

Brazil: Report on Observance of Standards and Codes (ROSC)—Fiscal Transparency Module

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BRAZIL

**Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module**

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November 28, 2001

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in Brazil in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on the authorities' response to the IMF fiscal transparency questionnaire and other documents provided by the authorities.

In the last few years Brazil has achieved a high degree of fiscal transparency, together with major improvements in the management of its public finances. This was done against the background of an international and domestic macroeconomic environment which has posed substantial challenges to the country's economic policymakers. The cornerstone of these achievements has been the enactment in May 2000 of the Fiscal Responsibility Law which sets out for all levels of government fiscal rules designed to ensure medium-term fiscal sustainability, and strict transparency requirements to underpin the effectiveness and credibility of such rules. Another pillar of the improved fiscal management has been the medium-term expenditure framework aimed at better aligning the allocation of budgetary resources over time to the government's priorities and regional development strategy. Also instrumental in promoting sustained fiscal adjustment of subnational governments has been the firm enforcement by the federal government of the debt restructuring agreements with most states and many municipalities.

Brazil has attained high standards with respect to main indicators of fiscal management and transparency. In particular, the following specific aspects are worth highlighting. Various specific aspects should be highlighted in particular. The coverage of fiscal targets and fiscal statistics is commendably broad. Recent reforms in the budget and planning process have substantially improved the realism and transparency of the federal budget, and its consistency with macroeconomic constraints, as well as its effectiveness in resource allocation. Mechanisms of internal and external control are generally well developed, and increasingly aim to assess not only formal compliance with legal requirements, but also the quality and cost-effectiveness of public spending. Fiscal statistics at the federal level are of high quality, timeliness, and detail. Brazil is at the forefront of countries at comparable level of development in the use of electronic means for the dissemination of fiscal statistics, legislation, and administrative regulation on tax and budgetary matters, and for delivery of government services, as well as to facilitate civil society's scrutiny of government activities and programs.

The report analyzes these achievements in detail, and highlights ongoing reform efforts. It also contains a number of staff recommendations for further consolidating and expanding the recent gains in fiscal management and fiscal transparency, for instance by continuing to reduce overlap and duplication of functions in specific areas of public spending; providing more detailed sensitivity analyses in the budget document so as to facilitate the assessment of fiscal risks; seeking to progressively reduce earmarking of budgetary resources to promote greater flexibility; preparing three-year rolling forward cost estimates of continuing spending programs; further strengthening the coordination of agencies involved in internal and external control; and further improving some specific aspects of fiscal statistics.

	Page
Abbreviations, Acronyms, and Weblinks	3
I. Introduction.....	6
II. Description of Practice.....	6
A. Clarity of Roles and Responsibilities.....	6
B. Public Availability of Information	18
C. Open Budget Preparation, Execution, and Reporting	21
D. Assurances of Integrity	30
III. IMF Staff Commentary.....	32
 Boxes	
1. The Fiscal Responsibility Law.....	8
2. The State Debt Restructuring Agreements	10
3. Privatization	15
4. Multi-Year Budgeting (PPA): Recent Developments.....	22
5. E-Government Programs and Initiatives.....	24
6. The Integrated Government Financial Management System (SIAFI).....	26

ABBREVIATIONS, ACRONYMS, AND WEBLINKS

AEB	National Space Agency (Agência Espacial Brasileira; www.agespacial.gov.br/index.htm)
ANA	National Water Agency (Agência Nacional de Águas; www.ana.gov.br)
ANATEL	National Telecommunications Agency (Agência Nacional de Telecomunicações; www.anatel.gov.br)
ANEEL	National Electric Energy Agency (Agência Nacional de Energia Elétrica; www.aneel.gov.br)
ANP	National Petroleum Agency (Agência Nacional do Petróleo; www.anp.gov.br)
ANS	National Supplementary Health Agency (Agência Nacional de Saúde Suplementar; www.ans.gov.br)
ANTAQ	National Waterborne Transportation Agency (Agência Nacional de Transportes Aquaviários)
ANTT	National Overland Transportation Agency (Agência Nacional de Transportes Terrestres)
ANVS	National Sanitary Oversight Agency (Agência Nacional de Vigilância Sanitária; www.anvs.gov.br)
ARO	Revenue anticipation operation (Antecipação de receitas orçamentárias)
BASA	Banco da Amazônia (www.basa.com.br)
BCB	Central Bank of Brazil (Banco Central do Brasil; www.bcb.gov.br)
BB	Banco do Brasil (federally-owned commercial bank; www.bancodobrasil.com.br)
BNB	Banco do Nordeste (www.bnb.gov.br)
BNDES	National Development Bank (Banco Nacional de Desenvolvimento Econômico e Social; www.bndes.gov.br)
BNDESPAR	BNDES investment corporation (Banco Nacional de Desenvolvimento Econômico e Social—Participações; www.bndespar.com.br)
CADE	Consumer Rights Protection Council (Conselho Administrativo de Defesa Econômica; www.cade.gov.br/)
CCAAF	Code of Conduct for Senior Federal Government Officials (Código de Conduta da Alta Administração Federal)
CEADP	Ethics code for federal government officials who manage the public debt (Código de Ética dos Administradores da Dívida Pública)
CEF	Federal Savings Bank (Caixa Econômica Federal; www.cef.com.br)
CEP	Public Ethics Commission (Comissão de Ética Pública; www.planalto.gov.br/etica/)
CFC	Federal Accounting Council (Conselho Federal de Contabilidade; www.cfc.org.br)
CGU	General Corrector's Office (Corregedoria-Geral da União; www.planalto.gov.br/cgu/index.htm)
CMN	National Monetary Council (Conselho Monetário Nacional; www.fazenda.gov.br/portugues/orgaos/cmnm/cmnm.html)
CMPO	Permanent Joint-Congressional Budget Committee (Comissão Mista Permanente de Orçamento)

CND	National Privatization Council (Conselho Nacional de Desestatização)
COPOM	Monetary Policy Committee of the BCB (Comitê de Política Monetária; www.bcb.gov.br/htms/copom/a-hist.shtm)
CVM	National Securities & Exchange Commission (Comissão de Valores Mobiliários; www.cvm.gov.br)
DO	Official Gazette (Diário Oficial; www.in.gov.br)
FAT	Unemployment Fund (Fundo de Amparo ao Trabalhador; www.mtb.gov.br/FAT/).
FCVS	Housing Mortgage Insurance/Subsidy Fund (Fundo de Compensação de Variações Salariais)
FGTS	Severance Pay Fund, a public forced savings scheme (Fundo de Garantia do Tempo de Serviço; www.mtb.gov.br/se/fgts/servicos/fgts_idx.htm)
GFS	Government Finance Statistics
IBGE	National Statistics Institute (Instituto Brasileiro de Geografia e Estatística; www.ibge.gov.br)
ICMS	Value-added tax (Imposto sobre Circulação de Mercadorias e Services)
IPEA	Applied Economics Research Institute (government-owned) (Instituto de Pesquisa Econômica Aplicada; www.ipea.gov.br)
IPI	Industrial Products Tax (Imposto sobre Produtos Industrializados)
ISS	Tax on Services (Imposto Sobre Serviços)
Itaipu	Itaipu Hydroelectric Power Company (www.itaipu.gov.br)
LCF	Fiscal Crimes Law (Lei dos Crimes Fiscais)
LDO	Annual Budget Guidelines Law (Lei de Diretrizes Orçamentárias)
LOA	Annual Budget Law (Lei Orçamentária Anual)
LRF	Fiscal Responsibility Law (Lei de Responsabilidade Fiscal; federativo.bndes.gov.br/lrf_textos_lei_responsabilidade_lei.htm)
MERCOSUL	Southern Common Market (Mercado Comum do Sul; www.mercosul.org).
MoF	Ministry of Finance (Ministério da Fazenda; www.fazenda.gov.br)
MoP	Ministry of Planning, Budget, and Management (Ministério do Planejamento, Orçamento, e Gestão; www.planejamento.gov.br)
MPAS	Ministry of Social Security and Assistance (Ministério da Previdência e Assistência Social; www.mpas.gov.br)
PNAFE	Modernization Program for State Fiscal Administration (Programa Nacional de Apoio à Administração Fiscal para os Estados Brasileiros)
PNAFM	Modernization Program for Municipal Fiscal Administration (Programa Nacional de Apoio à Administração Fiscal para os Municípios Brasileiros)
PND	National Privatization Program (Programa Nacional de Desestatização)
PPA	Government's Multi-Year Plan (Plano Plurianual)
PROES	Government program for reducing state banking activity (Programa de Incentivo à Redução do Setor Público Estadual na Atividade Bancária).
PSBR	Public sector borrowing requirement
RGF	Four-monthly report on fiscal management (Relatório de Gestão Fiscal)
RREO	Bi-monthly summary budget execution report (Relatório Resumido de Execução Orçamentária)

SEAE	Secretariat for Economic Monitoring of the Finance Ministry (Secretaria de Acompanhamento Econômico—Ministério da Fazenda; www.fazenda.gov.br/seae/).
SDDS	Special Data Dissemination Standard (dsbb.imf.org)
SDE	Secretariat for Economic Justice of the Justice Ministry (Secretaria de Direito Econômico—Ministério da Justiça; www.mj.gov.br/SDE/default.asp)
SFC	Federal Internal Control Secretariat of the Ministry of Finance (Secretaria Federal de Controle Interno; www.sfc.fazenda.gov.br)
SIAFI	Integrated Financial Management System of the federal government (Sistema Integrado de Administração Financeira do Governo Federal); www.tesouro.fazenda.gov.br/nova/diretorio/siafi/default.htm)
SIDOR	Integrated budget system of the federal government (Sistema Integrado de Dados Orçamentários)
SIG	Integrated Information System (Sistema de Informações Gerenciais)
SOF	Secretariat of the Federal Budget of the MoP (Secretaria de Orçamento Federal; www.planejamento.gov.br/orcamento/index.htm)
SPI	Secretariat of Planning and Strategic Investments of the MoP (Secretaria de Planejamento e Investimentos Estratégicos; www.planejamento.gov.br/planejamento_investimento/index.htm)
SRF	Internal Revenue Service (Secretaria da Receita Federal; www.receita.fazenda.gov.br)
STN	National Treasury (Secretaria do Tesouro Nacional; www.stn.fazenda.gov.br)
TCU	National Audit Court (Tribunal de Contas da União; www.tcu.gov.br)
TJLP	Long-term interest rate (government-regulated) (Taxa de Juros de Longo Prazo).

I. INTRODUCTION¹

1. This draft report provides an assessment of fiscal transparency practices in Brazil against the requirements of the IMF *Code of Good Practices on Fiscal Transparency*. The authorities have completed the fiscal transparency questionnaire prepared by the IMF staff. The assessment has two parts that are presented in Sections II and III. Section II is a description of practice, prepared by the IMF staff on the basis of the questionnaire response and additional information provided by the authorities. Section III is an IMF staff commentary on fiscal transparency in Brazil.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **Brazil uses very comprehensive fiscal definitions. The consolidated nonfinancial public sector** comprises the central government (the federal government, the Central Bank of Brazil (BCB), and the social security system), state and municipal governments, and the public enterprises (including federal, state, and municipal enterprises).² The definition of the **general government** (which comprises the central government, the state governments, and the municipalities) is broader than in the standard international practice as it includes the BCB. However, as a subscriber to the (SDDS), Brazil also reports data according to the standard definition of the general government excluding the BCB.³ The nonfinancial public sector is clearly separated from the financial public sector.⁴

3. **The allocation of responsibilities between different levels of government is defined in the Federal Constitution, which clearly separates revenue-raising**

¹ Prepared by an IMF staff team consisting of Teresa Ter-Minassian (head), Alvaro Manoel, Luiz de Mello, and Gerd Schwartz, based on a mission that took place during September 3-14, 2001.

² An enterprise is considered to be publicly owned either when it is wholly owned by the public sector or when more than 50 percent of the company's ordinary (voting) shares are owned by the public sector. Ordinary shares have to amount to a minimum of 33 percent of total shares (i.e., ordinary shares plus nonvoting preferential shares). With the inclusion of the central bank, the Brazilian definition of general government is broader than the one used by the Government Finance Statistics (GFS) manual.

³ See <http://www.bcb.gov.br/sddsi/sddsi.htm> for more information.

⁴ As of July 2001, there were a total of 22 public financial institutions (out of a total of 264 financial institutions), of which five were federal institutions, six were federalized former state banks that are slated for privatization in the near future, and 11 were owned by the states (of which one is slated to be privatized in the near future). The public financial institutions accounted for 42 percent of total banking system deposits, and 39 percent of total assets. The five federal institutions—Banco do Brasil (BB), Caixa Econômica Federal (CEF), Banco Nacional de Desenvolvimento Econômico e Social (BNDES), Banco do Nordeste (BNB), and Banco da Amazônia (BASA)—accounted for 35 percent of total deposits (mostly in BB and CEF) and 35 percent of total assets. A report on the federally-owned financial system (“Instituições Financeiras Públicas Federais—Alternativas para a Reorientação Estratégica”) was published in June 2000.

responsibilities of the three levels of government, but allows for significant areas of overlap on the expenditure side. According to Article 18 of the Brazilian Constitution, all members of the federation (i.e., the union, the states, the Federal District, and the municipalities) are autonomous. Articles 153–156 of the Constitution explicitly define the tax powers of each level of government, and Articles 157–159 set out revenue-sharing mechanisms between the different levels of government. As for government expenditures, the Constitution defines the powers and responsibilities of each level of government, thereby implicitly giving rise to certain expenditure assignments (e.g., national defense being the prerogative of the federal level). Article 25 of the Constitution stipulates that, as a general principle, the states have jurisdiction over all matters not forbidden to them. The Constitution also explicitly sets out areas of common powers (Article 23) (e.g., environmental protection) and concurrent legislation (Article 24) (e.g., education, social security). The absence of complementary laws⁵ that clearly define the expenditure responsibilities of the different levels of government means that there remain areas of significant overlapping responsibility. Since the mid-1990s, however, the federal government has implemented a policy of progressive decentralization, in particular, municipalization, of the delivery of social services, specifically in health and education, taking into account regional differences in economic and administrative capacities. The federal government has retained supervisory and coordinating functions and responsibilities in these areas, and provided targeted support to regions and municipalities with weak administrative capacities, as well as additional transfers to fund the decentralized expenditure programs.

4. **Within the limits set by the Constitution concerning the autonomy of all levels of government, Brazil has developed, over the last several years, important instruments to strengthen control over, and improve the transparency of, subnational government finances.** In general, the operations of each level of government are subject to checks and balances that are contained in complementary laws covering specific aspects of fiscal operations, including government balances and financing, public debt, government bond transactions, and the provision of government guarantees. A key piece of legislation in this area is the **Fiscal Responsibility Law (LRF)**—complementary law No. 101 of May 2000—which regulates comprehensively the operational responsibilities of various levels of government (Box 1). Also, Senate Resolution 78 of 1998, tightened conditions for debt and credit operations of the states, the federal district, and the municipalities, and the provision of guarantees. In addition, specific actions, including the government’s 1997 Program for Reducing State Banking Activity (PROES), and the debt refinancing agreements with the states and over 180 municipalities that were concluded over the last several years, have effectively conditioned federal financial support for state and municipal debt restructuring to improved fiscal discipline at these levels of government (Box 2).

⁵ Complementary laws can be viewed as “enabling legislation.” Like constitutional provisions, complementary laws set out general principles, applying to all levels of government, but they also address specific aspects of a given subject. Since their use is provided for in the Constitution, complementary laws prevail over ordinary laws and cannot be modified by them. Complementary laws have to be approved by each chamber of congress with an absolute majority of the respective members.

Box 1. The Fiscal Responsibility Law

The LRF—approved by congress in May 2000—sets a general framework for budgetary planning, execution, and reporting, applicable to all levels of government. It is a complementary law, requiring a qualified (two-third) majority of congress to be modified. The law calls for a sustained structural adjustment of public finances and for constraining public indebtedness. It comprises three types of fiscal rules: general targets and limits for selected fiscal indicators; corrective institutional mechanisms in the case of noncompliance; and institutional sanctions for noncompliance. The LRF requires the preparation and dissemination of transparent fiscal reports; the presentation of a fiscal policy annex to the government's multi-year plan (PPA) with multi-year fiscal targets; and the presentation of a fiscal targets annex to the Annual Budget Guidelines Law (LDO) with targets for the primary balance and projections for revenues, expenditures, the nominal balances, and the public debt for the following three fiscal years.¹ The LDO is also required to include an annex describing fiscal risks with an assessment of contingent fiscal liabilities.

The LRF regulates intergovernmental fiscal relations. In particular:

- on **revenues**, the LRF mandates: the withholding of discretionary federal transfers to states and municipalities that do not collect effectively their own taxes, and publication of the impact of tax exemptions in the budget of the year when the exemptions take effect and in two subsequent budgets;
- on **expenditures**, the LRF requires that permanent spending mandates not be created without corresponding increases in permanent revenues or cuts in other permanent spending items; and bans new spending commitments that cannot be executed before the end of the incumbent's term in office, as well as the recording of these as unspent commitments in the two quarters prior to the end of the incumbent's term in office, unless there are sufficient cash balances to cover them at the end of the fiscal year. Moreover, the LRF contains a golden-rule provision for capital spending (i.e., annual credit disbursements cannot exceed capital spending);
- on **personnel management**, the LRF establishes a limit for central government personnel spending (including pension payments and payments to subcontractors), equivalent to 50 percent of net revenues for the central government and 60 percent of net revenues for the states and municipalities; and sets separate subceilings on personnel spending for the executive, legislative and judicial branches of each level of government. After an initial two-year transition period for compliance with the ceilings, any future excesses will have to be eliminated within the next eight months. If in breach of the personnel ceilings, governments will not be allowed to engage in new credit operations, and subnational governments will not be allowed to receive discretionary transfers or credit guarantees from the federal government;
- the LRF also prohibits the central bank from issuing **debt securities** two years after it comes in effect (from May 2002 onward). Henceforth, the central bank will implement monetary policy with the Treasury securities in its portfolio; and
- the LRF prohibits **credit or rescheduling operations** among the various levels of government to avoid the risk of intragovernmental bailouts.

In addition to the institutional sanctions and penalties for noncompliance provided for by the LRF, public officials are liable to the sanctions and penalties detailed in the Fiscal Crimes Law (LCF). As an

¹ Special, less stringent provisions on budget reporting are made for small municipalities, defined as those with less than 50,000 inhabitants.

Box 1. The Fiscal Responsibility Law (Concluded)

integral component of Brazil's structural fiscal reform agenda, the LCF applies to public officials of the executive, legislative, and judiciary branches of federal, state, and municipal governments, as well as their decentralized agencies and public enterprises. Among other provisions, the LCF provides for detention of up to four years for public officials who (1) engage in credit operations without prior legislative authorization (or in breach of the credit or indebtedness ceilings); (2) incur expenditure commitments in the last two quarters of his/her term in office that cannot be paid within the current fiscal year, or without adequate cash balances; (3) incur unauthorized expenditure commitments; (4) extend loan guarantees without equal or higher-value collateral; (5) increase personnel expenditures in the 180 days prior to the end of his/her term in office, and (6) issue unauthorized unregistered public debt.

Ancillary legislation is pending in a few areas. Ceilings on the consolidated debt of the public sector (defined as a percentage of net revenues) are currently being considered by the federal senate. The government's proposal calls for debt ceilings of, respectively, 3.5, 2.0, and 1.2 times the net current revenues of the federal, state, and municipal governments. Once approved, revisions to these limits can be submitted to congress in case of economic instability or drastic changes in monetary or exchange rate policies. If the ceilings are exceeded, excesses are to be eliminated within one year. While the slippages persist, new financing, as well as discretionary transfers, in the case of subnational governments, are banned, including short-term revenue anticipation operation (ARO) loans, other than those taken to refinance securitized debt. The ministry of finance will publish every month a list of governments that exceed their debt ceilings. ARO loans are restricted, and to be liquidated by December 10 of the year in which they are incurred. They are prohibited in the last year of an incumbent's term in office.

The LRF allows for deviations from the mandated fiscal targets under special circumstances. The time frame for reducing personnel spending or indebtedness over the mandated ceilings can be increased if the economy contracts by 1 percent or more during the previous four quarters, or a national catastrophe is declared by the legislature, as well as in the case of a state of siege. These escape clauses can only be exercised with congressional approval.

The LRF also provides for more transparent fiscal reporting and social control. Fiscal results are to be disseminated through reports on bi-monthly budget execution, and through more comprehensive four-month reports on compliance with the various LRF ceilings, and on corrective measures if the ceilings are exceeded. Municipalities are to report to the ministry of finance the fiscal results of the previous year by end-April and the states by end-May. The ministry of finance is to publish a consolidation of the public finances of the previous year by end-June. The legislative branches of each government level, aided by the respective Court of Accounts, will monitor compliance with the fiscal targets and ceilings.

5. **The legislative and regulatory framework for taxation is comprehensive but fairly complex.** Article 153 of the Constitution allocates to the federal government the power of taxation on the following bases: imports and exports; income and earnings of any nature; industrial products; transactions of credit, foreign exchange, and insurance, or transactions with financial instruments and securities; rural property; and large fortunes. Article 154 of the Constitution allows for additional taxes to be instituted (by complementary law), provided they are noncumulative, and have a specific taxable event or assessment basis other

Box 2. The State Debt Restructuring Agreements

The growth of subnational indebtedness since the early 1990s has necessitated greater federal involvement in subnational fiscal consolidation. In the absence of arm's-length relations between state governments and their financial institutions in the high-inflation period prior to 1994, many state governments had financed their budget deficits by borrowing from state banks, without regard for normal commercial standards of creditworthiness or loan recovery, and in anticipation of federal bail-outs. A tighter monetary stance, particularly since the mid-1990s, and the absence of fiscal structural reforms aimed at fiscal consolidation at the subnational level, contributed to the increase in subnational indebtedness.

Subnational debt restructuring arrangements have been instrumental in promoting fiscal adjustment at these levels of government. The subnational debt restructuring program, launched in 1997, involved the consolidation of domestic liabilities of 25 (out of 26) state governments and the Federal District, as well as the restructuring of state banks, to the tune of RS205 billion, by September 2001. The federal government assumed these liabilities mainly through the issuance of federal securities (LFT-A and LFT-B) of up to 30-year maturity; the subnational governments, in turn, are paying interest at rates of 6 percent per annum plus inflation (IGP-DI). Subsidized interest rates have imposed costs on the federal budget, but lower subnational debt obligations have reduced subnational borrowing requirements. The bilateral agreements also involved federal intervention and subsequent liquidation and/or privatization of most state banks. Currently, there are six state banks that have been placed temporarily under the control of the BCB while their privatization is being carried out. Subsequent debt restructuring agreements were signed with over 180 municipalities. The debt restructuring contract of the states of Minas Gerais, São Paulo, and Rio Grande do Sul are available at the Ministry of Finance (MoF) website; all contracts have been published in the Official Gazette (DO).

The debt restructuring agreements have imposed tighter federal control over subnational finances. These agreements are legally binding and provide for the down-payment of 20 percent of the jurisdiction's outstanding debt stock; and a fixed repayment schedule based on the jurisdiction's revenue mobilization capacity, measured in terms of real net revenues, which includes own revenues and mandated transfers from higher levels of government net of mandated transfers to lower levels of government. More importantly, new debt issuance is banned when the ratio of debt to real net revenues exceeds one. Noncompliance with the terms of the contracts implies the replacement of the subsidized interest rates by the nominal interest rate paid on the federal securitized debt plus a penalty of 1 percent per annum. The states and municipalities have provided to the federal government as collateral for the service of the restructured debt, the mandated federal transfers to them, as well as their own revenues. This collateral has been promptly executed by the latter in case of noncompliance with their debt service obligations by some state and municipal governments.

Continued enforcement of the bilateral agreements and limited access to financing have required considerable fiscal adjustment at the state and municipal levels to generate the primary surpluses needed to service their outstanding debt obligations. A broad subnational privatization program, particularly in the sectors of transportation and energy, was also strengthened in support of the accompanying fiscal adjustment effort.

The debt restructuring arrangements have reinforced the fiscal rules enshrined in the LRF, as well as promoted transparency in subnational government finances. Embedded in the debt restructuring contracts are provisions for the reporting of subnational fiscal data based on a common methodology, which has allowed the National Treasury (STN) to consolidate subnational fiscal data and monitor subnational fiscal performance until the LRF is fully implemented. The definitions of ceilings and other fiscal parameters in the LRF is also broadly consistent with those used in the debt restructuring contracts, thereby facilitating the reporting of fiscal data by the subnational governments that have signed restructuring contracts with the STN.

than those specified in the Constitution.⁶ According to the National Tax Code,⁷ each tax requires an explicit legal basis: “it is forbidden for the federal government, states, and municipalities to levy or increase taxes without a corresponding law that establishes it.” Also, all contributions, fees, and duties require an explicit legal basis.⁸ The main tax bases for state governments are value-added (ICMS) and motor vehicles; for the municipal governments, they are services (ISS) and real estate. The LRF (Article 14) stipulates that new tax concessions by each level of government have to be recorded explicitly in the corresponding budget. The LDO also includes a table detailing existing federal tax expenditures. Tax administration has been strengthened significantly over the last several years, helped by a number of legal changes, including Law No. 10174 of 2001 which allows to break bank secrecy for tax enforcement purposes.

6. Roles and responsibilities of the executive, legislative, and judicial branches of all levels of government in the budgetary process are clearly defined in the federal Constitution. Article 2 establishes the independence of the three branches of government. Article 165 sets out the responsibilities of the executive branch regarding the budgetary process. At the federal level, it requires the preparation of three budgetary instruments—PPAs, LDOs, and annual budget laws (LOAs). Draft bills for each of these instruments must be prepared by the executive branch in accordance with Article 167 of the Constitution, which limits budgetary flexibility,⁹ and with the various existing laws, rules, regulations that cover the budget process—including, in particular, the LRF, but also other complementary laws, such as law No. 4320 of 1964,¹⁰ which establishes general rules for the preparation, execution, accounting, and reporting of the budgets for the three levels of the government, and Law No. 8666 of 1993, which establishes rules for government procurement and contracts. The executive branch submits the draft budget documents to the legislative branch, which subsequently reviews and discusses them, and may modify and amend them according to the procedures in Article 166 of the Constitution.¹¹ Various budget reporting requirements

⁶ The Constitution also allows for temporary extraordinary taxes in the case of foreign war. However, the Constitution also sets explicit restrictions on taxation (Article 150), including, among others, that a tax cannot be collected in the fiscal year in which the law that instituted or increased the tax was published (the so-called “annuality principle”). It also establishes a tax-exempt status for temples of any cult; the property, income, and services of political parties (including their foundations); of worker unions; of nonprofit educational and social assistance institutions; and for books, newspapers, periodicals, and the paper intended for printing these.

⁷ Law No. 5172/66 of 1966.

⁸ This can be done by different legal instruments, like complementary laws or provisional measures.

⁹ Article 167 specifies, among others, that borrowing should not exceed capital expenditures (“golden rule”), which is equivalent to requiring at least equilibrium in the current budget.

¹⁰ A complementary law to substitute law No. 4320/64 is currently under discussion in congress.

¹¹ The article mandates that the government’s budget proposal be examined by both houses of congress through a joint budget committee (CMPO); all amendments have to be consistent with the PPA and the LDO. Amendments for additional expenditure have to be matched by canceling other expenditures (excluding payroll, debt service, and transfers), and/or additional revenue resulting from errors and omissions. The submission of amendments follows internal regulations of the CMPO, in addition to the rules set by the congressional rapporteur’s report on the budget proposal.

are meant to facilitate budget oversight, be it in the form of internal control, or control by legislative or judicial bodies; these are detailed in subsection II.B below.

7. **There are no extrabudgetary funds or extrabudgetary expenditures.** Budgets are required to include the operations of all nonfinancial public sector institutions at the level of government to which the budget applies, and no expenditure can be made without explicit budgetary appropriation. There are various budgetary funds (e.g., the recently created poverty fund), all of which require a specific law to be created. All budgetary funds enjoy earmarked revenue for their specific expenditures, but they are an integral part of the federal budget and must comply with all budgetary procedures during budget preparation and execution. However, budgetary funds may carry over into the next fiscal year any financial surplus remaining from the current fiscal year, provided that it is properly budgeted and executed according to budgetary procedures.

8. **The central bank is not formally independent, but, in practice, enjoys substantial operational autonomy.** Formally, the BCB is under the authority of the MoF; efforts are under way to strengthen the legal basis for its autonomy—the BCB cooperates closely with the MoF in a number of areas, including macroeconomic projections and policy coordination, the consolidation of fiscal data (“below-the-line”) with “above-the-line” data, and external debt management. Under the inflation targeting regime that was established in mid-1999, the central bank was given the responsibilities to pursue the annual inflation targets established by the National Monetary Council (CMN), which is presided by the Minister of Finance. Monetary policies in pursuit of the inflation target have been carried out independently, based on decisions taken by the Monetary Policy Committee (COPOM), which consists of the BCB president and its board of directors.

9. **Relations between the budget and the central bank are transparent.** The BCB’s administrative budget (namely wages and administrative expenditures) is fully integrated into the federal budget; operations related to the conduct of monetary policy are outside the federal budget.¹² Article 164 of the Federal Constitution forbids the BCB to finance the STN. In particular, the BCB may not grant loans to the treasury, or to any agency or entity which is not a financial institution. Also, it may not buy primary issues of federal debt (although, the STN was allowed to roll over existing liabilities held by the BCB).¹³ STN balances held at the BCB are remunerated at the average interest rate for all government securities in the BCB’s portfolio. Positive BCB income is to be transferred to the STN each six months;

¹² The federal budget includes as financial revenue BCB income from domestic debt operations, foreign exchange and gold transactions, and international reserve operations; seignorage is excluded from the federal budget. Revenues from federal government deposits with the BCB and the holdings of treasury securities in its portfolio are netted out in the consolidation of BCB and federal government fiscal statistics.

¹³ Similarly, according to the LRF (Article 36), public financial institutions at all levels of government are not allowed to lend to their main shareholder. As a result, state-owned banks are no longer allowed to lend to state governments, and federal banks like the National Development Bank (BNDES) can no longer finance federal government projects. However, BNDES can continue to lend to states and municipalities within the limits on portfolio composition set by the CMN.

possible BCB losses have to be addressed through a transfer from the budget. As set out in the LRF, the BCB has to provide, on a quarterly basis, its balances and an account of the fiscal impact of its operations.¹⁴

10. Operations between the budget and the public financial institutions are transparent; operations of a quasi-fiscal nature have been largely eliminated. As other public companies, public financial institutions may not enjoy fiscal privileges which are not extended to private sector banks. Strict rules apply to the provision of guarantees by the federal government.¹⁵ In the past, quasi-fiscal or extrabudgetary practices were often pervasive, leading to the accumulation of unrecorded liabilities, the so-called “skeletons.” Since 1996, the STN has been securitizing a substantial amount of these liabilities,¹⁶ and it will continue to do so over the next few years. A few more “skeletons” may materialize in the future, depending mainly on the outcome of claims still under review in the court system.¹⁷ Some practices that used to be of a quasi-fiscal nature still continue, but with a reduced scope, and they are now captured in the budget through explicit transfers. In particular, BB and CEF are still subject to directed lending requirements to agriculture and housing, respectively.¹⁸ However, the subsidy element arising from these directed lending operations is now recorded transparently in the budget. The BNDES continues to rely, in part, on captive resources from the Unemployment Fund (FAT); these resources are

¹⁴ Also, starting two years after the publication of the LRF, (i.e., in May 2002) the BCB will no longer be able to issue public debt titles in its own name.

¹⁵ Also see Senate Resolution 96/89. A new government proposal to limit the stock of outstanding federal guarantees to 60 percent of net current revenues is under discussion in the Senate.

¹⁶ While the economic (aggregate demand) impact of these liabilities mostly occurred in the past, their impact on the public debt statistics is only recorded at the time they are securitized. To preserve the information content of the public sector borrowing requirement (PSBR) for a given year, the value of these securitization operations has been excluded from the PSBR, while their impact on the public debt is recorded as an adjustment to the debt stock. All interest payments resulting from these operations are included in overall interest payments, and therefore affect the PSBR.

¹⁷ The main past liabilities being recognized include those accumulated by the Housing Mortgage Insurance/Subsidy Fund (FCVS) during the past three decades, and those related to the recapitalization of some federal banks on account of quasi-fiscal losses incurred in the past. Possible liabilities to be recognized in the future mainly relate to areas in which there are pending cases in the courts, including the losses incurred by a few sectors due to government-imposed price freezes under past failed stabilization plans, the monetary correction applied to savings accounts frozen in March 1990, and interest penalties paid on tax arrears since 1996. In addition, the government has carried out some clean-up operations. This has included, for example, an exchange of illiquid low-interest debt for liquid debt titles that pay market interest rates, as in the case of the Severance Pay Fund (FGTS); and assets swaps, as in the case of the recent strengthening of the capital base of some federal banks. The LRF requires that the LDO for each level of government include a Fiscal Risks Annex assessing the scope of contingent liabilities and their likelihood of turning into actual liabilities.

¹⁸ For BB, 25 percent of its demand deposits and 40 percent of its savings deposits are directed toward agriculture; for CEF, 65 percent of its savings deposits are directed toward the housing sector. CEF has recently suspended all financing out of its own resources for the housing loan program to middle-income households, and will have the cost (subsidy) of loans to low-income households explicitly paid out of the federal budget.

remunerated at a government-regulated long-term interest rate (TJLP),¹⁹ which is adjusted periodically to reflect market developments, but is significantly lower than the benchmark overnight market interest rate. The Fiscal Risks Annex of the LDO also discusses the contingent liabilities associated with public guarantees, and provides the value of outstanding guarantees, which traditionally have been small.

11. **Quasi-fiscal operations of nonfinancial public enterprises have also been largely eliminated,**²⁰ particularly at the federal level. The nature and extent of these operations (and of government intervention in their controlled enterprises) is less transparent at the subnational level of government, although available (below-the-line) aggregate data on the finances of these enterprises suggest that they have remained in approximate balance in recent years.

12. **Government equity holdings still remain significant in some sectors;** they are reported clearly on a company-by-company basis, although not comprehensively in the aggregate. Notwithstanding the extensive privatizations in recent years (detailed in Box 3), government equity holdings remain significant, particularly in the oil sector (Petrobrás), electricity generation (Eletrobrás), airport administration (Infraero), the financial sector (as indicated above), and the sewerage and water sectors. At the federal level, equity is held either by the STN or by the BNDES and its investment corporation (BNDESPAR),²¹ but subnational governments have their separate equity holdings. According to the Brazilian Constitution (Article 173), public and private enterprises are subject to the same legal regime, and follow the same general accounting, reporting, and audit requirements.²² While there is no comprehensive list of the stock of all public sector equity holdings, the existing reporting requirements imply that, for any given company, government ownership is

¹⁹ The TJLP (plus a base spread and a sector-related risk spread) is also applied to BNDES investment lending operations. Export financing loans are remunerated by a mix of rates and tied to basket of currencies.

²⁰ For example, fuel prices used to be kept artificially low, resulting in significant losses for the government-owned oil company (Petrobrás) that were recorded in the "Petroleum Account." In late-1998, the accumulated losses were covered by a government debt issue to Petrobrás. Although the fuel price structure introduced in 1998 still contains some cross-subsidies on oil derivatives at the consumer level, the automatic fuel-price adjustment mechanism introduced in 2000 aims at ensuring that there is no overall subsidy. As a result, the Petroleum Account has remained in approximate balance since then, and the account is expected to be phased out in 2002 when the domestic oil market is to be liberalized.

²¹ BNDESPAR, fully-owned by BNDES, was created in 1982 and became a public company in January 1998. It is currently the most important venture capital agency in Brazil.

²² In addition, public enterprises and mixed public/private enterprises may not be granted fiscal privileges that are not extended to companies of the private sector. In general, the Federal Accounting Council (CFC) establishes the uniform accounting principles that are applicable to enterprises independent of their ownership. The largest public enterprises (e.g., Petrobrás) are organized as mixed (i.e., public/private) stock companies and ruled by law No. 6404 of 1976; like private stock companies, they are supervised by the National Securities & Exchange Commission (CVM) and subject to annual audit requirements. An exception to these general procedures, is the binational entity Itaipu, which is jointly owned by the governments of Brazil and Paraguay, and is audited by independent private-sector auditors.

Box 3. Privatization

A large-scale privatization program, that began over a decade ago, has been carried out successfully and with high standards of transparency. Up to the late 1980s, significant parts of the economy were state owned. Since then, privatization has involved all levels of government, and a broad range of economic sectors. From January 1991 to July 2001, gross privatizations receipts totaled US\$84.9 billion, of which US\$28.2 billion were raised by the National Privatization Program (PND) from the sale of companies controlled by the federal government, auctions of minority stakes, and the sale of concessions and leases; US\$28.8 billion came from separate privatizations in the telecommunications sector; and US\$27.9 billion from state-level privatizations. Including the debt transferred to the private sector of US\$18.1 billion, total privatization proceeds amounted to US\$103.0 billion during that period. Of all privatization receipts, 48 percent came from foreign investors. Under the PND alone, a total of 66 enterprises were privatized during January 1991–July 2001.

Brazil has a comprehensive legal framework for privatizations¹ that, among others, details procedures, and defines the responsibilities of privatization managers and the oversight bodies. At the federal level, the highest decision-making body is the National Privatization Council (CND),² which is directly subordinated to the President of the Republic, and whose members are various ministers; decisions on enterprises to be included in the PND are made by the President upon recommendation of the CND. In general, privatizations at the federal level have been managed by the BNDES, which has acted as the operational arm of the PND and the privatizations in the telecommunications sector; exceptions are privatization operations in the transport sector (largely concessions) and the financial sector, which have been carried out under the supervision of the Ministry of Transport and the BCB, respectively. There are, in general, no legal impediments to foreign participation, and privatization to foreign entities has accounted for a large part of privatization proceeds; the law explicitly stipulates that up to 100 percent of the voting capital may be sold to non-Brazilian individuals or legal entities. All privatization operations are subject to concurrent and ex-post oversight, including by the National Audit Court (TCU) and the Federal Internal Control Directorate of the Ministry of Finance (SFC); the operations of the BNDES, including in its roles as manager of the PND, are also audited annually by an independent auditor.³ The federal privatization legislation stipulates that all federal privatization proceeds accrue to the treasury, and that proceeds be primarily used for debt-reduction operations;⁴ proceeds from leasing operations and concessions have been recorded above the line as primary revenue.

Each privatization is carried out following standardized, transparent, and nondiscriminatory procedures. In the case of outright sales, which are always carried out via auctions, these procedures include, in chronological sequence, the hiring of two independent companies that carry out a “Serviço A” (valuation), and a “Serviço B” (including due diligence, valuation, modeling share offers), respectively; prequalification procedures (opening of prequalification for potential buyers to participate in the auction, announcement of the results of the procedures); opening of the data room (full access to data of the institution to be privatized for all prequalified buyers); sending the valuation reports to the TCU for approval (a minimum of 60 days before the auction; the TCU must approve the reports until 15 days before the auction); announcement of the auction (a minimum of 45 days in advance); and the privatization auction itself.⁵

¹ The current privatization framework is based on Law 9491/97 of September 9, 1997 which defines the PND, and Decree 2594/98 of May 15, 1998, which regulates the 1997 law. Separate legislation covers the electricity sector (Law 9648/98 of May 17, 1998); the telecommunications sector (Law 9472/97 of July 16, 1997), which has been privatized outside of the PND; and the sale of concessions (Laws 8987/95 of February 13, 1995, and 9074/95 of July 7, 1995). See “Brazilian Privatization Program—Legislation Collection” of July 2001, and the privatization website at <http://www.bndes.gov.br/pndnew/>.

² For privatizations in the financial sector, oversight is provided by the CMN. State-level privatizations are also covered by comprehensive state-level laws, supervised by state-level oversight bodies, and subject to internal and external controls similar to those at the federal level.

³ The PND also provides an Annual Report.

⁴ The impact of privatization receipts on the public debt has been partly offset by the inclusion in the latter of previously unrecorded liabilities known as “skeletons,” that originated from past extrabudgetary or quasi-fiscal operations.

⁵ A minority share (usually not exceeding 10 percent of total shares) may be offered for purchase to employees, based on a decision by the CND; employee purchases can be made using accumulated resources from the Severance Pay Fund (FGTS).

transparently reported to the general public, following private-sector accounting standards.²³ A detailed account of STN equity holdings (e.g., in companies like Petrobrás and BB) is published bi-monthly, including on the STN website. BNDES and BNDESPAR also report on their equity participations according to their standard reporting requirements every six months; these are published in the DO and in two other newspapers. Furthermore, the financial statements of BNDES and BNDESPAR, which include government equity participations, are sent to the CVM on a quarterly basis. New government equity participations (e.g., through the BNDES subsidiary BNDESPAR or directly) have been limited, and generally for temporary purposes.²⁴

13. Government regulation of the nonbank private sector is implemented with clear, albeit complex, regulations. While following the basic principle of self-regulation of markets, government regulation of the nonbank private sector is complex, with a fairly large number of legal stipulations, and of specific regulatory and control agencies. The supervisory activities of the CVM involve the monitoring of the information disclosure process (including of all publicly listed companies), and the behavior of securities traded.²⁵ Among others, the CVM carries out the registration of publicly held companies; registration of public offerings; accreditation of independent auditors; suspension of the trading, issuance, or distribution of securities. Particularly for sectors that were historically characterized by state monopolies, the government has created a number of specific oversight and regulatory agencies.²⁶

14. Public servants are subject to a strict code of behavior which is embedded in a number of legal stipulations. The 1990 *Statute for Civil Servants*²⁷ is applicable to all

²³ General accounting standards are comprehensive, but in some respects still fall short of international standards (e.g., the stringent requirements of the US GAAP).

²⁴ Generally, purchases of shares by the federal government have aimed at promoting the strengthening of capital markets, regional development, and strategic sectors; other acquisitions resulted from the transfer of ownership to the government of extinct companies, and the debt renegotiation agreements with the states (e.g., shares received as payment for state debt). All expenditures in these regards are recorded in the budget.

²⁵ The role of the CVM has recently been strengthened through increased financial autonomy and fixed mandates for its directors, as stipulated in the new corporate law that came into effect in November 2001.

²⁶ These include the National Telecommunications Agency (ANATEL), created by Law No. 9472 of July 1997; the National Electric Energy Agency (ANEEL), created by Law No. 9427 of December 1996; the National Petroleum Agency (ANP), created by Law No. 9478 of August 1997; the National Water Agency (ANA), created by Law No. 9984 of July 2000; the National Supplementary Health Agency (ANS), created by Law No. 9961 of January 2000; the National Sanitation Oversight Agency (ANVS), created by Law No. 9782 of January 1999; the National Space Agency (AEB), created by Law No. 8854 of February 1994; the National Overland Transportation Agency (ANTT), and the National Waterborne Transportation Agency (ANTAQ), both created by Law No. 10233 of June 2001. Also, there are various entities that guard against noncompetitive behavior, and/or have oversight on mergers & acquisitions, including the Consumer Rights Protection Agency (CADE), the Secretary for Economic Justice (SDE) of the Justice Ministry, and the Secretary for Economic Monitoring (SEAE) of the MoF.

²⁷ Law No. 8112/90 of December 1990.

employees of the federal government and its decentralized agencies (e.g., federal foundations). It comprehensively establishes hiring and employment procedures; general remuneration rules; rights and responsibilities of public servants; and disciplinary mechanisms and procedures. The 1992 *Law on Improper Administrative Behavior*²⁸ defines three main categories of improper behavior of public servants: illicit enrichment, acts that result in unfair advantages, and acts that are in conflict with good principles of public administration (e.g., honesty, impartiality, confidentiality, or use of privileged information). In 1994, the government established by decree a *Professional Ethics Code for Federal Civil Servants*;²⁹ however, this code did not provide for effective sanction mechanisms for noncompliance, apart from reprimand.³⁰ In 2000, a *Fiscal Crimes Law* (LCF) was enacted³¹ that, among others, defines specific infractions by public officials at all levels of government that would adversely affect fiscally responsible public administration, and sets out a general structure of penalties to be applied. Also, the government established a Code of Conduct for senior federal government officials (CCAAF),³² applicable to about 700 senior officials appointed by the President, and a separate ethics code for federal government officials who manage the public debt (CEADP),³³ which complements the CCAAF. The CCAAF clarifies, among others, the ethical rules applicable to high-level government officials; establishes basic rules regarding conflicts between public and private interests, and limitations on professional activities that are undertaken immediately after leaving office; and creates consultative mechanisms and procedures to prevent unethical conduct. To implement the CCAAF, a *Public Ethics Commission* (CEP), that has largely a preventive character, was created under the Presidency.

15. **Upon entry into service, all public servants have to supply a declaration of assets.** Also, in line with the CCAAF, all senior government officials have to provide, 10 days after taking office, a detailed statement on their assets and income; indicating which assets could raise conflicts of interest, and ways to avoid them.³⁴ Also, the CEP has to be notified immediately of any relevant changes in personal assets. To strengthen the public's

²⁸ See *Lei da Improbidade Administrativa* (No. 8429/92).

²⁹ See *Código de Ética Profissional do Servidor Público Civil do Poder Executivo* (Decree No. 1171 of June 22, 1994).

³⁰ Being a decree, rather than a law, noncompliance with the decree's stipulations can have no adverse consequences in a strictly legal sense. See Comissão de Ética Pública, *Projeto: Identificação de Modelos e Práticas de Gestão de Ética na Administração Pública Federal Brasileira (Executivo Federal)*, (Final Report of August 30, 2001).

³¹ Law No. 10028/00 of October 19, 2000.

³² The "Code of Conduct for the Senior Government Officers at the Federal Executive Branch," which was approved by the President on August 21, 2000.

³³ The "Ethics Code and Standards of Professional Conduct for Administrators of Public Debt" from February 2001; for more information, see http://www.stn.fazenda.gov.br/hp/codigo_etica.asp.

³⁴ There has been full compliance with these requirements. Until early September 2001, three officials had been dismissed by the President because of noncompliance.

recourse against improper behavior of public servants, the government established in April this year a *General Corrector's Office (CGU)*³⁵ to follow up on infractions by public officials against federal funds or assets, or, more generally, corrupt practices. The CGU can either act on its own initiative or on the basis of denunciations.

B. Public Availability of Information

16. **Detailed data on central government finances are readily available.** The STN posts at its website on a monthly basis, with a one-month lag, the above-the-line outturn of the consolidated operations of the central government (including the BCB).³⁶ Expenditures are reported in a mix of functional and economic classifications. In addition, the STN issues more detailed bi-monthly execution reports, as required by the LRF. These reports follow the classification of the LOA and, therefore, allow for an exact mapping of budget execution and budget allocations; they are also available at the STN website. The Internal Revenue Service (SRF) publishes monthly reports on central government revenues, with a month's lag, available at its website. Monthly reports are also available at the website of the Ministry of Social Security and Assistance (MPAS), showing the private-sector social security system's outturn, with a month's lag; annual reports on medium- and long-term projections for the social security system are also available. The above-the-line outturn of the federal public enterprises is available on an annual basis, but is monitored on a monthly basis by the Ministry of Planning, Budget, and Management (MoP), where information is consolidated from the federal enterprises' balance sheets, and reconciled with the budget accounts on a cash basis for the purpose of calculating the primary balance of the consolidated federal public enterprise sector.

17. **Data on subnational government finances are available, but they are less comprehensive and timely than central government data.** Many government agencies, including, among others, the STN, the BCB, the Federal Internal Control Secretariat of the Ministry of Finance (SFC), and the TCU, publish information on the central government mandated transfers to the states and municipalities. The National Statistics Institute (IBGE) collects annual above-the-line data on subnational finances for the 26 states and the Federal District, as well as a representative sample of 250 out of 5,561 municipalities for the purpose of producing national accounts statistics. The STN collects annual above-the-line data on the states' budget execution, typically with one-year lag. Data on the above-the-line outturn of individual public enterprises of the states and municipalities are readily available from their balance sheets and income statements, and are subsequently consolidated with government fiscal accounts. The quality of above-the-line information on subnational finances has improved significantly since the above-mentioned bilateral debt rescheduling arrangements

³⁵ See Provisional Measure 2143-31 of April 2, 2001. The CGU has a staff of about 60; investigations are frequently carried out with the help of the SFC. The CGU website contains information on all ongoing and completed investigations.

³⁶ A monthly budget execution report is published in the DO. Information on the operations of the central government excluding the BCB is available through the SDDS.

have been signed between the federal government and most states and over 180 municipalities.³⁷

18. **The BCB provides monthly below-the-line data on the consolidated operations of the various levels of government and the nonfinancial public sector.** The PSBR is calculated as the monthly change in the public debt stock. The latter is calculated on the basis of information from the banking sector; on domestic bond issues; and from the BCB's external debt register. Interest payments on domestic public debt, including the foreign exchange-indexed debt, are calculated on an accrual basis. Therefore, the PSBR includes the changes in the stock value of the foreign exchange-indexed debt due to exchange rate movements in the reference period.³⁸ The BCB also reports PSBR data using the harmonized Southern Common Market (MERCOSUL) debt statistics methodology, in which interest payments due on the exchange rate-indexed domestic debt are calculated on a cash basis. This methodology provides equal treatment to the debt service of the external debt and the foreign exchange-linked domestic debt. The BCB also publishes data on nominal interest payments for the different levels of government and their primary balances. The BCB has begun to publish on a monthly basis statistics on the uses and sources of financing of government operations, for all levels of government and the consolidated public sector, including a breakdown by broad categories of domestic and external financing. Reports of the external audits of the BCB are also available at its website.

19. **Data on public debt and the government's financial operations are comprehensive and readily available.** The BCB publishes on a monthly basis detailed information on the level and composition of the net debt of the general government (excluding the BCB), as well as indicators of average maturity and duration of the securitized debt stock issued by the STN and the BCB by security type. In addition to information on the net public debt stock, the BCB has recently begun to publish on a monthly basis information on the gross debt stock of the consolidated public sector, including information on the government's financial assets for all levels of government. The STN publishes on a monthly basis information on domestic and external debt operations during the previous month and on debt service payments due in the following months, as well as indicators of average cost, maturity, and duration of its debt securities; and, on an annual basis (since 2001), its baseline program for debt issuance and management during the year. The schedule of monthly debt

³⁷ To achieve further improvements in subnational government financial management, and support implementation of the debt restructuring agreements, the central government, in cooperation with multilateral institutions, devised a Modernization Program for State Fiscal Administration (PNAFE); PNAFE promotes the restructuring, modernization, and strengthening of the institutions responsible for state-level fiscal management, both on the revenue administration and the public expenditure management sides. In particular, PNAFE provides technical and financial support for projects that aim to improve the legal framework for government financial management; integrate, and strengthen financial management, auditing, and internal control; and ensure that state governments levy all taxes in accordance with the legislation. A similar Modernization Program for Municipal Fiscal Administration (PNAFM) was set up recently.

³⁸ Since September 2001, the BCB also provides a series with cash-basis accounting for domestic debt indexed to the foreign-exchange rate.

auctions is announced in advance. Detailed information on divestiture operations, including legislation, auction schedules, and financial statements of privatization operations and sales of assets, is available at the BNDES website. Information is available at the BCB website on the privatization of the state banks under its control, as well as on the government program for reducing state banking activity (PROES).

20. **Information on tax legislation and a wide range of taxpayer services is provided online.** Information on tax collections, tax legislation, as well as taxpayer services, is provided on the website of the SRF. About 90 percent of personal income tax returns are filed via the internet, and all corporate income tax returns are filed electronically. Information on state and municipal own tax revenues is available on an annual basis from the IBGE and the STN.

21. **The dissemination of federal budget documents and legislation is comprehensive. Information on the federal budget instruments—PPA, LDO, and LOA—is available at the MoP website.** The LOA includes the budgets of the central government, as well as investment ceilings for the nonfinancial federal enterprises. A detailed consolidated budget of the nonfinancial federal enterprises, comprising all revenues and expenditures, is issued separately through a presidential decree. The federal LDO sets the fiscal targets for the central government and the nonfinancial enterprises, as well as guidelines on budget formulation and execution. The LRF requires comprehensive dissemination of information at all levels of government, and the issuance of annual, bi-monthly, and four-monthly reports on budget execution. In line with the LRF, the LDO provides budget execution information for the preceding two fiscal years, based on which compliance with the fiscal targets is assessed, as well as key aggregate expenditure, revenue, and primary balance targets for the following three fiscal years (Fiscal Targets Annex).

22. **Information is provided on contingent liabilities and tax expenditures.** As indicated above, the LDO includes detailed annexes on the securitization of unfunded liabilities incurred in the past, as well as a fairly detailed assessment of the contingent liabilities that may arise in the future (Fiscal Risks Annex). Also reported in the LDO is detailed information on tax expenditures of the central government and the social security system;³⁹ revenues are reported in the budget net of tax expenditures. Subsidies and defense expenditures are clearly reported in the federal budget.

23. **The PPA has contributed to greater dissemination of information.** The PPA has allowed greater transparency in the dissemination of information by strengthening the link

³⁹ Tax expenditures are calculated for each tax separately, following the methodology summarized at the SRF website. For instance, for the Industrial Products Tax (IPI), tax expenditures are calculated based on the average tax rate for each product. Similarly, for the corporate income tax, tax expenditures are calculated based on actual deductions in individual enterprise tax returns. For enterprises reporting under the presumed profit regime for taxing small enterprises, tax expenditures are calculated relative to the marginal rate that would be applied to the turnover bracket for each enterprise. At the federal government level, tax expenditures have remained fairly stable over time at approximately 1.6 percent of GDP, and were granted predominantly in the context of regional development programs.

between multi-year planning and annual budget preparation and execution (Box 4). The PPA also facilitates a clear link between individual programs and the functional and economic classifications of expenditures in the central government budget. Updated information on the PPA's execution, program implementation, and program managers is provided to authorized users through an Integrated Information System (SIG). Information on the implementation of the PPA is available to the public at the MoP website, including the monthly implementation reports and the annual reports submitted to congress.

24. **Information on internal and external control is widely available.** The TCU posts its audit reports on its website, and publishes them in the DO. Reports of the SFC are submitted to the TCU and to individual program managers. Information on the activities of the SFC is available at its website, but not its audit reports. Efforts have been made to strengthen the internal control agencies in the Judiciary and Legislative branches of the federal government, and at the subnational level. Internal and external control agencies also receive grievances and information requests from the public at their websites.

25. **Several e-government programs are available.** A website-based federal procurement program is accessible to the public (Box 5). Most states provide online information on their tax legislations, public procurement instruments, including online auctions, and social assistance programs. Some municipalities provide information online on the services available to residents, social programs, and procurement activities.

26. **Brazil subscribes to the SDDS since March 2001.** Advance release calendars, as well information on the coverage of the fiscal accounts, are available at the BCB's website. A flexibility option on the timeliness of reporting general government operations is taken under the SDDS. Currently, the reporting delay for these data is about two years, reflecting the IBGE data release schedule; full compliance is expected in two years. Delays in reporting GFS statistics primarily reflect various changes in the government agency responsible for consolidating budget statistics, and the current lag in consolidating subnational, particularly municipal, budget outturns.

C. Open Budget Preparation, Execution, and Reporting

27. The preparation of the LOA is based on the PPA, and on an assessment of fiscal sustainability focusing on targets for the public debt-to-GDP ratio. For each level of government, preparation of the LOA bill is preceded by the LDO, which must indicate the fiscal targets for the reference year and provide projections for the two following years in terms of overall and primary balances, the stock of net public debt, and budgetary aggregates, including revenues and expenditures. The LDO must also indicate limits for overall expenditures, program priorities, and procedures that must guide the annual budget preparation. As of 2001, the LDO also included a discussion of the impact on revenues and on the net debt-to-GDP ratio of changes in macroeconomic assumptions, like the growth rate of real GDP, interest rates, and exchange rates (Fiscal Risks Annex). Although there is no law establishing overall fiscal targets for the public sector as a whole, the federal

Box 4. Multi-Year Budgeting (PPA): Recent Developments

Brazil has placed increased emphasis in recent years on multi-year, output-oriented budgeting. Based on the successful implementation of the *Brasil em Ação* Program, concluded in 1999,¹ output-oriented budgeting has been applied to other programs in the context of the 2000–03 multi-year budget (PPA, also known as *Avança Brasil* Program). Managerial practices have changed significantly, including the appointment of specific managers to each program, and the introduction of explicit targets for service delivery. The smooth transition from *Brasil em Ação* to the current PPA has ensured more continuity in the implementation of public policies, especially in the social and infrastructure sectors, as well as explicit budgetary allocations to each program. This effort is in tandem with ongoing improvements in expenditure management and control; emphasis has been placed in budget formulation on specific programs, rather than functions, and on consistency with the annual budget classification methodology. Partnership with the private sector, international organizations, subnational governments, and NGOs in funding specific programs is clearly stated in the multi-year budget framework.

The PPA integrates national long-term development policies with sectoral short- and medium-term objectives. Organized around 28 main objectives and four strategic actions, defined in line with the government's long-term development goals (*Eixos Nacionais de Integração*), the PPA provides a multi-year expenditure envelope for sectoral policy design and budget formulation. The eight-year development plans provide indicative targets for the four-year PPA, focusing on areas of complementarity between federal and subnational policies, as well as private sector involvement. Interaction with subnational governments has contributed to greater ownership of public policies that cut across jurisdictional borders.

Priority programs have been selected in the 2000–03 PPA. The 2000–03 PPA contains 386 programs, including a subset of 52 priority programs for the period 2001–02 period. Priority programs are protected from cuts in budget allocations and delays in execution during each fiscal year. Spending on these programs amounts to R\$ 67.2 billion in 2001. Funding comes primarily from budgetary sources (over 37 percent of total outlays on the priority programs). Social programs account for nearly two-thirds of the budget allocations for priority programs in 2001 and over 83 percent of the priority programs funded by the budget. Infrastructure programs account for approximately 34 percent of PPA spending on priority programs in 2001. The spending requirements in the PPA are taken into account in the preparation of the annual LDOs and LOAs. The selection of priority programs allows for greater efficiency of public spending in periods of fiscal consolidation, when budgets can be retrenched in line with national, rather than sectoral, priorities. In the case of priority programs, compliance with the program's physical execution timetable and targets is a pre-requisite for the timely disbursement of budget allocations.

Transparency has improved and procedures for the dissemination of information have been strengthened. Information on program characteristics, managers, budget allocations, and output targets is available on the internet to authorized users in the Management Information System (SIG, *Sistema de Informações Gerenciais*).² The SIG consolidates the information provided in separate sectoral information

¹ The *Brasil em Ação* Program was launched in 1996 to prioritize 42 programs in the areas of social development and infrastructure. The program was extended in 1999 to cover 58 programs, benefiting an estimated population of 62 million. The Program's budget was R\$ 70 billion during 1996–99. Social programs accounted for nearly 62 percent of total spending under the program, whereas the share of infrastructure programs was nearly 32 percent of total spending.

² The Management Information System is fully integrated with other expenditure management systems, such as the Integrated Financial Management System of the Federal Government (SIAFI) and the Integrated Budget System of the Federal Government (SIDOR), thereby strengthening expenditure management and control mechanisms.

Box 4. Multi-Year Budgeting (PPA): Recent Developments (Concluded)

systems. The information on program and financial budget execution is reported in monthly reports for the priority programs, and on an annual basis for all programs in the PPA (available at the MoP website).

Assessment of the PPA is carried out in a three-stage process. The first stage is based on self-assessment: program managers are required to evaluate their own program's design and progress in implementation relative to the output targets, and to report difficulties or constraints faced during implementation. The second stage focuses on a sectoral assessment carried out by line ministries and implementing agencies, and the formulation of an impact matrix for the sectoral programs and policy objectives. Finally, an overall assessment of the programs, and their consistency with the main objectives of the PPA as a whole, is performed by the ministry of planning and budget. Annual reports are then submitted to the legislature and to the Presidency. Budget allocations in subsequent fiscal years, as well as improvements in program design and implementation strategy, are determined on the basis of these assessments. Priority programs are also selected on the basis on this assessment.

The assessment of the first year of the 2000–03 PPA is now available. As in the case of the *Brasil em Ação* Program, the implementation of the new managerial practices was found to have reduced operating costs in certain programs, to have increased competition in public tenders and procurement, and to have encouraged the timely implementation of many programs. Other programs have outperformed their targets for service delivery. Partnerships with the private sector have also yielded positive results.³ The first assessment of the current PPA has highlighted the following challenges for the near future and for the formulation of the next PPA (2004–07):

- the focus on programs, rather than functions, requires deeper changes in the government's functional organization. In the case of projects that cut across ministerial jurisdictions, there needs to be better integration of the various activities in a program, and among program submanagers located in different line ministries or agencies;
- more emphasis is needed on the training of managers, particularly at the federal and state levels of government, given the challenges related to multi-sectoral nature of some programs, and the management of information required by the monitoring mechanisms available in the PPA;
- in recognition of the qualitative differences in the nature of different programs, more emphasis is needed on integrating sectoral information management systems with the consolidated PPA information system; and
- greater effort is needed on the dissemination of the annual evaluation reports, to encourage social control over the implementation of the PPA, promote more systematic feedback from society on the choice of programs selected in the current and future PPAs, and conduct regular opinion surveys among the main beneficiaries of public programs.

³ Private sector financing, in partnership with the public sector, accounted for 21.5 percent of the *Brasil em Ação* budget, particularly in infrastructure programs.

Box 5. E-Government Programs and Initiatives

Brazil has focused on e-government programs and initiatives to facilitate both the dissemination of information and the delivery of public services. The main programs/initiatives currently in place are:

- several ministries and agencies provide **online information services** to the general public. The type of information provided via the internet varies according to the main activities of different ministries and agencies. For instance, the BCB, MoF, and MoP provide extensive information on fiscal and macroeconomic data at their websites. Also, several federal agencies and ministries, particularly those in the social area, provide information at their websites on sectoral budgets, program implementation, and a variety of sectoral indicators. The legislative and judiciary branches of the federal government also provide services at their websites;
- several **taxpayer services** are provided via the internet by SRF, including the filing of tax returns and payment. Virtually 95 percent of PIT returns are filed via the internet, and all CIT returns are filed electronically. Nearly 5 percent of personal income tax returns are filed by phone, particularly for exempted taxpayers;
- several **social security and assistance services** are provided online including the submission of application forms, and the payment of social security contributions. Since early-2001, employers' social security contributions have been paid exclusively online. ATM cards issued to benefit recipients have now become the main mechanisms for payment of several targeted cash transfers to households (including income support programs) and pensions; and
- some **subnational governments** have used the internet for open discussions on government programs and policies, and for the implementation of participative budget initiatives. There is significant variation in the scope of online services provided by the state and municipal governments.

The implementation of e-government initiatives over time has led to some fragmentation in the mechanisms of dissemination of information and access to services via the internet. For instance, there are various channels for the general public to express grievances in different agencies and ministries. The government has therefore focused on the integration and consolidation of its various e-government initiatives and internet sites.¹ The main new initiatives, which are explicitly formulated as programs in the PPA, are:

- the implementation of an **integrated call center** to facilitate access to information and services in a single toll-free number. The call centers will also be a channel for receiving grievances from the general public, thus providing access to those not connected to the internet;
- in conjunction with policies in the health care and education sectors, the program also aims at **implementing IT facilities in public schools and hospitals**, with a view to facilitate the dissemination of information among these units and to reduce digital exclusion in the poorer regions;
- the implementation of online auctions for federal government **procurement** (www.comprasnet.gov.br). Procurement costs have been reduced significantly in many areas. It is estimated that nearly 40 percent of all competitive procurement activities (nearly 20 percent of outlays on procurement) could be carried out through online auctions, generating savings of nearly 20 percent in procurement outlays; and
- the creation of IT service posts in small municipalities to facilitate access to services provided online.

¹ The main federal government site is www.redegoverno.gov.br.

government's PPA, LDO and LOA⁴⁰ proposals have been consistent with a medium-term macroeconomic framework and fiscal consolidation program, which includes estimates for subnational government. The federal government budget is prepared within the general guiding framework of the PPA, and for that purpose it includes, alongside functional and economic classifications in line with current GFS standards, a program classification consistent with that utilized in the PPA. The budget is comprehensive, encompassing the operations of the executive, legislative, and judiciary branches of government, the attorney general's office, all government-controlled funds, the social security system, and all other federal entities, including foundations receiving public funds. The budget document also includes the capital investment budgets of the federal nonfinancial enterprises.

28. **The LOA is a comprehensive three-part document.** It comprises (1) a budget statement, including the macroeconomic framework and a discussion of spending priorities and main budgetary programs; (2) the budget proposal bill; and (3) the annexes including detailed information and classifications of all programs and activities. The LOA includes revenue and expenditure data of the preceding year (original budget and revisions) and the three latest audited accounts. The LOA also identifies earmarked revenues (constitutional transfers to subnational governments, resources for health programs, and social security), as well as tax expenditures and main contingent liabilities. After being sent to congress, this documentation, prepared by the MoP's Secretariat of the Federal Budget (SOF), is made available on the MoP website. While the program-based PPA is fully translated into the budget, administrative costs of programs, especially personnel costs, have not yet been disaggregated by program.⁴¹

29. **The federal government and subnational governments prepare and publish annual accounts, as well as statements of financial assets and liabilities. The expenditure accounting system is on an accrual basis (verified expenditure), while revenue is registered on a cash basis.**⁴² The accounting system of the federal government, embodied in SIAFI, is comprehensive and capable of generating data on all the stages of the expenditure execution and revenue collection processes.⁴³ Therefore, reliable information on verified but yet unpaid expenditures is available on a timely basis. The accounting system includes all domestic and external financial transactions, as well as the cash flow and balance of these credit operations. The system allows for (1) daily validation and confirmation by

⁴⁰ The PPA must be submitted to congress by the executive branch by August 31 of the first year of its four-year term; congress then has until December 15 to approve it. Once enacted, the PPA is in effect until the end of the first year of the next administration. The LDO bill must be submitted to congress by the executive branch by April 15 of each year; congress then has until June 30 to approve it. The LOA bill must be submitted to congress by the executive branch by August 31 each year; congress then has until December 15 to approve it.

⁴¹ Fifteen days after sending the budget proposal to the congress, the executive branch also provides complementary and more detailed information in more than 30 documents.

⁴² The SIAFI system also generates budget execution information on a cash basis (expenditure and revenues), as such published in the STN monthly report.

⁴³ Box 6 describes main features of the SIAFI.

Box 6. The Integrated Government Financial Management System (SIAFI) ¹

SIAFI has been used since 1987 by all ministries and agencies of the executive, legislative, and judiciary branches and other entities financed by the federal budget, as the main tool for registering, monitoring, and controlling their respective budgets and for the execution of these budgets. SIAFI is also used as management information system and as a source of information for internal and external audits. SIAFI has a production version (SIAFI Operational) used by 4,650 spending units (33,458 registered users) with 62 networks linked to the system, and a management version (SIAFI *Gerencial*) used mainly by management units (1,787 registered users) using 52 networks. On average, the system processes 13,333,557 documents and posts 56,700,000 accounting entries per year. There are more than 6,000 workstations connected online to the system.

SIAFI's various subsystems perform budget management functions, and allow for online recording, posting, and processing of: (a) budget execution transactions originating in spending units throughout the country; (b) the deposit of tax and other federal cash revenues in the treasury's unified account held at the central bank, and budget classification of the collected revenues; (c) payments to suppliers of goods and services and other parties, as well as transfers between government units through the treasury single account at the central bank;² (d) federal transfers to states and municipalities, whether mandatory or voluntary; (e) public debt disbursements and payments (the system has tools to calculate outstandings, amortization and interest payments, bank charges and commissions).

The system is based on the principle that each transaction is entered into the system only once, and that such single entry automatically produces all the corresponding budget, financial, and accounting entries. Upon entry of each transaction into the system, SIAFI will automatically (a) update balances of appropriations in the federal budget registering commitments, accruals and payments; (b) post the corresponding accounting entries; (c) update all other financial records, such as balances in the treasury's unified account, debt outstandings, balances of mandatory and voluntary transfers to states and municipalities. Utilities of the system allow producing at any time the federal government's interim financial statements and budget execution statements, as well as formal closing statements at the end of each fiscal period. SIAFI also includes a subsystem to input the financial statements of states and municipalities in order to produce the consolidated financial statement of the general government.

SIAFI's functionality includes facilities for: (a) **programming the financial execution of the federal budget** on the basis of budget programming prepared by the MoP and the treasury's cash flow estimates (financial programming); (b) **managing and reconciling the treasury's single account** held at the central bank, and of payments there from BB; (c) **daily and monthly validation and confirmation by spending unit managers of transactions and documents** entered into the system; (d) monitoring the fulfillment of contract conditions by states, municipalities, and other entities that benefit from government funding, whether reimbursable or not; (e) **performance of detailed consultations** by operational and management users, and for preparing standardized and customized reports.

Future SIAFI upgrade and challenges. The current SIAFI was not designed to manage the information flows on the funding of multi-annual programs, and on the allocation and technical efficiency of public expenditure based on strategic priorities and targeted outputs and outcomes, as required by the PPA. SIAFI is also not fully

¹ Based on World Bank Programmatic Fiscal Reform Structural Adjustment Loan, Report No. P 7427 BR, from December 2000.

² More than 95 percent of total expenditures is electronically effected through the 4.650 workstations by debiting the treasury single account and crediting a beneficiary banking account, which is previously registered in the system. Neither cash nor checks are involved in these transactions.

Box 6. The Integrated Government Financial Management System (SIAFI) (Concluded)

equipped to support the verification of compliance with the mandates and information requirements recently set out by the LRF. Moreover, the current reform of its debt management systems, as well as the decision to centralize all debt management functions in the STN, will require the development of a strengthened public debt information system to satisfy the operating requirements of the new back, middle, and front offices for debt management. Similarly, the government is making efforts to gain better control over the recording and the flow of its assets and liabilities on an integrated basis, and that effort will fall under the purview of the STN. This functionality has to be improved in the current SIAFI.

SIAFI XXI, currently being development, will upgrade the current SIAFI with a more modern, flexible, and functionally integrated financial management application. The SIAFI 21st Century project that begun in January 2001 is expected to be implemented over a three-year period. It will incorporate new management approaches and techniques, such as program-based multi-annual planning; monitoring and evaluation of the physical and financial execution of the budget from a results-oriented management perspective rather than only from an accounting perspective; costing of government outputs and outcomes, enhanced public debt and asset/liability management; and improved accountability. More detailed information related to the payment stage, such as individual payments made, which are not currently available, will be generated by the system. The project also aims at modernizing the administration of the STN, providing it with advanced information management and workflow tools for the control of its operations and documents.

spending unit managers of transactions and documents entered into the system, and monthly validation and confirmation of the system's corresponding automatic accounting entries; and (2) the preparation at any time of interim financial statements and budget execution reports, as well as formal accounts at the end of each fiscal period, including changes in government assets and liabilities. The system also registers and controls the guarantees given by the STN for the external debt of all members of the federation and of public enterprises.

30. Budget and planning forecasts are clearly presented in the budget documents. There are three integrated planning horizons. First, there is an indicative planning stage in which the government's long-term (eight-year) general strategy, objectives, goals and priorities are defined. Second, there is a programming phase, involving the preparation of the four-year PPA, in which the allocation of projected budgetary resources over the following years to different programs and activities is defined, consistent with the medium-term macroeconomic framework, fiscal targets, and revenue forecasts. Third, there is an annual budgeting phase in which the annual budget allocations to the programs and activities defined in the PPA are established in light of the updated macroeconomic framework for the year, prepared by the MoF, in coordination with the MoP and the BCB. This framework is widely debated and scrutinized by the public, including financial analysts, who compare it with their own forecasts. New government programs and activities and their cost are clearly identified in the preparation of the PPA and in the LOA. As indicated above, the budget documents include a clear statement of the main underlying macroeconomic assumptions, and, starting with the 2002 budget, some sensitivity analysis of the budgetary implications of changing these assumptions. The government must present new tax policy initiatives, if any,

in the LDO. The budget speech identifies main changes in tax policy and their revenue impact. Additional expenditures to be financed by proposed new tax measures have been conditioned to approval in full of such measures by the congress.

31. The LRF has preserved the practice of a presidential decree that establishes guidelines and limits for budget execution, financial planning, and payments. According to the budgetary legislation, budgetary allocations are not mandatory. Therefore, the LRF mandates that a decree on budget execution and financing procedures be issued no later than 30 days after the approval of the LOA. The LRF also requires this decree to be reviewed every two months, and revised if necessary, should projected revenues fall short of what would be required to achieve the government's fiscal targets. The decree establishes ceilings for expenditure commitments and payments that are equal or below the corresponding approved budget allocations. The decree also establishes, by ministry, monthly ceilings on payments, including those on account of previous year's undisbursed commitments (*restos a pagar*) and those financed by the spending units' own revenues. Each ministry, given the overall ceilings established by the presidential decree, defines sublimits for its spending units. These limits are recorded in the SIAFI, which does not allow the execution of expenditure commitments in excess of the limit. The execution of the budget through the SIAFI is closely monitored by the STN, as well as the Secretariat of Planning and Strategic Investments (SPI), which focuses on the implementation of priority programs identified in the PPA. Also, the legislation allows for three forms of supplementary budget appropriations⁴⁴ during the year (the first two of which require that for each increase in expenditure the corresponding additional financing sources be identified):

- supplementary budget appropriations (*créditos orçamentários suplementares*), which can be enacted through presidential decrees during the fiscal year, provided that the proposed increase in expenditure, does not exceed a certain percentage⁴⁵ approved in the LOA—above this limit, the legislation requires the supplementary budget proposal to be approved by congress;
- special budget appropriations (*créditos orçamentários especiais*), approved by congress, for new expenditures which are not included in the budget; and
- extraordinary budget appropriations (*créditos orçamentários extraordinários*), which may be enacted by a provisional measure and then approved by congress, for unforeseen and urgent expenditures.

⁴⁴ Although the government often resorts to supplementary budget provisions, budget alterations during the year have tended to be marginal and mainly related to the switching of budgetary provision between different items of expenditure.

⁴⁵ In the last three years, this maximum percentage has been 10 percent. Supplementary budget appropriations can also be used for reallocating budgetary appropriations.

32. The bi-monthly review of expenditures is accompanied by a **report on the budget execution**, presented to Congress in a public hearing every four months. This report, signed by top MoP officials, explains changes in the budget programming, and, if needed, suggests measures to reduce risks to the achievement of the government's fiscal targets. **Budgetary developments are also monitored closely by a committee**, co-chaired by the vice ministers of finance and planning, which is responsible for approving new spending initiatives that may have a significant impact on the budget, and preparing recommendations on remedial actions in the event of perceived risks to the achievement of the primary surplus target. These recommendations, published in the DO, are considered by a high level interministerial committee, chaired by the Chief of Staff of the Presidency, and including the Central Bank President, and transmitted to the President of the Republic for approval. The deliberations of these committees are not made public, but budgetary developments during the year, and any policy response to them, are explained in the bi-monthly reports on budget execution.

33. **Goods and services are purchased according to comprehensive procurement regulations.**⁴⁶ However, there are still risks of fraud because of exemptions in specific tenders, which may call for certain technical requirements and may indirectly determine the choice of a particular supplier. According to the current legislation, government purchases above the equivalent of US\$260,000 for goods and services and US\$600,000 for engineering services are subject to procurement procedures. Simpler procurement procedures may be followed for purchases that are below these amounts but above US\$3,200 for goods and services and US\$6,000 for engineering services. Standard procurements of goods and services can be carried out through auctions, independent of the value of the purchase. All relevant legislation, the requirements for inclusion in the government suppliers' registry, electronic auctions procedures and all auction results are available online.⁴⁷

34. **Internal control procedures are in place.** The internal control is carried out by the SFC, which reports to the minister of finance. According to Article 74 of the federal constitution, internal control has to evaluate budgetary programs and management, including financial data, and provide support to the external control. Since 1998, the SFC has focused on auditing and program evaluation, including results of government programs and activities. Each year, it carries out an average of 18,000 inspections (physical verification of use of resources and results) and 3,000 audits (more comprehensive and detailed analysis, including but not limited to, legal compliance), of which around 2,000 are submitted to external control organs (i.e., the TCU). All inspections and audit results are available in a database that is shared with the external control. The internal control has no legal power to penalize irregularities, errors, abuses, mismanagement or loss of public resources due to waste. Internal audit and inspections reports are not disclosed to the public, but are sent, for further followup and application of due penalties, to both the external control and the institution that was audited, and or inspected, and its respective minister. The internal control also

⁴⁶ Law 8666 of June 1993.

⁴⁷ See <http://www.comprasnet.gov.br>.

consolidates the annual government accounts, which are sent to congress for approval. The SFC website contains all relevant legislation, annual reports on the accounts of the government, and the respective TCU's opinion in this regard, as well as information on the budget execution of discretionary transfers to states and municipalities.

35. **Annual federal government accounts are to be prepared, examined by the external control organs and submitted to the legislature, within five months for entities comprising the direct administration and six months for those included in the indirect administration.**⁴⁸ Subnational governments, especially the states, have reasonably met this standard. The 26 states and the Federal District are audited by their respective courts of accounts that report to the respective state legislative branches. These state courts of accounts also audit all the municipalities in their respective states, except for the municipalities of the states of Bahia, Ceará, Goiás, and Pará, which have special state audit courts for their municipalities.⁴⁹ The PPA and the program budgeting implemented in 2000 have improved the evaluation of the government programs and the results have been presented to the legislature. Further improvements are still needed, including enhancing the timeliness of the physical evaluations of decentralized programs of the states and municipalities.

D. Assurances of Integrity

36. **Repeated macroeconomic shocks, as well as overoptimistic upward revisions by congress of the revenue estimates included in the government's budget proposals, and commensurate increases in expenditures, have generally required an underexecution of the approved budget in recent years.** The disinflation that followed the implementation of the *Real Plan* in the mid-1990s facilitated substantial improvements in budgetary forecasts. Nevertheless, in light of severe external and other macroeconomic shocks, and of the above-mentioned revisions by congress to the revenue estimates included in the government's LOA bill, the government has been resorting to supplementary budgetary appropriations, in-year revenue raising measures, selective budget cuts, and limits on commitments and payments. Inevitably, this has diminished the reliability of the LOA as an indicator of the likely fiscal outturn.

37. **Appropriate revenue forecasting techniques are used by the institutions involved in the preparation of the budget. These techniques include the estimation of elasticities, trends, and the impact of policy change and macroeconomic developments.** The basic macroeconomic parameters and assumptions used in preparing the PPA, LDO, and the LOA are made available to the public. Except for periods of extreme volatility in the relevant macroeconomic parameters, the revenue forecasts prepared by the government have been quite accurate. As regards expenditure, the implementation of the PPA has facilitated a more

⁴⁸ The executive branch has 60 days after the beginning of the legislature session (around the middle of February each year) to prepare and send to TCU the annual government accounts. The TCU, after receiving it, has 60 more days to prepare a prior opinion that is sent to the congress (Article 71 of the Constitution).

⁴⁹ The cities of São Paulo and Rio de Janeiro are audited by their respective municipal courts of accounts.

realistic costing of programs and activities. The program preparation techniques used—including the bottom-up approach, medium-term expenditure framework, costing by activities and actions and by economic classification—have provided more reliable estimates on current and capital expenditure (except for personnel cost) for the annual budget preparation. The MoP, in coordination with sectoral ministries and agencies, prepares personnel cost estimates. More disaggregated estimates of personnel expenditure and of a few other administrative costs by program and activities are still being developed.

38. General rules for the preparation, execution, accounting and reporting of the budgets at each level of the government were set out in 1964 in the budget framework Law No. 4320. This law requires revenues to be registered on a cash basis and expenditure on an accrual basis, although capital expenditures are treated as ordinary expenditure and there is no capitalization or depreciation of assets. All phases of the expenditure process are recorded, including commitment and verification. Since 1967, the TCU has monitored compliance with accounting principles and rules at the federal level, while state audit courts have overseen compliance at the state municipal levels. Except for small municipalities, public sector entities generally comply with these procedures.

39. The processes for accounts reconciliation and fiscal reporting are effective. As outlined in Box 6, the SIAFI has been in use since 1987, and it encompasses budget appropriations, accounting procedures (automatic registering and consolidation), financial management (cash release, control of the treasury single account), and reporting (preparation of accounts and reports). All budgetary units are linked online to the system. Monthly financial reports are formally reconciled in an effective and timely way, including with bank accounts. The SIAFI also generates reports on the internal and external federal public debt and other liabilities, as well as on government financial assets. This information on the federal debt is periodically reconciled with the BCB's statistics, which encompass financial assets and liabilities of other components of the public sector as well.⁵⁰

40. The TCU and the state and municipal audit courts carry out external audits, as established by the constitution, and independently from the executive branch. According to the constitution, the President appoints and submits for senate approval, one-third of the nine-members TCU, while the congress appoints the remaining two-thirds. The TCU staff is entirely selected through competitive recruitment and enjoys higher remuneration than other comparable government employees. The staff is systematically trained, including in modern techniques of performance auditing, and auditing of computer systems. The mandate of the TCU includes attesting annually the financial accountability of each budgetary organization (around 2,400) and the federal government as a whole, as well as to audit financial systems and internal control. The TCU also audits appointments and retirements of civil servants and the federal transfers to states and municipalities. The TCU has constitutional power to judge and impose penalties on budget organizations for irregularities, errors, abuses,

⁵⁰ Reconciliation is needed between debt information from the National Treasury's SIAFI and the central bank because of differences in accounting and registration procedures.

mismanagement and waste of public resources. Penalties imposed by the TCU include fines, barring from public office position, punishment by loss of position, ineligibility, and reimbursement of the damage made. The audit reports are sent to congress, as well as to the Attorney General's Office for prosecution, if appropriate, and are published in the DO and on the TCU website. The Constitution (Article 74) stipulates that any citizen, political party, association, or trade union is allowed to denounce irregularities or illegalities to the TCU.

41. **The IBGE reports to the MoP (and, hence, is not legally independent), but has operational autonomy.** IBGE is in charge of the production and analysis of statistical and geographical information, and it is the main coordinator, consolidator, and disseminator of statistical information within the government. The IBGE has established several advisory committees, which include private sector representatives, to discuss methodological issues. Fiscal data published by the IBGE are limited to the broad categories of the annual national income accounts.

III. IMF STAFF COMMENTARY

42. As the analysis in the preceding sections suggests, **in the last few years Brazil has achieved a high degree of fiscal transparency, together with major improvements in the management of its public finances.** These improvements have been achieved against the background of an international and domestic macroeconomic environment which has posed substantial challenges to the country's economic policymakers. These challenges partly relate to the federal nature of Brazil and the constitutionally-sanctioned autonomy of each member of the federation, strongly rooted in the democratization of the country after the mid-1980s. Although the improvements in fiscal transparency and management have been achieved through a wide range of policy initiatives and institutional reforms, the cornerstone of this effort has been the enactment in May 2000 of the **LRF** which sets out for **all levels of government** not only fiscal rules designed to ensure medium-term fiscal sustainability, but also strict transparency requirements to underpin the effectiveness and credibility of such rules. Another pillar of the improved fiscal management has been the **PPA** aimed at better aligning the allocation of budgetary resources over time to the government's priorities and regional development strategy. Also instrumental in promoting sustained fiscal adjustment at the subnational government level has been the firm enforcement by the federal government of the **debt restructuring agreements with most states and municipalities.**

43. Brazil has attained high standards with respect to main indicators of fiscal management and transparency. In particular, the following specific aspects are worth highlighting:

- **the coverage of both its fiscal targets and fiscal statistics is unusually and commendably broad,** a fact that should be appropriately taken into account in international comparisons involving Brazil. In particular, the inclusion in the general government of the nonmonetary operations of the central bank ensures that any quasi-

fiscal activity of the bank is promptly and transparently reflected in the fiscal accounts of the consolidated public sector;

- **recent reforms in the budget and planning process have substantially improved the realism and transparency of the federal budget, and its consistency with macroeconomic constraints, as well as its effectiveness in resource allocation.** Nevertheless, overoptimistic revisions by congress of the government's budget proposals, and the need to adjust the fiscal stance during the year, in response to external or domestic shocks, have frequently led to underexecution of budgetary appropriations, inevitably weakening the correspondence between approved budgets and the corresponding outturns. The close monitoring by the authorities of fiscal developments during the year, and of the implementation of the budgetary programs included in the PPA has allowed them to closely align the degree of underexecution of different programs in the budget to evolving government priorities, as well as to the performance of each program;
- **the mechanisms of internal and external control are generally well developed,** and increasingly aim to assess not only formal compliance with legal requirements, but also the quality and cost-effectiveness of public spending;
- **fiscal statistics at the federal level are of high quality, timeliness, and detail.** At the subnational level, there remains significant scope for improvement, but the institutional foundations of such improvement have been laid out by the comprehensive reporting requirements of the LRF, and by the support that is being provided by the federal government to the states and municipalities in improving their public expenditure management systems, in order to meet these requirements; and
- **finally, Brazil is clearly at the forefront of countries at comparable level of development in the use of electronic means** for the dissemination of fiscal statistics, legislation, and administrative regulation on tax and budgetary matters, and for delivery of government services, as well as to facilitate civil society's scrutiny of government activities and programs.

44. In the view of the staff, **further progress in the following main areas** would help consolidate and expand the gains in fiscal management and transparency made so far.

45. While significant progress has been made in recent years in clarifying **respective responsibilities of the various levels of government** in sectors such as education and health, there remains significant overlapping and duplication of functions in various areas of public spending (e.g., transport and water and sanitation). Further efforts in reducing such overlapping would improve efficiency in the allocation of public resources, as well as facilitate privatization, or partnerships with the private sector in those sectors.

46. The scope for the occurrence of **quasi-fiscal operations** through financial public institutions would be further reduced by the approval of the draft law strengthening the legal

basis for operational independence of the central bank, and by additional progress in divestiture, and in ensuring full managerial autonomy and transparency in the operations of the public banks.

47. As regards the **budget formulation and approval process**, the staff would recommend:

- including in the budget document **more detailed sensitivity analyses** of the implications for the fiscal aggregates of changes in macroeconomic assumptions, building upon the analysis of fiscal risks already contained in the LDO. This should facilitate a more comprehensive assessment of fiscal risks, and a better-informed debate of the budget in congress;
- seeking to progressively reduce the currently relatively high degree of **earmarking** of budgetary resources to promote greater flexibility in the allocation of those resources over time; and
- preparing three-year **rolling forward cost estimates of continuing spending programs**, to complement the three-year rolling fiscal aggregates projections in the LDO. This would help improve the realism of these projections, as well as complement the PPA which, by constitutional requirement, is linked to the presidential term of office.

48. The staff fully supports the ongoing efforts by the authorities to improve and modernize the budget and planning **information systems (SIAFI and SIG)** outlined in Boxes 4 and 6 above. Of particular importance are the planned steps to improve the monitoring and evaluation of the execution of spending programs from a result-oriented perspective; the cost-accounting of government activities and programs; and the generation of information needed for efficient government assets and liability management.

49. Desirable improvements in the mechanisms of **internal and external controls** include a clearer definition of respective responsibilities of the various agencies involved in these functions; and more systematic followup of the reports of those agencies.

50. Finally, as concerns **fiscal statistics**, the staff would recommend: greater detail (including separating the economic and functional classifications) in the monthly reports of budget execution by the STN; the publication of periodic consolidated reports of all government equity holdings; and more systematic efforts to further reduce discrepancies between above-the-line and below-the-line fiscal data for the federal enterprises and the subnational governments, and their enterprises. Adequate improvement in the quality and timeliness of fiscal statistics at the subnational level will crucially depend on the speed of progress made by those governments in modernizing their expenditure management and reporting systems.