burden? A Correction", in *Oxford Economic Papers*, 11(2), feb.: 109-110.
- MODIGLIANI, F. (1961) "Long-run implications of alternative fiscal policies and the burden of the national debt", in *The Economic Journal*, 71, dec.: 730-55.
- MUSGRAVE, R A . (1959) *The Theory of public finance*. New York, McGraw-Hill International Student Edition.
- NUNES, Ricardo da Costa & NUNES, Selene P. P. (1997) "União Monetária Européia - UME: Evolução recente e perspectivas", in *Anais do XXV Encontro Nacional de Economia*. Recife: ANPEC
- NUNES, Selene P. P. (1998) "Dívida Pública, Déficits Quasi-Fiscais e Coordenação entre Políticas Econômicas no Brasil", in *Finanças Públicas - II Prêmio STN de Monografia*. Brasília Ministério da Fazenda.
- NUNES, Selene P. P. (1999) "Relacionamento entre Tesouro Nacional e Banco Central: aspectos da coordenação entre as políticas fiscal e monetária no Brasil", Master's Thesis, Economics Department, University of Brasília
- OCDEIPUMA (1996). "Managing Structural Deficit Reduction. France, OCDE, *Public Management Occasional Papers* n° 11, 1996.
(1997) . *Budgeting for the future*. France, OCDE 1997.
- OJEDA, Galo Abril (1991) *El Deficit Cuasifiscal en Ecuador (1979-1987)*. CEPAL, Serie Política Fiscal n°25.
- PATURY, Luis Romero (1992). "Lei Complementar sobre Finanças Públicas e sobre Sistema Financeiro" in *Caderno de Economia* n° 7. Rio, IPEA, apr./1992.
- PETREI, Humberto (1997). *Presupuesto y control - Pautas de reforma para América Latina*. BID, 1997.
- PISSARIDES, C. A. (1980) "British Government Popularity and Economic Performance." *The Economic Journal*, n° 90.
- SARGENT, Thomas J. (1979) *Macroeconomic Theory*, Academic Press, San Francisco.
- SCHICK, Allen (1995). *The Federal Budget. Politics, policy, process*. The Brookings Institution, p. 3248, 1995.
- SCOI], Grabam C. (1996). "Government Reform in New Zealand". Washington, IMF, *Occasional Papers* n° 140, oct, 1996.
- SERRA, Jose (1989) "A crise fiscal e as diretrizes orçamentárias", in *Revista de Economia Política*, 9:p.137-155.
- TANZI, Vito (1995) "*The Role of Sub-National Governments in Financial Stabilization*". Mimeo.
- TER-MINASSIAN, Teresa & CRAIQ Jon (1997) "Control of Subnational Government Borrowing", in Ter-Minassian, Teresa (ed.3) *Fiscal Federalism in Theory and Practice*, Washington: International Monetary Fund.
- TER-MINASSIAN, Teresa (1997) "Intergovernmental Fiscal Relations in a Macroeconomic Perspective: an Overview", in Ter-Minassian, Teresa (ed.) *Fiscal Federalism in Theory and Practice*, Washington: International Monetary Fund. (1998). "Selected Issues in Public Debt Management". CEPAL, X *Seminário de Política Fiscal*, p. D45-D57, 1998.

- von HAGEN, Jurgen & HARDEN, Ian (1996) Budget Processes and Commitment to Fiscal Discipline, IMF Working Paper WP/96/78.
- von HAYEK, Friedrich A. (1973) *Law, Legislation and Liberty*, London: Roudedge & Kegan Paul.