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**Intertemporal Budgetary Balance: A compared analysis
of the mandatory spending and tax expenditures
controls in the United States and in Brazil**

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I. SUMMARY

Two of the reasons for the occurrence of uncontrolled budgetary imbalances are the ever-growing increase of the government mandatory spending (those expenditures that cannot be subject to reduction during the annual budgetary allocation of resources, which represent, in almost all the countries, the largest portion of the Government expenditures) and the budgetary unplanned increase of tax expenditures (or “tax benefits”, “tax breaks”, “tax incentives” and so on).

The recent Brazilian Fiscal Responsibility Law (FRL) has as one of its main objectives to control mandatory spending increases. Through the institution of rules whose essence is the same of the "pay-as-you-go" process, or PAYGO, established in the Budget Enforcement Act (BEA), enacted in 1990 in the United States: increases in mandatory spending must be offset by reduction of another mandatory spending or by a permanent increasing of revenues.

Another important objective of the FRL is to avoid unplanned budgetary reductions in revenues derived from legislation that create or increase tax expenditures. Passing such legislation requires demonstration that the potential revenue reduction is explicitly considered in the budget revenue estimates or otherwise revenue legislation offsetting the reduction must be enacted. This process also received inspiration from the PAYGO process.

However, the implementation of both processes is extremely complex: operational, political and, foremost, legislative.

This paper is divided into five sections. In the first one, I will make some general considerations on the Fiscal Responsibility Law, in order to highlight

that, among its underpinnings, the control over mandatory spending and tax expenditures prescribed by FRL is the only one that has never been experimented in the Brazilian federal budgetary process.

In the second section, a description of the PAYGO process conceived in the Budget Enforcement Act will be provided, showing its main features and the historical and economic context that has led to its enactment.

In the third I will discuss how the control over legislation concerning mandatory spending and tax expenditures framed in the Fiscal Responsibility Law has been put into practice. I will argue that the process has not been implemented yet and to do so it will be necessary to design an operational and legislative process that has not been tested. The Executive Branch is adopting an interpretation of the Fiscal Responsibility Law that makes it less restrictive and more flexible and, thereby, making it possible to accomplish its requirements for both new mandatory spending and tax expenditures. However, this interpretation was not followed by technical and legislative proposals for procedures to enforce the law.

In the fourth section, this essay will design the guidelines to those procedures, in order to enable Congress, in a comprehensive medium term perspective of fiscal equilibrium, to fulfill the FRL provisions when reporting pieces of legislation related to mandatory spending and tax expenditures.

The last section will be reserved to present some scholars' and practitioners' evaluations on the PAYGO process in United States and final comments on the Fiscal Responsibility Law's process to control mandatory spending and tax expenditures.

II. AN OVERVIEW OF THE FISCAL RESPONSIBILITY LAW

In the eighties, the role of the State started to be reconsidered in a more intense way and reforms began in the developed countries, especially in England, New Zealand, Australia and the United States, aiming at the reduction of the government expenditures dimension. In the context of these reforms, many countries around the world adopted more rigid budgetary control policies and measures to increase the efficiency of the public administration. The control over the budget deficit and the public debt has become permanent and fundamental concerns of the economic policies sponsored by international institutions like International Monetary Fund and World Bank.

In 1998, when the worldwide economic and financial crisis led Brazil to appeal to the International Monetary Fund, the Brazilian Government built up the *Fiscal Stability Program* and settled an agreement with IMF. In this program, the government compromised, clearly, to approve a fiscal responsibility law, as an instrument to balance the public accounts. Besides this, other factor contributed to the presentation of the Fiscal Responsibility Law proposal: the 18th Constitutional Amendment, promulgated in June of 1998, which obligated the Executive branch to present a bill on public finance in one hundred and eighty days.

Instruments of fiscal control (“fiscal responsibility” principles, control and reduction of the public expenditures, control over the indebtedness) already experimented in the European Union and countries of the Organization for Economic Cooperation and Development constituted a source of inspiration to develop the proposal of Fiscal Responsibility Law. However, they were not simply incorporated by the proposal. The proposal grafted those instruments to

the Brazilian realistic landscape, joining them to the budgetary and public finance norms already existing, and building up a completely different legislation from any foreign provision that had serve as inspiration.

Since the presentation of its first draft, throughout its consideration by the Chamber of Deputies and the Federal Senate, and during the first two years after its introduction in to the legal, political and economic Brazilian world, the Fiscal Responsibility Law¹ was surrounded by heated rhetorical debates. Some politicians and policymakers greeted the FRL as a “*historical landmark*”, a “*behavior code for public managers*” and, in a more enthusiastic expression, as a “*revolution in the public finance*”. Others repudiated it as “*an act of submission to the IMF and the interests of the international financial market*”, for representing the institutionalization and the imposition to the States and Municipalities of an economic policy that gives preference to the payment of interests at the expense of the social expenditures. During these three years, this ideological quarrel has gradually lost importance and nowadays no longer matters.

In very few occasions in our country’s history has a law ever been so well known and heatedly debated. However, this notoriety seems have not been enough for the FRL become correctly understood. A series of articles and statements based on superficial knowledge (and unsupported by the language of the FRL) originated from ill-informed politicians, scholars, and governmental authorities, was largely broadcast by the media and has helped to mislead the society regarding the real effects and objectives of that law.

¹ Supplementary Law nº 101, of 2000.

Two of the most controversial and ill-understood sets of provisions instituted by the FRL are those related to “mandatory spending of a continuing nature” and to tax expenditures. Both are subjects of this paper.

1. The objectives and structure of the Fiscal Responsibility Law

The reasons and the objectives of the FRL were presented by the President of the Republic in the message that addressed the Fiscal Responsibility Proposal to the Congress: *“legal conformation of a framework aiming at the drastic and quick reduction of the public deficit and the stabilization of the public debt in relation to the GDP”; “to prevent recurrent and immoderate deficits and undesirable expansion of the public debt”; “to assure the inter temporal balance of the public accounts, creating the necessary conditions for the consolidation of a new fiscal regimen in the country, compatible with the stability of prices and the sustainable development”.*

To reach those objectives, the FRL is based on six pillars, as we can label those sets of provisions concerning: i) debt and indebtedness; ii) fiscal and budgetary planning; iii) personnel expenditures; iv) expenditure generation; v) tax incentives and accountability of the tax administration; vi) social control and monitoring.

The core objective of the FRL, thus, is the establishment of norms to assure that the governmental expenditures are compatible with its collection and capacity of indebtedness and, in a more general level, to assure in the medium and long run the maintenance of the macroeconomic equilibrium of the country, through the control of public debt and budget deficits.

Mandatory spending, spending that can not be controlled by the budgetary process, which we will better discuss later, accounts for more than two-thirds of the United States expenditures, and more than eighty per cent of the current expenditures in Brazil. It is easy to realize that would not be possible to achieve that core objective of FRL without setting controls over legislation that create and increase such a spending. It is required political and budgetary practices entirely new to implement those controls, which are in the early stages of conception.

Of those previously described normative pillars, in the federal level, only the process that is related to the control over the mandatory spending and tax expenditures, a PAYGO-inspired process, actually represents a entirely new set of provisions in the institutional processes used to control public expenditures, the budget deficit and the public debt. And, hence, they must be analyzed deeply in order find ways to really put it into practice and enforced it. The others pillars, in one way or another, represent improvements in the processes already existing, as we will demonstrate briefly.

2. Provisions on debt and indebtedness

This set is constituted by two main norms. The first one prohibits the Union to grant loans or to refinance the debts of the states and municipalities. In this case, we must remember that, under our Constitution, borrowing operations between Union and other member of the Federation must be ruled in to law and authorized by the Senate. Having an explicit prohibition in a supplementary law just means that an absolute majority in both Legislative Houses will be required to enact a new law authorizing those operations.

The other set is related to limits on the debt imposed to all members of the Federation. Our Constitution prescribes that the Senate shall define limits on the debt for the Union, states and municipalities. The Fiscal Responsibility Law only establishes that those limits on the public debt will be defined taking as parameter the “net current revenue”. Limits and controls related to the debt and the indebtedness already existed for the states and municipalities and already were regulated in the Federal Senate resolutions, but only in a somewhat different from the one established in FRL.

The Senate, in 2001, defined new limits for these members of the Federation, but it did not define limits for the Union. Thus, the states and municipalities are, as already they were before, submitted to limits on its total debt; the Union still is not. What FRL really did was to set a more sophisticated mechanism to monitor the evolution of the public debt and enforce the accomplishment of the limits. This is not enough to see this set of provisions as a substantial change in the process already existing.

3. Provision on personnel expenditures

Personnel expenditure in Brazil is deemed as mandatory spending and represents in the majority of the states and municipalities the largest governmental expenditure. Since the Constitution of 1967, the Congress has been tried to keep this expenditure under control, through the imposition of limit (approximately 60% of the net current revenue). Specific laws were approved with this goal, in 1995 and 1999; but they were not successful.

The FRL seeks to institute a more efficient process, setting personnel expenditures limit for each branch of each member of the Federation, and rules

to enforce the accomplishment of the limit in case of excess. The submission to limits is an important rule, to which the Union, states and municipalities had already been obligated, and to a certain extent, accustomed.

What is really new is the determination to apply the same rules established for the generation of mandatory spending to increase personnel expenditure. Neither the Union nor the states and municipalities have ever experimented with such a rule, which in fact represents the most severe restriction imposed by FRL to the personnel expenditures. But this determination has not been fulfilled (or when it says that it is being fulfilled the fulfillment is only in appearance).

4. Provisions on fiscal and budgetary planning

The use of fiscal targets (such as primary surplus, budget deficit or total public debt) has been part of the fiscal planning in developed countries since the early eighties. In Brazil since the early nineties the primary surplus (the main fiscal target) has been used, in the Union, as the guideline to the budget execution, in order to reach macroeconomic objectives. The FRL determines that this parameter must be clearly defined in the Budgetary Directives Law (BDL), institutionalizing the procedure and extending it to the states and municipalities. These goals work as an indirect limit to the expansion of the governmental expenditures.

The basic control included in the FRL to enforce the achievement of the primary result target is the determination to restrict the use of the budget authorizations when a review in revenues and expenditures estimates carried through in the course of the budget execution demonstrates that the primary

result target will not be fulfilled. Such systematic have been already applied since the beginning of the last decade in the Union, under the denomination of "contingenciamiento" (or "impoundment", in the budgetary parlance of the United States). The states and municipalities, under different forms, also promoted the "non execution" of budget authority, in order to fulfill the primary result target adjusted with the Union in the debts refinancing contracts.

The innovation is that the president, governor or major must be set in his draft Budgetary Directives Law a fiscal target (positive or negative). This innovation will strengthen the objective of making compatible expenditures and revenues, but the process *per se* does not constitute something that has never been done in the past.

5. Provisions on social control and monitoring

The FRL prescribes the presentation of some reports and demonstratives, which must be broadly broadcast. To some of them, the main enforcement rule for states and municipalities is the prohibition to receive some federal funds. Much legislation previous to the FRL already determined the presentation of financial and budgetary demonstratives, which however had never received the desired attention.

III. UNITED STATES BUDGET - THE PAYGO PROCESS

To understand the economic and political context in which the Budget Enforcement Act and PAYGO process were created, it is necessary to present a retrospective of the changes in the federal budget process since 1985, when the major focus of federal budgeting had become the budget deficit reduction.

1. A retrospective - From limit over deficit to expenditures and revenue control

In the middle of the 1980s, a deficit explosion occurred. The deficit increased, as a percentage of GDP, from 2.7% (US\$ 74 billion) to 5.1% (US\$ 212 billion), and the debt increased from 26.1% (US\$ 712 billion) to 36.4% (US\$ 1,506 billion). Alarmed by this trend, Congress responded to the deficit crisis by passing the Balanced Budget and Emergency Deficit Control Act in 1985, Public Law 99-177, commonly referred to as the Gramm-Rudman Hollings (GRH) Act.

The purpose of the GRH was to balance the budget by establishing declining deficit targets for each of six fiscal years beginning in 1986, leading to a target of zero in 1991. Although deficits shrank somewhat in the late 1980s, the targets fixed in the GRH were not accomplished. The enforcement measures of GRH were incapable of controlling one of the areas most responsible for deficit growth: the higher spending on mandatory programs².

In 1990, when the deficit was US\$221 billion, the Congress and the President were beset by a budget crisis. The GRH target allowed a deficit of only US\$ 64 billion for fiscal year 1991, but budget projections made in July 1990 indicated a deficit in excess of US\$ 230 billion. After difficult negotiations, a multi-year agreement to reduce deficits between the legislative and executive branches was settled, and Congress passed the Budget Enforcement Act, in the Omnibus Budget Reconciliation Act of 1990 (OBRA), Public Law 101-508, an omnibus package of tax increases, spending cuts and new budget enforcement rules which intended to produce about US\$500 billion in deficit reductions over 5 years.

The Budget Enforcement Act of 1990 (BEA) modified budget enforcement procedures to ensure future fiscal discipline. In contrast to the previous GRH, BEA was not designed to control the deficit directly. BEA abandoned GRH's focus on deficit outcomes and shifted to limiting spending and guaranteeing that the baseline level of revenues was collected. New procedures for deficit control were established: annual caps related to discretionary spending and a pay-as-you-go process, which requires that legislated increases in mandatory spending authorized in substantive law or cuts in taxes be offset by reductions in other mandatory programs or by revenue increases.

The BEA's procedures were originally supposed to expire at the end of fiscal year 1995. However, the Congress has periodically extended their life - the Omnibus Budget Reconciliation Act of 1993 extended both the discretionary spending limits and pay-as-you-go and, in 1997, most of the provisions were extended until September 30, 2002.

2. Discretionary and mandatory spending - the two main categories of spending

The BEA divided federal spending into two categories: discretionary spending, controlled through the annual appropriations process, and direct spending (or mandatory spending), controlled through legislation outside the jurisdiction of the appropriations committees.

² GRH had exempted major entitlement programs (for example, Social Security and Medicaid) from sequestration and limited the cuts that could be imposed on others, such as Medicare.

Discretionary spending refers to those programs that are subject to annual funding decisions in the appropriations process³. If the Congress decides to lower funding for a discretionary program, it can simply reduce the annual appropriation.

Mandatory (or direct) spending means: a) budget authority provided by law other than appropriation acts; b) entitlement authority, and; c) the food stamps program. The fundamental characteristic of a mandatory spending is the lack of annual discretion to determine spending levels. Mandatory spending is controlled by permanent laws.

Mandatory spending is frequently referred to as entitlement spending. Entitlement spending is a subset of mandatory spending and represents the largest component of mandatory spending. An entitlement represents a legally binding obligation on the part of the Federal Government and spending occurs pursuant to laws governed by eligibility rules and benefit formulas that provide all eligible individuals, entities or units of government with financial assistance or other benefits⁴. Unless the underlying law establishing the entitlement is modified, those individuals and entities retain a legal right to benefits, regardless of the budget situation. Consequently, eligible recipients have legal recourse to compel payment from the government if the obligation is not fulfilled.

³ Most of the Federal Government operations are discretionary spending. Funding for salaries and other operating expenses of Government agencies, for example, is usually discretionary because it is usually provided by appropriations acts.

⁴ Medicare and Medicaid payments, unemployment insurance benefits, and farm price supports are examples of mandatory spending, because permanent laws authorize payments for those purposes.

3. A brief overview of the PAYGO process

The PAYGO process prescribed in the Budget Enforcement Act was designed to constrain future budgetary actions of the Congress and the President. The BEA placed mandatory spending and revenue legislation into the PAYGO requirements. Any new program or policy expansion of an existing mandatory program or any tax cut, including tax expenditures, requires offsetting reduction in spending or increase in receipts for each year that is affected. A revenue loss must be offset by either an increase in other revenues or a decrease in mandatory spending. Similarly, an increase in mandatory spending must be offset by either a decrease in other mandatory spending or an increase in revenues.

PAYGO does not require offsets for mandatory program increases or revenue decreases driven by inflation, recession, growth in the numbers of people eligible for a program, or the other external factors that influence mandatory spending programs and revenues under existing law.

PAYGO does not require that every bill dealing with mandatory spending and revenues be deficit-neutral. Only the net effect of all such legislation enacted during that session of Congress has to be.

And, as pointed out by Allen Schick, *“Congress may not use an increase in revenues resulting from improved economic circumstances to offset legislated revenue losses”*.

If revenue or mandatory program legislation are not completely offset at the end of the session of Congress in the fiscal year in which the deficit would be increased, a sequestration procedure would be triggered, and mandatory

programs could be cut to make up the difference. This sequester occurs fifteen days after Congress adjourns for the year.

The PAYGO sequester deal with mandatory spending and revenues and the key to understanding it is the baseline.

4. The baseline

Baseline is a set of projections related to spending, revenue, deficit or surplus, and the public debt, that would occur if no changes are made in existing programs and policies under current laws during the period covered by the budget, according to rules established in Gramm-Rudman-Hollings Act.

For mandatory spending and receipts, the baseline assumes they will continue in the future as required by current law. With respect to entitlement programs, the baseline is adjusted for, among other things, the effects of inflation and demographic changes that alter the expected number of beneficiaries. For discretionary programs, the baseline assumes that the future funding will equal the most recently enacted appropriation, adjusted for inflation.

The baseline serves several useful purposes: a) it may warn about future problems either for Government fiscal policy as a whole or spending programs; b) it represents a starting point both for formulating the President's budget and for the Congress action on it, and provides a "policy-neutral" benchmark against which the President's budget proposal and alternative proposals can be compared to assess the magnitude of proposed changes; c) as BEA directs, the Office of Management and Budget (OMB) uses the baseline to determine how much will be sequestered from each program, when necessary, and; d) members of the Senate and the House, in considering proposed levels of

spending and revenues, usually describe the cost of their proposals as being above, below, or equal to the baseline.

BEA allows several adjustments to be made to the baseline. The major one allows the President to adjust the baseline for "emergency" mandatory spending increases and revenue reductions, but BEA does not define what it means by an "emergency". Such an emergency can be anything that Congress and the President agree with.

5. *The sequestration process*

The BEA established a PAYGO scorecard to record the projected five-year budgetary effects of each piece of legislation that affects mandatory spending or revenues. The House and Senate Budget Committees, Congressional Budget Office (CBO) and OMB are involved in the scoring (estimating) the budgetary effects of each piece of PAYGO legislation as they move through the legislative process. CBO and OMB are required to maintain a "scorecard" showing the cumulative deficit/surplus effect of PAYGO legislation to track progress against the PAYGO requirements:

As soon as possible, after Congress completes action on PAYGO legislation, CBO is required to report to OMB the estimated amount of new budget authority provided by the legislation. Within seven working days after a PAYGO legislation is enacted, OMB must report its estimates for these amounts, using the same economic and technical assumptions underlying the most recent budget proposal.

Under the Balanced Budget and Emergency Deficit Control Act of 1985, OMB and CBO must to publish three sequestration reports: 1) *preview report*, at

the time the President submits the budget, in February; 2) a *update report* in August, and; 3) a *final report*, at the end of a session of Congress.

These reports must contain: a) estimates of the changes in outlays or receipts for the current year, the budget year, and the following four fiscal years resulting from enactment of PAYGO legislation; b) the amount of net deficit increase or decrease; c) a list identifying each law enacted included in the calculation of the amount of deficit increase or decrease, with a specification of the budgetary effect of each such law, and; d) the sequestration percentage necessary to prevent a deficit increase. The estimates must rely on the economic and technical assumptions underlying the most recent President's budget.

The preview report discusses the status of discretionary and PAYGO sequestration, based on current law. CBO issues its preview report to OMB, the Senate, and the House of Representatives, five days before the President's annual budget submission to the Congress. OMB issues its preview report in the day of the President's budget submission, to the Senate, the House of Representatives, and the President. Thus, the session of Congress begins with the White House and Congress knowing that they must find offsets. If they do not enact these offsets, they would face an end-of-session sequester for the "next fiscal year".

The update and final reports revise the preview report estimates to reflect the effects of newly enacted discretionary and PAYGO laws. In the final sequestration reports, OMB and CBO calculate the net change in the deficit or surplus due to PAYGO legislation. CBO issues its final report to the House of Representative, Senate and OMB, in 10 days after the end of a congressional

session. OMB issues its reports to the President, Senate and House of Representatives, in 5 days after receiving the CBO's report. The OMB report is the sole basis for determining whether an end-of-session sequester is required, and must explain any differences between its report and CBO's report.

If a sequestration would be required, the President must issue an order implementing it, without changing the sequestration required by OMB's report. The General Accounting Office (GAO) must issue a report stating the extent to which orders issued by the President and reports issued by OMB or CBO comply with Budget Enforcement Act requirements.

Only eligible mandatory programs are allowed to be reduced by an across-the-board percentage. The BEA exempts most mandatory spending, including Social Security, interest on the public debt, Federal employees retirement, Medicaid and most unemployment benefits. So, despite the fact that mandatory spending accounts for more than sixty-five percent of the federal budget, there is only a limited amount that is eligible to be cut if a PAYGO sequester occurs. As a result of exemptions and special rules, only about three percent of all mandatory spending is subject to sequestration, including the maximum amounts allowed under special rules.

The sequestration rules can be suspended if either of the following circumstances arises: war and recession. In either event, the director of CBO must notify Congress. In this case, the majority leader in the Senate must introduce a joint resolution that, if enacted, suspends the sequestration provisions through the fiscal year that begins at least twelve months later, as long as the recession is projected to be over by that time.

6. Reconciliation - the legislative process to change mandatory spending and tax legislation

Although the BEA does not specifically require it, the assumption and usual practice is that a specific plan to match changes in mandatory spending and revenues will be worked out in the budget resolution, and will be package in an omnibus bill, through the reconciliation process, which is explained in the following paragraphs.

The budget process includes methods of controlling mandatory spending. In the Congressional Budget Act (CBA) of 1974, the Congress established the congressional budget resolution, which is the Congress' budget. The major purpose of the budget resolution is to provide a fiscal blueprint for all congressional committees. The budget resolution must set the total level of budget authority, outlays, and revenues (and, therefore, the deficit or surplus and the appropriate level of public debt) and determines priorities.

To enforce the priorities and totals defined in the budget resolution, the Congressional Budget Act created the reconciliation process, which provides Congress with expedited procedures to achieve changes in revenues and mandatory spending through an omnibus bill and bring revenue and direct spending under existing laws into conformity with the levels set in the budget resolution. The process has two distinct phases: issuance of reconciliation instructions in the budget resolution and enactment of reconciliation bill (or bills)⁵.

⁵ Allen Schick. "The Federal Budget - Politics, Policy, Process. (Brooking Institution Press: Washington, D.C. , 2000), 125.

If the budget resolution calls for changes in mandatory spending or in revenues, it shall contain reconciliation instructions direct one or more committees to report new legislation promoting changes in mandatory spending or revenues as needed. The budget committees would then draft the budget resolution including, for example, the proposed spending increases and/or revenue reductions and the necessary offsets. The offsets would then not just be assumed to occur, but would be ordered through reconciliation instructions. If the committees refuse or are unable to comply, the budget committees can be given authority to make the changes for them.

The reconciliation process is an optional process that is used most extensively in years in which major changes are made in budget policy. Once it is initiated, there is a strong probability that the reconciliation bill will pass, due to the fact that reconciliation is considered as a package, under rules and procedures that restrict the time available for debate and opportunities to amend the measure. The House takes up the reconciliation bill pursuant to a special rule specifying which amendment may be considered. The Senate allows only twenty hours of debate. When the twenty hours are up, the Senate votes on the bill, without further debate.

7. Points of Order - A legislative PAYGO enforcement procedure in the Senate

In order to help Congress legislate within the budgetary constraints dictated in the budget resolution, the Budget Act provides for a number of points of order, which are a parliamentary device by which any member of Congress can object to an amendment or a piece of legislation on the grounds that it is not within the limits set in the budget. Normally, a point of order may be waived

by a simple majority vote. However, in the Senate, to waive some points of order requires a three-fifths vote.

As observed by Allen Schick⁶,

“In the House, points of order can be waived by a special rule that is voted on before consideration of the measure to which it pertains; such rules need only a majority to pass. In the Senate, however, many budgetary points of order can be waived only by a three-fifths vote (60 votes) of the membership. In light of the party lineup in the Senate, neither Democrats nor Republicans can waive affected budget rules without obtaining some support from the other side. The effect has been to give party a veto on revenue and spending initiatives and to impel them to negotiate budget agreements that satisfy both parties ...The Presiding Officer of each house, in consultation with the Parliamentarian and the Budget Committees with respect to the “scoring”, is responsible for determining if a Member has correctly raised a point of order.”

The budget resolution for fiscal year 1994, which implemented President Clinton’s first budget, included a new pay-as-you-go rule in the Senate. This rule provided a three-fifths-vote point of order in the Senate against consideration of legislation that would cause an increase in the deficit over the next 10 years. The Concurrent Resolution on the Budget for Fiscal Year 1996 made some changes to the Senate’s pay-go rule, but continued to require a ten-year deficit neutrality requirement. That section prohibits consideration of legislation that would increase the deficit for first year, years 1–5, or years 6–10.

⁶Allen Schick. “The Federal Budget - Politics, Policy, Process. (Brooking Institution Press: Washington, D.C. , 2000), 124.

To determine a violation, CBO measures the budget impact of a direct spending or revenue bill (score) combined with the budget impact of all direct spending and revenue legislation enacted since the latest budget resolution's adoption. If CBO concludes that a direct spending or revenue bill would result in a net deficit increase for any one of the three time periods (the first year, the sum of years 1 through 5, and the sum of years 6 through 10), the direct spending or revenue bill is subject to a three-fifth-vote point of order in the Senate.

8. The scoring process

As we commented in “The Sequestration Process” section, every piece of legislation must be scored (estimate of budgetary impact) by the CBO and OMB, in order to be provided a means to enforce PAYGO requirements and other congressional budget rules,

The score process is the basis from which the enforcement of the rules works and it has become a fundamental part of the PAYGO process, which concerns potential beneficiaries and lawmakers, as we can see in the following words of Philip G. Joyce⁷:

“Since the BEA was enacted, the existence of explicit spending limits (the discretionary caps) and explicit assumptions of deficit neutrality (PAYGO) has made the question “How will you pay for it”? the first one asked of proponents of costly new spending. How much they will pay is tied up in the enforcement mechanism established as part of the budget process. [...] Once the decision was made to use the budget process to return the budget to (or close to)

balance through enacting deficit limits and spending limits, it was necessary to have some kind of mechanism in place to enforce those structures. This has given rise to a complex set of administrative rules and procedures that govern the “scorability” of various policy changes. In response to this rules, advocates of particular policies sometimes adjust the parameters of their policy proposals to reflect how OMB and CBO will score them.”

The score is not straightforward. It is complex and based on technical data and forecast assumptions, which allows more than one interpretation. Thus, it can be used to promote or impede legislation. Each side can use the assumptions that supported its position and to better the score.

IV. THE FISCAL RESPONSIBILITY LAW AND THE CONTROL OF MANDATORY SPENDING AND TAX EXPENDITURES

1. Discretionary and mandatory spending - A short explanation

As noted previously, in the American budgetary model there is a distinction between discretionary spending (controllable) and mandatory spending, described in the Budget Enforcement Act.

Discretionary spending will only occur if it is approved during the budgetary process. Mandatory spending is determined out of this process and it must be carried through in the sums due, unless appropriate legislation is enacted reducing it, eliminating it, or removing the compulsory nature from it.

⁷ Philip G. Joyce, “Congressional Budget Reform: The Unanticipated Implications for Federal Policy Making”, *Public Administration Review*, July/August 1996, Vol. 56, n 4, p. 321-322.

The Fiscal Responsibility Law introduced, in article 17, the concept of mandatory spending of a continuing nature, which is quite similar to the entitlement concept:

“Current expenditures are considered to be mandatory and of a continuous nature when deriving from the law, provisional measure or normative administrative act, which determines that the member of the Federation must execute such outlays for a period of more than two years”.

At this point, we must clarify an important distinction. In the American budgetary process, expenditure is classified as discretionary or mandatory. There are several types of expenditures classified as mandatory but not all of them match the concept of *mandatory spending of a continuing nature* defined in the Fiscal Responsibility Law, which is directly related to the concept of entitlement. Specific programs like Food Stamps, for instance, are considered mandatory spending, although the law that has created them determines that the total amount will be established by the appropriations committees.

In the Brazilian budgetary process there are a number of expenditures with the same feature of Food Stamps: they are neither totally discretionary nor totally mandatory. They don't fit into the concept of *mandatory spending of a continuing nature* and hence, they are not submitted to a specific control. A recent example of a such an expenditure is the program called *First Job* (Project of Law nº 1.394/2003), which, on one side, guarantees a subsidy to the employers who hire adolescents, and on the other side prescribes a ceiling on that expenditure, to be decided annually in the budget.

The concept of *mandatory spending of a continuing nature* does not encompass all sorts of expenditures, which in the Brazilian budgetary process

are usually classified as “mandatory spending”. Thus, the term “mandatory spending” can be used to refer to: a) *mandatory spending of a continuing nature*, as defined in article 17 of the FRL; b) mandatory spending by law, but prescribed to be executed in less than two years period, not classified as “a continuing nature”, and so exempt from the article 17 requirements; c) a set of expenditures whose aggregated sum must be equal or greater than a minimum amount fixed in the Constitution, or in law, although each component can constitute a *mandatory spending of a continuing nature* or a discretionary spending (this is the case OF health and education expenditures); d) transferences of resources to states and municipalities classified as expenditures in the budget, but which, actually, constitute transferences of revenues collected by the Union, determined by the Constitution or specific laws.

From this point as forward, when we refer to “mandatory spending” should understand *mandatory spending of a continuing nature*, as defined in the article 17 of the Fiscal Responsibility Law.

2. Provisions to generate mandatory spending of a continuing nature

In contrast to the discretionary spending (controlled by the annual budgetary process of resources allocation) the sum of resources to be allocated to the mandatory programs is defined by criteria of eligibility and payment in the non-budgetary legislation, and therefore they need to be object of a specific control. Rules regarding the generation of mandatory spending are framed in the Fiscal Responsibility Law, as follows.

An act that creates or increases this type of expenditure must be accompanied with: a) the estimate of the financial and budgetary impact in the fiscal year the act will be effective and in the two following ones, and; b) demonstration that the act won't affect the fiscal targets (primary result). The act also must have its financial effect offset by either reduction of mandatory spending or permanent increase in revenues. In this later case, the increase must be "*arising from the increase in tax rates, the broadening of calculation base, or the increase or creation of tax or contribution*".

The offsetting measures must be blend in the act that has created or increased the mandatory spending, which will only take into effect after the offsetting measures take into effect too. These rules are applied to the acts that provoke increase of the personnel expenditure, as prescribed in the article 21 of the Fiscal Responsibility Law.

As one can see, the essence of that control remains on legislated increases in mandatory spending⁸ are immediately compensated by specific provisions reducing permanent expenditures or increasing permanent revenues.

However, some authorities and analysts have been transmitting to the society (and they still transmit) a wrong view of that system. It has been broadcasting that, as prescribed in the FRL, expenditures just can be increased if the total revenue increases too. But that idea is not ruled in the article 17 of the Fiscal Responsibility Law.

⁸ Typically social security expenditures: health, social assistance, and retirements and pensions.

3. The lack of clear rules and the problems of interpretation

In spite of the fact that the underlying idea of the offset system appears straightforward (permanent legislated increasing in expenditures must be compensated by permanent legislated increasing in revenues or reduction in expenditures), its implementation is complex, such as occurs in the PAYGO process, described earlier in this paper, and corroborated by Allen Schick: “*The BEA rules are not complicated, but implementing them entails complex budget calculation and procedures, increasing the complexity of the budget process.*”⁹

Due to the insufficient time dedicated, in the Congress, to conceive, analyze and debate the rules to generate mandatory spending, they were written into the proposal without precision. Less than a dozen of congressmen had the awareness of the dimension the new restrictive rules would impose to certain social programs and the personnel policy, if the law were applied strictly in accordance with its initial conception. The core provisions were not accompanied by either enforcement rules or clear concepts and detailed rules to implement them.

At that time, the Budget and Fiscal Monitoring Office of the Chamber of Deputies foresaw that the system would be impracticable and would raise a number of interpretation matters. In fact, during three years of Fiscal Responsibility Law questions have come about and remained to be resolved. We can brief some:

⁹ Allen Schick. “The Federal Budget - Politics, Policy and Process”. Brooking Institution Press: Washington, D.C., 2000, pp. 23-24.

a) The concept of mandatory spending is not sufficient clear and misleads some scholars and practitioners, who really do not understand the new process to control the generation of mandatory spending. Some of them, for example, advocate that contracts with service providers are a source of mandatory spending;

b) There is no definition of the extension of the period to be used in calculating financial effects of a bill and the necessary compensation. There are interpretations completely different: one is that compensation must happen for an indefinite period, which maybe extended to ten, twenty or thirty years. Another could also be that the offset requirements must be accomplished just in the following two fiscal years after the first one the law goes into effect. And, still, a third one, by which compensation is only mandatory if the fiscal targets are affected¹⁰;

c) There is no definition of what must be considered as permanent reduction of expenditures. No matter that it is implicit that “permanent reduction” correspond to a mandatory spending, one can foresee that other expenditures which do not have this nature will be enclosed as “permanent”, if this interpretation comes to facilitate the accomplishment of the rules;

d) There is no definition of minimum parameters or methodologies to estimate financial and budgetary impact and its compensation.

¹⁰ The question in this case it would be to know how to prove that the targets are not affected. And the response would be the use of the margin of expansion, as shown in this paper.

4. How the rules to generate mandatory spending are being put into practice

It does not required political acumen to foresee that some public policies would become extremely difficult to be enacted according to the legal obligation to include offset measures in the same act that creates or increases mandatory spending. That rule would stimulate stronger interest groups to seek for and support ways to skirt the intentioned severity of the law.

It was the Executive Branch itself, in the project of Budgetary Directives Law for fiscal year 2001, the first governmental entity to beginning the process of creative interpretations. Two provisions of the FRL were blended into an interpretation that allows carrying through the compensation in another way. The first one is the § 2 of article 17, where it is said that among the hypotheses of increasing revenues considered as “permanent” is the “broadening of calculation base” of the taxes. The Executive Branch has provided the following interpretation:

“In accordance with the § 3º of article 17 of the FRL, permanent increasing of revenue is that one derived from increase in tax rates, broadening of calculation base, increasing or creation of taxes. It is understood as “calculation base” the economic or numerical base on which it is applied a tax rate to obtain the amount of tax to be collected. Thus, the real growth of the economic activity is one of the key factors which increase the “calculation base” of tax collection.”

The second one is the article 4º, § 1º, V, in which is determined that the Budgetary Directives Law must contain a demonstration of the “expansion margin of mandatory spending”.

In 2001, the Executive Branch defined the “margin of expansion” as that one constituted by the portion of revenues originated from the “real growth of the economic activity”, deducting from this amount the transferences of taxes collected by the Federal Government to the states and municipalities and some increases in mandatory spending recently enacted.

This amount would correspond to a “reserved fund” to offset increases in mandatory spending derived from new legislation. However, none of the FRL provisions explicitly allows that the balance of a “margin of expansion” might offset an increase on mandatory spending.

5. Margin of expansion: the reappearance of a vetoed item

To understand the meaning of the term “margin of expansion” we should go back to the article 4o, III, of the Fiscal Responsibility Law, vetoed: “*The Budgetary Directives Law shall define limits and conditions for the expansion of mandatory spending of a continuing nature referred to in article. 17.*”The veto reasons were:

“Article 17 of the project of supplementary law already establishes the rules for the expansion of the mandatory spending of a continuing nature. On the other hand, if the expenditure has already been defined by law as being mandatory, there is no reason to establish limits and conditions for its expansion. Therefore, in face of the contradiction that presents the language of the item in discussion, it is recommended the veto, since the item is contrary to the public interest”.

Actually, the author of the veto’s reasons did not understand the underlying objectives of that provision: the objective was not to limit the expansion of mandatory spending already existing, through the imposition of

budgetary limits. The intention was to allow the Budgetary Directives Law to define limits and conditions for increases in mandatory spending derived from new legislation. Those limits would be materialized in a “margin of expansion”. That is the reason why the FRL demands the BDL contain a demonstration of the margin of expansion (and this item was not vetoed).

Thus, legislative proposals (pieces of legislation or provisional measures) or agencies’ regulations, executive orders and so on, which increase mandatory spending besides observing the requirements of article 17 might have observed the limits and conditions established in the BDL. The aggregated financial and budgetary impact of those acts could not exceed the amount of the margin of expansion.

That margin, in a more flexible interpretation, foreseen as possible at that time, would represent the sum of revenues reserved to face legislated increases in mandatory spending.

The implication of the Executive Branch interpretation was, in to some extent, put into effect the item vetoed and so revived the main idea underlying it, as explained above. Since then, in the messages that accompanied projects of law and provisional measures stated that the increase in mandatory spending will be offset by the margin of expansion, as the examples better illustrate:

- 1) Exposition of Motives of the Provisional Measure nº 124, July 11, 2003, which is related to the salaries of the National Agency of Water personnel:

“[...] The expenditure for the fiscal year 2004, estimated in R\$ 5,2 million, will be included in the Project of Annual Budgetary Law of 2004, in phase of elaboration, being absorbed by the net margin of expansion, calculated and

demonstrated in the annex to the Budgetary Directives Law. In the fiscal year 2005, the annual expenditure of R\$ 5,2 million will reduce the net margin of expansion of that fiscal year, which is compatible with the increase of revenues derived from the real growth of the economy, as demonstrated the historical series to the broadening of the calculation base in the last years.”

2) Exposition of Motives of Provisional Measure nº 45, June 25, 2003, which is related to the salaries of Brazilian Central Bank personnel:

“[...] The annual expenditure is being estimated for the fiscal year 2002 in R\$ 9,36 million, and will be absorbed by the net margin of expansion, calculated and demonstrated in the annex of Budgetary Directives Law [...] In the fiscal years 2003 e 2004, the expenditure estimated in R\$ 10,57 million will represent an increment of R\$ 1,21 million over fiscal year 2002, amount that will reduce that margin in those fiscal years, which is compatible with the increase of revenues derived from the real growth of the economy, as demonstrated the historical series to the broadening of the calculation base in the last years.”

6. Margin of expansion: a potential instrument of fiscal control waiting to be implemented

The Executive Branch interpretation of the offset process design in the article 17 of the FRL shifted radically its underlying rationale: the compensation must be compulsory promoted by new legislation (reducing mandatory spending or increasing permanent revenues). Nevertheless, it has a positive effect: it will help to make the process conceived in the FRL suitable for our political reality, in a way very similar to that one several congressmen would have liked to

approve four years ago, when Congress debated the Fiscal Responsibility Law project.

But, one more time, the new rules created by that interpretation was not accompanied with the necessary institutional and technical initiatives to give effectiveness to the process, and we can demonstrate this by pointing out the following evidence.

First, in fact, there is no margin of expansion, since the real increase in revenues is totally allocated in other expenditures. There are no reserved funds to absorb costs originated from future legislative measures. Therefore, if a new law creating mandatory spending is approved, the Government will have to leave carrying through other expenditures, but there is no regulation regarding this.

Second, there is no control over the margin of expansion. It is possible to present to the Congress many provisional measures and pieces of legislation related to mandatory spending indicating as offsets the amount of the margin of expansion, and consequently it is possible to pass laws which total increases in expenditures is bigger than the amount of the margin. There is no agency or legislative process able to verify if the margin of expansion has enough balance to be used as an offsetting source when a legislative act is proposed.

Third, there is no process either in the Executive Branch or in the Congress to estimate the budgetary and financial impacts of legislative proposals and provisional measures.

Four, there is no comprehensive framework to control all the legislative measures that increase or reduce both mandatory spending and permanent

revenues. Hence, most of the legislative proposal dealing with potential matters subject to the rules of the Fiscal Responsibility Law simply does not approach the offset question. Some proposals and provisional measures have been presented offering the margin of expansion as a compensation source, and some try to fulfill the law but do it erroneously, as the example below shows.

The Project of Law nº 1.152/2003, presented by the President, entitles people to receive payments in order to help them to be reintegrated into society, and prescribes: “§ 2º *The increase in mandatory spending of a continuing nature resulting from this benefit will be offset within the minimum amount of resource allocated to health programs, according to article 77 of the Temporary Constitutional Provisions Act.*” But, according the Fiscal Responsibility Law rules, reductions in discretionary spending cannot be used to compensate increases in mandatory spending.

In this way, the President and the members of the Congress can present piece of legislation creating or increasing mandatory spending claiming its financial effect will be compensated by the margin of expansion, or by other means, as the case described above exemplifies. Hence, it is giving an appearance of fulfillment of the law:

7. The control of the generation of tax expenditures

In its article 14, the Fiscal Responsibility Law instituted conditions for the concession of tax benefits. Although it is not explicit, one understands that these rules are applied only to the legislative acts that grant directly or authorize the concession of tax benefits.

The proponent (the legislative proposal sponsor) must present estimates of the financial and budgetary impact during the period covering the fiscal year in which the act is taken into effect and the two following. He also must demonstrate that the loss of revenue was considered in the revenues estimates of the Annual Budgetary Law, and that the act will not affect the fiscal targets established in the Budgetary Directives Law.

If it will not be possible to demonstrate the fulfillment of these two requirements, the proponent must present offsetting measures, covering the same period aforementioned. It is only accepted as offsetting those derived from increasing in revenues, and only those that raise tax rates, broadening the calculation base, or increase or create taxes. When offsetting measures are required, the act providing tax expenditures will take into effect after the offsetting measures are implemented.

8. The difficulty to define “tax expenditures”

In this process, an important point must be analyzed: the concept of “tax expenditures”. The complexity of this subject is recognized by the International Monetary Fund (IMF) in its Manual of Fiscal Transparency: *“the definition of tax expenditures is sufficiently complex, therefore it requires the identification of a “normal” tax structure or “of reference ”; the tax expenditures would correspond then to shunting lines in relation to this “normal” structure”*.

The manual also says: *“the minimum standard demands that is included in the budget a demonstrative of the main tax expenditures (our Constitution demands this demonstrative too), including one brief explanation of the nature of each program (which is not provide in our demonstrative), to allow an*

evaluation of its justification and fiscal relevance. For this it will be necessary to adopt some decisions on the definition of tax expenditures.”

The § 1º of article 14 of the Fiscal Responsibility Law lists cases considered tax expenditures: amnesty, remission, subsidy, presumed credit, exemptions granted on an exceptional basis, changes in tax rate or calculation base which imply in a discriminating reduction in taxes or contributions, and other benefits that result from a differentiated treatment.

Since article 14 does not apply to any act of revenue loss, but only to those deemed as tax expenditures, there are many cases in which doubts will remain on the application of the law. If the situation is understood as tax expenditures, the article 14 is applied; if it is understood as "a normal" modification of the tax system, the rules for tax expenditures generation are not applied. As the law left a wide margin of interpretation, in many cases it would be possible to prevent the enforcement rules by providing an “appropriated” interpretation of what is a “tax expenditures”.

9. The lack of a legislative control process: the ineffectiveness of the rules

As previously noted, besides to the fact a better definition of the acts submitted to the new rules is necessary, the achievement of the objectives intended with this new process of generating tax expenditures demands the implementation of legislative and technical processes capable to deal with it.

In the jurisdiction of the Union, the analysis of some bills passed after 2000, as well of its legislative debates, discloses that, for the lack of those processes, in almost the totality of the cases one verifies that do not exist the followings: a) estimates of the financial and budgetary impact; b) demonstration

of the impact on the fiscal targets; c) demonstration that the revenue forecasts of the annual budget explicitly took into account the impact of new tax expenditures or, alternatively, the offsets measures were provided in the tax expenditures proposal.

There are no methodologies to estimate financial and budgetary impact or technical structures capable to make it reliable. There are no rules defining how to prove that the proposal will not affect the fiscal targets or how to prove that in the revenue forecasts was considered the effects of the proposal. There is no process either in the Congress or in the Executive Branch able to enforce the FRL rules.

Due to what we explained above, in the cases where at any stage of the legislative process the failure to accomplish the FRL is raised, the political decision towards becoming the proposal into law probably will determine a way to seem to fulfill the law.

One example of forms of "apparent fulfillment" can be found in a proposal recently enacted which presented as offset measure the use of the "reserve for contingencies" and the "excess of revenue regarding the estimates". The Fiscal Responsibility Law simply does not allow such "sources of compensation"

Without the institution of legislative and budgetary processes able to deal with this innovative system required to approve bills which grant or increase tax benefits, it will not be possible to fulfill the Fiscal Responsibility Law effectively. And if this "apparent fulfillment" occurs in the jurisdiction of the Union one can presume what the situation in the jurisdiction of the states and municipalities is. It is not very different.

10. Control of changes in revenue legislation: differences between the PAYGO and the Fiscal Responsibility Law

One can point out some important differences between the PAYGO and the Fiscal Responsibility Law process to control changes in revenue legislation.

The rules of the FRL are applied only to the legislative measures regarding tax expenditures (creation or increasing). The foremost feature of the FRL is the requirement that increases in tax expenditures be compatible with the short run fiscal policy set in the Budgetary Directives Law. Thus, when Congress establishes the triennial fiscal targets and defines the revenue estimates in the budget, it should take into account the impact of increases in tax expenditures derived from changes in legislation. Otherwise, the Congress will be required to include in the proposal increasing tax expenditures measures to offset its financial and budgetary impact.

The main objective of the PAYGO process is to put under legislative control the increase in the budget deficit that could result from legislation reducing revenues or increasing mandatory spending. The PAYGO rules are applied to any piece of legislation able to lower revenue below the baseline (be it tax expenditures or not). The Congress must pass legislation increasing revenue or decreasing mandatory spending to offset any proposal of revenue reduction. The Fiscal Responsibility Law does not allow that an increase in tax expenditures be offset by reductions in mandatory spending.

In the PAYGO system, revenue losses resulting from new legislation cannot be compensated by a revenue increase driven by economic growth. In its inception, the FRL system also did not allow that possibility. However, things have changed. Since increases of revenues derived from real economic growth

are being considered a form of “broadening of the calculation base”, our system, nowadays, allows that revenues losses originated from new legislation be offset by increasing revenue driven by economic growth.

V. GUIDELINES TO CONCEIVE A NEW LEGISLATIVE PROCESS TO CONTROL THE GENERATION OF MANDATORY SPENDING AND TAX EXPENDITURES

In the previous sections we argued that it will not be possible to accomplish the FRL provisions concerning mandatory spending and tax expenditures without an appropriate legislative process. Based on the knowledge acquired studying the American legislative budgetary process, on the experience with the Chamber of Deputies’ “analysis of budgetary and financial consistency” and on the concept of “margin of expansion of mandatory spending of a continuing nature”, it is possible to envision a process to control mandatory spending and revenue reducing legislation, in order to attain the objectives of the Fiscal Responsibility Law. In this section we will discuss that process.

1. The “analysis of budgetary and financial consistency” in the Chamber of Deputies

Since the early nineties the political and technical units of the Chamber of Deputies have been improved the legislative process to consider and report bills that impact the expenditures or revenues of the Union. Thus, many years before the Fiscal Responsibility Law was enacted a rule applied to those pieces of legislation was created in the Chamber of Deputies. The starting point for designing a new process able to ensure the accomplishment of the FRL comes from that legislative act.

The Internal Rules of Order of the Chamber of Deputies determines that all bills with potential impact on public finance must be submitted to the “analysis of financial and budgetary consistency”, carried out by the Committee of Finance and Taxation (CFT). This Committee can kill the proposal if it considered it inconsistent with the budgetary laws, the Fiscal Responsibility Law and the Constitution. In the Senate an analysis like that does not exist.

The moment in which the “analysis of budgetary and financial consistency” is conducted is the main flaw of that process, which makes it inadequate for the necessary legislative control to be exerted on mandatory spending and revenues legislation.

After being approved by the Committee of Finance and Taxation, the bill goes to the Committee of Constitution and Justice and, in general, goes to the Floor of the Chamber of Deputies. After being passed by the Chamber of Deputies, the bill goes to the Senate, where a new process will begin and where there does not exist an analysis of consistency with the budgetary laws.

Thus, a bill considered consistent with the budgetary laws by the Committee of Finance and Taxation probably would not still be “consistent” months or years later, when the President signs it into law. On the other hand, a bill considered inconsistent at the beginning of the legislative process could become “consistent”, through certain legislative procedures, before it is submitted to the final vote in the Congress.

Anecdotal evaluations show that when the large majority of bills submitted to the “analysis of budgetary and financial consistency”, in the Committee of Finance and Taxation, comes into force, the budgetary laws used as a basis to the report of the Committee are no longer in effect. In these cases,

that analysis can become: a) innocuous, when it passes bill taking into account Budget Directives Law, Annual Budgetary Law, and even Multiyear Plan, which no longer will be in force when the bill is signed, or; b) inopportune, when kill bills that could be considered “budgetary and financially consistent” in a later moment, through, for example, modifications in the budgetary laws.

2. The function of the margin of expansion

We will provide here the basic considerations to compose a margin of expansion with a minimum consistency. The first experiences of calculation that margin will reveal difficulties and complexities not analyzed in this paper.

As saw previously, given the undesirable political rigidity that the strict fulfillment of the FRL would provoke, the interpretation allowing a margin of expansion to absorb legislated increase of mandatory spending, and even revenue reduction due to new tax expenditures, has become a non-explicit consensus between the Executive Branch and the Congress.

It will not try to overcome that consensus. It will be adopted. Thus, the definition and regulation of the margin of expansion becomes the core control of the enactment of mandatory spending and tax expenditures legislation.

The margin of expansion is not a cap on the increase in mandatory spending. Even when does not exist margin of expansion it is possible to create or increase mandatory spending, according the FRL rules, since the legislation which creates mandatory spending includes offset measures, by permanent increase of revenue, reduction of permanent expenditures or both.

The margin is equivalent to a reserve of funds to face anticipated revenue losses and mandatory spending increasing derived from legislation. If

the financial and budgetary impact of such legislation were covered by the margin, will not be necessary to seek offsets.

3. The composition of the margin of expansion

The sources of the expansion margin must to be those indicated in article 17 as sources of offsets, in the case of mandatory spending, or in article 14, in the case of tax expenditures.

The expansion margin would be composed by the amount estimated to be provided by legislative acts (and also acts derived from executive orders and agencies' regulatory procedures) related to " permanent reduction of expenditures" (or mandatory spending) and "permanent increase of revenue", arising from the increase in tax rates, the broadening of calculation base, or the increase or creation of taxes.

We can define two types of "broadening of calculation base". The first one is labeled "horizontal broadening". In this case, the tax system legislation is modified in such a way that revenues will be increased without increasing tax rates. The second one is the "vertical broadening", which means that the increase in the amount collected will be derived from the real growth of the economy, without any change in the tax system legislation, as interpreted by the Executive Branch.

4. The basic stages to define the margin of expansion

To define the expansion margin we must go through the following stages.

Stage 1 - The first step is to proceed such as it is proceeded to establish the baseline in the American budget process (this is not a attempt to import

budgetary instruments used in other countries, but simply to apply the intrinsic logic of the process to define margins).

Baseline, in the American budget process, represents the projection of expenditures and revenues, budget deficit or surplus and of public debt level for a determined number of fiscal years, considering the laws and public policies into effect.

To define the margin of expansion, we must to conceive a narrower baseline, which we can call “permanent baseline”, since it is composed by “permanent revenues” and “mandatory spending”. The expansion margin should be calculated for a period of three fiscal years, the same period required to define fiscal targets in the Budgetary Directives Law.

On the side of revenues, the “permanent baseline” is composed, primarily, by the amount forecast to be collected as a result of the real growth of the economy. Doing so, we are adopting the Executive Branch’s interpretation regarding the meaning of the expression “broadening of calculation base”, named in article 17 as an offset source for increase in mandatory spending, and for increase in tax expenditures, in article 14.

It will be necessary to define methodology (econometric models and concepts) to estimate the real increase in revenues, which is not the scope of this paper.

This initial amount must be deducted by: a) the forecast of increase in tax expenditures derived from the real growth of GDP; b) the amount of revenues collected by the Federal Government to be transferred to the states and municipalities according to our Constitution and laws.

On the side of expenditures, we must consider the real increase in mandatory spending, in a broader sense, which includes besides the *mandatory spending of a continuing nature* (similar to entitlements) certain expenditures considered mandatory, as: a) the accomplishment of minimum level of expenditures in health and education set by the Constitution; b) payments required by Judiciary Branch; c) personnel expenditures.

Calculating the real increase in mandatory spending will require data on, for example: a) demographic growth; b) increase in the number of people or entities entitled to social security and health benefits, subsidies, bonifications, indemnities and so on; c) unemployment rates; d) real cost increase in items of formula or criteria payments; e) the progressing effects of legislation passed in recent years.

The amount resulting from this balance between revenues and expenditures, we could call “Revenue Real Increase Available-Initial”.

Stage 2 - The “Permanent Baseline” is the starting point to define the margin of expansion of the mandatory spending derived from new legislation, and also to new tax expenditure acts. In the following stage we have to take into account that the balance between “real increase in revenues” and “real increase in mandatory spending” might be consumed by part of the most important fiscal target: the primary surplus, which is set in the Budgetary Directives Law. So, deducting a part of the primary surplus from the RRIA we achieved the “Revenue Real Increase Available after Primary Surplus”.

Stage 3 - Since 1988, the Constitution demands a previous allocation of resources and specific authorization in the BDL for hiring or personnel salary increases. In addition to that, the article 21 of FRL determines that increases in

personnel expenditures must fulfill the same requirements for generation of *mandatory spending of a continuing nature*, defined in article 17. Thus, portion of the RRIA-I might be allocated to fund increases in personnel expenditures derived from hirings and salary increase legislation. We could call the amount remaining as “Real Revenue Increase Available after Primary Surplus and New Personnel Expenditures” (RRIA-APSP).

Stage 4 – A portion of the RRIA-APSP could also be allocated to funding discretionary spending. This decision is established in the Budgetary Directives Law, which is the constitutional instrument where the Congress and the President define directives for the annual budget. We can call the final amount “Real Revenue Increase Available- Final” or “margin of expansion of mandatory spending of a continuing nature”. That is the amount available to face increases in mandatory spending derived from proposals in discussion in the Congress, to be established in the Budgetary Directives Law.

5. The margin of expansion: a budget reserve

The expansion margin shall constitute a reserve in the budget and will be deducted and transferred to be appropriated to mandatory programs created or increased by new legislation, as soon as they take effect.

6. How to increase the margin of expansion

The margin of expansion could be increased during the fiscal year if legislation that increase permanent revenues (including those which reduce tax expenditures) or reducing mandatory spending (including those related to personnel expenditures) were enacted. In both cases the “baseline” shall be recalculated and hence the margin of expansion.

7. Margin of expansion and tax expenditures

As we have seen, to generate new tax expenditures it is necessary to demonstrate that: a) the loss of revenue will not affect the fiscal target; b) the loss of revenue was considered in the budget.

The easier way to accomplish the requirements of the article 14 of the Fiscal Responsibility Law is to include the revenue loss of each piece of tax expenditures legislation in the calculus of the “Real Increase Revenue Available-Initial”, reducing the potential “margin of expansion”. In this case, the Budgetary Directives Law would contain a list of bills whose financial and budgetary impact was previously included in the triennial fiscal plan, and also would define the amount of revenue loss allowed for each one.

Tax expenditures bills passed under these conditions would not need to contain offsets measures, since the revenue loss would have already been considered in the triennial forecast of revenues and fiscal targets, and hence in the budget.

Since the major component of the expansion margin is the “broadening of calculation base” derived from the real growth of the GDP, which, as we commented earlier, have been considered as “permanent increase of revenue”, the sponsor of a tax expenditure bill not previously included in the triennial fiscal targets is allowed to indicate that the revenue loss will be offset by an equivalent reduction in the margin of expansion.

8. The basic structure for a new legislative process

The next question to be faced is how to keep control and make possible the use of the margin of expansion by the tenths of bills regarding mandatory

spending and tax expenditures presented annually to the Congress, by representatives, senators and the President.

The complexity of the legislative and political process demands detailed analyzes and rules, involving several important actors (congressmen, Executive Branch, technical institutions). This sort of analysis is far beyond the scope of this paper. The objective of this section is to address several aspects of the process to be ruled, as following:

First - Each bill concerning *mandatory spending of a continuing nature*, personnel expenditures or tax benefits shall be accompanied by an estimate of the budgetary and financial impact in the fiscal year in which it will take into effect and in the following two years. This estimate is supposed to be provided by the sponsor of the project. The committee that is reporting the bill can also request that the estimate be prepared by the Budget Office of the respective legislative house (Chamber of Deputies or Senate).

Congress Resolution shall establish rules on estimates of budgetary and financial impact and define the Congress units that will carry through them. This resolution should also grant appropriate dominance status to this estimate over the estimates provided by political or interest groups. However, it is recommended to set means to waive the dominance of the estimates provided by the Congress units, giving desirable flexibility to the system.

Second - Before moving to a final vote in the Floor of the Chamber of Deputies or the Senate, the bills on mandatory spending (including those related to personnel expenditures) or increasing tax benefits, must be sent to an special joint committee of Deputies and Senators, which we could call "the Joint Committee of Budgetary and Financial Consistency" (JCBFC). That committee

must be given the authority to certificate whether the requirements of the Constitution, the budgetary laws and the Fiscal Responsibility Law are being fulfilled or not, in particular the offset rules (either by employing offsetting measures or by using the margin of expansion).

Third - The Joint Committee should not be allowed to modify the bills, but will be able to return them to the competent committee with appropriated jurisdiction (of the Chamber of Deputies or the Senate), recommending modifications in order to accomplish the Fiscal Responsibility Law requirements.

Four - A legislative mechanism must be ruled to allow any congressman to raise "point of order" before the Joint Committee against the approval of a bill that does not fulfill the requirements of the FRL. The president of the Joint Committee, with the advisory of Congress technical units, shall decide on the "point of to order". If the "point of order" is approved, it will require an absolute majority of votes to waive it.

A "point of order" could also be raised when the bill is being considered by the Floor. The president of the legislative house (Chamber of Deputies or Senate) must decide whether the "point of order" was correctly raised or not. If the point of order is accepted, it will require an absolute majority of votes to waive it. If the "point of order" prevails, the bill shall return to the competent committee to be altered.

Five - The Joint Committee, with the assistance of the Executive Branch and technical units of the Congress, would present a proposal of Congress Resolution to provide guidelines, as detailed as possible, regarding the margin of expansion and budgetary and financial impact estimates; and also directives defining when a program must be considered a mandatory one or not, when a

modification in the tax system should be considered a tax expenditures or not, and hence whether the requirements of FRL are applicable or not. The Joint Committee must also assess if it is necessary to present a piece of legislation regarding these matters.

Six – The authority to issue a report on the margin of expansion recommended in the project of Budgetary Directives Law, presented annually (by April 15) to the Congress by the President, shall be given to the Joint Committee.

Seven - The Joint Committee shall control the use of the margin of expansion by the pieces of legislation under Congress consideration. The Joint Committee must present to the presidents of the Chamber of Deputies and Senate a list of bills, in order of priority, which can be approved, according to the margin of expansion balance. The proposal not sent to a final voting by the Floor should be included in a sort of “waiting-list”, with its respective financial and budgetary impact.

The Joint Committee could also recommend the approval of bills that increase revenues (including those that reduce tax expenditures) or reduce mandatory spending (including those related to personnel expenditures) aiming to increase the margin of expansion in an amount necessary to cover new mandatory spending or tax expenditures proposals.

Eight - The president of the Chamber of Deputies and the Senate will decide, within the list presented by the Joint Committee, which bills will receive priority and will be sent to the final voting in its respective Floor, before becoming law by the President’s signature.

Nine - Every year, during the Congress consideration of the Budgetary Directives Law and the margin of expansion, it will be an appropriate opportunity to assess which bills should be approved by the Congress definitively. In that time, the members of the Joint Committee (presidents and vices-president of the committees) should promote meetings with the members of its committees to define priorities. These priorities will be an input to the Joint Committee report on the margin of expansion.

Ten - The Congress should modify its Resolution nº 1, of 2001, regarding provisional measures, in order to submit those legislative acts to the control proposed here. The provisional measures will only be approved if they contain offsetting provisions or if it would be possible to use the margin of expansion.

Eleven - Due to the institutional power of the Joint Committee, one can suggest that it should be composed of the presidents and vice-presidents of the committees of the Chamber of Deputies and the Senate.

VI. FINAL REMARKS

In this paper we covered the PAYGO process created by the Budget Enforcement Act, in 1990. We sought to collect the scholars' and practitioners' views on that process, which has influenced the budgetary system of many countries around the world.

1. PAYGO was successful

To most of the scholars, the control on mandatory spending and revenue legislation established by the PAYGO process is considered successful and must continue. Some scholars suggest changes in the process, mainly due to a

perspective of an “era of surplus” in the United States budget, which was dissolved since two years ago.

Alan Greenspan, Chairman of the Federal Reserve Bank, recognized that the BEA and PAYGO were useful tool to control the deficit and must be preserved: “[...] *The so-called PAYGO rules requiring changes in mandatory spending and revenue policies to be budget-neutral, backed by a 60-vote point of order in the Senate, served as useful tools to control deficits. [...]*”

James A. Thurber¹¹ understands that “*the primary impact of PAYGO has been to discourage spending. The difficulty of either raising taxes or cutting popular existing mandatory program has effectively closed out new mandatory programs.*”

Barry B. Anderson, Director of Congressional Budget Office¹², declared in 2001 that “*from 1991 through 1997, the law's limits on discretionary appropriations and its PAYGO requirement helped to control deficits and new mandatory spending and revenue laws enacted during the period did not increase net deficits*”.

Leon Panetta, former Chairman Committee on Budget said in 2001¹³, in a more emphatic way, that PAYGO requirements save the Congress: “[...] *Let me tell you, the PAYGO requirement saved us because there were efforts to obviously implement huge tax cuts, there were efforts to try to implement new*

¹¹ James A. Thurber. Twenty Years of Congressional Budget Reform, 25. The Public Manager: The New Bureaucratic 6, 7 (1996).

¹² Statement “Structural Reform of the Federal Budget Process”, before the Committee on the Budget U.S. House of Representatives, July 19, 2001.

entitlement programs. If we didn't have a PAYGO requirement, we would not have been able to maintain discipline”.

Susan J. Irving, former Director Federal Budget Analysis of General Accounting Office, observed, in 2002, that *“The PAYGO provisions of the BEA have worked effectively to curb the expansion of existing and the creation of new mandatory programs.”*¹⁴

2. PAYGO helped to change political culture

Besides its usefulness in controlling the deficit, the PAYGO process has helped to change the political and budgetary environment.

Allan Greenspan affirms that PAYGO changed the way policymakers analyzed fiscal policy: *“The PAYGO rules changed the way policymakers analyzed fiscal policy proposals: Rather than focusing solely on the benefits of a proposal, policymakers were required to recognize the costs as well.”*¹⁵

Philip G. Joyce, professor of The George Washington University, shares that point of view:

“Since the BEA was enacted, the existence of explicit spending limits (the discretionary caps) and explicit assumptions of deficit neutrality (PAYGO) has made the question “How will you pay for it”? the first one asked of proponents of

¹³ Forthcoming Extension/Modification of the Budget Enforcement Act. Hearing before the Committee on the Budget, House of Representatives, One Hundred Seventh Congress, first session. Hearing held in Washington, DC, June 27, 2001.

¹⁴ Budget Process - Extending Budget Controls”. General Accounting Office, April 25, 2002.

¹⁵ Statement before the Budget Committee of U.S. House of Representatives in 2002.

costly new spending. How much they will to pay is tied up in the enforcement mechanism established as part of the budget process.”¹⁶

Elizabeth Garrett, Assistant Professor of Law, University of Chicago, considers the PAYGO the most important change in modern federal budgeting:

“Budget rules [...] both demand and highlight tradeoffs among several federal beneficiaries. Intricate offset provisions dominate federal budgeting shaping decisions regarding annual appropriations, entitlement legislation, and the tax code. They require advocates of new spending to find revenues offsets, and they limit the kinds of programs that can be eliminated or scaled back to pay for particular kinds of new spending. [...] This heightened awareness of the zero-sum nature of federal allocative decisions is perhaps the most importance change in modern federal budgeting.”¹⁷

3. PAYGO has impacted interest groups

Elizabeth Garrett has provided a deep analysis of PAYGO’s impact on the interest groups, which is condensed as follow.

The offset requirements have reduced the ability of interest groups and others to receive new benefits or increase federal benefits, because advocates for new tax expenditures are required to pay for them in one of three ways: raising taxes, reducing current tax subsidies or reducing spending for existing entitlement programs.

¹⁶ Philip G. Joyce, “Congressional Budget Reform: The Unanticipated Implications for Federal Policy Making”, *Public Administration Review*, July/August 1996, Vol. 56, n 4, pp. 321-322.

¹⁷ Elizabeth Garrett, Assistant Professor of Law, University of Chicago. “Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process”. *The University of Chicago Law Review*; Spring, 1998; 65, 2; Research Library Core, p. 503.

PAYGO imposes several other costs on groups seeking new tax subsidies. Offset requirements force those seeking federal benefits to undertake an additional role; not only are they funding seekers, but they must also become funding predators. To receive funding for any new program, groups can no longer rely on deficit financing to push the costs into the future. They must invest resources in identifying a promising offset, eliminating or reducing an existing one. Even if a group finds a weakly defended target to use as an offset, it has no enforceable property rights in its discovery. Interest groups must be prepared to defend the offset against other predators who might seek to use it to pay for their own new benefits¹⁸.

Elizabeth Garret sum up her analysis in this way:

“In sum, offset requirements seem well-designed to achieve their objective: to make it more difficult to enact new federal programs through the tax code. They increase the costs of obtaining a new tax expenditures, and they also increase the costs of maintaining it once it is obtained. Groups know that any benefit they manage to enact is susceptible to repeal or modification. Thus, the costs will continue to mount as groups work to discover any threats and to discourage raids by protecting a strong and visible opposition. If these conclusions are right, PAYGO and related provisions have worked a significant change in federal budgeting by intensifying and institutionalizing conflict among interest groups.”¹⁹

¹⁸ Ibid, p. 524.

¹⁹ Ibid, p.543.

4. PAYGO increased accountability and information

These rules, besides being a mechanism to harness the interest group activity, have four other effects: i) increasing the legislators accountability to the electorate, once the structure of this process encourages legislators to provide reasons for their decisions; ii) creating a clientele for the review of tax expenditures; iii) restructuring the nature of congressional deliberation, often forcing members to compare new proposals with other proposals and existing provisions, and; iv) providing Congress with an opportunity to assess, modify, or repeal existing tax expenditures.

Offset requirements also provide Congress with more information about tax expenditures. As advocates of new tax subsidies work to enact their programs, interest groups research likely targets and share some of the information they develop with lawmakers and technical staff. Their data may be able to be use to evaluate whether a tax provision is efficient, whether it provides the intended incentive, or whether it has significant macroeconomic effects that current estimating techniques do not capture. Advocates of proposed legislation always want to disclose favorable data to legislators, but, with PAYGO, the groups supporting the targeted offset counter the arguments in order to block the proposal's enactment.

In this battle, competing interest groups will produce information by comparing various new programs in an attempt to sell their particular proposal to lawmakers. The ultimate decisions may turn largely on political considerations such as interest groups' clout and constituency concerns, but the public debate will encompass arguments on traditional tax policy grounds.

5. PAYGO - Budgetary impact versus overall aspects

It is also important to highlight the analysis of Philip Joyce, warning against the risk of putting too much emphasis in the budgetary impact of the programs while disregarding the overall impact on economy and on the effectiveness of the program:

*“By design, the enforcement procedures created as a part of the budget process have a narrow focus. The question that is asked under the BEA is, for example, “What is the effect of this policy (bill) on federal taxes and spending for each of the next five-year (or fewer) fiscal years?” This is the right question in many cases, although it does create incentives to push costs beyond the five-year enforcement window in others. Relying solely on the information created as a result of these rules may distort decision making in cases where [...] the more important effects to be considered are the overall economic effects, independent of the federal budgetary effects. [...]”*²⁰

6. PAYGO must be supported by political agreement

Leon Panetta, former Chairman Committee on Budget, stressed that PAYGO cannot be enforced unless there is political agreement:

“You cannot enforce caps. I know this is a hearing about caps and PAYGO, but let me say something right off. You cannot enforce caps and you can't enforce any kind of PAYGO requirement. They simply do not work, unless there is bipartisan agreement as to the numbers and the process, unless there are realistic numbers that try too, at the very least, meet national priorities that are

²⁰ Philip G. Joyce, “Congressional Budget Reform: The Unanticipated Implications for Federal Policy Making”, Public Administration Review, July/August 1996, Vol. 56, n 4, p. 320.

out there, and if there isn't a strong commitment by the leadership and by this committee to enforce a set of ground rules that protect budget discipline.”²¹

7. PAYGO and the importance of the budgetary rules

If one must recognize that the political will is the key factor to the success in reaching budget goals, on the other hand one ought to too recognize that budgeting rules matters greatly. They shape the choices presenting to lawmakers. Better rules lead to more appropriate tradeoffs among the competing claims on limited resources.

Despite having no control over either the growth of mandatory spending or tax expenditures under existing laws, since 1990 the PAYGO process has helped policymakers to deal with the near term without ignoring the long term in the foremost budgetary aspects: revenue and mandatory spending. Now, when the United States is entering in a political environment claiming for changes in the whole budgetary process, several proposals to change the control on mandatory spending and tax legislation have been suggested, as exemplified below.

8. PAYGO and the importance of flexibility

Robert D. Reischauer suggests that PAYGO restraints must be realistic and flexible enough to accommodate vicissitudes:

“Experience suggests that multi-year discretionary spending caps and PAYGO restraints can serve useful roles if Congress wishes to adopt procedures that

²¹ Forthcoming Extension/Modification of the Budget Enforcement Act. Hearing before the Committee on the Budget, House of Representatives, One Hundred Seventh Congress, first session. Hearing held in Washington, DC, June 27, 2001.

*lead to the attainment of a specific fiscal goal sometime in the future. [...] To be effective, however, spending caps and PAYGO restraints must be realistic—they must reflect the overall budget situation, the fiscal goal, and changes in the political consensus. Both restraints must be flexible enough to accommodate the vicissitudes of the budget—they must be able to bend, but not too much”.*²²

9. PAYGO - Reformulation proposal and its similarity with the margin of expansion

A way to provide the flexibility suggested by Reischauer is shown by Susan J. Irving, former Director Federal Budget Analysis of General Accounting Office:

*“When surpluses return and Congress looks to create a PAYGO process for a time of surplus, it might wish to consider the kinds of debt targets we found in other nations. For example, it might wish to permit increased direct spending or lower revenues as long as debt held by the public is planned to be reduced by some set percentage or dollar amount.”*²³

Carol Cox Wait, president of the Committee for a Responsible Federal Budget suggests limits settled in the budget resolutions:

“[...] We think that the budget resolution ought to specify each year the amount is to be available for tax cuts or entitlement increases or whatever. You can bifurcate, i.e., separate spending increases and tax cuts, if you want. Any amounts over that, any bills that would use up surpluses beyond those amounts should be subject to old-fashioned PAYGO enforcement. Congress and the President should be required to raise the money or cut other entitlements to

²² Framing the Budget Debate for the Future -Statement of *Committee on the Budget United States Senate - January 29, 2002

²³ “Budget Process - Extending Budget Controls”. General Accounting Office, April 25, 2002.

offset those amounts. [...] These are political issues. The politicians settle them. You ought to spell out, when you adopt the budget resolution, what is going to count for PAYGO and what isn't and how much you've got available for tax cuts and/or entitlement increases. Anything beyond that ought to be subject to PAYGO provisions.”²⁴

One can observe that these two suggestions are quite similar to the margin of expansion process, which is the core issue of this paper.

10. Control increasing complexity and the necessity of new processes in Brazil

Once more it is important to remember Allen Schick's words: *“The BEA rules are not complicated, but implementing them entails complex budget calculation and procedures and increasing the complexity of the budget process [...]”²⁵*.

In the United States the PAYGO process created by the Budget Enforcement Act has contributed significantly to change the behavior of politicians when considering proposals that increase mandatory spending or reduce revenues. In Brazil, the rules to generate *mandatory spending of a continuing nature* and tax expenditures has not achieved such effect yet, because there are no legislative and technical processes to enforce those rules.

The use of a margin of expansion to compensate increases in mandatory spending and tax benefits is a distortion of the offset principle established in

²⁴ Forthcoming Extension/Modification of the Budget Enforcement Act. Hearing before the Committee on the Budget, House of Representatives, One Hundred Seventh Congress, first session. Hearing held in Washington, DC, June 27, 2001.

²⁵ Allen Schick. *“The Federal Budget - Politics, Policy, Process.* Brooking Institution Press: Washington, D.C. , 2000, p. 23-24.

articles 17 and 14 of the Fiscal Responsibility Law. Nevertheless, we considered it as the best option in hand, provided by a very convenient and less restrictive interpretation of the FRL, that is able to become an effective instrument to control legislated-increasing in mandatory spending (including personnel expenditures) and also, in some extension, those related to tax benefits.

The strengthening of a margin of expansion theory will provide support for a new legislative process to control mandatory spending and tax benefits legislation that affect the intertemporal budget equilibrium. The margin of expansion is part of a complex system that must be implemented to manage the public finance.

It is not possible to structure and make fiscal rules to control the budget deficit work harmoniously and effectively based only on a few sets of principles and general provisions articulated in the law. Those rules, similar to others prescribed in some developed countries, are simple in its appearance, but require a highly complex implementation.

The FRL rules concerning mandatory spending and tax expenditures were not accompanied by a detailed set of technical and legislative provisions to enforce them. That is its most critical flaw. Without processes able to effectively allow it to reach its objectives, the Fiscal Responsibility Law will be merely a potential strong fiscal instrument, politically manipulated so far.

We can raise two reasons to explain the lack of governmental and political interest about the depth of the language in the FRL and disinterest in working hard to put its rules in practice, effectively. First, few authorities understand what the FRL is and what are its implications on the political

process. Second, some of our leaders may believe that what really matters is fiscal austerity as a political guideline; adherence to the rules is not as important.

It is interesting to observe that the second reason correspond to the opinion of some economists who argue that fiscal rules, as established in the FRL, are insufficient and unnecessary to assure the fiscal discipline²⁶. Fiscal rules would be insufficient because there are a number of ways to cheat the rules, simply disregard them or using accounting gimmicks (and, we could add, by creative language interpretations). The rules would be unnecessary because a political compromise would be enough to ensure a balanced budget balance. In this sense, if a political compromise on fiscal discipline is present fiscal rules become mere consequences or ornaments. Although we argue that, in Brazil, the fiscal responsibility principles enunciated in the FRL have been respected much more due to a new fiscal culture than by the normative strength of the law²⁷, we do not agree with the fiscal rules ineffectiveness thesis.

Even though they are not being fully accomplished, rules such as those of the FRL regarding generation of mandatory spending and tax benefits form a foundation for direct political and technical considerations on fiscal controls and enforce them by judiciary decisions. While there is political will to proceed according the principles of “fiscal responsibility”, the law appears to be

²⁶ See LIMA, Edilberto Pontes, in his essay “Disciplina Fiscal no Brasil: Atuais Instituições Garantem Equilíbrios Permanentes?”, Brasília: ESAF, 2002, p.7, mentioning Alesina and Perroti, 1996.

²⁷ OLIVEIRA, Weder. “Lei de Responsabilidade Fiscal - Uma abordagem didática”. Brasília, 2003.

unnecessary. But when the interest group pressure was strong enough to threaten the political will, fiscal rules might help politicians to say no.

As mentioned, fiscal rules and principles without a well-conceived set of rules to enforce them will not be able to quiet interest groups and guarantee the accomplishment of limits and fiscal restrictions. The lack of enforcement rules allows the officials and congressmen to say to the society that the law is being fulfilled, when it is not. This had been the political behavior observed in federal legislation regarding mandatory spending and tax expenditures enacted recently.

This assertion is illustrated in a recent article published in the newspaper Valor Economico in October 16, 2003. The article said that the “Statute of the Elderlies”, signed into law this year, will cost around R\$ 600 million annually. This new expenditure was not appropriately funding. The statute entitles elderly people (over 65 years) to receive free medication and other benefits. The statute is a typical mandatory program and was enacted without to accomplish the FRL requirements concerning mandatory spending.

Finally it is critical to stress once again that it is absolutely necessary to institute appropriated technical and legislative processes to control mandatory spending and tax benefits legislation to meet the Brazilian society expectation of strong governmental fiscal discipline, which has significantly increase since the FRL was enacted. As the late professor Aaron Wildavsky once said, “*a partial truth is often worse than none at all*” or, in a less elegant phrase, “a law apparently accomplished might be worse than the lack of law,” since the problems will still remain there, waiting to be solved. Sooner or later they will surge again.

Allen Schick, when analyzing changes in the American budget process in the 1980s and 1990s, concluded that those changes were centered on one premise, perfectly applicable to Brazil: *“politicians need to be restricted in the financial choices they make.”*²⁸

The process outlined here intends to contribute to making a reality this premise (also a basic principle of the Fiscal Responsibility Law).

²⁸ Allen Schick. “The Federal Budget - Politics, Policy, Process. Brooking Institution Press: Washington, D.C., 2000, p. 35.

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