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# My main take-aways from the seminar

It is an honor, but also a significant challenge, for me to try to present the main conclusions of this very interesting and thought-provoking seminar. Obviously, I cannot hope to do justice to the many excellent contributions by presenters and commentators in the brief time that I had to prepare, and have now to deliver, these concluding remarks. Therefore, **I will focus on my main personal take-aways from the discussions** of the last day and a half.

First of all, I wish to **congratulate the organizers for a very successful seminar, and especially for its focus on lessons for Brazil from international experiences** in a range of fiscal policy issues of tremendous current relevance, namely: trends in global public finances; fiscal risks; medium- and long term fiscal challenges; sub-national fiscal crises; and fiscal transparency and management. The seminar has made it clear that **the problems that Brazil faces in its public finances are not unique,** and that their solution can benefit from international experiences, but also that any strategy for their solution needs to be designed and implemented taking into due account the specific socio-political and institutional, as well as economic characteristics; the history; and the current circumstances of the country.

There is little doubt that **Brazil needs to restart a trend of sustainable economic growth in the not-too distant future**; this is necessary to prevent a further substantial deterioration of social, as well fiscal, indicators that would ultimately lead to more severe crisis. Unfortunately, as we learned from Carlos Mulas-Granados sobering presentation, the baseline outlook for the global economy does not justify hopes for a recovery mainly externally led, and the risks are skewed on the downside. Therefore, **Brazil will need to rely primarily on its own forces to get out of its current predicament**.

Clearly, the hopes for a sustained recovery hinge crucially on a resolution in the near term of the current political uncertainties. But, **just having a new government (or confirming the current one) will not be enough**. Sustainable growth will require what Mr. Carlos Simonsen referred to as a **credible national strategy, encompassing structural reforms to make the economy more competitive, productive and resilient**. Such reforms (especially, opening the economy externally, increasing internal competition in product, labor, and financial markets, and ensuring a stable and predictable regulatory environment) are politically difficult, due to the opposition of the affected interest groups, and therefore may need to be implemented gradually. But, without a determined start in the near term, the much-needed improvement in business confidence and recovery of investment are unlikely to materialize.

**The seminar has evidenced the crucial importance of fiscal adjustment and structural fiscal reforms in a sustainable growth-oriented strategy for Brazil**. As a matter of fact, the seminar has highlighted that **sustained fiscal adjustment is virtually impossible in Brazil nowadays without fundamental fiscal reforms**, especially on the expenditure side of the budget, given the already relatively high level of the tax burden. To be sure, there is ample scope and need for reforms to make the tax system more efficiency-friendly, simple, and equitable, and these have been broadly discussed in many fora here in Brazil. Moreover, some of these reforms , for example a significant reduction of tax expenditures that currently are equivalent to about 5% of GDP, would also generate additional revenues, in addition to reducing distortions and improving horizontal equity.

But **the focus of this seminar has been clearly on the spending side of the budget**. The discussions have highlighted a **number of fundamental weaknesses in this area:**

- First and foremost, the **high degree of rigidity of public spending,** due to earmarking of revenues; minimum spending requirements in health and education; the indexation of pensions and other social benefits to the minimum wage; and the difficulty of adjusting downward the public payroll in the face of declining revenues

- Second, **the short-term orientation of the budget process**, due to the lack of credible medium-term expenditure frameworks. The presentations of Antonio Nucifora and Mario Pessoa highlighted the potential benefits of such frameworks, as witnessed by their increasing use not only in advanced economies, but also in a number of emerging and developing ones. They also noted, however, that MTEFs have proven most useful in countries with lesser budget rigidities than is currently the case in Brazil, that is in countries where the budget is a true instrument of resource allocation to reflect evolving national priorities, as Mr. Simonsen aptly put it in his opening remarks. The presentation by Mr. Nucifora also emphasized the **need to develop long-term fiscal projections**, in particular to highlight and sensitize the public opinion to the fiscal challenges posed by the aging of the population, and promote social consensus for ultimately unavoidable reforms in this area.
- Third, a number of presenters have noted that there is **substantial scope for improving both the allocative and the technical efficiency of public spending at all levels of government.**, As noted by Secretary Renato Villela in his thoughtful reflections on the difficulties of spending well in

Brazil, this reflects not only the above-mentioned rigidities but also other shortcomings of the budget process and accounting legislation.
In this respect, it was encouraging to hear from the Fabiana Rodopoulos about the efforts that the STN, in collaboration with other relevant ministries and agencies, is making to institutionalize a process of review and evaluation of federal spending programs. Clearly, best international practices in this area, as mentioned by Luiz de Mello and Antonio Nucifora, can provide useful examples and inputs to this process.

- **A fourth area in need of improvement is the coverage of the public sector accounts**. Recent years have seen a **proliferation of quasi-fiscal operations**, mainly through public enterprises and public banks. The two largest public enterprises (Petrobras and Eletrobras) have been severely impacted by administered price and regulatory policies of the federal government; the public banks have suffered many interferences in their credit and dividend policies; and a complex web of transactions and cross-liabilities has been built among the federal SOEs, the federal banks, and the federal government, with significant potential multiyear fiscal implications, as highlighted by Mansueto Almeida in his presentation.

**Another important theme of this seminar has been the identification, disclosure and management of**

**fiscal risks and contingent liabilities**. The presentation by Gilbert Terrier highlighted a range of fiscal risks related to unexpected macro-economic developments, exogenous shocks, legal rulings, and crises in the financial sector, SOEs and sub-national governments; and the fact they tend to be correlated, compounding the fiscal damage involved. As he put it, international experiences show that "when it rains, it pours". Mr. Terrier also discussed good and best practices in the **identification, analysis and quantification, and disclosure of such risks**, as well as steps to mitigate them, or absorb them without jeopardizing long-term fiscal sustainability.

His presentation emphasized in particular:

- The importance of both **credible baseline budget projections, preferably vetted by independent fiscal watchdogs,** a point emphasized by Mario Pessoa as well; and of systematic stress-testing of such projections; and
- The benefits of creating adequate **fiscal buffers,** especially during the upward phase of economic and commodity price cycles (something that unfortunately Brazil failed to do at all levels of government during the last several years). Progress in this respect would allow a reduction of the traditional pro-cyclicality of fiscal policy in Brazil.

It was encouraging to hear from Prof. Arbache that steps are being taken by the Brazilian authorities to improve the Fiscal Risks Annex in the LDO, and to analyze in greater depth specific fiscal risks in a quarterly bulletin on the subject. Clearly, there is ample scope for continuing and deepening such efforts, also drawing on relevant examples of such analyses in other countries, as highlighted by Mr. Terrier.

The seminar devoted a full session to **sub-national fiscal crises**. My presentation discussed briefly international experiences as regards the incidence of such crises, their roots, costs, and resolution mechanisms. It highlighted in particular that:

- **SN fiscal crises are not the preserve of emerging countries**, having occurred also in a number of advanced economies, especially at the local level
- They are frequently the result not only of irresponsible fiscal policies at the sub-national level, but also of **adverse spillovers of policies of the central government**
- **Avoiding the emergence of SN SBCs is fundamental to minimize the risk of such crises**, and this requires avoiding a number of flaws in the intergovernmental fiscal system, and in particular in the system of controls of SN borrowing

- **SN fiscal crises have serious costs**, not only fiscal but also social and political, and not only for the SNG in crisis but also frequently for other SNGs, as well as for the CG
- **Resolution mechanisms frequently entail CG bailouts**, with varying modalities, cost and conditionality
- **The probability of such bailouts representing lasting solutions depends very much on the extent to which their conditionality addresses the root causes of the crisis and the firmness with which it is enforced**.

The commentators (Secretary Ana Carla Abrao end Messrs. Marcos Mendes and Luiz Villela) found **many echoes of these points in the Brazilian experience**. They especially emphasized the deleterious effect of the indiscriminate relaxation of sub-national borrowing restraints in recent years, which created space for an excessive growth of state payrolls, and the difficulties of reverting these excesses in the current environment of falling revenues and curtailed access to credit. As Secretary Abrao aptly stated, the current crisis of the states in Brazil is essentially a spending crisis, and its resolution will need a determined effort to restrain the growth of sub-national spending. The presenters also noted the need to revise the FRL, to address some of the weaknesses that the current crisis has highlighted in this framework that was so important in creating a

fiscal responsibility culture in Brazil at the beginning of the last decade.
In his concluding remarks, Prof. Rezende, a foremost expert of fiscal federalism in Brazil, expressed the view that the current states' crisis is the result of fundamental flaws in the system of intergovernmental fiscal relations, and its lasting resolution would require the adoption of a comprehensive and radical reform strategy.

In the last session of the seminar, Mr. Mario Pessoa emphasized the public good character of sound, responsible and transparent fiscal policies. In this context he discussed the role of **various innovations in the public financial management (PFM) architecture** that have emerged in recent decades worldwide, to address a number of systemic problems in the formulation and implementation of fiscal policies, such as short time horizon of policy makers, time inconsistency, collective action, and asymmetric information. He focused in particular on **MTEFs,** as already mentioned, **fiscal responsibility legislation, budget transparency, and the role of independent fiscal councils**. These are all topics on which substantial **analytical work** has been done in recent years by the IMF, the World Bank, the OECD, and various other international and national institutions, especially in advanced countries. **Significant empirical experience has also accumulated on these**

**instruments**, which shows that their effectiveness depends crucially on their design and implementation, which have to be carefully adapted to individual countries' institutional and socio-economic characteristics. Mr. Pessoa's presentation highlighted a number of useful lessons from such experience.

The National Treasury's Secretary Otavio Ladeira highlighted in his presentation the **range of efforts that Brazil is making to strengthen the quality and transparency of its fiscal accounts**, including the preparation of comprehensive public sector balance sheets. Brazil already scores well in a number of international assessments of transparency, and is currently undertaking an assessment under the modernized Fiscal Transparency Code of the IMF. I have no doubt that this assessment will not only recognize the important achievements of Brazil in this area, but also offer useful suggestions for further improvement.

In his comments, Mr. Weder de Oliveira, Ministro Substituto of the Tribunal de Contas da Uniao (TCU), explained the important role of the TCU in the external control of the public accounts, and of compliance with the LRF in Brazil. He also emphasized that fiscal transparency has to also include a sustained effort to explain clearly to the general public the magnitude of the fiscal challenges facing the country.

To conclude, this seminar has taken place in an environment of **serious economic, political and social difficulties in Brazil,** but I come out from it encouraged about the prospects for the country to deal with, and ultimately overcome these difficulties, in the not-too-far future. I say this because I have seen here in a range of policy makers, private sector representatives, and academics, a greater awareness of the root causes of these difficulties than at other times in the past, and a desire to implement as rapidly as feasible the necessary reforms to address them. The diagnosis is clear and so are the key remedies. Obviously, **it is essential to build a broad recognition of the need and urgency of such reforms in society at large and in the main political fora, especially the Congress**. I am sure that this seminar and its echoes in the press will make a significant positive contribution in this respect.

Thank you for your attention and I look forward to your reactions.