REFLECTIONS ON THE IMPLICATIONS OF EARMARKED REVENUES AND MANDATORY OUTLAYS OF THE BRAZILIAN FEDERAL BUDGET

Author: Franselmo Araújo Costa

e-mail: franselmo.costa@gmail.com

Advisor: Professor William Handorf

Minerva Program
Washington DC, April 2011
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I. INTRODUCTION

I.1. Overview of Brazilian Budgetary Process

Brazil is a federation with three levels of government, including the federal Level (1), states (26) and federal district (1), and municipalities (5,565).

The Federal level, states and federal district have three spheres of government: executive, legislative and judicial branches. Municipalities have two sphere of government: executive and legislative branches.


I.2. Budget Legal Framework

The finance law sets accounting procedures for the elaboration and execution of the budgetary law, the period of the fiscal year (jan 1st to dec 31st), and other procedures. In addition, it gives some principles to be followed by all government levels, like the comprehensiveness of the budget, among others.

The Federal Constitution of 1988 establishes general budget rules for each level of government regarding revenues and outlays assignments, introduces two new budget instruments, besides the budgetary law, the Multiyear Plan - PPA and the Budgetary Directives Law - LDO.

The Government Multiyear Plan – PPA is a 4 (four) year governmental plan. It is prepared by the President/Governor/Mayor in his first year of mandate and submitted to legislature approval. It must include all relevant investments for the next 4 year and precede the annual budget.

The Budgetary Directives Law – LDO is a yearly law that precedes the annual budget. It must include: i) fiscal goals for the Annual Budget; ii) inflation target for the next fiscal year; iii)
the overriding investments (chosen from the PPA) in the next fiscal year; and other rules to be followed during the process of approval and execution of the annual budget.

The Budgetary Law - LOA, in turn, must estimate public revenues and appropriate public expenditures for the fiscal year.

The PPA, the LDO and the LOA are prepared by the executive branch and submitted for the legislative approval, which can make amendments on the executive proposal. In the end, they must be signed by the Chief of the executive branch, who can veto parliamentary amendments.

**Table 1: Federal Budget Timetable**

<table>
<thead>
<tr>
<th>Multiyear Plan – PPA</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 31st - Executive transmits the PPA to Congress</td>
</tr>
<tr>
<td>December 31st - Deadline to Congress approve the PPA</td>
</tr>
<tr>
<td>The executive branch can veto parliamentarian amendments</td>
</tr>
<tr>
<td>January 1st of the 2nd year of the President - the PPA begins its power</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Budgetary Directives Law - LDO</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 15th - Executive transmits the LDO to Congress</td>
</tr>
<tr>
<td>July 17th - Deadline to Congress approve the LDO</td>
</tr>
<tr>
<td>The executive branch can veto parliamentarian amendments</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Budgetary Annual Law - LOA</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 31st - Executive transmits the Budget to Congress</td>
</tr>
<tr>
<td>December 31st - Deadline to Congress approve the LOA</td>
</tr>
<tr>
<td>The executive branch can veto parliamentarian amendments</td>
</tr>
</tbody>
</table>

Related to revenues assignments, the Federal Constitution is very clear, indicating the responsibilities of each government level to collect taxes. On the other hand, outlays assignments were left implicit and remain unresolved (Nazareth & Lopes Porto, 2002, TCE, 2009b). So, in many cases, the three levels of government try to transfer the responsibility of budget allocation to the other level.

The **Fiscal Responsibility Law**, from 2000 (Supplementary Law 101, of May 4, 2000), is another powerful budget legal framework. This law establishes public finance rules enforcing responsibility in fiscal management, and set other provisions. Indeed, it forces all levels of
government to set fiscal targets for the coming fiscal years, establishes limits for personnel expenditures and public debt, assign some rules for forecasting and collection of public revenues, determine conditions for expenditure generated, among other measures of fiscal transparency.

I.3. Budgetary Laws


The budget for state-owned profitable enterprises must include all investments for those companies controlled by the public sector which do not receive funds from the treasury to cover personnel, overhead or capital expenditures. Petrobras, Eletrobras and Itaipu Bi-national are examples of enterprises embraced in this budget.

Social security budget must cover all public expenditures in health, social security and social programs and benefits to civil and military servants. It does not include expenditures from state-owned profitable enterprises.

The fiscal budget must include all other public expenditures not predicted in profitable enterprises and social security budgets. It covers direct administrations, funds, government agencies, foundations and non-profitable state-owned enterprises.

All 3 (three) budgetary laws have the same legal process for approval and execution, but with different types of accounting classification.

I.4. Comprehensiveness of this Paper

This paper covers the Brazilian Federal Budget, including social security and fiscal budgets and does not include the budget for profitable enterprises. These companies have a special treatment during the elaboration and execution budget process, being more difficult to make suggestions or improvements in their budget process.

In addition, this paper will cover only the primary revenues and outlays from the fiscal and social security budgets. In other words, it will not take into consideration revenues and outlays from borrowings and lendings.
II. EARMARKED REVENUES

II.1. Key Concept

Earmarked Revenues are those transferred by law to a particular purpose or program. For many years, the link between earmarked revenue and its appropriation was accounted through a mechanism called federal funds. Recently, the budget system has created new forms/codes of accounting these earmarked revenues, not necessarily being identified by federal funds. Anyway, the most important is to make sure that these earmarked revenues should not have different uses than those designated by law.

II.2. Overview of the Federal Budget Earmarked Revenues

Before the Brazilian Federal Constitution of 1988, the federal budget used to have few federal funds, which was the consequence of few earmarked revenues. In most cases, a decree issued by executive power, instead of a law, established the earmarked revenue. It was a reflection of the political situation under the military regime, a period when the budget policy had very little democratic debate among civil society.

After democratization (1985), a new constitution was issued in 1988. The new constitution set general rules for taxation. The main innovations were the following:

- introduction of a new figure called social contributions to be collected by federal government. These social contributions consisted in special revenues established by law to finance expenditures in health, social security and other social programs;
- taxes transfers to states and municipalities based on a percentage of federal revenues; and,
- obligation to spend 18% of federal taxes on education programs.

After the federal constitution of 1998, federal earmarked revenues increased substantially. Besides the constitution, a significant number of tax laws have been revisited and changed under

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1 The military regime in Brazil started in 1964 and ended in 1985.
the new political configuration. In general, the changes tried to increase or preserve budget protection of certain economic sectors, that reinforced the budget rigidity.

An increase in Brazilian tax burden after Plano Real (1994)\(^2\) should also be highlighted. With the end of high inflation era, it was necessary to find a way to rearrange the budget balance between revenues and expenditures. To do this equilibrium, the Brazilian federal government made few and very discrete changes in spending framework. On the other hand, legal tax framework was subjected to several changes addressed to increase collections. The total primary revenues from the federal government was equivalent to 16.96% of GDP in 1995 and increased to 24% of GDP at the end of 2010.

In general, the federal government increased the social contribution collections as a major way to solve its fiscal/budget problem (see chart 1). These social contributions are earmarked revenues (linked to health and social areas). Politically, it was much easier to justify increasing these taxes as soon as it is oriented to finance the expansion of social expenditures.

![Chart 1: Revenues Collected by Receita Federal do Brasil](chart.png)

\(^2\) Plano Real was an economic plan responsible for the end of high inflation in Brazil.
It is important to mention that the federal government made an important decision in 1994 to de-link federal revenue and smooth the excessive rigidity from legally earmarked revenues. Through a Constitutional Amendment, congress allowed the federal government to de-link 20% of all social and economic contributions and earmarked taxes. This instrument is called “DRU – De-Linking of Federal Revenues”, which will be enforced until the end of 2011.

Chart 2 below shows the evolution of federal budget rigidity in terms of earmarked revenues.

II.3. Earmarked Revenues Data for the Fiscal Year of 2011

The previous chapter tried to show how the political environment contributed to the increase in the level of federal earmarked revenues. In this way, the actual percentage of primary earmarked revenues in the federal budget, excluding borrowings, is expected to be around 745.5 billion Reais for the fiscal year of 2011, corresponding to 75% of the total primary federal revenue. De-linked revenues correspond to 246.1 billion Reais.

Most of the earmarked revenues are linked to social security expenditures (social contributions), and to transfers to states and municipalities (see chart 3).
Hereafter, each part showed in chart 3 will be analyzed individually.

The great amount of earmarked revenues comes from social security contributions. This group of revenues is linked to spendings in health and social security. For the fiscal year of 2011, the total revenue linked to social security is 431.2 billion Reais, being 240.1 billion of Reais from payroll collections tied to the Fund of Private Retirement (Regime Geral de Previdência Social) and 191.1 billion of Reais to social contributions levied on company’s operations and profits to support other social benefits. On the other hand, for 2011, spending in social security programs will reach 517.7 billion Reais. It means that the government has to use all earmarked revenues and even a part of de-earmarked taxes (86.5 billion Reais) to finance the social security budget. The main reasons for this situation are the deficit of the Fund of Private Retirement (projected in 38.3 billion for 2011), the mandatory spending in health set by Constitutional Amendment 19/2000 (for 2011, spending in health will be about 75.8 billion Reais) and the Program of Transfers to Lower Income Families, called “Bolsa Família” (will reach 13.4 billion Reais for 2011).

The other group refers to legal transfer to states and municipalities. The percentage of tax collection transferred to states and municipalities are defined in the Federal Constitution of
For the fiscal year of 2011, it will be 147.4 billion Reais. These earmarked revenues were predicted in the legal framework to strengthen the federalism system. The federal government, for example, is responsible for the collection and surveillance of revenues on income and on industrialized goods, but it has the obligation to automatically transfer a percentage of these revenues to states and municipalities under a predetermined formula. These transfers are classified as the Funds of Participation of States and municipalities (FPE and FPM). The distribution of these revenues among states and municipalities follows a formula that take into consideration an inverse relation of per capita income and direct relation of inhabitants, in order to promote a better income distribution.

Regarding **linked resources to education**, for the fiscal year of 2011, the resources will achieve 49.9 billion Reais. It corresponds to constitutional rules, that set: i) 18% of all federal taxes, after legal transfers to states and municipalities, must be applied in education maintenance and development; and, ii) the federal government must collect a payroll tax to finance primary education. 18% of taxes are estimated in 38.0 billion Reais and the payroll tax for primary education in 11.9 billion Reais. From 1995 to 2010, the De-Linked Federal Revenues (DRU) levied on education resources. But, after a hard and intense debate, the parliament took a decision to not apply the DRU on the resources reserved to education, starting in the fiscal year of 2011.

Resources related to **employment programs** total 34.8 billion for the fiscal year of 2011, which 32.6 billion Reais are linked to the Workers’ Aid Fund (FAT) and 2.2 billion are related to a legal transfer to the Government Severance Indemnity Fund for Employees (FGTS). Related to FAT, the resource comes from a payroll contribution, and its goals are: i) support a monthly salary to unemployed workers for a period of 5 months if the employee has worked for a consecutive period of 16 months; ii) offer courses of qualification to workers; iii) finance companies in order to create jobs with a subsidized interest rate; and, iv) give an extra minimum wage for employees that have received, on average, less than two minimum wages during the fiscal year. The FGTS is an extra budgetary fund that consists in individual accounts for every employee, where the employee can make withdrawals in certain circumstances, for example to finance his own property.

Regarding **earmarked revenue to pay debt**, it comes from dividends paid by federal profitable state-owned companies. The law 9.530 of 1997 established that these revenues must be used to pay debt in order to keep the indebtedness under control. For 2011, it will be 17.3 billion Reais. Although it may
be controversial to earmark this revenue for the debt payment, it should be considered a good practice, being in consonance with the Fiscal Responsibility Law.

The institutions’ own collections and donations will total 9.6 billion Reais for 2011. The institutions’ own collections refer to those taxes that are related to the productive activities of Funds, Government Agencies and Foundations. In general, they come from a specific service provided by the government institution. Regarding donations, they come from private or external public institutions to finance a specific public service.

By the end, the universe of other earmarked taxes represents 7% of the total earmarked revenues. These taxes will total for the fiscal year of 2011 the amount of 5.52 billion Reais. Below, following their components (table 1):

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Billion of Reais</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total of Other Primary Revenues</td>
<td>55.2 100.0%</td>
</tr>
<tr>
<td>Royalties by Use of Natural Resources</td>
<td>27.4 49.6%</td>
</tr>
<tr>
<td>Receita Federal do Brasil and PGFN</td>
<td>5.9 10.7%</td>
</tr>
<tr>
<td>Fees (taxas)</td>
<td>6.1 11.0%</td>
</tr>
<tr>
<td>Transportation</td>
<td>4.9 8.9%</td>
</tr>
<tr>
<td>Fund of Science and Technology - FNDCT, to Tolecomunication and Energy Systems</td>
<td>2.6 4.7%</td>
</tr>
<tr>
<td>Concessions</td>
<td>2.2 4.1%</td>
</tr>
<tr>
<td>Merchant Marine</td>
<td>1.9 3.4%</td>
</tr>
<tr>
<td>Lotteries</td>
<td>1.1 2.1%</td>
</tr>
<tr>
<td>Other Earmarked Revenues</td>
<td>3.1 5.6%</td>
</tr>
</tbody>
</table>

Source: Budget Data - SIDOR.

In the case of royalties, these are revenues collected by the federal government from companies that explore natural resources to operate. For example, companies that use the continental platform to drill oil must pay royalties. All royalty revenues are earmarked by law to a specific area or purpose. For 2011, transfers to states and municipalities where the natural resource is situated will be 17.3 billion Reais. The amount of 10.1 billion Reais will be shared between federal institutions. The most important beneficiaries will be the Oil National Agency – ANP, the Fund for Developing of Science and Technology – FNDCT, the Navy Force and the Environment Ministry. It is important to point that for many years the federal government is not allocating a significant amount of these revenues. It happens for many reasons, but the main ones are: i) the lack of projects in the sector that has the earmarked revenue; or, ii) the President order to save this money in order to achieve the primary balance goal. In the last case, it became clear that this earmarked revenue had little consonance with the President’s priorities. For 2011, for example, 6.1
billion Reais of the royalties are without expenditure appropriation in the budget. So, this money cannot be used to fulfill other priorities, and has to stay in the treasury as long as it is an earmarked revenue.

The resources linked to the activities from Receita Federal do Brasil – RFB e Procuradoria-Geral da Fazenda Nacional – PGFN are a percentage of the fines applied and revenues collected based on court decisions from those resources under administration of Receita Federal do Brasil. Its amount for 2011 is 5.9 billion Reais. We should emphasize that these RFB and PGFN belong to the Finance Ministry direct administration. The explanation for this earmarked revenue (Laws 8.383/91 and 7.711/88) was to guarantee budget resources to the modernization of the tax system in Brazil, reducing evasion and tax elision. In fact, for many years, these earmarked revenues are a strong tool for Union employees to force the government to give better wages for those federal institutions. It is a very unusual earmarked revenue. Indeed, there is no reasonable explanation to reward a public institution of the direct administration to do an activity that is part of its own assignment.

Fees are taxes that require a specific public service available to citizens (definition given by Brazilian tributary law – law 5.172 from 1966). By definition, fees must be set to finance the specific public service provided by the government. That is why, in its origin, fees are earmarked revenues. For 2011, fee collection for the federal fiscal budget will be R$ 6.1 billion Reais. The main ones are linked to the Telecommunication Agency – ANATEL (3.3 billion Reais), to the Electric Power Agency – ANEEL (0.42 billion Reais), to Manaus Free Trade Department – SUFRAMA (0.34 billion Reais) and to the Federal Police Department (0.32 billion Reais). The legislation, in general, is very restrictive, not permitting the use of these earmarked revenues to pay personnel or other current outlays. In recent years, because of lack of projects in some agencies or in order to promote public savings to comply with the fiscal goals, the federal government is not permitting the appropriation of the whole revenue by the agency or department responsible to collect and provide the public service. The most typical case is the revenue linked to ANATEL, that for 2011 is not appropriated in the federal fiscal budget.

The linked revenues for transportation come from an economic contribution levied on price of gasoline sold in the market, called “CIDE COMBUSTÍVEIS”. It has a very restrictive application, not permitted to pay personnel or current outlays of transportation programs. For 2011, this revenue is estimated to be 4.9 billion Reais. Given Brazilian shortage in transportation infrastructure, these revenues are in consonance with the Acceleration Growth Program – PAC.

Earmarked revenues to the Fund of Science and Technology - FNDCT, to telecommunication and energy systems are called economic contributions charged on operations that involve transfer of technology from country to country, and on profits of companies from the electrical and phone sectors. For 2011, the total amount of these revenues is 2.6 billion Reais (1.1 billion Reais to
FNDCT, 1.1 billion Reais to Telecommunication System, 0.5 billion Reais to Energy System). Similar to what happens to the earmarked revenues of the royalties and some fees, these revenues are not being used in their entirety. For example, for 2011, the federal budget will not appropriate 1.1 billion Reais of this earmarked revenue.

**Concessions** of public services are linked to develop research in specific sectors. For 2011, 2.2 billion Reais of Concessions revenues are expected to be collected, which 1.1 billion Reais should come from permission to explore oil platforms. These revenues, ultimately, have the same configuration of other earmarked revenues, and are being sterilized (not used) in order to improve public savings. For 2011, 1.1 billion Reais are not allocated in the fiscal budget spendings.

Revenues linked to **merchant marine** correspond to a contribution paid on freight of goods left in Brazilian ports. The revenues go to the Fund of Merchant Marine – FMM and are linked to develop the marine industry and to repair Brazilians ships. For 2011, it will collect 1.9 billion Reais.

**Earmarked revenues from lotteries** come from a percentage of gambling in official lotteries. The collection of this tax goes to many sorts of public entities. The Ministry of Education is the main beneficiary. It receives this resource to lend subsidized money to finance studies in private universities. For 2011, it is predicted 1.1 billion Reais for this revenue, which 0.4 billion Reais goes to Ministry of Education.

The other linked revenues are around 3.1 billion Reais for 2011 and finance a lot of fragmented collections with small values.

II.4. A Comparison of the Earmarked Revenues and the Growth Acceleration Program – PAC

The Growth Acceleration Program - PAC was launched in 2007 by the former Brazilian President, Mr. Lula da Silva, to comply with investments in infrastructure and social areas. The final goal is to stimulate the economic growth and to reduce income and regional inequalities. According to the site of the federal government\(^3\), these investments are organized in three sectors: **logistics**, involving highways, railways, harbors, airports and waterways; **energy**, corresponding to generation and transmission of electric power, production, drilling and transport of oil, natural gas and clean energy; and, **social matters**, that encompass sanitation,  

habitation, urban subways and trains, the program called illumination for every Brazilian citizen (Luz Para Todos) and water resources.

The Brazilian President elected for the period from 2011 to 2014, Mrs. Dilma Rousseff, emphasized the need to continue the PAC investments. In her inaugural speech as Brazilian President, she said:

“PAC will continue being an instrument of tenacity of the governmental action and voluntary coordination of the structural investments of states and municipalities. It will also be a tool to encourage private investment and to enrich all initiatives of constitution of long term private funds.” (translated by author)

This section tries to make a quick and empirical comparison between the earmarked revenues and the PAC. For this comparison, it takes into consideration only the fiscal year of 2011 and assumes that there are no de-earmarking revenues in the federal budget. Based on this assumption, the outcome is that only 46.4% of the PAC investments are financed with earmarked revenues (table 2).

<table>
<thead>
<tr>
<th>TABLE 2</th>
<th>BILLIONS OF REAIS (CURRENT VALUE)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PAC 2 (A)</td>
</tr>
<tr>
<td>Program of Financing Housing (Minha casa Minha Vida)</td>
<td>12.7</td>
</tr>
<tr>
<td>Support for the improvement of Precarious Housing Conditions</td>
<td>2.1</td>
</tr>
<tr>
<td>Sanitation</td>
<td>1.4</td>
</tr>
<tr>
<td>Harbor</td>
<td>0.9</td>
</tr>
<tr>
<td>Urban Metro</td>
<td>0.5</td>
</tr>
<tr>
<td>Justice Ministry</td>
<td>0.4</td>
</tr>
<tr>
<td>Urban Drainage</td>
<td>0.2</td>
</tr>
<tr>
<td>Preservation of Risk Areas</td>
<td>0.2</td>
</tr>
<tr>
<td>Education</td>
<td>1.4</td>
</tr>
<tr>
<td>Energy</td>
<td>0.4</td>
</tr>
<tr>
<td>Health</td>
<td>1.6</td>
</tr>
<tr>
<td>Transportation</td>
<td>15.3</td>
</tr>
<tr>
<td>Planning Ministry</td>
<td>0.2</td>
</tr>
<tr>
<td>Land Agrarian Reform</td>
<td>0.5</td>
</tr>
<tr>
<td>Dams, Waterways and Revitalization of River San Francisco</td>
<td>2.4</td>
</tr>
<tr>
<td>Others</td>
<td>0.1</td>
</tr>
</tbody>
</table>

40.1 | 18.6 | 21.5

| Percentage of PAC 2 = | 46.4% | 53.6% |

Source: Budget Data - SIFOR.

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Of course, as soon as we made unrealistic assumptions (no de-earmarked revenues), we cannot assure, based on the data, that earmarked revenue legal framework is a risk for PAC. But, anyway, it is a good exercise to highlight that priorities are volatile and earmarked revenues can be a barrier in rearranging public policy needs.
III. MANDATORY OUTLAYS

III.1. Key Concept

Mandatory expenditures are those that simultaneously fulfill the following criteria: i) the government has no power to stop or decrease its budget value, once the beneficiary fulfills all legal requirements; and, ii) the rules to establish the beneficiaries are set before the budgetary law. Constitutional transfers to states and municipalities and payment of retired employees are examples of mandatory outlays.

On the other hand, food stamp programs, investments in health and education are not considered discretionary expenditures. It happens because their annual amount and appropriation between programs ((i.e. medicine, construction of hospital, primary education, universities) will be established in the discussion of the annual budget.

III.2. Trajectory of Mandatory Outlays in the Federal Budget

First of all, it is important to mention that many of the earmarked revenues can be applied in mandatory expenditures. This mechanism helps to neutralize a certain amount of earmarked revenues, as soon as the government uses these collections to finance outlays that have little space to be reduced.

Since the Brazilian fiscal adjustment, started after the crisis in Russia in the year of 1988, the main federal budget constraint in monetary terms is the primary balance goal. The Fiscal Responsibility Law of 2000 strengthened this fiscal policy concept and predicted that the Budgetary Directives Law must set goals for revenues and outlays:

“Article 4. The Budgetary Directives Law must comply with the provisions of Article 165, § 2 of the Brazilian Constitution, and:

... § 1. The Budgetary Directives Law must enclose a Fiscal Target Appendix, which will set annual targets, in current and constant values, for revenues and expenditures, nominal and primary results, and the public debt, for the current and for the two subsequent years.”
The Fiscal Responsibility Law has also established the pay as you go concept during the budget execution. That means that investments and other discretionary outlays predicted in the budget must be decreased if the revenue inflow is not enough to comply with the fiscal targets:

“Article 9. If, by the end of two months, it is concluded that the revenue inflow may not be enough to ensure the compliance with the primary or nominal result targets set in the Fiscal Target Appendix, the Branches and the General Attorney’s Office must, at their own initiative and in the required amounts, within the next 30 days, take measures to restrict commitments and financial operations, according to the criteria set in the Budgetary Directives Law.”

Based on this legal framework, the primary surplus (established yearly) and the total amount of mandatory expenditures will be crucial to define the amount of discretionary expenditures, that include all major budget investments. For this and other macroeconomic reasons, the government has to have reasonable parameters to readjust or expand the mandatory outlays.

Discretionary Outlays = Primary Revenues – Primary Surplus – Mandatory Outlays

In the federal government budget, the mandatory outlays for over the past ten years tend to represent 80% of the primary outlays. In terms of GDP, the mandatory expenditures show an increasing tendency, while the discretionary ones are more instable (chart 4).

The discretionary spendings had a discreet improvement in the last decade, with periods of decline, as the example of the first year of the first mandate of President Lula (2003).
Reduction in discretionary spendings in the first year of the executive chief is a common phenomenon in Brazil in all three government levels. The explanation for this phenomenon is that the new governor always wastes a lot of time appointing his/her principal staff (ministries) and discussing the needs and main investments to be done for the coming years. It is a period of public budget inefficiency. Anyway, PAC played an important role in order to increase the discretionary spendings that achieved their peak in 2010 corresponding to 4.8% of GDP.

On the other hand, the mandatory outlays experienced a significant increase in terms of GDP during the past decade, closely linked to the expenditures in personnel and social security pensions. From this moment on, let us concentrate the analysis on the mandatory outlays of the federal government, looking at data from the fiscal year of 2011.

III.3. Mandatory Outlays Data for the Fiscal Year of 2011

The total amount of mandatory outlays for the federal budget of 2011 is established in 714.5 billion Reais, corresponding to 18.2% of GDP. The table below shows the details of federal budget mandatory outlays for this fiscal year.

| TABLE 3 |
|----------|----------|----------|
| TOTAL MANDATORY OUTFAYS FOR 2011 | 714,5 | 18,20 |

<table>
<thead>
<tr>
<th>Description</th>
<th>Billion of Reais</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Security Expenditures</td>
<td>333,7</td>
<td>8.50</td>
</tr>
<tr>
<td>Personnel (including Civil Servants and Militaries)</td>
<td>176,6</td>
<td>4.70</td>
</tr>
<tr>
<td>Constitutional Transfer to States and Municipalities</td>
<td>163,1</td>
<td>4.15</td>
</tr>
<tr>
<td>Subsidies</td>
<td>13,0</td>
<td>0.33</td>
</tr>
<tr>
<td>Supplementary Fund to Education (FUNDEB)</td>
<td>8,9</td>
<td>0.23</td>
</tr>
<tr>
<td>Constitutional Fund for the Federal District - FCDF</td>
<td>8,7</td>
<td>0.02</td>
</tr>
<tr>
<td>Transfer to States to Compensate Losses in</td>
<td>2,9</td>
<td>0.10</td>
</tr>
<tr>
<td>Expenses to Meet Court Decisions</td>
<td>2,9</td>
<td>0.07</td>
</tr>
<tr>
<td>Transfer to FGTS</td>
<td>2,8</td>
<td>0.07</td>
</tr>
<tr>
<td>Others Mandatory Outlays</td>
<td>0,9</td>
<td>0.02</td>
</tr>
</tbody>
</table>

Source: federal budget approved by Congress for the fiscal year of 2011.

The social security expenditures can be subdivided in two groups: i) the Fund of Private Retirement – RGPS; and, ii) other social benefits linked to the minimum wage. The RGPS
involves all payments of retired employees of the private sector, including pensions, plus court decisions in favor of the beneficiaries of this Fund. Other social benefits linked to the minimum wage embraces the following benefits: i) Workers’ Aid Fund (FAT), paid in case of unemployment and in case of a special annual assistance to workers who have received less than two minimum wages during the fiscal year (the revenues come from the earmarked revenue on payroll); ii) benefits from the law of social assistance (law 8.742/1993), that guarantees one monthly minimum wage for elderly people (more than 65 years old) and disabled people with no income; and, iii) other social benefits set by a sort of federal laws that give a monthly minimum wage payment for people that suffer from Thalidomide (law 7.070/1982), for dependents from those who died of toxic hepatitis (law 9.422/96), for people with leprosy that must become isolated (law 11.520/2007) and for the victims of political persecution during the military regime (law 10.559/2002).

Federal expenditures for personnel include spendings with executive, legislative and judiciary branches. It embraces civil and military employees working or retired, including pensions. It also contains expenditures related to court decisions regarding federal civil or military servant.

**Constitutional and legal transfer to states and municipalities** are all legal transfers to states and municipalities established in the federal constitution or under a specific law as a percentage of taxes collected by the federal government. It equals the earmarked revenues of tax collections transferred to states and municipalities. The main transfers regard the Funds of Participation of States and municipalities (FPE and FPM), that are made of a percentage of the income tax and the tax on industrialized goods.

**Subsidies** correspond to government expenditures to cover losses or to stimulate employment and growth in certain economic sectors. For the Brazilian federal budget the most important amounts go to protect agriculture price and to protect other export sectors (like Embraer).

**The supplementary fund for education** (FUNDEB) was established by Constitutional Amendment 53/2006. The main goal of the Fund is to finance elementary and high school education in states and municipalities. Annually, the federal government sets by Decree a target in terms of minimum value per student. The Constitutional Amendment sets a percentage of
states and municipalities tax collections to be part of this fund. In the case of the federal government, it must transfer to this fund (managed by states and municipalities) 10% of the total earmarked revenues collected by states and municipalities.

**The constitutional fund for the Federal District** – FCDF was predicted in the Federal Constitution, article 21, and established by the federal law 10.663/2002. It was predicted to permit the Federal District to support its military force in order to protect embassies and federal government apparatus. The federal government is obliged to transfer a certain amount of resources based on a fixed value multiplied by the variation of federal revenue.

**Transfer to States to Compensate Losses in Export Revenues** regards Complementary Law 87, known as “Lei Kandir”. This law establishes that the federal government must transfer money to states in order to compensate the losses in states VAT generated by a tax credit on VAT for exporters.

**Court decisions expenditures** are judicial commands of payment for the federal government in processes against the public administration.

**Transfer to Government Severance Indemnity Fund for Employees (FGTS)** is a legal transfer linked to payroll revenue collected by the federal government. Its fiscal effect equals zero, because the transfer achieves the same amount of the payroll revenue.

For practical reasons, this paper will focus its analysis on three mandatory expenditures: i) the social security expenditures; ii) personnel; and, iii) The constitutional fund for the Federal District – FCDF.

**III.3.1. Social Security Expenditures**

Social security expenditures are financed by payroll contributions (social contributions). In the last years, the balance between social contributions and social security expenditures has showed a substantial deficit. The main indicators that influence the amount of expenditures are the minimum wage, the number of new beneficiaries and the inflation (responsible to increase benefits above 1 minimum wage).
Since 2005, the federal government, in accordance with congress and employee associations, is granting a real annual readjustment for the minimum based on the GDP growth. This parameter was chosen with the objective of sharing a part of growth with employees as well as to create a predictable parameter for the public budget and for the market. The formula used is:

\[
\text{Minimum Wage Readjustment (t = 2011)} = \text{Actual Value of Minimum Value (t-1 = 2010)} \\
\times \text{Inflation (t-1 = 2010)} \times \text{GDP real growth of two years ago (t-2 = 2009)}
\]

Even with the formula established by law, for some years the real readjustment exceed the GDP growth (example: 2006: real growth of GDP of 2004 = 5.7%; minimum wage real readjustment = 13%). Following this real readjustment policy, the minimum wage has grown more than 50% in real terms since 2005, what was decisive to increase the value of the social security expenditures (valued for prices of 2011) from 202.5 billion Reais in 2004 to 333.7 billion in 2011.

**Table 4 - Minimum Wage Readjustment**

<table>
<thead>
<tr>
<th>Year</th>
<th>Base Value Last Year (a)</th>
<th>Inflation (INPC) (b)</th>
<th>Real (c)</th>
<th>% (d - b * c)</th>
<th>New Minimum Wage (e - a * d)</th>
<th>Legal Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>200.00</td>
<td>18.00%</td>
<td>1.70%</td>
<td>20.00%</td>
<td>240.00</td>
<td>Law 10.699 of 2003</td>
</tr>
<tr>
<td>2004</td>
<td>240.00</td>
<td>7.16%</td>
<td>1.97%</td>
<td>8.33%</td>
<td>260.00</td>
<td>Law 10.888 of 2004</td>
</tr>
<tr>
<td>2005</td>
<td>260.00</td>
<td>6.35%</td>
<td>8.49%</td>
<td>15.39%</td>
<td>300.00</td>
<td>Law 11.164 of 2005</td>
</tr>
<tr>
<td>2006</td>
<td>300.00</td>
<td>3.24%</td>
<td>13.00%</td>
<td>16.57%</td>
<td>350.00</td>
<td>Law 11.321 of 2006</td>
</tr>
<tr>
<td>2007</td>
<td>350.00</td>
<td>3.17%</td>
<td>5.23%</td>
<td>8.57%</td>
<td>380.00</td>
<td>Law 11.149 of 2007</td>
</tr>
<tr>
<td>2008</td>
<td>380.00</td>
<td>4.97%</td>
<td>4.04%</td>
<td>9.21%</td>
<td>415.00</td>
<td>Law 11.709 of 2008</td>
</tr>
<tr>
<td>2009</td>
<td>415.00</td>
<td>5.92%</td>
<td>5.79%</td>
<td>12.05%</td>
<td>465.00</td>
<td>Law 11.944 of 2009</td>
</tr>
<tr>
<td>2010</td>
<td>465.00</td>
<td>3.45%</td>
<td>6.02%</td>
<td>9.68%</td>
<td>510.00</td>
<td>Law 12.256 of 2010</td>
</tr>
<tr>
<td>2011</td>
<td>510.00</td>
<td>6.47%</td>
<td>0.37%</td>
<td>6.86%</td>
<td>545.00</td>
<td>Law 12.382 of 2011</td>
</tr>
</tbody>
</table>

Resume: % accumulated of readjustment from 2003 to 2011 = 75.46%, 55.30%, 172.50%

Outlays from the Fund of Private Retirement – RGPS will achieve 278.4 billion Reais in 2011, showing a deficit for this fiscal year of 38.3 billion Reais when compared to payroll collections linked to this Fund (240.1 billion Reais). Based on the LDO information, the total of beneficiaries of the RGPS will achieve 24.7 million people at the end of 2011. Those who receive a minimum wage represent 65% of the total beneficiaries.
Although the real value of expenditures is increasing, the RGPS deficit is decreasing in GDP terms, as a reflection of Brazilian economy growth.

The social security budget related to other expenditures (rather than RGPS) will be 55.3 billion Reais for the fiscal year of 2011. This amount belongs to the Workers’ Aid Fund – FAT, R$ 30.1 billion Reais (paid in case of unemployment and with an extra annual wage for workers who receive in average less than 2 minimum wages), and to the elderly and disabled people, 25.2 billion Reais. All these benefits are based on the minimum wage. It is important to quote the positive correlation between the GDP growth and the amount of benefits paid to help unemployed workers. The reason for this is the number of employees that comply with conditions to access this insurance (be at least 16 months in the same job). So, as result of economic and minimum wage expansion, these values have increased lately, both in real and GDP terms.
Looking at data, at the perspective of increasing life span in Brazil and at the consolidation of real minimum wage adjustment rule, a constant rise in the deficit of the social budget for the next years is expected.

III.3.2 Personnel

Personnel federal expenditures involve civil and military servants and absorb a huge amount of the budget. For 2011, it will correspond to nearly 19% of the primary expenditures. If we consider only federal net expenditures, less constitutional and legal transfers to states and municipalities, it achieves 23% of the primary expenditures.

There are some Constitutional and legal rules to be followed before awarding federal government higher wages. The main ones are:

- granting of any advantage or increase in compensation, creation of jobs or alteration in career structures, as well as the hiring of personnel in any way, by agencies and entities of the direct or indirect administration, including foundations instituted and maintained by the Government, may only be affected if: i) there is a prior budgetary appropriation sufficient to cover the estimated personnel expenditures and the accretions resulting therefrom; and, ii) there is specific authorization in the budget directives law, except for public companies and mixed capital companies (article 169 of the Federal Constitution);
- the acts creating or increasing personnel expenditures must show the origin of funds for its financing (article 17 of Fiscal Responsibility Law);
- personnel expenditures of the federal government should not exceed 50% of the net current revenue, being 2.5% for the legislative branch, 6% for the judiciary branch, 40.9% for the executive branch and 0.6 for the Office of the Federal Prosecutor (articles 19 and 20 of Fiscal Responsibility Law); and,
- act resulting in an increase in personnel expenditures it will be null and void when issued within 180 days before the end of the term of the Head of the respective Branch (article 21 of Fiscal Responsibility Law).

By the way, constitutional and legal requirements were not enough to void real increase in federal government payroll, as we can see in the following table:
An increase in personnel expenditures was a result of President Lula’s policy. Since 2003, the public policy was to provide a sort of improvement in public servant wages and to renew the public sector with new employees (graph x):

![Chart 7: Civil Federal Servant in Activity (thousand of workers)](image)

This personnel policy drove to a fiscal concern in the economic area of the federal government. Economic reports showed that these expenditures could be a risk to meet with fiscal goals established, as well as reduce future government investments. This concern made the executive branch send to congress in 2007 a proposal to set a ceiling for personnel expenditures. The proposal tried to set a limit (1.5%) to federal payroll annual real growth. But, unions were successful in blocking the debate of this proposal in the national congress, and up to this moment it was not possible to vote on the proposal.
III.3.3. Constitutional Fund of the Federal District - FCDF

FCDF is an obligatory transfer from the federal government to Federal District government. It was predicted in Federal Constitution (article 21, XIII e XIV) to finance the military force and to provide additional resources to health and education of the Federal District. It was regulated by the Law 10.633 of 2002, that established a formula to update the FCDF amount. The formula is based on the net revenue of the federal government, as follow:

\[
\text{Amount to Be Transferred to FCDF (t)} = \text{Amount Transferred in the Previous Year (t-1)} \times \text{Variation of Federal Government Net Revenue of the Previous Year (t-1)}
\]

According to this formula, the values transferred to FCDF since 2003 are ones showed in the following chart:

As observed in chart 8, the real variation of the values from the end of 2003 to 2011 was about 71%. This improvement was higher than most of other economic parameters. For example, in this period, the real economic growth was 41% and the inflation (INPC index) was 51%.
The parameter (net revenue) used to correct FCDF has also some economic inconsistencies. These inconsistencies rely especially on the fact that federal collections include once-and-for-all revenues. These revenues can provoke high variations on federal collections from period to period. As long as more than 90% of the transfers go to pay wages of military employees, this situation (once-and-for-all revenue) can lead to wrong decisions in terms of wages increasing, which may not be covered by enough resources in the future.
IV. CONCLUSION

Budget figures show of a lot of earmarked revenues (about 80% of primary collections) and mandatory outlays (more than 80% of the primary expenditures). In this “budget strait jacket”, new public policies are subject to several legal constraints. The increasing curve of earmarked revenues and mandatory outlays is another fact of budget concern.

Facts show that once established by law, neither earmarked revenues nor mandatory outlays are discussed again. At this point, Howard (1994)\(^5\) says:

“Once the words were designated as law, there was no need to think about it. Almost no one who builds new houses knows why the requirement is there. Nor do bureaucrats. They abide by it because they have to”.

The passage above describes what happens with some protections set in the Brazilian budget. Despite the fact that the huge budget protections can be seen as a good thing to avoid abrupt changes and to preserve ongoing investments and projects, it becomes a problem to deal with new challenges and priorities. This budget situation leads to the following question: “if more than 80% of Brazilian federal budget is defined prior to political debate, why does Brazil have elections for president every 4 (four) years?”

Trying to improve the budget process, this paper explores in the next two sections some proposals to improve the legal framework of the Brazilian federal budget.

IV.1. Proposals for Changes in Legal Framework of Earmarked Revenues

Chapter II showed that earmarked revenue can be separated into two groups: i) the **first group** is responsible for 93% of the total amount of earmarked revenue and includes social security, transfers to States and Municipalities, education, employment, Institutions own collections, donations and debt; and, ii) the **second group** is responsible for 7% of the total earmarked revenue and embraces royalties by use of natural resources, linked revenues to Receita Federal do Brail and Procuradoria-Geral da Fazenda Nacional, fees, transportation, telecommunication and electricity services, concessions, merchant marine, lotteries and others.

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Even though it is very hard to measure the efficiency of the earmarked revenues of the first group, it seems to be very difficult at this moment, for political or technical reasons, to raise the debate about legal changes regarding this set of collections. It seems that the executive branch is not willing to “pay such a high political price” to rearrange the legal framework related to these collections. It does mean that these revenues should not be submitted to some sort of revision.

It is important to quote that the DRU mechanism (20% of de-earmarking revenues) expires in December 2011. Actually, it does apply on social security revenues. But, given the huge deficit of social security budget (expenditures higher than revenues), DRU has no practical consequence on de-linking social security revenues.

Although the second group corresponds to a smaller amount of earmarked revenues, legal changes are necessary to improve the budget efficiency and to avoid distortion in public allocation of resources.

Proposals for legal changes of this paper will be focused on these revenues, as showed below.

IV.1.1. Earmarked Revenue: Royalties by use of natural resources

Problems Identified: federal laws (Laws 7,990 of 1989, 9,478 of 1997 and 11,097 of 2005) give government little room to apply these revenues. In general, these resources can only be used for capital expenditures (investments). For many years, they are not fully employed because of the lack of projects or of fiscal needs. By the way, this amount will increase with pre-sal. Congress is right now (beginning of 2011) discussing how to apply future revenue for oil discoveries from pre-sal.

Proposals of changes in legal framework:

1) de-earmark a percentage (proposal of 20%, similar to DRU) of these revenues to free allocation, to be applied in accordance with Multiyear Plan - PPA priorities;
2) establish, by a specific law, that the allocation of these revenues must be reviewed at every 4 (four) years (the same period of the PPA review in order to rearrange priorities and debate the effectiveness of the earmarked resources.
IV.1.2. Earmarked Revenue: Resources Linked to Receita Federal do Brasil - SRFB and Procuradoria-Geral da Fazenda Nacional - PGFN

Problems Identified: earmarked revenue that awards the direct administration to practice an activity that belongs to its legal duties, which is nonsense. If all public administration claimed for an identical treatment, it would lead to an unsustainable budget position.

Proposals of change in legal framework:

1) quit this link (earmarked revenue to SRFB and PGFN), by modifying the law 7.711 of 1988 and the law 8.383 of 2001.

IV.1.3. Earmarked Revenue: Fees (taxas)

Problems Identified: in some cases, collections surpass the real needs of public goods and services provisions, especially in the communication and electricity sectors. It is responsible to unnecessarily increase prices of specific sectors.

Proposals of changes in legal framework:

1) promote a periodic revision of fees tariffs (maybe at every 2 years);
2) permit a broad allocation of the fees. In the case of the communication and electricity sectors, allow lendings to private companies wishing to make investments in these areas;
3) allow the allocation of these resources to pay active employees of the related public sector.

IV.1.4. Earmarked Revenue: Earmarked revenues to the Fund of Science and Technology - FNDCT, to telecommunication and energy systems

Problems Identified: collections surpass the real needs of the provision of public goods and services linked to the revenue.

Proposals of changes in legal framework:

1) review periodically the tariffs to be applied;
2) allow a broad allocation of these resources, to lend money to private companies to make investments in these areas and to pay active employees of the related public sector.
IV.2. Proposals for Changes in Legal Framework of Mandatory Outlays

Related to mandatory outlays, our focus of analysis was on social security, personnel and the Constitutional Fund of Federal District – FCDF.

Regarding social security, the minimum wage is the key indicator for the variation of the expenditures. According to the evaluation from the Ministry of Planning\(^6\), each increase of 1 Real in the minimum wage corresponds to an increase of 286.4 million Reais in social security expenditures, and each increase of 1% to 1,460.1 million Reais. Although the actual rule of real gains to the minimum wage contributes to increase the social security deficit, it seems to be a reasonable rule in terms of fiscal planning. It gives a parameter to estimate the future expenditures, even to the public and private sectors. Anyway, it should be established a limit, in fiscal terms, to award this real gain to the minimum wage.

In the case of personnel expenditures, the federal government is in an increasing expenditures curve. Pressures of Unions, broad legal limits and President Lula’s policy to recover the purchasing power of public employees led to this situation. Given the unsuccessful initiatives of promoting a remuneration system based on employee performance, a reasonable way to stop the escalade of personnel expenditures is to retake the debate around the proposal presented to the national congress in 2007, establishing limits of real increasing in the total payroll of the federal government.

At last, the Constitutional Fund of Federal District – FCDF has the federal revenue collection as a parameter to update its amount. This parameter has no direct relation to expenditures financed by the Fund, which are the Federal District military force. So, this indicator must be reviewed to avoid unexpected fluctuations in transfers that may be harmful both for the federal government and for the Federal District. At this point, the proposal is a revision of law 10,633 of 2002, establishing another index that keeps consistency with the expenditure financed by the Fund. Given that more than 90% of the FCDF expenditures relate to payment of military employee, we propose new parameters, based on the inflation index, in order to guarantee the purchasing power of the employees, plus a variable and discretionary amount to be discussed annually in the budget process, in order to renew the Federal District military equipment.

V. REFERENCES


Lei de Responsabilidade Fiscal. Lei Complementar nº 101, de 4 de maio de 2000.

Lei 4,320, de 17 de março de 1964.