



BRAZIL

FISCAL TRANSPARENCY EVALUATION

May 2017

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Brazil

Fiscal Transparency Evaluation

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GLOSSARY

BCB	Central Bank of Brazil
BGU	Financial statements of the Federal Government
BNDES	National Bank for Economic and Social Development
BSPN	Financial statements of the General Government
CG	Central Government
DEST	Department for Coordination and Governance of State Enterprises
GFSM	Government Finance Statistics Manual
GG	General Government
FAD	Fiscal Affairs Department
FTC	Fiscal Transparency Code
FRL	Fiscal Responsibility Law
IBGE	Brazilian Institute of Geography and Statistics
IPSAS	International Public Sector Accounting Standards
LDO	Budget Guidelines Law
LOA	Annual Budget Law
MTEF	Medium-Term Expenditure Framework
PAC	Program for the Acceleration of Growth
PCPR	Accounts of the President
PLDO	Draft Budget Guidelines Law
PLOA	Draft Annual Budget Law
PPA	Multiyear Plan
RFB	Federal Tax Administration
RGPS	Social Security Fund for private sector workers
RPPS	Social Security Fund for public sector employees
RTN	Results of the National Treasury
SNA	System of National Accounts
SDDS	Special Data Dissemination Standards
SOF	Federal Budget Secretariat
STN	National Treasury Secretariat
TCU	Federal Court of Accounts

Legend for Summary Tables

LEVEL OF PRACTICE	RATING			
	Not Met	Basic	Good	Advanced

LEVEL OF IMPORTANCE	RATING		
	High	Medium	Low

PREFACE

In response to a request from the Brazilian Ministry of Finance (MoF), a mission from the Fiscal Affairs Department (FAD) of the International Monetary Fund (IMF) visited Brasilia during the period June 1-14, 2016 to conduct a Fiscal Transparency Evaluation (FTE).

The mission was led by Benedict Clements and included Paulo Medas, Miguel Alves, Fabien Gonguet, Xavier Rame (all FAD staff); Fabian Bornhorst (IMF Resident Representative), Timothy Irwin (FAD expert), Ernesto Jeger, and Jose Luiz Rossi (both IDB). The objective of the mission was to evaluate Brazil's fiscal reporting, fiscal forecasting and budgeting, and fiscal risk analysis management practices against the standards set by the 2014 version of the IMF's Fiscal Transparency Code (FTC). This evaluation is based on information available at the time it was completed in January 2017. The mission also prepared an action plan to further improve fiscal transparency.

At the Ministry of Finance, the mission met with Mr. Henrique Meirelles (Minister of Finance), Ms. Ana Paula Vescovi (incoming Treasury Secretary), Messrs. Otavio Ladeira (outgoing Secretary of the National Treasury), Carlos Hamilton Araujo (Secretary of Economic Policy), Mansueto Almeida (Secretary of Economic Affairs), and Marcelo Caetano (incoming Secretary of Social Security), and their staff, including Ms. Fabiana Rodopoulos, and Messrs. William Baghdassarian, Leonardo Nascimento, Felipe Bardella, Renato Dias, and Daniel Borges, and Ms. Karla Rocha. At the Central Bank of Brazil, the mission met with Messrs. Luiz Queiroz, Lucio Capelletto, Wagner Guerra, Bruno Saraiva, João Pereira, and Andre Miguel.

It also met at the Ministry of Planning and Budget with Mr. Fernando Soares (Director of DEST) and his staff, including Ms. Elvira Schulz and Mr. Pedro Machado. The mission also met with staff of the Ministry of Mining and Energy, including Messrs. João Patusco and Andre Regra (National Agency of Petroleum, ANP), Ms. Natalia Souza (Undersecretary of Public Investment Monitoring at Casa Civil), and Messrs. Leonardo Albernaz (Secretary of Government Macro Analysis) and Tiago Dutra (Secretary of External Control of the Ministry of Finance) at the Federal Court of Accounts (TCU). The mission appreciates the feedback provided by staff from the Ministry of Planning and Budget, Central Bank, and Ministry of Finance on their presentations.

The mission expresses its gratitude for the excellent cooperation it received from all government officials and for the candid discussions. Particular thanks are due to Mmes. Fabiana Rodopoulos, Karla Rocha, and Mr. Felipe Bardella for the excellent cooperation before and during the mission. Ms. Flavia Barbosa, local economist in the IMF office in Brasilia, provided valuable support for the mission and preparation of the report.

EXECUTIVE SUMMARY

This report assesses fiscal transparency practices in Brazil in relation to the requirements of the IMF Fiscal Transparency Code (FTC). It also contains recommendations for further consolidating and expanding fiscal transparency.

Despite the development of fiscal responsibility legislation, several weaknesses in fiscal transparency have had adverse effects on the quality of fiscal policy—many of which are being addressed. Brazil has made significant progress over recent decades in providing regular information on the budget and its implementation at all levels of government, partly driven by the 2000 Fiscal Responsibility Law (FRL). These include advances in implementing international standards to improve the quality of data. At the same time, fiscal transparency has been undermined by weaknesses in the fiscal framework and by practices that are inconsistent with the principles of the FRL (including unreported liabilities, the “pedaladas”). These include: incomplete information on policies and their costs or risks; accounting changes, and lack of clarity on fiscal reporting standards, that undermine the effectiveness of the fiscal rules (at all levels of government); lack of transparency in the relationship between the central government and public banks and between the central government and subnational governments; and corruption involving some of the largest public enterprises. Since 2015, important efforts have been underway to address some of these weaknesses.

Brazil’s practices meet many of the principles of the Fiscal Transparency Code (Table 0.1) at good or advanced levels. Fiscal statistics encompass the general government sector and recognize most of its assets and liabilities. Fiscal reports are published in a frequent and timely manner and annual financial statements are audited by the Federal Court of Accounts (TCU). The transparency of fiscal forecasting and budgeting benefits in some areas from good or advanced practices. The institutional scope of budget documentation is comprehensive and the key sequences of the budget process are timely. Extensive budgetary information is made available to the general public through websites and online databases. Fiscal risk disclosure and management are anchored in the FRL, which mandates the publication of a statement of fiscal risks. While still an area of relative weakness, the monitoring and management of fiscal risks have improved recently.

This evaluation highlights a number of areas in which Brazil’s fiscal transparency practices could be further improved:

- *Some of the key elements of fiscal policy and fiscal risks are not well communicated to the broader public.* While Brazil provides a wealth of fiscal information, it does not systematically provide summary documents that describe developments across the entire public sector, the main risks that could impact public finances, and how they relate to the government’s policy priorities. For example, information on the role of Brazil’s public banks in implementing public policies (including quasi-fiscal activities) is not widely disseminated.

- *Brazil's fiscal reports lack information on key parts of the public sector.* For example, the reports do not include Petrobras and Eletrobras. These institutions have played a key role in implementing government policy and represent large fiscal risks.
- *Information on medium-term fiscal policy goals and challenges is lacking.* Budget documents do not provide a clear picture of the objectives of fiscal policy over the medium term, including for key fiscal aggregates like public debt. This in part reflects the absence of a medium-term budgetary framework. There is also limited information on medium-to long-term fiscal challenges, such as the implications of rising pension liabilities for debt sustainability.
- *The government's budget and compliance with fiscal rules are not scrutinized by an independent fiscal council.* For example, there is no ex-ante independent assessment of whether fiscal projections are realistic or the budget is in line with fiscal rules.

This report proposes recommendations aimed at enhancing information for decision making and ensuring that Brazil keeps pace with best practices on fiscal transparency. The most important ones are:

- *Produce comprehensive fiscal statistics on the public sector.* This means incorporating Petrobras and Eletrobras into the data on non-financial public enterprises and more comprehensive information on the entire public sector. It will be also important to disclose the quasi-fiscal costs of all public corporations. A more comprehensive view of the public sector (Table 0.2) would improve the assessment of the fiscal sector's financial position and fiscal risks.
- *Further disclose the relationships between the public banks and other parts of the public sector.* This will help better understand the fiscal costs and fiscal risks involved, as public banks have significant exposure to public enterprises and subnational governments.
- *Improve transparency on transactions between the BCB and the Treasury.* Include separate reporting of transactions and the balance sheets of the BCB and the central government, which are two separate units of the public sector. Present more clearly discussion of policy objectives and fiscal costs.
- *Formalize decision making ahead of the budget and provide more clarity on policy intentions by publishing a medium-term fiscal policy statement.* This could be complemented with improvements to the legal framework by introducing a modern organic budget law.
- *Create an independent fiscal council* to evaluate the realism of budget forecasts, assess fiscal policy, and monitor compliance with fiscal rules and reporting standards for all levels of government.¹
- *Strengthen disclosure and management of fiscal risks.* Create a working group to monitor fiscal risks to help improve disclosure and assess whether risks are being monitored and

¹ The Federal Senate, in November 2016, created the Instituição Fiscal Independente (Independent Fiscal Institution) which will have some of the functions envisaged for a fiscal council but only for the federal government.

managed adequately throughout the public sector. Strengthen the fiscal risk statement by clearly explaining the key risks and their potential impact on the public purse. The analysis of risks should be expanded (e.g., to include public enterprises, subnational governments, and the financial sector).

- *Disclose key medium-to long-term fiscal challenges, especially rising pension and health costs.* For example, the negative net financial worth (-131 percent of GDP, Table 0.2) is much lower than many other countries, reflecting the large public pensions liabilities (88 percent of GDP).² Liabilities of the private sector employees' pensions (208 percent of GDP) also pose a major challenge for sustainability of the public accounts. Publishing a report on long-term fiscal sustainability would help build consensus for indispensable reforms (e.g., pensions).

The actions required to implement these reforms, and other complementary recommendations to strengthen fiscal transparency, are identified in the “Fiscal Transparency Action Plan” included as Annex 1.

² Brazil's net financial worth is lower than emerging market economies such as Peru (-34 percent of GDP), the Philippines (-22 percent), and Russia (-18 percent) but is higher than that of some European countries such as Ireland (-157 percent of GDP) and Portugal (-232 percent of GDP). The latter two also have high pension liabilities (73 and 134 percent of GDP, respectively).

Table 0.1. Brazil: Summary Assessment Against the Fiscal Transparency Code

LEVEL OF IMPORTANCE	LEVEL OF PRACTICE		
	1. Fiscal Reporting	2. Fiscal Forecasting and Budgeting	3. Fiscal Risk Analysis and Management
HIGH	1.1.1 Coverage of Institutions	2.1.2 Macroeconomic Forecasts	3.1.1 Macroeconomic Risks
	1.1.2 Coverage of Stocks	2.1.3 MT Budget Framework	3.1.3 Long-Term Fiscal Sustainability
	1.1.3 Coverage of Flows	2.1.4 Investment Projects	3.2.2 Asset-and-Liability Management
		2.4.1 Independent Evaluation	3.2.5 Financial Sector
MEDIUM	1.4.1 Statistical Integrity	2.2.1 Fiscal Legislation	3.1.2 Specific Fiscal Risks
	1.4.3 Comparability of Fiscal Data	2.3.1 Fiscal Policy Objectives	3.2.6 Natural Resources
		2.4.2 Forecast Reconciliation	3.3.1 Subnational Governments
			3.3.2 Public Corporations
LOW	1.1.4 Coverage of Tax Expenditures	2.1.1 Budget Unity	3.2.1 Budgetary Contingencies
	1.2.1 Frequency of In-Year Reporting	2.2.2 Timeliness of Budget Documents	3.2.3 Guarantees
	1.2.2 Timeliness of Annual Financial Statements	2.3.2 Performance Information	3.2.4 Public-Private Partnerships
	1.3.1 Classification	2.3.3 Public Participation	3.2.7 Environmental Risks
	1.3.2 Internal Consistency	2.4.2 Supplementary Budget	
	1.3.3 Historical Revisions		
	1.4.2 External Audit		

Legend

LEVEL OF PRACTICE	RATING			
	Not Met	Basic	Good	Advanced

LEVEL OF IMPORTANCE	RATING		
	High	Medium	Low

Table 0.2. Brazil: Public Sector Financial Overview, 2014
(in percent of GDP)

	General Government						Public corporations			Consolidation Public Sector	Public Sector
	Central Government			State governments	Local governments	Consolidated Gen. Govt.	Nonfinancial	Financial	Central bank		
	Budgetary central government	Extrabudg. central government	Consolidated Central Govt.								
Transactions											
Revenue	25.2	2.8	27.8	12.0	8.7	40.1	11.2	7.0	3.5		
Expenditure	30.4	2.3	32.5	12.9	8.5	45.5	12.5	6.2	3.4		
Expense	30.3	2.3	32.3	12.4	8.2	44.5	11.5	6.2	3.4		
Investment in NFA	0.1	0.0	0.2	0.5	0.3	0.9	1.0	0.0	0.0		
Net operating balance	-5.0	0.6	-4.5	-0.4	0.4	-4.5	-0.3	0.8	0.1		-3.9
Net lending/borrowing	-5.2	0.5	-4.6	-0.9	0.1	-5.4	-1.3	0.8	0.1		-5.8
Stocks											
Assets	149	7.8	155	14.3	5.9	166	19.0	62.1	37.9	-68.5	216
Nonfinancial	103	0.1	103	9.2	5.3	117	12.7	0.5	0.0	0.0	131
Financial	46.5	7.7	52.1	5.1	0.6	48.5	6.2	61.6	37.9	-68.5	85.8
Liabilities	90.5	6.3	94.6	67.7	15.2	168	17.2	62.2	37.9	-68.5	217
Liabilities, other than equity and pensions	90.5	6.1	94.6	67.7	15.2	168	11.6	58.1	37.5	-58.3	217
Public servants pensions (RPSS entitlements)	23.0	0.0	23.0	53.4	11.9	88.3	0.0	0.0	0.0	0.0	88.3
Equity	0.0	0.2	0.0	0.0	0.0	0.0	5.6	4.1	0.4	-10.1	0.0
Net worth	58.8	1.5	60.3	-53.4	-9.3	-2.6	1.8	-0.1	0.0	0.0	-0.9
Net financial worth	-44.0	1.4	-42.5	-62.6	-14.5	-120	-11.0	-0.6	0.0	0.0	-131
Memorandum items:											
Stock of RGPS entitlements	208	0.0	208	0.0	0.0	208	0.0	0.0	0.0	0.0	208
Net Worth Including All Pensions	-149	1.5	-147	-53.4	-9.3	-210	1.8	-0.1	0.0	0.0	-209

Sources: Quarterly General Government Finance Statistics (STN); Press Release on Fiscal Policy (BCB); BGU and BSPN (STN); Financial Statements of Public Corporations (DEST database for nonfinancial corporations, and individual financial statements for financial corporations); and staff estimates.

Note: This table presents estimates in accordance with the *GFSM 2014*, and adopts the accrual basis of recording for transactions and market valuation for stocks to the extent possible. It does not cover transactions related to the accrual of civil servants' pension entitlements, and acquisition of assets and incurrence of related liabilities derived from PPP contracts. The estimates differ from the information published in the STN's "Resultado do Tesouro Nacional" and BCB's "Nota de Imprensa de Política Fiscal" because those reports are compiled primarily using a cash basis. The presentation of data in percent of GDP is for scaling purposes only. For more details, see Annex 4.

I. FISCAL REPORTING

1. Fiscal reports should provide a comprehensive, timely, reliable, comparable, and accessible summary of the government’s financial performance, financial position, and cash flows. This chapter assesses the quality of Brazil’s fiscal reporting practices against the standards set by the IMF’s Fiscal Transparency Code for the following dimensions:

- i. coverage of public sector institutions, stocks, and flows;
- ii. frequency and timeliness of reporting;
- iii. quality, accessibility, and comparability of fiscal reports; and
- iv. reliability and integrity of reported fiscal data.

2. In the past decades, Brazil has made substantial improvements in government accounting and fiscal statistics compilation. With the introduction of the FRL, fiscal reporting became a central input to fiscal policy discussions, and numerous initiatives were launched to increase the transparency and reliability of fiscal data. In the public accounting area, most of these initiatives have been related to the gradual implementation of IPSAS-based accounting standards since 2008, which allowed Brazil’s government units to produce increasingly more comprehensive accrual-based financial statements. In parallel, fiscal statistics evolved from pure cash-based reports, covering only central government units, to a report consolidating all general government subsectors and presenting comprehensive information on revenue, expenditure and financing on both cash and noncash³ bases, as well as stock positions and other economic flows of the most relevant financial assets and liabilities. Following the recommendations of the G20 Data Gaps Initiative, the Treasury started reporting general government data on a quarterly basis in April 2016, placing Brazil in the group of most advanced countries in GFS reporting. Many of the advances have yet to be reflected in the main reports used by the public and policy makers (e.g., Treasury report and Central Bank statistics on the public sector).

3. Brazil publishes a large volume of fiscal data through a number of different documents, resulting in a fragmented reporting framework. In part, this results from the need to comply with legal requirements and adhere to international dissemination standards. Brazil’s various fiscal reports cover different institutions, include different flows and stocks, are prepared on different accounting bases, and are classified according to different standards. Brazil’s main summary fiscal reports, presented in Table 1.1, comprise:

- **monthly financial statistics**, including the Treasury’s data on the pure cash revenue and primary expenditure of the federal government and the Central Bank’s data on the financing

³ Some elements of the accrual basis of recording are still not incorporated in these statistics, most notably the accrual of pension entitlements related to the civil servants’ pension schemes (RPPS), the recognition of transactions related to government-controlled assets constructed through PPP arrangements, and the time adjustment of taxes and social contributions. STN and IBGE are developing compilation procedures to allow the incorporation of these elements in future vintages of this report.

of the nonfinancial public sector (excluding Petrobras and Eletrobras) and associated stock positions;

- **monthly debt management reports**, published by the STN's Debt Management Unit, comprising detailed information on stocks and flows (issuance/redemption) of Treasury securities, including breakdowns by counterpart residency, type of interest rate, currency, maturity, and average cost; they include data on both the primary and secondary markets, including main groups of investors;
- **budget execution reports**, including a bi-monthly update of the annual budget estimates, and a four-monthly assessment of compliance with the fiscal target;
- **revenue collection reports**, published by the Federal Revenue Authority, containing data on the monthly collection of taxes and social contributions and annual estimates of tax burden and revenue loss from tax expenditures;
- **annual government finance statistics**, jointly published by the Treasury and IBGE, which provide the most comprehensive data on stock positions of financial assets and liabilities and cash/accrual flows of general government and its subsectors. These data are compiled and disseminated in the GFSM 2001/2014 and 2008SNA frameworks, and include a disclosure of other economic flows for the financial instruments reported in the balance sheet. A preliminary version of these data is made available by the Treasury on a quarterly basis;
- **annual report on public corporations**, published by the Ministry of Planning's Department for Coordination and Governance of State Enterprises (DEST), comprising the budget execution and annual financial statements (individual and aggregated) of the non-dependent financial and nonfinancial corporations of the federal level;
- **annual financial statements**, comprising the Federal Government's Financial Statements (Balanço Geral da União, BGU) and the consolidated⁴ financial statements of the Federal, State, and Municipal governments (Balanço do Setor Público Nacional, BSPN).

⁴ Until 2014, the consolidated financial statements were simply an aggregation of the financial statements of units in the three levels of government that reported data to the central database by the required deadline (for this reason, 5 states and 1,353 municipalities were not covered in the 2014 BSPN; in 2015, there was full coverage of the states, but 1,070 municipalities were still not covered). Starting with the 2015 edition, the BSPN eliminates intragovernmental transactions and stock positions of all reporting units, bringing it closer to the consolidation requirements of the accounting standards.

Table 1.1. Brazil: List of Fiscal Reports

	Agency	Coverage			Accounting		Publication	
		Flows	Stocks	Institutions	Basis	Class	Frequency	Date
In-Year Reporting								
Press Release - Fiscal Policy	BCB	Fin	A, L	NFPS	Cash	Nat	M	30d
Central Government Primary Balance	STN	R, E	...	CG	Cash	Nat	M	30d
Analysis of Federal Revenue Collection	RFB	R	...	CG	Cash	Nat	M	30d
Budget Execution Summary Report	STN	R, E	...	CG	M-	Nat	M	30d
Fiscal Management Report	STN	R, E, Fin	L	CG	M- cash	Nat	four months	4m
Trial Financial Statements of the Union	STN	R, E,	A, L	CG	M-	Nat	Q	3m
Budget Execution Summary Report - Subnationals	SNG	R, E	...	SNG	M- cash	Nat	bi-monthly	2m
Fiscal Management Report - Subnationals	SNG	R, E, Fin	L	SNG	M- cash	Nat	four months	4m
Monthly Debt Report	STN	Fin	L	CG		Nat	M	30d
Press Release - Open Market	BCB	Fin	L	CG		Nat	M	30d
Quarterly Government Finance Statistics	STN	R, E	...	GG	M- cash	GFSM 2014	Q	3m
Annual Reporting								
Government Finance Statistics Yearbook	STN, BCB	R, E, Fin	A, L	GG	M- cash	GFSM 2014	An	10m
Government Finance Statistics and Government Sector Account	STN, IBGE, BCB	R, E, Fin	...	GG	M- cash	GFSM 2014	An	16m
Statements of Tax Expenditures	RFB	R	...	CG	Cash	Nat		
Federal SOEs Budget Execution – Annual Report	MPOG	R, E, Fin	A, L	PC	M- cash		An	
Profile of Federal SOEs	MPOG	R, E, Fin	A, L	PC			An	
Annual Financial Statements of the Public Sector	STN	R, E, Fin	A, L	GG	Accru- al	Nat	An	6m
Annual Financial Statements of the Union	STN	R, E, Fin	A, L	CG	Accru- al	Nat	An	3m
Federal Public Debt Annual Report	STN	Fin	L	CG		Nat	An	2m
General Government Gross Tax Burden	RFB/STN	R	...	GG	Cash	Nat	An	3m

Note: Fin = Financing, R = Revenue, E = Expenditure, A = Assets, L = Liabilities, M = Monthly, Q = Quarterly, An = Annual.

1.1. Coverage of Fiscal Reports

1.1.1. Coverage of Institutions (Good)

4. In 2014, Brazil's public sector comprised 7,231 separate institutional entities of various legal forms. These can be broken down into the following subsectors (Table 1.2):⁵

- **budgetary central government**, which comprises 459 legislative, judiciary, and executive bodies including 109 direct administration units (ministries and departments), 214 agencies, 28 non-commercial enterprises, 47 foundations, and 61 funds. The latter include the two social security funds: the Regime Próprio de Previdência Social (RPPS), covering public sector

⁵ In this report, subsectors are defined in accordance with *GFSM 2014* methodology. As a result, the number of units and financial information may differ from groupings according to national definitions.

employees and the Regime Geral de Previdência Social (RGPS), covering private sector workers;

- **extrabudgetary central government**, which comprises 5 constitutional funds, 9 nonprofit institutions controlled by government, 23 professional councils, 3 public corporations providing services primarily to government units, 2 public corporations operating on a nonmarket basis, and 1 defeasance structure (EMGEA);
- **subnational governments**, which comprise the legislative, judiciary and executive bodies of 27 states (including the Federal District) and 5,570 municipalities;
- **public corporations**. These are mainly nonfinancial corporations, which comprise Petrobras, Eletrobras, and another 59 federal corporations, 394 state corporations, and 664 municipal corporations. In addition, there are 12 financial corporations, including Banco do Brasil, BNDES, Caixa Econômica Federal, and 3 other federal public banks, 6 regional development banks controlled by States, and the Brazilian Central Bank.

Table 1.2. Brazil: Public Sector Institutions and Finances, 2014
(in percent of GDP, unless otherwise stated)

	Number of entities	Revenue	Expenditure	Balance	Intra-PS expenditure	Net expenditure	percent net expenditure
Public Sector	7,231						
General government	6,099	40.1	45.5	-5.4	4.6	40.9	70.3
Central government	502	27.8	32.5	-4.6	11.9	20.6	35.3
Budgetary central government	459	25.2	30.4	-5.2	12.1	18.3	31.4
Extrabudgetary units and funds	43	2.8	2.3	0.5	0.0	2.3	3.9
State governments	27	12.0	12.9	-0.9	0.9	12.0	20.6
Local governments	5,570	8.7	8.5	0.1	0.2	8.3	14.3
Central Bank	1	3.5	3.4	0.1	1.3	2.0	3.5
Nonfinancial public corporations	1,119	11.2	12.5	-1.3	2.2	10.3	17.7
Other financial public corporations	12	7.0	6.2	0.8	1.3	4.9	8.5

Source: IMF staff estimates.

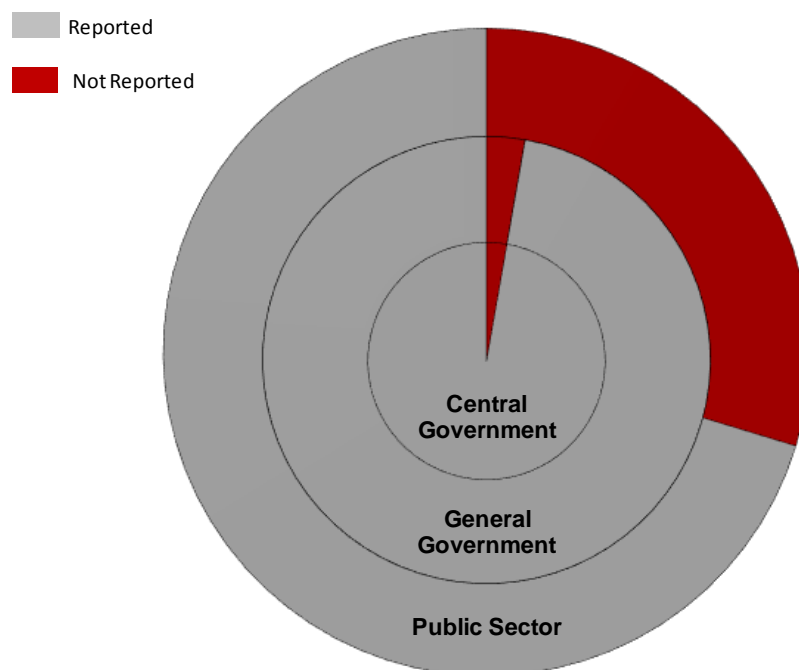
5. Brazil's public sector includes a sizeable presence of subnational governments and public corporations (Table 1.2).⁶ Since Brazil is a decentralized federation, it is not surprising that the central government represents less than half of the general government expenditures (net of intra-government transfers) in 2014. State governments expenditures account for around 1/3 of total general government, while local governments account for around 20 percent. At both state and local levels, the estimates exclude expenditure of non-dependent enterprises. Brazil's public sector also includes a strong presence for nonfinancial corporations, to a large extent reflecting the two largest companies Petrobras and Eletrobras.

6. Brazil's most comprehensive fiscal reports cover most of the consolidated general government, as defined in international statistical standards (GFSM 2001/2014). The units covered in the Treasury's annual general government financial statistics accounted for 63 percent

⁶ The estimates for the size of the public sector were based on official statistics and staff estimates when necessary. As such, it should be seen only as an approximate view of the public sector (see also Annex 4).

of public sector expenditure in 2014. The Treasury is gradually introducing in the statistics the units comprising the extrabudgetary central government subsector; so far, only Fundo de Garantia do Tempo do Serviço (FGTS) and the Fundo Remanescente PIS/PASEP are covered. The missing units (due to source data unavailability) are small in size, accounting for less than 1 percent of the central government expenditure (Figure 1.1.).

Figure 1.1. Brazil: Coverage of Public Sector Institutions in Fiscal Reports
(in percent of expenditure)



Source: IMF staff estimates.

Note: "Not Reported" refers to expenditures of units not consolidated in summary fiscal reports.

7. Expanding the institutional coverage of Brazil's fiscal reports from the general government to the entire public sector (including financial corporations) results in a slightly higher deficit in 2014. Including nonfinancial public corporations would increase the deficit by 1.3 percent of GDP, mainly reflecting Petrobras and Eletrobras. While adding both nonfinancial and financial corporations (including the Central Bank) results in a public sector deficit of 5.8 percent of GDP.

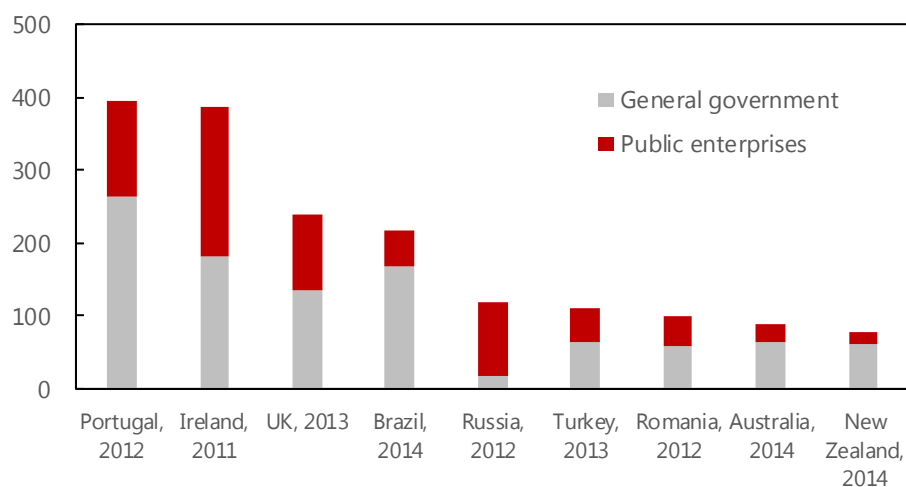
1.1.2. Coverage of Stocks (Good)

8. The federal government's annual financial statements (BGU) includes a comprehensive coverage of financial assets and liabilities, but only a partial assessment of nonfinancial assets. Brazil's balance sheet coverage goes beyond that of most emerging and many advanced countries, by including the value of both financial assets and liabilities (including part of civil servants' pension liabilities) and parts of the nonfinancial assets in the BGU. The 2014

BGU balance sheet provides a detailed breakdown of the federal government assets and liabilities, amounting to:

- 13.5 percent of GDP in **nonfinancial assets** including 13.1 percent of GDP in buildings, structures, and land; however, it does not include estimates of subsoil assets (see below).
- 46.1 percent of GDP in **financial assets** including 5.4 percent of GDP in shares and equity of corporations, 18 percent of GDP in currency and deposits, and 19 percent of GDP in loans granted mainly to states and municipalities;
- 86.5 percent of GDP in **liabilities** including 59.1 percent of GDP in debt securities, 21.3 percent of GDP in pension entitlements of civil servants, and 5.9 percent of GDP in accounts payable;⁷
- an **overall net worth and net financial worth** of -26.9 and -40.4 percent of GDP, respectively.

Figure 1.2. Brazil: Public Sector Gross Liabilities in Selected Countries
(in percent of GDP)



Source: IMF staff estimates.

9. The financial statements of the general government (BSPN) understate the value of some assets and liabilities. On an annual basis, the STN consolidates the BGU with the financial statements of states and municipalities. The balance sheet resulting from this exercise expands the coverage of stocks, but still undervalues or omits material assets and liabilities of the public sector. As shown in Table 0.2 and Figure 1.3, consolidated public sector asset holdings are

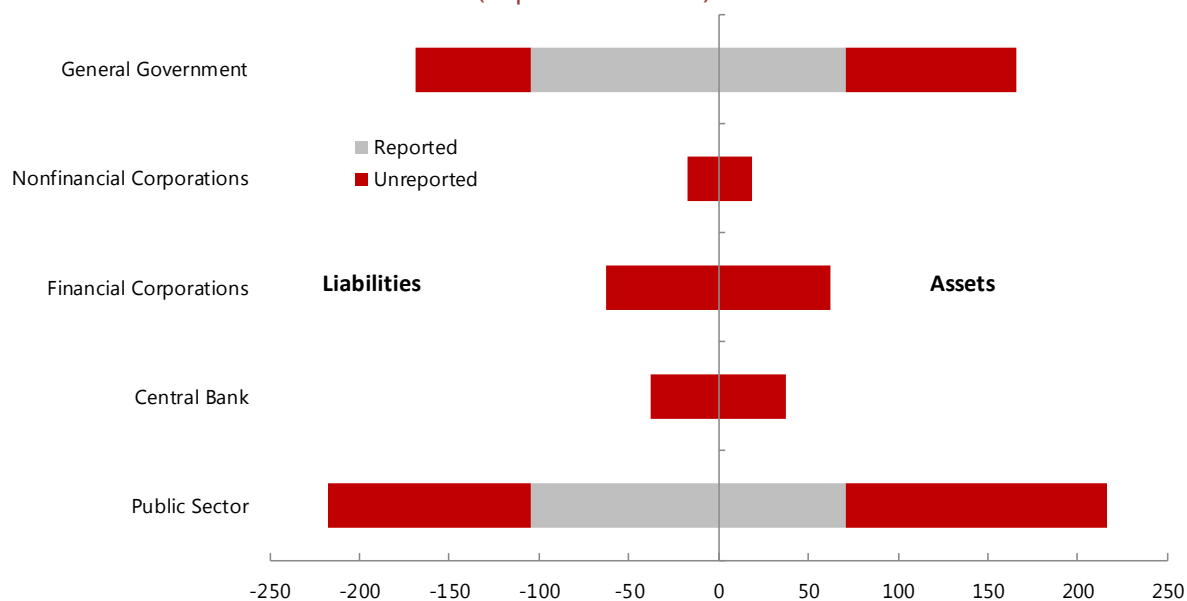
⁷ The presentation of the public debt stock varies according to reports. For example, the GFS Yearbook includes as central government debt all Treasury securities. However, in the Central Bank press release on the fiscal accounts, debt securities held by the Central Bank under outright ownership are not considered as central government (or general government, GG) debt, only those that are used as collaterals for repos (*compromissadas*) are included in debt statistics (see also Annex 2).

estimated to be at least 216 percent of GDP and its liabilities are estimated to be around 217 percent of GDP in 2014. The differences between these figures and those reported in fiscal reports, such as the financial statements or the general government financial statistics, reflect:

- Brazil's large reserves of natural resources are not recognized. In particular, the central government has unrecognized **subsoil assets** (petroleum, natural gas, iron ore, copper, bauxite, niobium, gold, and nickel) of around 87 percent of GDP, based on staff estimates, as discussed further in Section 3.2.6;
- states and municipalities undervalue their holdings of **land and other nonfinancial assets** by at least 2.8 percent of GDP by virtue of the fact that (i) the units still do not fully reflect those assets in their balance sheets, and (ii) the valuation of those assets is not based on market values;
- general government has unreported liabilities in the form of **civil service pension entitlements** (related to the pension systems of the personnel of the armed forces, states, and municipalities) accrued to date of around 58.8 percent of GDP;⁸
- the general government has growing assets and liabilities under **public private partnerships (PPPs) and concession contracts** estimated by 2014 at 4.6 percent of GDP, split between central government (2.2 percent of GDP) and subnational governments (2.4 percent of GDP);
- **public corporations** (including the Central Bank) have 107.2 percent of GDP in non-equity liabilities and 119 percent of GDP in assets.

⁸ The BSPN already recognizes part of the central and subnational pension liabilities.

Figure 1.3. Brazil: Public Sector Balance Sheet Coverage in Fiscal Reports, 2014
(in percent of GDP)

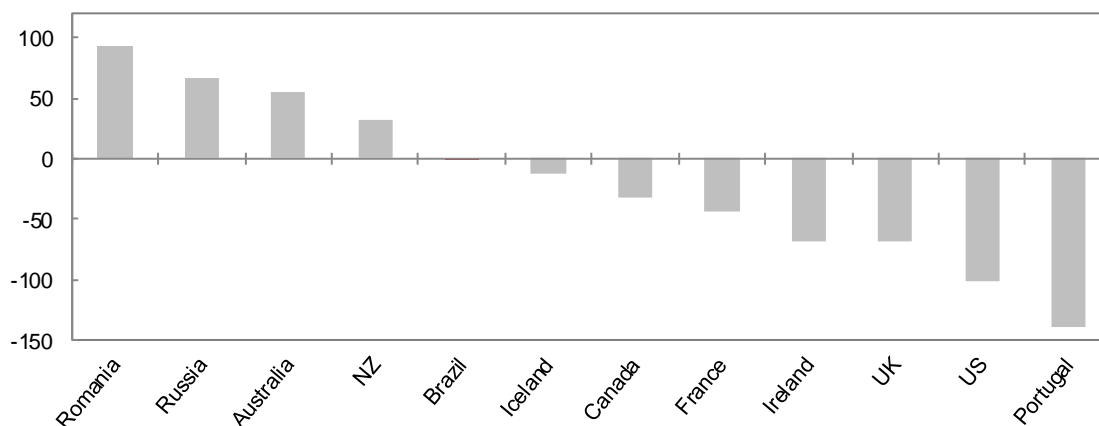


Source: IMF staff estimates.

10. Expanding the coverage of the public sector balance sheet in accordance with international statistical standards would improve Brazil's estimated financial position.

Initial estimates of the public sector balance sheet suggest a net worth in 2014 of about -0.9 percent of GDP, 33 percent of GDP higher than currently reported. This increase comes mainly from the inclusion of unreported subsoil assets and revaluation of land in the balance sheet, which are larger than the additional liabilities from civil service pension entitlements. As in other resource-rich countries, the estimates for Brazil's public balance assets are particularly difficult to calculate and subject to large year-to-year fluctuations reflecting the volatility of commodity prices. Brazil's overall public sector is comparable to the average of other countries for which net worth estimates are available, but significantly lower than other resource-rich countries (Figure 1.4).

Figure 1.4. Brazil: Public Sector Net Worth in Selected Countries
(in percent of GDP)



Source: IMF staff estimates.

11. If private sector employees' pension entitlements were included in public sector liabilities, the overall public sector net worth would decrease to -209 percent of GDP. The treatment of pensions in the government's accounts raises difficult issues in Brazil, as in many countries. At present, the financial assets of RGPS are included on the statistical balance sheet of general government, while the system's liabilities are not. Although this asymmetric treatment follows international statistical standards, it presents the government's fiscal position as better than it really is.

1.1.3. Coverage of Flows (Basic)

12. The coverage of flows in Brazil's summary fiscal data varies significantly across reports. The monthly Central Government Primary Balance Bulletin, widely used for fiscal policy discussions, covers most cash inflows and outflows of the federal government. One notable exception is the flows resulting from the relationship between the Treasury and the Central Bank, as monetary authority, which are only disclosed as memorandum items (the recording of this relationship in the various reports is described in Annex 2, along with a discussion on its impact in fiscal transparency). The implementation of IPSAS contributed to a much wider coverage of flows with annual financial statements covering not only full cash flows but also most accrual data, including accounts payable/receivable, depreciation, revaluations of assets (including equity holdings) and liabilities, or accrual of pension entitlements of civil servants. The financing reports compiled by the Central Bank present comprehensive cash data, but accrual information is limited to accrual of interest and a subset of other economic flows whose classification is not always in line with the 2014 GFSM. Fiscal statistics disseminated in the IMF's statistical databases on Brazil (*Government Finance Statistics Yearbook* and *International Financial Statistics*) have recently improved with the adoption of a modified-cash basis for the reporting of expenditure data. Revenue, however, continues to be reported only on a cash basis.

13. Nonetheless, significant accrued flows remain outside the most comprehensive fiscal reports. Most of these missing flows are associated with the limitations in coverage. The most relevant is the unreported annual net accrual of pension liabilities.⁹ Staff estimates, based on limited data, indicate that these transactions were 4.7 percent of GDP in 2014, but could vary significantly year-to-year.¹⁰ There are also annual investments in PPPs and concessions, which are estimated at 1.1 percent of GDP. Unlike the unitary cash payments to private suppliers associated with completed PPP projects, these accrued expenses are not reflected in statistics or accounts, given that IPSAS 32 has not yet been adopted. Finally, reports also exclude the depletion of subsoil assets, which would neutralize the increase in net worth deriving from the royalties received from extracting corporations.

Table 1.3. Brazil: Cash to Accrual Adjustments
(in percent of GDP, unless otherwise stated)

	2014
NFPS Primary balance (below-the-line, cash) 1/	-0.4
Net interest expenditure (accrual)	-5.5
NFPS Overall balance (modified cash) 1/	-6.0
Coverage adjustments	0.1
Cash-Accrual adjustments on recognized transactions	0.1
NFPS Net Lending/Borrowing (modified accrual)	-5.8
<i>Adjustment for missing public enterprises:</i>	
Petrobras	-1.2
Eletrobras	-0.1
NFPS (expanded) Net Lending/Borrowing	-7.1
Other adjustments	0.4
Public Financial Sector balance	0.9
Public Sector Net Lending/Borrowing	-5.8
<i>Additional accrual adjustments:</i>	
PPP Investment	-1.1
Accrual of pension entitlements	-4.7
Augmented Public Sector Net Lending/Borrowing FTE	-11.6

1/ Based on authorities reports (RTN, Nota Imprensa Bacen).

⁹ See Annex 4 for a detailed description of the treatment of employment-related pension schemes prescribed by the GFSM 2014, which was adopted in this report.

¹⁰ The estimates of the transactions of accrued pension liabilities were based on the changes in stock of liabilities and additional adjustments calculated by staff based on available information. See Annex 4 for details.

14. The overall net fiscal impact of recognizing these additional accrued revenues and expenses would increase Brazil's reported public sector deficit (Table 1.3). If the estimated public sector net lending/borrowing in 2014 included the accrual adjustments discussed above and other adjustments (mainly broader coverage) it would be around -11.6 percent of GDP. The nonfinancial public sector (NFPS) deficit would be 5.8 percentage points higher than currently reported in official documents. The key drivers of the difference are the accrued pension entitlements of public servants and accrual of PPP investments.¹¹ In addition, including the deficit of the two largest nonfinancial public corporations also adds to the reported deficit by about 1½ percent of GDP. The financial public sector has a positive effect on the balance.

15. The more comprehensive coverage of accrued liabilities is a recent development. Financial statements of the federal government (BGU) prior to fiscal year (FY) 2015 did not reflect significant accounts payable to public financial corporations and use of extra-budgetary funds accumulated over time as a result of the overdue compensation for quasi-fiscal activities (the so-called “pedaladas”, see Box 1). Following the recommendation of the TCU on the 2014 financial statements,¹² the federal government recognized the associated liabilities and subsequent payments in 2015, but accounts for previous years were not restated (the 2014 stock positions of assets and liabilities were revised only in the disclosure of the opening balance sheet for FY 2015). The joint Treasury/IBGE publication of GFSM 2014/2008SNA -based data has retroactively recorded the accrual of the missing expenditure. The BCB is also now regularly compiling the operations between the Treasury and extra-budgetary funds.¹³

16. One area of concern is the large increase in “Restos a Pagar” (RAP, unpaid commitments) between 2007-14, including some representing liabilities from more than a decade ago.¹⁴ RAP grew from around 5 percent of the central government budgetary expenditures to 13.4 percent at end of 2014 (close to 4 percent of GDP). In 2015, despite an effort to reduce those, they still remained high (12.3 percent of budgetary expenditures). The large size and the fact that some of the RAP refers to liabilities accrued more than a decade ago suggest the need for more transparency on these liabilities. This would help ensure appropriate classification between accrued and non-accrued liabilities and greater disclosure on how they are

¹¹ The more known fiscal balance measures in Brazil record the transactions related to the civil servants defined benefit pension schemes on a cash basis (actual contributions recording when they are received, pensions recorded when they are paid), which often understates the fiscal impact of those schemes. Even if the payment of contributions is sufficient to cover the benefits currently paid, it is often not sufficient to meet the increase in the benefits accruing from the current year's employment. In the broader definition in the FTE, the deficit takes into account the accrual of pension liabilities as discussed in the previous footnote.

¹² TCU report on the 2014 accounts of the central government (Relatório e Parecer Prévio Sobre as Contas do Governo da República).

¹³ The TCU ruling of December 2015 (Acórdão 3297/2015-TCU-Plenário) determined that FGTS and Finame (subsidiary of BNDES) should provide timely information to the Central Bank on their assets and liabilities against the federal government in order to be recorded in the monthly fiscal statistics.

¹⁴ The “restos a pagar” concept is subdivided into two components: unpaid accrued expenditure (“restos a pagar processados”), and budgetary carryovers yet to be accrued (“restos a pagar não processados”). At end 2015, the value of these two components was R\$ 32.2 billion (26 percent of the total) and R\$ 89.3 billion (74 percent of the total).

being addressed (e.g., explaining long delays in processing RAP, which has sometimes taken many years).

Box 1. Relations Between the Treasury and Public Banks: Unreported Liabilities

In 2015, in response to a demand by the Court of Accounts (TCU), the government settled a series of unreported liabilities—the so called “pedaladas.” These involved the three largest public banks (BNDES, Banco do Brasil, and Caixa Econômica Federal) and FGTS.

Although some of these unreported liabilities arose more than a decade ago, most have been incurred since 2013. The *pedaladas* included:

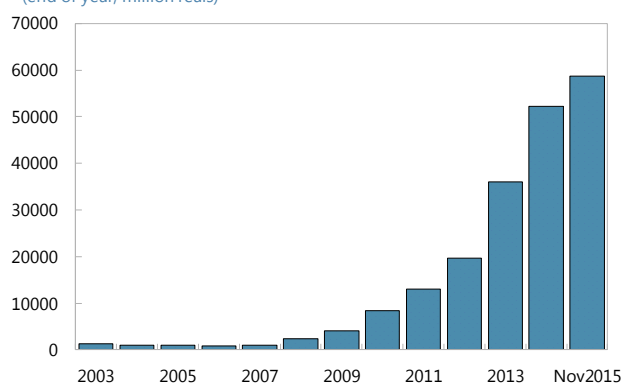
- arrears on payments to BNDES for subsidies related to the BNDES PSI (Program to Sustain Investment) to allow for subsidized loans. The Treasury has extended about R\$ 500 billion in loans to BNDES since 2008 to boost its lending capacity and also committed to subsidize loans to companies under the PSI. While the subsidy expense from BNDES was immediate, the government decided to delay by up to 24 months the recognition of its liabilities to BNDES, but reversed this decision following the TCU ruling.
- arrears to Banco do Brasil to compensate for subsidies related to agricultural/rural credit lines, especially to support subsidized interest payments related to the Safra Agrícola (harvests). The TCU found there were no clear procedures to recognize or address the payment delays.
- arrears with Caixa Econômica Federal and FGTS (managed by Caixa). The FGTS extended cash advances to the Union to cover expenses in a housing program (Minha Casa Minha Vida) and covered delays on social contributions. There were also delays in compensating for social benefits paid by Caixa as the agent of the government (e.g., Bolsa Família), which were registered in “below the line” statistics in 2014.

In economic terms (and according to the TCU) these delays functioned as a source of financing for activities of the central government by public banks. As noted by the TCU’s assessment of the financial statements of the government, these transactions did not follow the principles under the fiscal responsibility legislation and were not properly reflected in the fiscal and debt statistics. They lacked transparency as in most cases there was little public information on the fiscal impact of the operations. They also had economic consequences as the public banks’ capacity to lend to the private sector was reduced.

These liabilities were settled by the Treasury at the end of 2015, amounting to payments of R\$ 72.4 billion or 1¼ percent of GDP (included interest). The Central Bank has released historic time series from 2002 onwards on the accrual and clearance of these delays, improving ex-post transparency. Following a request from the TCU, the Treasury is now producing bi-monthly reports on future payments due to BNDES.

Stock of unrecorded Liabilities (Pedaladas)

(end of year, million reais)



Source: Central Bank of Brazil

1.1.4. Coverage of Tax Expenditures (Good)

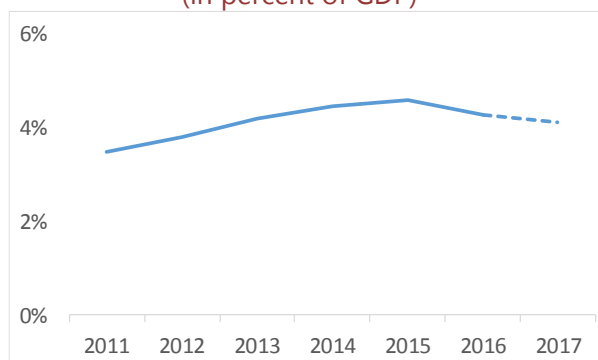
17. Every year, the government attaches to the PLDO and the PLOA a detailed report on the estimated central government revenue foregone from tax expenditures.¹⁵ In accordance with Article 14 of the FRL, the government releases an annex to the PLDO (Annex IV.11) which include a detailed list of tax expenditures for the next budget year and for two forward years, as well as different aggregates (by geographical area, sector, and tax). *Ex post* estimations of the individual impacts of central government tax expenditures are published on the Federal Revenue Authority website. Central government budget documents do not cover state tax expenditures—these are covered in the states' respective LDOs.¹⁶

18. There are no limits on tax expenditures, although they need to follow legal rules. Article 14 of the FRL states that any tax expenditure should fulfill one of the following conditions: either it is proven that it does not affect the targets set in the LDO, or it should be accompanied with a compensatory tax measure. An annex to the PLDO (Annex IV.12) is devoted to reporting the tax measures that were implemented to compensate for the creation of tax expenditures in the previous budget. However, this compensatory system has had only a partial effect in containing the growth of central government tax expenditures, which expanded at the same time that the fiscal deficit deteriorated and the fiscal target was missed. In total, central government tax expenditures averaged 4.1 percent of GDP over the period 2011-2016 (Figure 1.5). Subnational tax expenditures could represent as much as 1 percent of GDP, though consolidated data is not available. Taking both central and subnational tax expenditures into account, Brazil ranks at a similar level as the regional average (Figure 1.6) and below advanced economies such as the United Kingdom or the United States.

¹⁵ It reflects the estimated revenue losses from special exclusions, exemptions, deductions, credits, deferrals, and preferential tax rates.

¹⁶ According to an IDB study (Afonso J.R., *A renuncia tributaria do ICMS no Brasil*, 2014), only 6 states out of 27 do not provide information on tax expenditures in their LDOs.

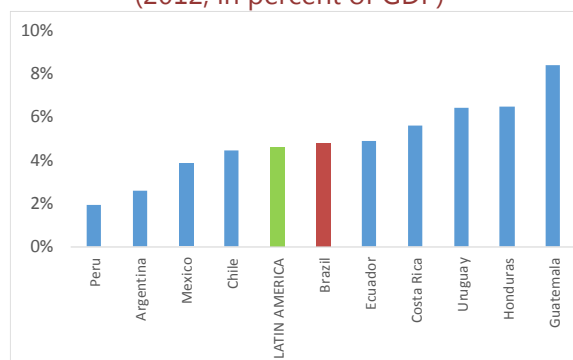
Figure 1.5. Brazil: Revenue Loss from Tax Expenditures
(in percent of GDP)



Source: Federal Revenue Authority.

Note: Simulation of the impact of central government tax expenditures based on 2013 tax base.

Figure 1.6. Brazil: Revenue Loss from Tax Expenditures, Regional Comparison
(2012, in percent of GDP)



Source: Inter American Center of Tax Administrations (2014), IADB and Federal Revenue Authority. It includes estimate for subnational tax expenditures.

1.2. Frequency and Timeliness of Fiscal Reporting

1.2.1. Frequency of In-Year Fiscal Reporting (Advanced)

19. Brazil's federal government financial statistics are produced monthly with a 30-day lag and general government statistics are available on a quarterly basis. The cash-based Central Government Primary Balance Bulletins, which cover the budgetary central government (around 45 percent of total general government expenditure, excluding intragovernmental interest and grants), are produced on a monthly basis and within 30 days of the end of each month. Since April 2016, Treasury has been publishing quarterly general government data, on a modified cash basis (revenue on cash basis and expenditure in both cash and modified-cash bases) in the GFSM 2014 format for publication in the IMF's *International Financial Statistics*. These data are disseminated with a lag of 90 days after the end of the quarter.

1.2.2. Timeliness of Annual Financial Statements (Advanced)

20. The opinion of the TCU on the "Accounts of the President" (PCPR) is usually published within six months of the end of the fiscal year. Article 84 of the Constitution provides that the PCPR should be submitted to Congress no later than 60 days after the beginning of the first Congressional session.¹⁷ Congress then transmits the PCPR to the TCU, which has 60 days to provide an opinion on whether the accounts present a fair view of the financial position of the government and comply with the constitutional and legal principles governing the federal public administration. This opinion is written and published by the TCU in a document titled "*Report and Preliminary Opinion on the Accounts of the Government of the*

¹⁷ In accordance with the article 57 of the Constitution, the Congress shall be in session each year from February 2 to July 17 and from August 1 to December 22.

Republic." This opinion aims at providing to Congress a technical analysis to support its final decision on the accounts approval.

Table 1.4. Brazil: Timetable of PCPR Submission and Audit

Fiscal Year	Transmission of the PCPR to Congress	Publication of the TCU's Opinion
2015	April 1, 2016	October 5, 2016
2014	April 4, 2015	October 7, 2015
2013	April 3, 2014	May 28, 2014
2012	April 9, 2013	May 29, 2013

Source: Mission, Congress website¹⁸, and TCU website.

21. The TCU's opinion on the 2014 PCPR was delayed due to the need to undertake additional investigations. On June 2015, the TCU requested clarifications on the 2014 accounts, to be provided within 30 days. The deadline was extended twice, after new findings were added to the process. The Presidency presented counterarguments, but they were not deemed sufficient to justify the irregularities. As a consequence, the Court recommended to reject the accounts on October 7, 2015—the first time this has occurred since 1937. Similar reasons explain the delay regarding the 2015 accounts, which the TCU also recommended to reject in October 2016.

22. The final approval of the accounts by Congress is not timely. This approval has a political nature and is not bound by the preliminary opinion of the TCU. The last accounts approved by both the Chamber of Deputies and the Senate are those from 2001.¹⁹

1.3. Quality of Fiscal Reports

1.3.1. Classification (Basic)

23. Brazil's fiscal reports include administrative, economic, program, and functional classifications, but the latter are not consistent with international standards. National classifications are applied to all levels of general government, which is a notable achievement for a large country with a high degree of fiscal decentralization. Classifications for revenue and expenditure do not follow the structure of the *GFSM 2001/2014* economic classifications, but are sufficiently detailed to allow a bridging to those standards.²⁰ On the contrary, for the functional classification, there are several areas (e.g., research and development and foreign aid) where a breakdown is not available which would allow a direct conversion to the first level of the United

¹⁸ <https://www.congressonacional.leg.br/portal/atividade/contasPresidente> (Accessed on June 7, 2016)

¹⁹ Source: <https://www.congressonacional.leg.br/portal/atividade/contasPresidente> (Accessed on June 7, 2016)

²⁰ This bridging is used in the compilation of the new joint Treasury/IBGE publication, which adopted the GFSM 2014 economic classification.

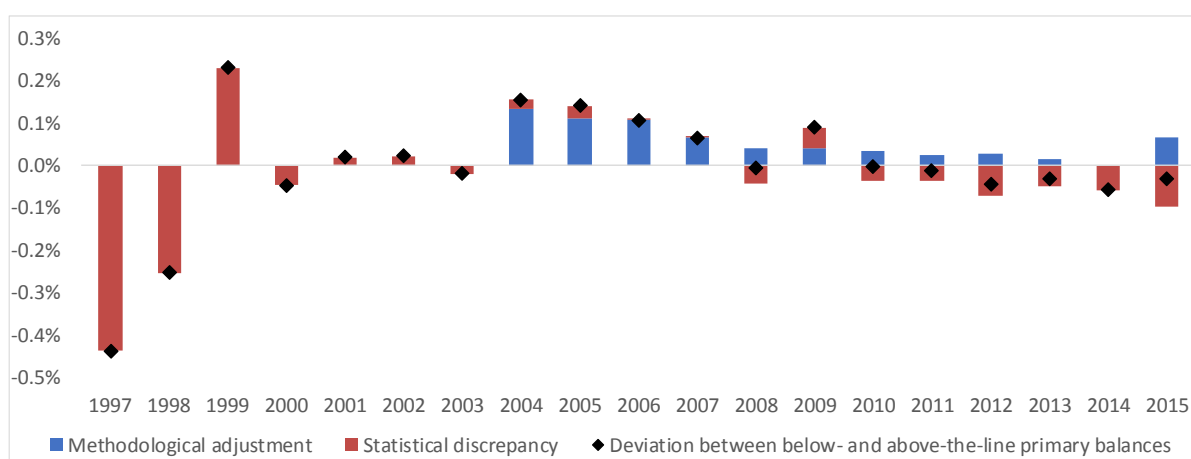
Nations' Classification of Functions of Government (COFOG). The Treasury intends to disclose expenditure by COFOG in the near future, and has been developing a compilation procedure that addresses the classification inconsistencies. This is being done primarily through a combination of the functional and administrative classifications.

1.3.2. Internal Consistency (Advanced)

24. The key internal consistency checks called for under the FTC are provided on a regular basis in the public fiscal reports. The above-the-line central government fiscal balance is computed by the Treasury, while the below-the-line calculation is provided by the Central Bank. The Treasury makes sure that both calculations are reconciled in the primary balance tables it publishes every month. The resulting discrepancy is broken down between a methodological adjustment (amortization of specific contracts) and a statistical component. In addition, the monthly debt reports published by the Treasury contain consistent information on public debt transactions and variations in public debt holdings from a unique database on securities held by the Central Bank. Last but not least, on a monthly basis, the Central Bank updates the breakdown of the explanatory factors behind the change in the general government gross debt stock.

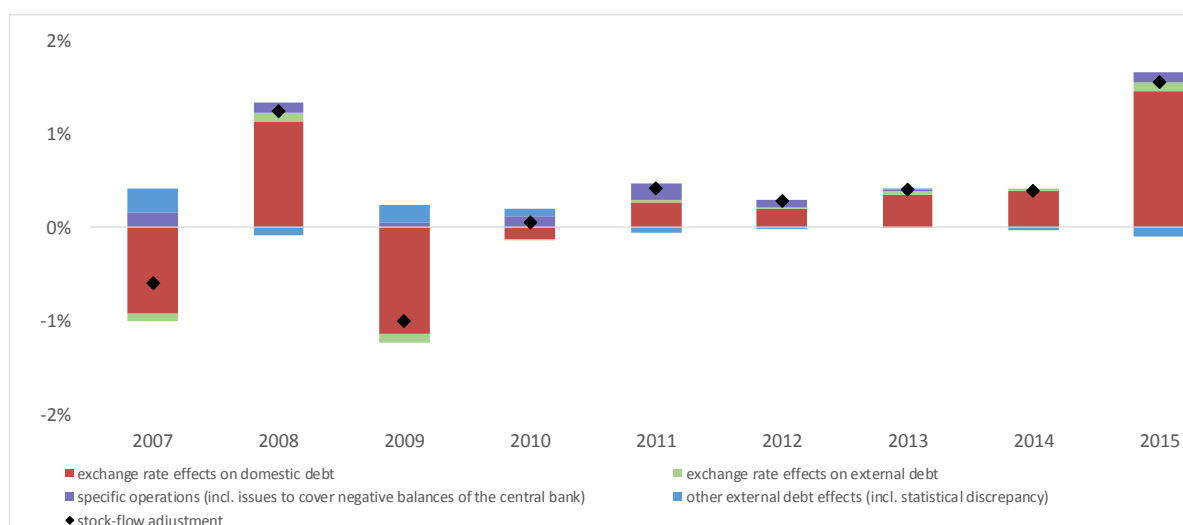
25. Discrepancies have been contained over the past few years. Differences between above- and below-the-line calculations of the central government primary balance have been small, with an average absolute deviation of 0.1 percent of GDP (Figure 1.7). Stock-flow adjustments have averaged around 0.2 percent of GDP over the 2007-2015 period, mostly driven by the effects of exchange rate movements (including related to FX swaps) on the stock of debt (Figure 1.8).

Figure 1.7. Brazil: Deviation Between Below- and Above-the-Line Central Government Primary Balances, 1997-2015
(in percent of GDP)



Source: Treasury, Resultado do Tesouro Nacional.

Figure 1.8. Brazil: Stock-Flow Adjustment, 2007-2015
(in percent of GDP)



Source: Central Bank and IMF staff calculations.

1.3.3. Historical Revisions (Good)

26. All revisions to fiscal statistics and reports are applied retroactively, with changes qualitatively explained. Online databases of the monthly reports produced by both the Treasury and the Central Bank are updated retroactively whenever any change occurs to sources and methods. Nevertheless, an archive of old published reports remains available at those institutions' websites. The same applies for fiscal statistics disseminated for publication in the IMF's Statistical Department databases, which always contain an entire time series, fully updated to reflect the latest compilation procedures. All major changes are explained in the metadata accompanying the first release of revised data.

27. Information on major revisions does not usually include bridging tables between the old and new time series. The only case where a revision of methodology in fiscal statistics led to a disclosure of a bridging table, together with data to allow the conversion of the new time series into the old methodology, was the change in the Central Bank's compilation of the General Government Gross Debt. For broader revisions, no bridging table was published (e.g. the recent change in the sources and methods for compilation of GFSM data, disclosed in the new joint Treasury/IBGE publication).

1.4. Integrity of Fiscal Reports

1.4.1. Statistical Integrity (Basic)

28. Fiscal statistics have been disseminated according to international dissemination standards since 2001. Brazil subscribed to the SDDS on March 14, 2001 and met all SDDS requirements at the time of subscription. Until 2008, Brazil's in-year and year-end fiscal statistics

covered only budgetary central government cash revenues, expenditures, borrowing, and debt, based on the GFSM 86 methodology. Since 2009, the Treasury—the agency in charge of GFS compilation—has gradually improved its compilation procedures, allowing it to start disclosing quarterly general government operations on both cash and modified-cash bases and a financial balance sheet, in the GFSM 2014 reporting format. With this, Brazil complied with the dissemination requirements set up under the G20 Data Gaps Initiative.

29. However, there is room for improvement in the implementation of methodological standards. Treasury's compilation procedures are still significantly bound to the source data, which constrains its ability to perform reclassifications for alignment with the GFSM 2014 methodology (e.g., for classification of units or the statistical treatment of operations). The Treasury's mandate as compiler of fiscal statistics, requiring it to align fiscal statistics to both international best practices and local requirements, results in a fragmentation of the reporting framework. Currently, there is no systematic analysis of consistency with the methodological guidelines. Statistical classifications follow the legal form rather than economic substance.

30. There is also room for improvement in the verification of fiscal statistics against external sources. The current compilation procedures are essentially based on the conversion of accounting data into the GFSM format. The resulting numbers could be checked against data that are compiled from different sources but have linkages with the government sector—in particular, external sector and monetary statistics, results from TCU audits, and financial statements of public corporations. Efforts in this direction were taken in the past—particularly with the setting up of a temporary inter-agency working group (Treasury, IBGE, and Central Bank) for the improvement and harmonization of macroeconomic statistics—but they have never been fully institutionalized.

1.4.2. External Audit (Good)

31. The TCU is the Supreme Audit Institution in charge of auditing the federal government's financial statements. Based on the judicial model, it benefits from the constitutional protections and guarantees aiming at ensuring the independence of judges.

32. The TCU opinions, on the last three fiscal years' accounts, include major qualifications. The *"Report and Preliminary Opinion on the Accounts of the Government of the Republic"* includes an audit of the BGU, which is part of PCPR. Regarding the fiscal year 2014, it expressed a qualified opinion based on 16 identified irregularities and 2 limitations on the scope of its audit.

Table 1.5. Brazil: TCU's Preliminary Opinions on the Accounts of the Government of the Republic
(fiscal years 2012-14)

Fiscal Year	Opinion
2014	Qualified opinion (16 major issues identified and 2 limitations of the audit scope)
2013	Qualified opinion (13 major issues identified and 3 limitations of the audit scope)
2012	Qualified opinion (4 major issues identified)

Source: "Report and Preliminary Opinion on the Accounts of the Government of the Republic," 2012, 2013, and 2014.

33. The TCU is currently further strengthening its audit methodology through the implementation of international audit standards. The *"Brazilian Standards for the Audit of the Public Sector - Level 1"* (NBASP), based on International Auditing Standards of Supreme Audit Institutions (ISSAI) Levels 1 and 2, have been published in 2015. A *"Manual of the Financial Auditor,"* based on international standards, has been prepared by the TCU and was subject to public consultation in June 2016.

1.4.3. Comparability of Fiscal Data (Basic)

34. The breakdown table of the primary balance of the central government is the key presentation format that is provided and monitored across budget documents, in-year financial statistics, and budget execution reports. Forecasts and outturns according to this presentation can be found in the PLOA and in budget execution reports published by the Treasury. Recent efforts have been made to improve comparability between documents: the format of the Central Government Primary Balance Bulletin (*"Resultado do Tesouro Nacional"* (RTN)) has been revamped in 2015 to allow proper comparability with budget documents. Other FRL-mandated types of presentation, which distinguish between current and capital revenue and expenditure of the central government, are also consistently used in budget documents and the final accounts published by the Presidency. It can, however, be difficult for the public to understand differences across documents, as bridging tables that could explain differences in the scope or coverage of different documents are not provided.

35. Budget outturns, which have been slightly different from one report to another in recent years, are not reconciled with fiscal statistics or final accounts. There are no bridging tables which explain differences between the RTN, GFS, or BGU formats. Information on fiscal outturns can also slightly vary from one document to another, complicating any efforts at reconciliation. Such differences could be due to recent changes in the formatting of the documents or in the classification of the different revenue and expenditure items, but they are not quantified or mentioned in the budget documents and fiscal reports. Even though the discrepancies are quite limited (Table 1.6), they should be accounted for in fiscal reports to allow for a transparent understanding of outturns.

Table 1.6. Brazil: Discrepancies Between Outturn Figures
(in R\$ million)

2013 Outturns	Date	Net Primary Revenue	Primary Expenditure	Primary Balance
Resultado do Tesouro Nacional	08/2014	991,113	914,115	76,998
PLOA 2015	08/2014	991,321	914,249	77,072
Resultado do Tesouro Nacional	08/2015	991,109	914,115	76,994
PLOA 2016	08/2015	991,321	914,249	77,072
Resultado do Tesouro Nacional	04/2016	995,588	918,595	7,6994
<i>Discrepancy between 08/2014 and 04/2016</i>		0.5%	0.5%	0.0%
2014 Outturns	Date	Net primary Revenue	Primary Expenditure	Primary Balance
Resultado do Tesouro Nacional	08/2015	1,013,867	1,031,086	-17,219
PLOA 2016	08/2015	1,015,574	1,032,793	-17,219
Resultado do Tesouro Nacional	04/2016	1,021,513	1,038,723	-17,211
<i>Discrepancy between 08/2015 and 04/2016</i>		0.8%	0.7%	0.0%

Conclusions and Recommendations

36. Brazil's fiscal reporting meets good and advanced practices in most areas. The assessment against the FTC, summarized in Table 1.6, shows that fiscal statistics cover the general government sector and recognize most of its assets and liabilities. It also shows that fiscal reports are prepared frequently and in a timely manner, and that annual financial statements are subject to an audit by an independent supreme audit institution, whose opinion has contributed to improvements in the government's accounting practices.

37. However, there remains scope to enhance the coverage and integrity of fiscal reporting in key areas. Brazil's fiscal reports do not consolidate the large public corporations sector (the two largest nonfinancial corporations are excluded), whose expenditure accounts for 22.1 percent of GDP. The general government's balance sheet excludes important elements, such as government employees' pension entitlements of around 59 percent of GDP or subsoil assets of approximately 89.7 percent of GDP. The assessment also shows that the compilation of fiscal statistics is often constrained by classification decisions that do not always comply with international statistical standards (e.g., recording of the relationship between the Treasury and the BCB, as described in Annex 2).

38. Based on the above assessment, the evaluation highlights the following priorities for improving the transparency of fiscal reporting:

- **Recommendation 1.1: Expand the institutional coverage of fiscal reports by incorporating all public corporations and public banks to provide an overview of the fiscal performance of the entire public sector.** This would provide a more comprehensive picture of the extent of government-directed activity in the economy. In particular, it would allow for a more accurate accounting of the cost of quasi-fiscal operations undertaken by public corporations and public banks.
- **Recommendation 1.2: Expand the coverage of (a) balance sheets to reflect the full market value of government infrastructure, subsoil assets, and pension entitlements of all public employees; and (b) flow statements to capture the associated expenses.** This would provide a comprehensive view of the government's overall net worth and the costs associated with transactions in nonfinancial assets and the accrual of pensions obligations.
- **Recommendation 1.3: Enhance the integrity of fiscal statistics by:**
 - **a. Setting up a permanent inter-agency committee for harmonized classifications in macroeconomic statistics.** This would help ensure that economic substance prevails over legal form in the classification of institutional units and statistical treatment of public sector units' operations;
 - **b. Recording Treasury-Central Bank transactions according to the most recent international statistical standards.** This would help better reflect transactions according to their true economic nature. It would also allow for separate reporting of transactions and the balance sheets of the BCB and the central government (a complex task at present), which are two separate units, classified in different parts of the public sector.
 - **c. Conducting regular consistency checks between different macroeconomic datasets.** This would help detect misclassifications or inconsistent recording of government operations with other sectors of the economy; and
 - **d. Including reconciliations of key fiscal aggregates within and between the different fiscal reports.** These would explain the reasons behind apparent inconsistencies between related key fiscal aggregates, such as stock flow adjustments or differences in coverage or accounting basis. This will become increasingly more important as the authorities gradually converge to GFSM 2014 standards.

Table 1.7. Brazil: Summary Assessment of Fiscal Reporting

Principle		Assessment	Importance	Recs
1. Coverage	1	Good: Published fiscal reports consolidate most of general government (only some very small entities excluded) but not the public corporations.	High: Public corporations with expenditures of 22% of GDP and non-equity liabilities of 107% of GDP are outside fiscal statistics.	1.1
	2	Good: The latest annual financial statements cover all financial assets and most liabilities. Some nonfinancial assets are also recognized.	High: Unreported nonfinancial assets of 90% of GDP and unreported pension entitlements of military personnel and subnational governments' civil servants represent 59% of GDP.	1.2a
	3	Basic: Fiscal reports cover all cash and some accrual revenues and expenditures.	High: Accrued general government pension expenses of 5% of GDP and PPP investment 1% of GDP are outside fiscal reports.	1.2b 1.3b
	4	Good: Tax expenditures are estimated annually by tax, sector, economic type and geographical area.	Low: Tax expenditures have represented an average 4 percent of GDP over the 2010-2016 period, which is relatively low by international standards.	
2. Frequency and Timeliness	1	Advanced: In-year fiscal reports are published on a monthly basis, within a month.	Low: Fiscal reports covering the budgetary central government (45% of GG expenditure, excluding grants) are published at t+30 days.	
	2	Advanced: The TCU preliminary opinion on the accounts is usually published in June.	Low: The final approval of the accounts is under the responsibility of Congress.	
3. Quality	1	Basic: Fiscal reports include administrative, economic and functional classifications, but the latter is not fully consistent with COFOG.	Low: Classifications are harmonized across general government and most inconsistencies with COFOG could be addressed through a combination of classifications.	
	2	Advanced: Reconciliations between above- and below-the-line balances, debt issuances and debt holdings, and financing and change in debt are all available.	Low: Discrepancies between the different calculation methods have been contained.	
	3	Good: Revisions to fiscal statistics and reports are applied retroactively, with all major changes qualitatively explained.	Low: Some major revisions are accompanied by a bridging table between the old and new time series.	
4. Integrity	1	Basic: Although fiscal statistics are disseminated in accordance with international dissemination standards, compilation processes do not ensure full compliance with GFSM.	Medium: Treasury's mandate to align fiscal statistics to both international best practices and local requirements results in a fragmentation of the reporting framework.	1.3 a,b,c
	2	Good: The accounts are audited by an independent institution and are subject to an opinion including major qualifications.	Low: The ongoing process of implementing international standards on auditing should further improve the effectiveness of the external audit.	
	3	Basic: The breakdown of the central government primary balance can be found in budget documents and execution reports, but it coexists with other formats, for which reconciliation tables are not provided.	Medium: The multiplicity of presentation formats and the frequent corrections introduced in outturn data hinder the readability of budget documents and fiscal reports.	1.3d

II. FISCAL FORECASTING AND BUDGETING

39. This chapter assesses the quality of fiscal forecasting and budgeting practices relative to the standards set by the FTC. It focuses on four main areas:

- Comprehensiveness of the budget and associated documentation;
- Orderliness and timeliness of the budget process;
- Policy orientation of budget documentation; and
- Credibility of the fiscal forecasts and budget proposals.

The assessment is based on information publicly available (Table 2.1). In addition to the multi-annual plan and budget documentation, the assessment takes into account freely available online databases that provide detailed information on budget authorizations and execution, including performance information.

2.1. Comprehensiveness

2.1.1. Budget Unity (Good)

40. The budget documentation presents gross revenue, expenditure, and financing for the central government, budgetary funds, and social security. The LOA includes the operations of central government and no expenditure can be made without explicit budgetary appropriation. Budgetary funds are created by law and are funded by earmarked revenue. Nevertheless, they are included in the LOA and are submitted to the common rules regarding budget preparation and execution. The administrative budget²¹ of the Central Bank is also presented in the LOA. Nevertheless, as the budget does not include extensive information related to FGTS, a large extra budgetary fund submitted to specific governance arrangements, the practice related to budget unity is not meeting the advanced standard.²²

²¹ This includes wages, recurrent expenditures, and investment but not the operations related to monetary policy.

²² The FGTS was also used to finance government programs without budget authorization (Box 1).

Table 2.1. Brazil: Documents and Data on Fiscal Forecasting and Budget

Document Type	Title	Content	Fiscal Year	Publication Date
Fiscal Forecasting and Budgeting Documents				
Multi-Annual Plan	Plano Plurianual (PPA) 2016-2019	Main strategic targets and programs of the Federal Government for the next four years	2016–2019	January 14, 2016
Draft Pre-Budget Statement	Projeto de Lei de Diretrizes Orçamentárias (PLDO) 2016	Guidelines for the budget preparation and economic assumptions, fiscal targets for the primary budget balance, debt levels, and revenue forecasts for the year of the budget and two years forward	2016	April 15, 2015
Enacted Pre-Budget Statement	Lei de Diretrizes Orçamentárias (LDO) 2016	Guidelines for the budget preparation and economic assumptions, fiscal targets for the primary budget balance, debt levels, and revenue forecasts for the year of the budget and two years forward	2016	December 31, 2015
Executive Budget Proposal	Projeto de Lei Orçamentária Anual (PLOA)	Draft annual budget	2016	August 31, 2015
Citizens Budget	Orçamento Cidadão 2016	Presentation of the PLOA for a reader without budget expertise and summarizing the key information through simple charts and graphs	2016	August 31, 2015
Enacted Budget	Lei Orçamentária Anual (LOA)	Budget approved by Parliament	2016	January 15, 2016
Financial and Budgetary Planning Decree	Decreto - Dispõe sobre a programação orçamentária e financeira, estabelece o cronograma mensal de desembolso do Poder Executivo para o exercício de 2016	Decree setting ceiling for ministries expenditure	2016	February 12, 2016
Online Data				
Planning and Budgeting Integrated System	Sistema Integrado de Planejamento e Orçamento (SIOP)	Detailed plan, budget authorizations and execution data, and performance information	2010–2016	Daily update
Transparency Portal	Portal da Transparência	Direct expenses of the Federal Government	2004–2016	Monthly update
		Transfers to states and municipalities	2004–2016	
		Agreements with individuals, corporations or government entities	1996–2016	
		Revenue forecasting and collection	2009–2016	

2.1.2. Macroeconomic Forecasts (Basic)

41. Three-year forecasts for key macroeconomic indicators are provided in several budget documents and execution reports, but explanations of the forecasts are limited.

The PLDO and the PLOA (and the PPA before them) include, at a minimum, forecasts of real GDP growth, inflation, the real/dollar exchange rate, and short-term interest rates, covering the budget year and between one and three years forward. However, the scope of the forecasts presented can vary significantly across documents (Table 2.2). The PLOA complements the annual forecasts with monthly projections of imports, total wages, price indexes, and oil prices for the budget year. Though the analysis of the most recent outturns is fairly detailed in the Presidential message attached to the PLOA, only a short explanation of the macroeconomic scenario is provided to support the forecasts. Forward year forecasts are indicative and rely on extrapolation methods, rather than on detailed analysis. There is only a very brief mention of the expected impact of global economic developments on the Brazilian economy. Furthermore, the forecasts of the different components of GDP are not published (the Presidential message attached to the PLOA does contain both a demand and supply breakdown of GDP over the past few years).

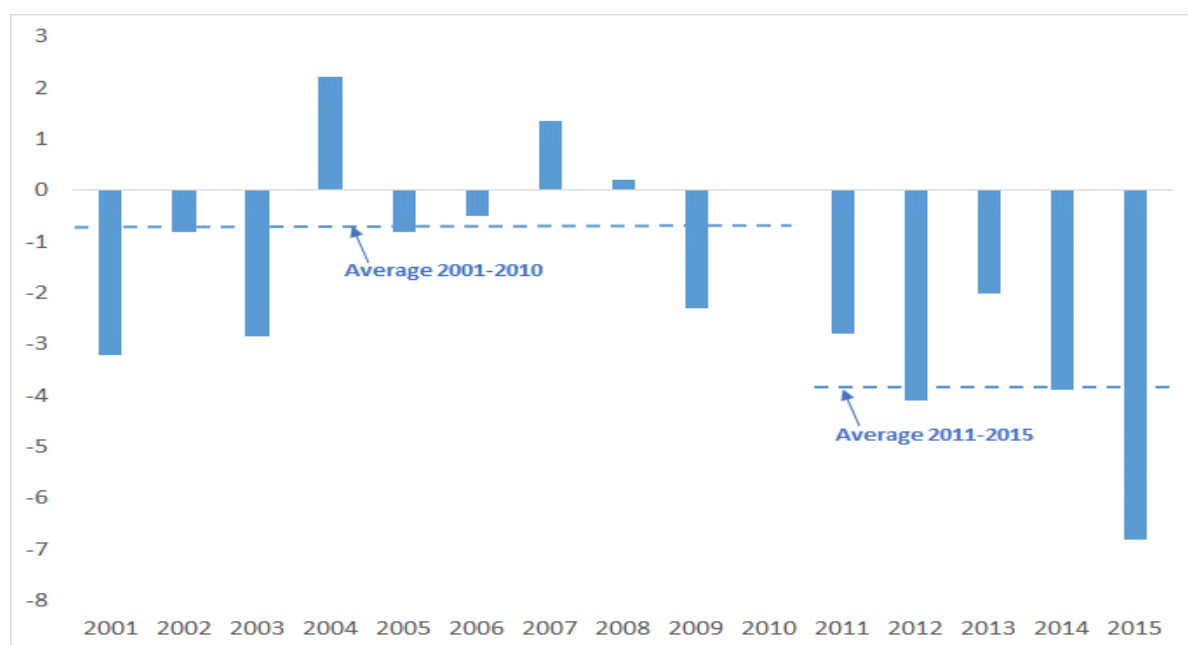
Table 2.2. Brazil: Scope of the Macroeconomic Forecasts Contained in Recent Budget Documents

Document	Section	Macroeconomic indicators	Time Horizon
PPA 2016-2019	Presidential Message	Nominal and real GDP growth (with supply breakdown), inflation, short-term interest rates, exchange rate, minimum wage, working population, total investment.	4 years (2016-2019)
PLDO 2016	Annex IV.1 – Annual fiscal objectives	Real GDP growth, inflation, short-term interest rates, exchange rate.	3 years (2016-2018)
PLOA 2016	Presidential message	Real GDP growth, inflation, short-term interest rates, exchange rate.	3 years (2015-2017)
	Complementary Information–Vol. III, Section XXI	Nominal and real GDP growth (with supply breakdown), industrial activity (2015-18), wage bill growth and levels, oil prices, importations, short-term interest rates, exchange rate.	2 years (2015-2016)
Bimonthly execution reports		Nominal and real GDP growth, inflation, short-term interest rates, exchange rate, oil prices, minimum wage, nominal wage bill.	1 years (current year)

Source: Ministry of Planning.

42. More extensive discussion of the assumptions underlying the macroeconomic projections could improve their credibility, as they have shown an optimism bias in recent years. While the average deviation between one-year-ahead GDP forecasts and outturns was commensurable with independent forecast practice over the 2000s,²³ it has been systematically negative since 2011, reaching -3.9 percentage points over the period 2011-2015 (Figure 2.1). In part, this reflects the unexpectedly difficult macroeconomic environment in the last two years, but also reveals an optimism bias relatively to market projections for the main economic variables.²⁴ Explaining the assumptions and choices which led to the forecast presented in the budget could help inform the public. Furthermore, the assumptions regarding new fiscal policy measures (which can have a significant impact on the economy, especially tax measures) should be communicated.

Figure 2.1. Brazil: Real GDP Growth: Deviation Between One-Year-Ahead Forecast and Outturn, 2001–2015



Source: Ministry of Planning; WEO.

²³ The average deviation between real GDP growth one-year-ahead WEO forecasts for G20 countries and outturns reached -0.5 percentage point over the 1990-2011 period (IMF Internal Evaluation Office estimate); the deviation between MoF forecasts for Brazil and outturns over the 2001-2010 period is slightly larger, at -0.7 percentage point.

²⁴ This can be observed by comparing the accuracy of projections by the private sector for economic growth—which are collected in the Central Bank's *Focus* reports—with those in the budget. The *Focus* reports show that the average deviation between the real GDP growth one-year-ahead forecasts at the end of August (the month the budget is published) and outturns over the period 2011-2015 was -2.7 percentage points. This compares with the -3.9 percent deviation between projected and actual growth in budget documents over this period.

2.1.3. Medium-Term Budget Framework (Basic)

43. The Brazilian budget system does not include a rolling medium-term budgetary framework. The PPA is prepared by the Executive during the first year of a government and defines the main strategic targets and programs of the Federal Government for the next four years, including the first year of the next government. It includes the main economic assumptions and fiscal targets for the primary budget balance, debt levels, and nominal deficit. The PPA covers all activities and expenditures of the central government and provides a broad estimate of the resource allocated to each activity or project during the four-year period. *De facto*, it is a strategic planning tool relying on optimistic assumptions regarding both resource availability and implementation capacity. As a consequence, it does not effectively provide a policy anchor for the annual budget process. Annual budget preparation is informed by the LDO submitted every year to Congress. It includes economic assumptions, fiscal targets for the primary budget balance, debt levels, and revenue forecasts for the year of the budget and two years forward. Nevertheless, neither document presents expenditure estimates at the program or ministry level.

2.1.4. Investment Projects (Basic)

44. Brazil continues to face challenges in executing its public investment budget. On average, about two thirds of the investment budget has been executed over the past three years. Though due in part to the “Lava Jato” investigations in the recent years (Box 2), these shortfalls are macroeconomically important, as Brazil’s public investment is lagging behind other emerging market economies, both in quantitative and qualitative terms (Figure 2.2). Brazil’s public investment rate has been consistently below the average of emerging market economies, leading to a relatively low level of capital stock. The perceived quality of infrastructure is also inferior to the average for emerging economies and for countries in the Latin America and Caribbean region.

Box 2. Transparency and Fiscal Risks: The Case of Petrobras and Eletrobras

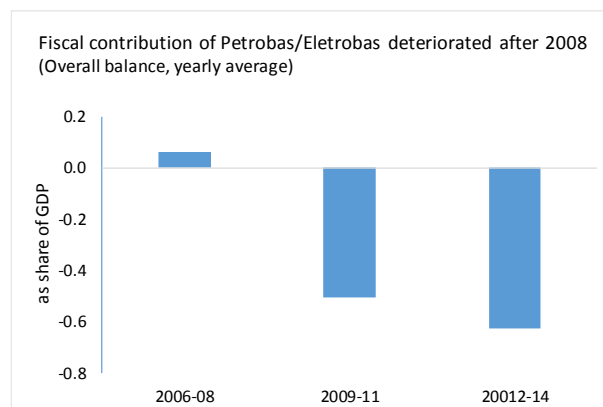
Petrobras and Eletrobras are the two largest nonfinancial public corporations, but they have been excluded from the fiscal targets since 2009. The objective was to allow the companies, considered to pose low fiscal risk, more flexibility to conduct their large investment plans. They were also removed from fiscal statistics of the public sector (deficit, debt) weakening fiscal transparency. In addition, Petrobras has been exempted from several of the public sector procurement, borrowing, and personnel rules. The fiscal performance of the two companies has deteriorated since 2009. If they had been included in the fiscal accounts, they would have caused a further deterioration of the primary surplus of around ½ percent of GDP yearly on average during 2009-14.

Both companies' operations and financial health have been affected by corruption scandals:

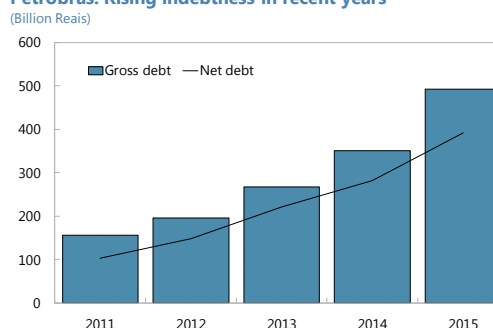
- In 2009, the federal police started an investigation of money laundering in several states, called operation "Lava Jato" (Car Wash). From 2014, the investigation focused on irregularities involving constructing companies and suppliers of Petrobras. A group of companies colluded to overcharge Petrobras with some of the funds being directed to illegally finance political parties, among others. The contracts affected had a value of about R\$ 200 billion. Petrobras estimated that the overcharging represented about 3 percent of the value of the contracts (R\$ 6.2 billion). Petrobras' shares have suffered with the scandal and the company faces the risk of losses arising from lawsuits.
- Several large projects by Eletrobras (and companies in the group) are being investigated by Brazilian prosecutors after executives in the projects were involved in corruption scandals (including "Lava Jato"). The company's ADRs were suspended on the New York Stock Exchange and could be delisted for failing to submit audited financial statements to the Securities and Exchange Commission—the auditing firm has not signed the reports due to a lack of information on losses from corruption in its large projects (e.g., Belo Monte hydroelectric plant and the Angra 3 thermonuclear plant). The quality of the company's governance has been downgraded (e.g., "weak" by S&P).
- Both companies have adopted measures to improve procurement practices and internal controls, including an anticorruption plan at Eletrobras. The government has also approved a new law for public enterprises (2016) and has issued a series of directives in recent years to improve governance (including strengthening Boards), procurement rules, and controls of SOEs.

The two companies represent significant fiscal risks to the rest of the public sector:

- The large fall in international oil prices and high leverage—net debt almost quadrupled since 2011 to 6½ percent of GDP—has put Petrobras under financial distress. Eletrobras may also need further government financial support.
- Neither company paid dividends in 2015 (after paying as much as 0.3 percent of GDP in 2009) and their problems contributed to the deepening economic recession (and fall in tax revenues) as they curtailed their investment plans. They also represent a risk for public banks that have granted them considerable loans and have equity participation in the companies.

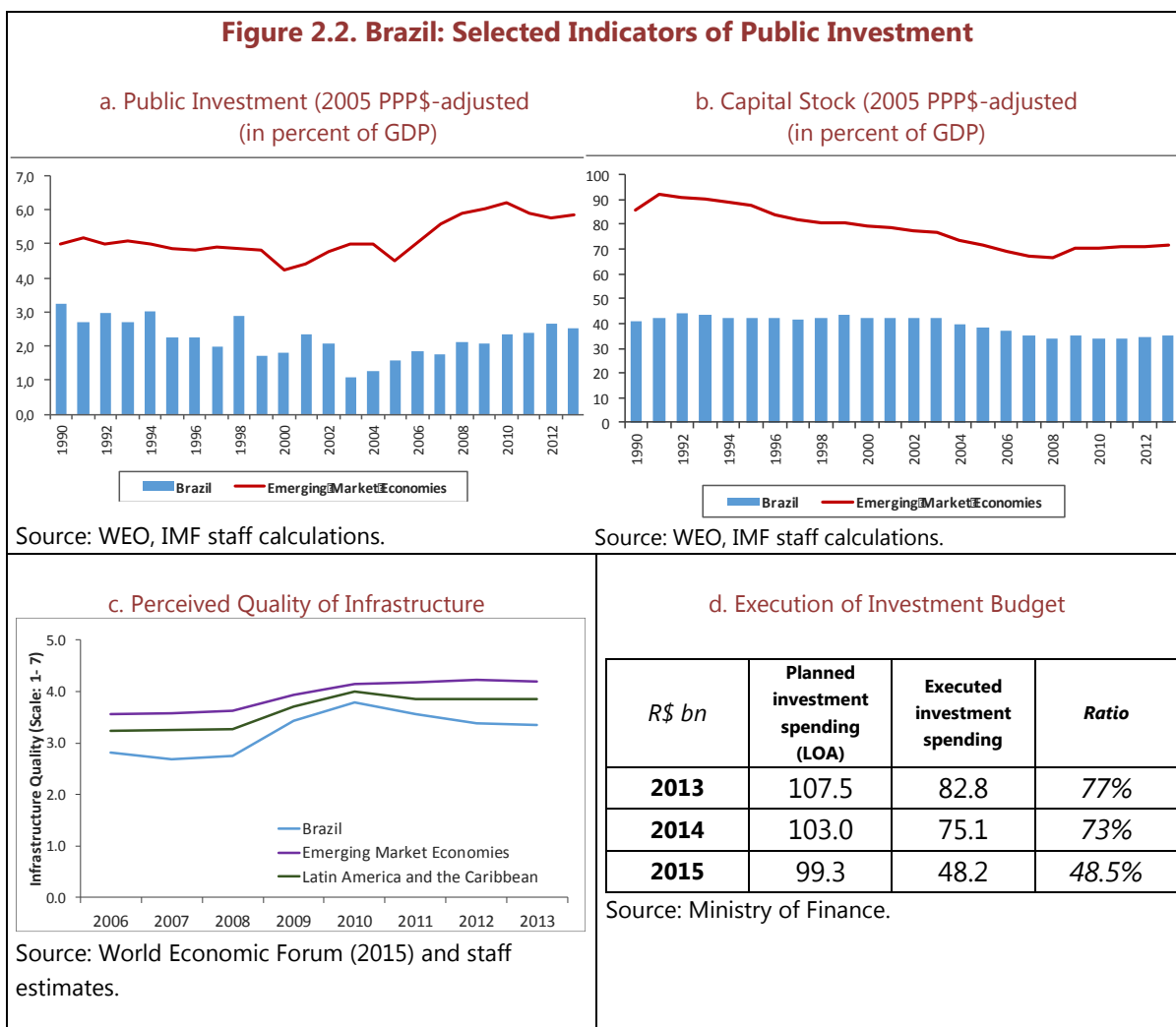


Petrobras: Rising indebtedness in recent years



Source: Petrobras

Figure 2.2. Brazil: Selected Indicators of Public Investment



45. Detailed information on major investment projects is available online, but the total amounts of multiyear commitments attached to them are not published.

- The PPA, published every four years, contains a list of ongoing and pre-selected investment projects, with a projection of their overall costs, as well as their planned beginning and end dates, classified by program and ministry.
- The PLOA provides both an aggregate view and individual information on planned investment spending, though only amounts to be appropriated for the budget year are disclosed—information on multiyear commitments is not available in the budget documents. Though there is a clear separation between investment project expenditure and maintenance and operational costs, the latter are not presented in a project-specific manner.
- Projects under the *Programa de Aceleração do Crescimento* (PAC), which account for approximately two-thirds of the federal government’s investment spending, are subject to

deeper scrutiny, with the publication of total overall costs, monthly disbursement reports and regular information on expected and realized outputs, and sometimes, outcomes.

46. Project appraisal, selection, and procurement processes still fall short of best practices in terms of transparency. Investment projects do not systematically go through cost-benefit analyses before being selected, and when they do, these analyses are not made public and do not follow a common standard methodology. Public procurement procedures are regulated by a 1993 law²⁵ which covers the federal government as well as states and municipalities. Open and competitive public tender is a core principle of this law, and complements the Constitution, which already states that public tender “should assure equal conditions for all bidders” (Article 37). Most tenders are available online via the government’s *Portal da Transparência*. However, ongoing judicial investigations, in the “Lava Jato” case for instance, indicate that there have been weaknesses in the procurement process in the recent past. Consequently, cost overruns have been frequent. The legal framework and public procurement processes are being strengthened to address some of these weaknesses: for instance, the new Public Companies General Law (June 30, 2016) clarifies the rules and procedures for public procurement driven by public enterprises.

2.2. Orderliness

2.2.1. Fiscal Legislation (Advanced)

47. The Federal Constitution, Law No. 4320 of 1964,²⁶ and the FRL clearly set the budget timetable and its content. Article 165 of the Constitution requires that the executive branch prepares the draft PPA, LDO, and LOA. Article 35 of the Temporary Constitutional Provisions Act sets the deadlines for their transmission to Congress and to return it to the executive branch (Table 2.3). The Constitution and the FRL define the format and the content of the documentation supporting the budget process.

Table 2.3. Brazil: Timetable for Budget Preparation and Approval

Law	Deadline for Transmission to the Legislative Branch	Deadline for Return to the Executive Branch
PPA	August 31 of the first year of the presidential term	December 22
LDO	April 15	July 17
LOA	August 31	December 22

Source: Constitution of the Federative Republic of Brazil.

48. The legal framework clearly defines Congress’ power to amend the executive branch’s budget proposals. Article 166 of the Constitution provides that amendments to the

²⁵ Law No. 8.666, June 21, 1993.

²⁶ Law No. 4320 provides the general rules for the preparation, execution, accounting, and reporting of the budgets for the three levels of the government.

budget proposals should be compatible with the PPA and the LDO and specify their funding from either the cancellation of other expenditure or higher revenue than initially forecast. Nevertheless, this obligation is not always implemented. Some policy changes have been adopted while their financial cost or funding was not identified. In the case of the modification of the social security factor (*fator previdenciário*) in 2015 both the cost and offsetting measures were not identified. In the case of the increase of net revenue allocated to health expenditure, offsetting measures were not identified.

49. The fragmentation of the legal framework limits its accessibility to the public. The Constitution provides that a supplementary law must be enacted to detail the rules and procedures related to public finances. In effect, this would have provided an organic budget law, updating and replacing the 1964 law. As this new law was never adopted, the legal framework for the budget comprises not only the 1964 law (which is outdated in some aspects) and the FRL but also the LDOs, which include detailed legal provisions related to the public finances. As a result, the legal framework is excessively complex. Consolidating the legal framework into a single modern organic law would increase the transparency of the rules related to the budget and reduce legal uncertainties resulting from the extensive use of the LDOs to set up new procedures and rules every year.

2.2.2. Timeliness of Budget Documents (Basic)

50. The enacted budget has been published after the beginning of the fiscal year for the last two years. The last three budgets have been submitted to Congress four months before the beginning of the fiscal year. The 2014 and 2016 budgets were approved by Parliament in December. The 2015 budget approval and publication have been delayed, due to the October 2014 general elections. The 2016 budget was published in January 2016.

Table 2.4. Brazil: Dates of Budget Submission, Approval, and Publication, 2014-2016

	2014 Budget	2015 Budget	2016 Budget
Transmission to Congress	August 28, 2013	August 28, 2014	August 31, 2015
Approval by Congress	December 18, 2013	March 17, 2015	December 17, 2015
Publication	December 30, 2013	April 22, 2015	January 15, 2016

Sources: Transmission to Congress: date of the presidential message; Approval by Congress: Senate website; Publication: Date of publication in the Diário Oficial da União.

2.3. Policy Orientation

2.3.1. Fiscal Policy Objectives (Good)

51. The PPA and the LDO are the two main tools used by the Brazilian government to set numerical fiscal objectives and to regularly report on its performance against them.

- The PPA²⁷ contains macroeconomic forecasts (Table 2.1.), as well as indicative fiscal objectives for the primary balance, the nominal balance, and debt levels. Every year, the Ministry of Planning releases an evaluation report, which discusses progress made and updates the forecasts and targets.
- Brazil does not have a fully developed medium-term budgetary framework. However, it is bound by the guidelines set every year in the LDO.²⁸ Brazil's fiscal objectives for year t are stated every year in an annex (Annex IV.1) to the LDO drafted in April $t-1$. These are also compared with the outturns in another annex to the LDO (Annex IV.3), drafted in April $t+1$. The key fiscal target is the primary balance of the non-financial public sector (excluding Petrobras and Eletrobras), which drives the debates on fiscal policy. Targets for primary revenue and expenditure, the nominal balance and net debt are also set, but they are secondary in practice. The LDO also provides objectives for two forward years, but they are mostly rough indicative objectives and are not backed by robust economic and fiscal projections in published documents.

52. Brazil's budget documents do not provide a clear picture of the fiscal strategy and how policy measures will help achieve the government's objectives for fiscal policy. The description of the policy intentions of the government for the budget year and the medium-term, as well as the explanations accompanying the targets, remain limited. Furthermore, in-year large revisions to the targets through supplementary revisions, together with large adjustors to the main fiscal target, undermine the role of the LDO as providing clear guidance to the fiscal strategy.

53. The three last LDOs have been approved by Congress more than six months after the release of the drafts, highlighting the limits of the framework in a fast-changing macroeconomic environment. While the LDO is supposed to be approved by Congress before the draft budget (PLOA) is released in August, the LDO was approved just before the LOA for the last three budgets. Each time, the adopted LDO has been substantially different from the PLDO, with targets set to match the appropriations and forecasts of the LOA. As such, the LDO has thus

²⁷ Article 165 Constitution: The executive power shall establish under its initiative: I- The PPA; II- The budgetary directives; III- The annual budgets.

²⁸ Article 165 Constitution, §2: The LDO shall comprise the targets and priorities of the federal government, including capital expenditures for the next budget year, shall guide the preparation of the LOA, shall specify the changes in tax legislation and shall establish the investment policy of financial agencies.

not acted as a guide for the preparation of the budget, but rather as a legal formality which has not constrained the level of spending.

2.3.2. Performance Information (Good)

54. For more than a decade, the Brazilian government has been developing performance indicators and evaluations through its planning process and the PPA. The PPA includes for each of its programs high-level performance indicators, objectives, and output targets. All programs in the PPA are required to be evaluated each year. Program managers report on progress against PPA targets, using an online system (SIOP). The evaluations and indicator results feed into the annual PPA progress report, which is sent to the Executive and Congress. Since 2011, the PPA has been significantly revised and streamlined. The number of programs in the plan was reduced from over 300 to 54 thematic programs, covering policy areas. Outcome targets have been de-emphasized in favor of more output and activity based targets. In addition, there have been efforts to improve monitoring and reporting on output indicators included in budget documents. Despite the progress made with reporting performance information, its use in the budget decision-making process is reportedly still limited.

55. Budget documentation includes targets for the outputs to be delivered under each major government policy. The PLOA presents the outputs expected for each governmental programs at the detailed policy measure ("action") level and links it with the budget allocation. An online register of the actions, the *Cadastro de Ações*, aims at providing qualitative information on the actions planned in the budget of each year. It comprises 54 thematic programs, 42 management and support programs, and 12 special operations programs.

2.3.3. Public Participation (Good)

56. Since 2010, the government has published a Citizens Budget. It is published alongside the PLOA. It presents, in a non-technical and visual manner, the core information expected from a citizens' budget, as defined by the International Budget Partnership.²⁹ It also includes information about the budget preparation and execution process. Moreover, it provides information on key inputs, outputs, or outcomes of policies per sector and clarifies the funding source of these policies. The implications of the budget proposal are presented from the point of view of a typical citizen, but the proposal does not provide detailed information for different demographic groups (for example, low-income households or indigenous populations).

57. Brazil fosters the public's knowledge of budgetary matters through a number of other initiatives. An e-learning system, *Escola Virtual SOF*, provides on-line training and information to all interested citizens for free. In addition, a comic book, "*Sofinha and her gang*," presents in a very accessible language the key information on the budget institutions and

²⁹ These comprise expenditure and revenue totals, the main policy initiatives in the budget, the macroeconomic forecast upon which the budget is based, and contact information for follow-up by citizens.

concepts. Furthermore, a radio program, Budget Time, provides information to the listener in a simple and direct language.

58. Brazil is a leading country in providing citizens with a formal voice in budget deliberations. The Intercouncil Forum (*Forum Interconselho*) comprises elected representatives of National Councils and committees and representatives of civil society. It aims at formally incorporating policy experts in the preparation of the PPA. The budget preparation benefits from the expertise of the National Councils, composed of civil society organizations (CSOs) and government representatives, that are in charge of formulating the budget within their policy area. Moreover, CSOs and citizens can contribute to the legislative process through their participation in public hearings.

2.4. Credibility

2.4.1. Independent Evaluation (Not Met)

59. There is no independent evaluation of the government's macroeconomic and fiscal forecasts and performance. There is no independent fiscal institution³⁰ that examines the accuracy of fiscal projections. Furthermore, no budget document provides a comparison of the government's forecasts with those of independent or consensus forecasts. Greater comparison of the authorities' macroeconomic assumptions and fiscal projections with those done outside of government could help improve the quality of fiscal forecasts.

2.4.2. Supplementary Budget (Basic)

60. The legal framework clearly mandates that substantial modifications of the budget or increases in the total level of expenditure needs to be approved by Congress. The legislation foresees three options to modify the enacted budget during the fiscal year:³¹

- Supplementary budget appropriations (*créditos orçamentários suplementares*) can be enacted through presidential decrees during the fiscal year, as long as the expenditure increase is backed up by identified funding and does not exceed a percentage approved in the LOA (a supplementary budget proposal must be approved by Congress to exceed this limit). During fiscal year 2015, 21 decrees increased budgetary credits for a total of R\$ 116 billion.
- Special budget appropriations (*créditos orçamentários especiais*) are approved by Congress, for new expenditures which are not included in the enacted budget. They must also identify the funding source. During fiscal year 2015, Congress approved 28 laws, increasing budgetary credits by R\$ 40 billion.

³⁰ The FRL (Article 67) has created a fiscal management council, involving both federal and state levels of government, focusing on the harmonization of fiscal practices across the country. However, this council has not been implemented, and it would likely not deal with the assessment of the macro-fiscal forecasts.

³¹ In all cases the modifications of appropriations must comply with the fiscal target.

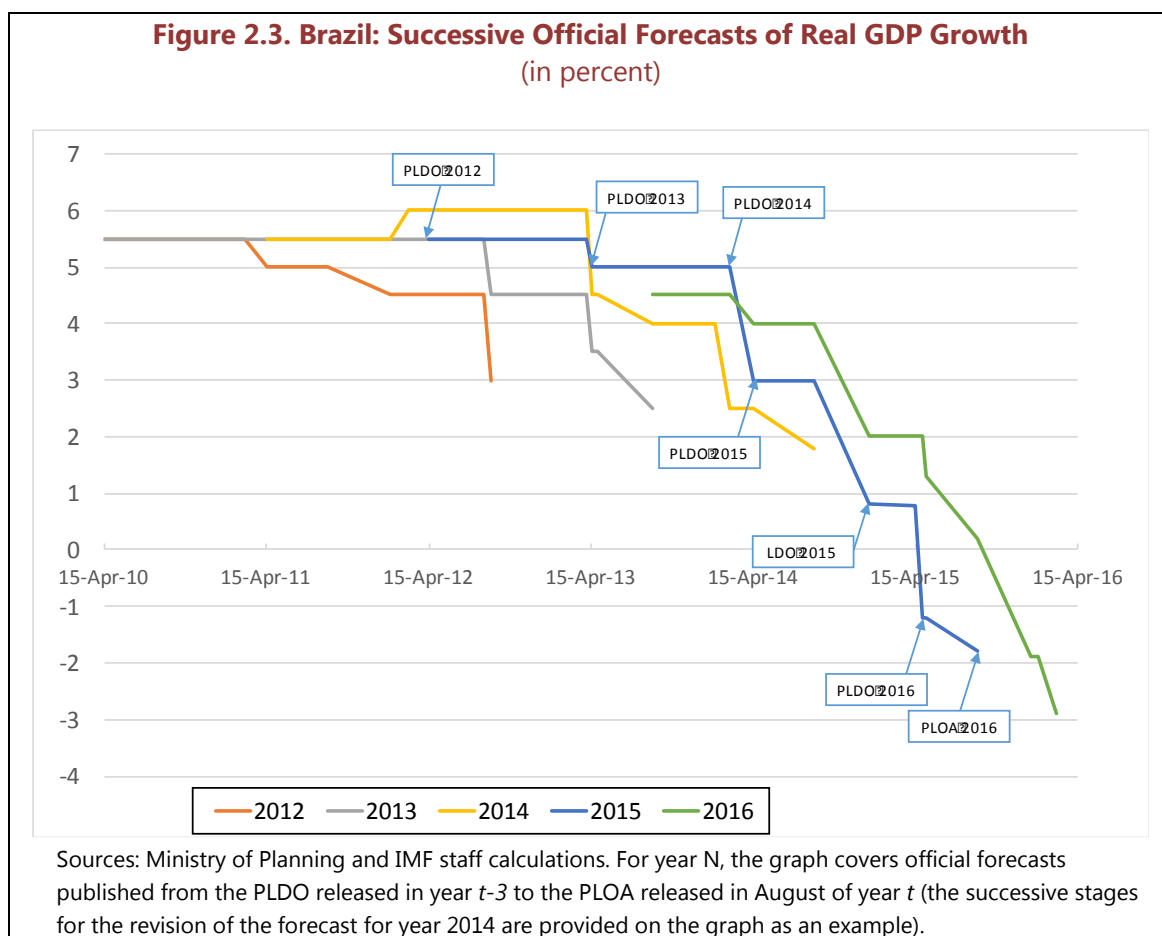
- Extraordinary budget appropriations (*créditos orçamentários extraordinários*) cover unforeseen and urgent expenditures. These may be enacted by a provisional executive measure and should be approved by Congress *ex post*. During fiscal year 2015, six provisional executive measures made available additional budgetary credits for a total of R\$ 116 billion.

61. Over the last several years, budget modifications have been approved after, rather than before, their implementation. The practice has deviated from the legal requirements in two key areas.³² Regarding the investment budget for federal public enterprises, in several cases public corporations have modified significantly their investment plans from the budget before authorization from Congress. This is usually resolved before the end of the year, but not always. Regarding the “fiscal” budget (central government), the key issue has been the need to change the fiscal target before implementing changes to budget allocations (as required by law). This has become a crucial issue in recent years, as the initial fiscal targets were based on projections that were too optimistic. In some cases, the authorities decided to execute modifications of the budget prior to approval of Congress of the change in the fiscal target. This happened as recently as 2015, when the requested modifications were approved by Congress before the end of the fiscal year. The TCU recently stressed that these practices were not according to the law, and as a result stricter adherence to the legal framework for supplementary appropriations is expected.

2.4.3. Forecast Reconciliation (Basic)

62. Macroeconomic and fiscal forecasts are revised from one budget stage to another, with little explanation for the reasons for the changes. Changes in one-year-ahead real GDP forecasts from one vintage to another have been especially significant in the past few years, due to the slowing growth of the Brazilian economy (Figure 2.3). Consequently, total revenue projections have also been significantly revised at every new official step. Nevertheless, forecast revisions from one LDO to the next or between a LDO and a LOA are not explained in budget documents. In particular, tables presenting the new forecasts do not contain a reference to the previous forecasts.

³² See also Box 1 on unreported liabilities, which refers in part to changes in the budget that were not approved.



63. In contrast, in-year forecast revisions introduced in the bimonthly execution reports of the Treasury are better documented. Article 9 of the FRL states that if after a period of two months, the government is off track to meet its fiscal targets, it should take measures to meet the LDO's targets. Consequently, the FRL has made it compulsory to publish bimonthly reports which update the macroeconomic and fiscal forecasts, if deemed necessary by outturns in the first months of the year or by the macroeconomic environment. Tables compare the fiscal forecasts (primary revenue and expenditure, detailed by tax or spending type, and primary revenue) from the previous bimonthly report and the new ones. The reports also provide details of the updated underlying assumptions to each forecast. However, they do not provide a comparison with the assumptions that had been used in the previous report.

Conclusions and Recommendations

64. Brazil's budgeting and forecasting practices are basic or good for most principles set by the FTC, but critical weaknesses remain. Areas of particular strength are the unity of the budget and public participation in the budget process (Table 2.5). A key weakness of the system is that the policy intentions for fiscal policy are not discussed in budget documents, nor is the outlook for key fiscal variables such as the budget deficit, primary balance, and public debt

ratios. In addition, there is no scrutiny of the government's fiscal projections by an independent fiscal institution. In this context, key reform priorities are as follows:

- **Recommendation 2.1. Publish a full-fledged medium-term fiscal policy statement.** A medium-term fiscal policy statement, which could be attached to the next PLDO as an annex, would bring more clarity to the government's fiscal intentions for the budget year and the medium term, reduce the uncertainty surrounding fiscal policy decisions, and provide a better sense of available fiscal space for new policies. It would provide, on top of the fiscal objectives and targets proposed by the government:
 - A concise (no more than a few pages) overall view of the government's economic and fiscal strategy for the medium term;
 - Detailed information on the medium-term macroeconomic scenario, including an analysis of the international macroeconomic environment, an explanation of the assumptions underlying the GDP forecast (which could be broken down according to supply or demand), specific analyses on employment, inflation, the wage bill, and at least a few alternative scenarios to assess the level of uncertainty surrounding the forecasts;
 - A qualitative discussion of the government's fiscal objectives, as well as a quantitative distinction between the baseline scenario and the impact of new measures;
 - An account of the revision of forecasts and objectives compared with the previous LDO, with a quantitative breakdown of the key revision factors.

Elaboration of a medium-term fiscal policy statement would also help prepare the government and the public for an eventual shift to an MTEF. Preferably indicative and limited in scope at first, an MTEF would require, among other things, a clear distinction between the baseline³³ and the impact of new measures, and include an evaluation of the multiyear commitments the budget is facing due to ongoing investment projects.

- **Recommendation 2.2. Create an independent fiscal council.** A fiscal council is a permanent independent entity with a statutory or executive mandate to assess government's fiscal policies and performance, and promote sustainable public finances.
 - a. Such a council could at least express a judgment on the realism of macroeconomic and fiscal forecasts, provide *ex ante* and *ex post* evaluation of fiscal policy, and assess compliance with the fiscal rules. It could also assess how well different states are complying with their adjustment programs and requirements under the FRL. In addition, the council could provide an assessment on long-term fiscal sustainability. For the fiscal council to be effective, it needs a high degree of independence and be appropriately staffed.

³³ A baseline is an estimate of future revenues and costs of policies and programs already approved with the assumption that no new policy decision is made.

- b. The government could at least compare and disseminate its forecasts with the ones published by independent analysts, and provide ex post analyses of differences between forecasts and outturns.
- **Recommendation 2.3. Initiate a full review of the existing legal framework and prepare a modern organic budget law.** A consolidation of the legal framework into a single law would increase the overall transparency of the budget process. A modern organic budget law in line with best international practices, which was envisaged in the Constitution, is long overdue. It would also facilitate broader reform of the public financial management system. Many emerging market economies have focused in recent years on strengthening fiscal rules, medium-term fiscal frameworks, and management of fiscal risks. Most advanced economies have adopted these reforms after revising their basic budgeting framework, including a modern organic budget law.

Table 2.5. Brazil: Summary Assessment of Fiscal Forecasting and Budgeting

Principle		Assessment	Importance	Recs	
1. Comprehensiveness	1	Budget Unity	Good. Budget documentation presents gross revenue, expenditure and financing for the central government, budgetary funds, and social security.	Low. The current budget structure ensures an exhaustive institutional coverage of the Federal Government's entities on a gross basis.	
	2	Macroeconomic Forecasts	Basic. Budget includes forecasts of key macroeconomic variables, with little explanation of the underlying assumptions.	High. The gap between forecasts and outturns for real GDP growth has been significant in the past few years, due in part to an optimism bias.	2.1
	3	MT Budget Framework	Basic. LDO includes economic assumptions, fiscal targets for the primary budget balance, debt levels, and revenue forecasts for the year of the budget and two years forward.	High. A rolling medium-term budgetary framework can help achieve a well-designed multi-year fiscal consolidation plan.	2.1
	4	Investment Projects	Basic. The amounts of multiyear commitments due to investment projects are not available in the budget. Cost-benefit analyses are not published. Tenders are available online.	High. Public investment is lagging (both in size and quality), when compared with other emerging market economies.	2.1
2. Orderliness	1	Fiscal Legislation	Advanced. The legal framework is clear and comprehensive.	Medium. Considerations could be given to prepare an updated legal framework, consolidating the topics covered by the 1964 law and the FRL and introducing new PFM features.	2.3
	2	Timeliness of Budget Documents	Basic. Enacted budget was published after the start of the fiscal year for the last two years.	Low. Delayed budget publications resulted from specific circumstances.	
3. Policy Orientation	1	Fiscal Policy Objectives	Good. The PPA and the LDO set precise and time-bound targets for the main fiscal aggregates; the late promulgation of the LDO has undermined its role in the last three years.	Medium. Meeting fiscal targets has become more difficult in recent years.	
	2	Performance Information	Good. Budget documentation includes targets for the output to be delivered under each major government policy.	Low. Quality of indicators should be improved.	
	3	Public Participation	Good. There is an active policy to ensure effective public participation.	Low. Information on the budget impacts for different demographics category could further improve public participation.	
4. Credibility	1	Independent Evaluation	Not Met. There is no independent evaluation of the government's economic and fiscal forecasts and performance.	High. Weak credibility of the macro-fiscal forecasts could justify setting up an independent fiscal council.	2.2
	2	Supplementary Budget	Basic. Substantial modifications of the budget were frequently implemented prior their formal approval by Congress.	Low. Budget execution is actively monitored to not exceed the expenditure ceilings set by the LOA.	
	3	Forecast Reconciliation	Basic. Differences with previous forecasts are mostly discussed on a qualitative basis, except for in-year revisions in the bimonthly execution reports.	Medium. Revisions of forecasts have been significant in the recent years.	

III. FISCAL RISKS

65. This section assesses the government’s analysis, reporting, and management of fiscal risks against the practices of the Fiscal Transparency Code. It looks at three dimensions:

- General arrangements for the disclosure and analysis of fiscal risks;
- The reporting and management of risks arising from specific sources, such as government guarantees, public-private partnerships, and the financial sector; and
- Coordination of fiscal decision making between central government, subnational governments, and public corporations.

Table 3.1 lists key government reports that provide information on fiscal risks.

Table 3.1. Brazil: Selected Government Reports Relevant to Fiscal Risks

Report	Related Risks	Author
PLDO Annex V, Fiscal Risks (<i>Riscos Fiscais</i>)	Macroeconomic risks, public debt, financial assets, public banks, and contingent liabilities and contingent assets related to court cases	Ministry of Planning, with inputs from the Ministry of Finance and other agencies
Report of the Accounts of the President of the Republic, (<i>Prestação de Contas da Presidenta da República</i> , including <i>Balanço Geral da União</i>)	Government guarantees, etc.	Presidency, with inputs from the Ministry of Finance and Ministry of Planning
Accounts of the National Public Sector (<i>Balanço do Setor Público Nacional</i>)	States and municipalities	National Treasury
Statistics on the Finances of General Government (<i>Estatísticas de Finanças Públicas do Governo Geral</i>)	Subnational governments	National Treasury
Reports on Fiscal Management (<i>Relatórios de Gestão Fiscal</i>)	Debt, guarantees	Federal, state, and municipal governments individually
Public Federal Debt: Annual Report (<i>Dívida Pública Federal: Relatório Anual</i>)	Debt	National Treasury
Fiscal Indicators and Indebtedness of States and Municipalities (<i>Indicadores Fiscais e de Endividamento de Estados e Municípios</i>)	Subnational governments	National Treasury
Bulletin on Finances of Subnational Governments (<i>Boletim de Finanças Públicas dos Entes Subnacionais</i>)	Subnational governments	National Treasury
Report on Financial Stability (<i>Relatório de Estabilidade Financeira</i>)	Financial sector	Central Bank
Profile of Federal State Enterprises (<i>Perfil das Empresas Estatais Federais</i>)	Public corporations	Ministry of Planning
PLDO: reports on long-term actuarial projections of the social security systems ¹	Debt, long-term sustainability	Ministry of Social Security and Ministry of Defense

^{1/} General social security system (RGPS) (Projeções Atuariais para o Regime Geral de Previdência Social), civil servants’ pension scheme (RPPS) (Relatório da Avaliação Atuarial do Regime Próprio de Previdência Social), and of the military pensions (Avaliação Atuarial do Regime Próprio de Previdência Social dos Militares da União).

3.1. Disclosure and Analysis

3.1.1. Macroeconomic Risks (Basic)

66. The Brazilian economy is exposed to significant macroeconomic uncertainty, which, in turn, creates high uncertainty on fiscal outturns. It is crucial that budget documents discuss how macroeconomic developments could influence the public finances. This is critical at the current juncture where macroeconomic uncertainty has increased in light of less favorable and more volatile external conditions, a sharp decline in economic activity, and political turbulence. With the timing of the recovery uncertain, government revenues and the budget balance are likely to remain volatile, creating new forecasting challenges for the government. The forecasting is also complicated by the large number of revenue earmarking and mandated spending and indexation of key variables (like minimum pensions).

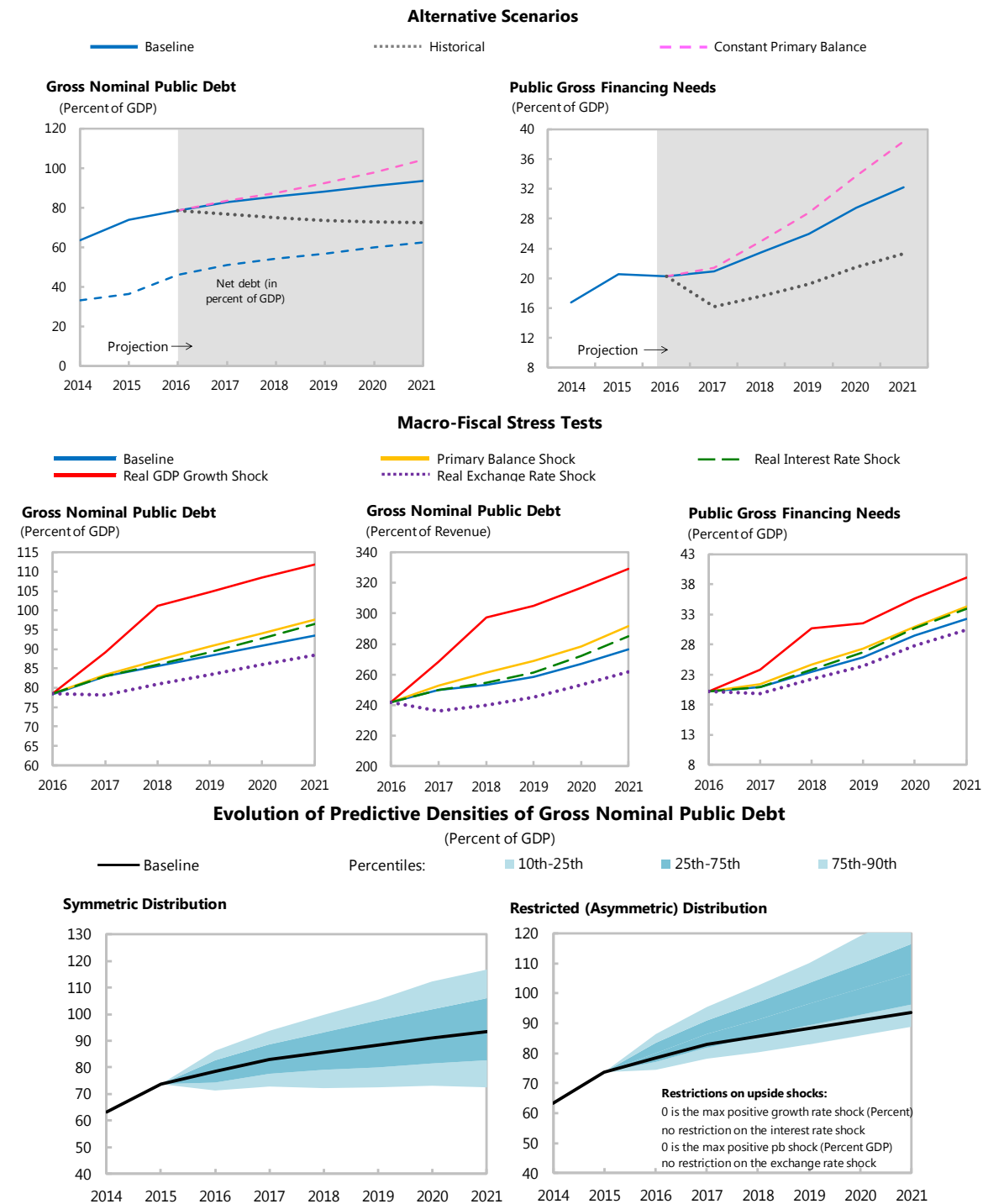
67. The statement of fiscal risks published every year provides some analysis of the sensitivity of revenue, expenditure, and debt to key macroeconomic indicators. Annex V of the PLDO on fiscal risks devotes a few paragraphs to macroeconomic risks. It provides a series of sensitivity analyses (impact of a 1 percentage point change in GDP, inflation, the exchange rate, policy interest rate, and the wage bill) on total tax revenue and total social security revenue; and the impact of a 1 percent change in the exchange rate, inflation rate, and policy interest rate on expenditure and debt. Moreover, a new feature of the PLDO 2017 report (published in April 2016) is the presentation of an alternative macroeconomic scenario (or stress test) for the years 2016 and 2017, with its consequences for the projections of selected revenues and expenditures. The sensitivity analysis does not, however, cover all key variables of interest in assessing fiscal policy—the budget balance and gross financing needs, notably. An example of this type of sensitivity analysis is provided in Figure 3.1, which is drawn from the IMF's debt sustainability framework for market access economies and the 2016 Article IV Staff Report for Brazil.

3.1.2. Specific Fiscal Risks (Basic)

68. Many specific fiscal risks are disclosed, though the disclosure is not comprehensive and the relationship of the risks to the fiscal forecasts is sometimes unclear. The annual report on fiscal risks mentioned above has been published since the early 2000s—making Brazil one of the pioneers in transparency about fiscal risks. The most recent edition of the statement discusses, in addition to macroeconomic risks, specific fiscal risks relating to the government's financial assets, public banks, public debt, and lawsuits brought by and against the government. Risks that are not discussed include those arising from subnational governments, public corporations, government guarantees, private banks, natural disasters, and concessions and public-private partnerships. Another important source of fiscal risks not discussed are linked to the volatility of commodity prices, although these are more relevant to some subnational governments. When risks are discussed, it is sometimes unclear how they might affect the achievement of the fiscal target and the forecasts for the following years. In addition, the statement does not address the fact that many risks are positively correlated—for example,

periods of low economic growth are likely to be associated with the realization of fiscal risks from the financial system and state-owned enterprises.³⁴

Figure 3.1. Brazil: Example of Sensitivity and Debt-Sustainability Analysis



Source: IMF (2016), Article IV Staff Report for Brazil.

³⁴ See, IMF, 2016, "Analyzing and Managing Fiscal Risks—Best Practices".

3.1.3. Long-Term Sustainability of Public Finances (Not Met)

69. There is no information on the long term, or even medium term, sustainability of key fiscal aggregates such as gross debt in budget documents. Projections of debt levels in the LDO only cover the budget year and, only indicatively, two forward years. There is no analysis on the possible impact of medium- and longer-term economic trends, such as demographic developments, on the fiscal accounts. There is no assessment of the available fiscal space in the coming years, nor a mention of legal constraints—earmarked revenues, mandated spending—that tend to rigidify fiscal balances and complicate medium- to long-term projections. Such analyses could give policymakers a better sense of the fiscal challenges that lie ahead.

70. Long-term projections for social security and pensions are available and provide a valuable building block for developing long-term projections of fiscal aggregates. These reports, which are required by the FRL, are produced by the Ministry of Social Security (and by the Ministry of Defense, in the case of military pensions). The report on the general social security scheme (RGPS) projects its annual balance over the next 45 years, relying on a set of detailed assumptions on demographics, the labor market, and labor productivity growth. The civil servants' pension scheme is projected over the long term (75 years) in another report, as are the military pensions in separate reports. These reports indicate sizeable fiscal problems—for example, under present policies, spending related to the RGPS is projected to increase by almost 9 percentage points of GDP between 2014 and 2060. International comparisons also show Brazil has a much larger challenge than other countries (Table 3.2). Though these reports could be made more useful by including sensitivity analyses or alternative scenarios, they provide key inputs for long-term projections. Nonetheless, it should be noted that there remain important gaps in the coverage of long-term spending pressures, including pension funds at the subnational level and for public enterprises, and public healthcare spending.

Table 3.2. Long-Term Sustainability of Pension Spending

	Pension spending Change 2015-50 (% GDP)	Accrued Pension Liability (% GDP)
Brazil	10.2	296
Advanced average	1.0	220
Emerging average	3.0	125
Source: Fiscal Monitor database, IMF.		

3.2. Risk Management

3.2.1. Budgetary Contingencies (Good)

71. The budget allocation for contingencies can be used at the government's discretion to meet unforeseen expenditures. Article 5 of the FRL provides that the LOA must contain a contingency reserve. While its use and amount must be defined in the LDO, the FRL provides that it aims at meeting contingent liabilities and other unforeseen events. The LDO for 2016 provided that the budgetary contingency would at least represent, respectively, 2 and 1 percent of the net revenue in the PLOA and the LOA. The difference of 1 percentage point aims to provide resources to fund amendments during the examination in Congress of the LOA. The contingency reserve has not been used during the fiscal years 2013 to 2015.³⁵

72. In addition, at the beginning of each fiscal year, a presidential decree sets the ceilings for ministries' expenditure. These are always below the amounts voted by Congress to contain public expenditure. Subsequent presidential decrees usually increase expenditures, resource permitting. Moreover, every two months, the Federal Budget Secretariat and the National Treasury Secretariat issue limits for commitments and cash disbursements. The requirement to meet the primary surplus target set by the LDO exacerbates this very short-term management of the budget. This implies an active control of the budget execution and leaves little room for a strategic management of the budget and its medium-term consequences.

3.2.2. Management of Assets and Liabilities (Good)

73. The government has large liabilities and also valuable financial assets. At the end of March 2016, the gross debt of the general government was 73.6 percent of GDP.³⁶ At the same time, the financial assets of general government were worth 34.1 percent of GDP, the largest of the assets being deposits at the Central Bank (16.5 percent of GDP) and loans to BNDES (8.5 percent of GDP). In recent years, both the assets and liabilities have grown (Figure 3.2).³⁷ The value of the government's assets and liabilities, and the cash flows they give rise to, vary with inflation, interest rates, the exchange rate, and the performance of the companies the government owns or has lent to. Among the most salient risks now are the possibilities that the

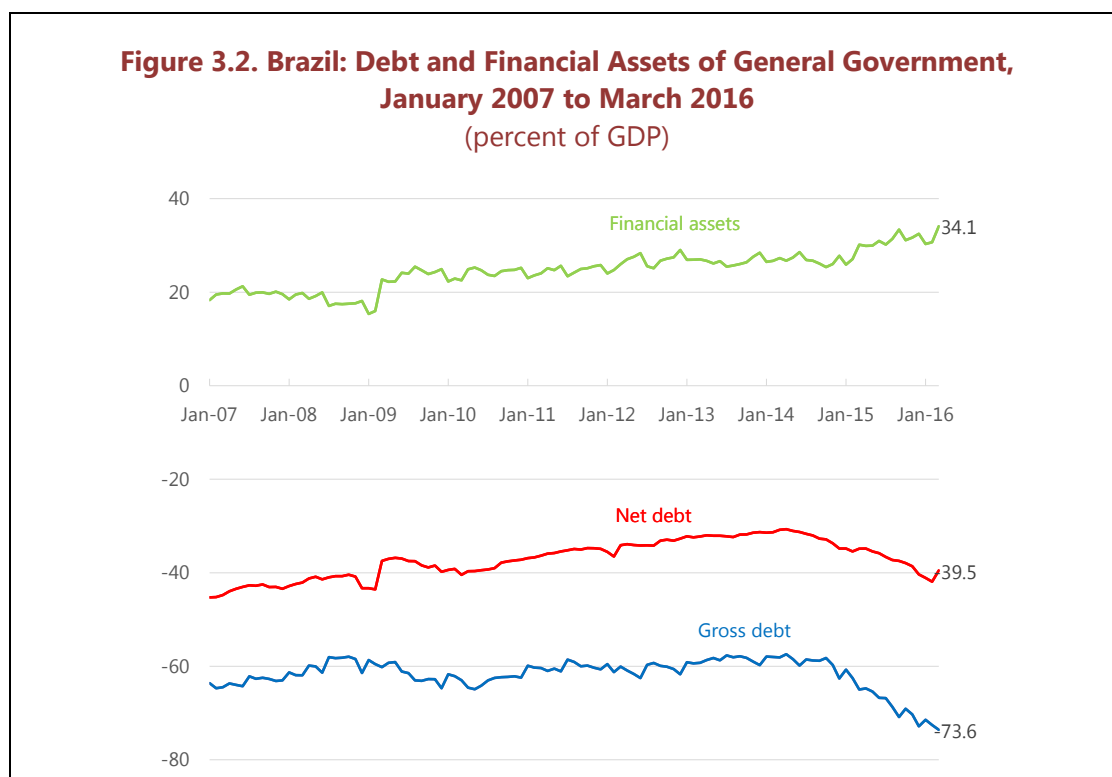
³⁵ See "Síntese da execução orçamentária – união – 2013" (p. 197, PCPR 2013), "Síntese da execução orçamentária – união – 2014" (p. 177, PCPR 2014), and "Execução orçamentária da despesa – poder executivo – 2015" (p. 309, PCPR 2015).

³⁶ The debt data are from the Central Bank's "Série Histórica da Dívida Líquida e Bruta do Governo Geral," available at <http://www.bcb.gov.br/htms/infecon/seriehistDLSPBruta2008.asp> (accessed May 30, 2016). This figure includes all government debt held by the Central Bank. If debt not pledged by the Bank as security in monetary policy operations is excluded, as in the government's measure, debt is 67.3 percent of GDP.

³⁷ These data exclude some liabilities and financial assets on which only less timely data are available (Table 0.2).

government will have to pay higher interest rates on its debt and that BNDES's creditworthiness will decline, reducing the value of the government's loans to the bank.

74. Government borrowing is authorized by law, and risks related to the government's debt and financial assets are disclosed. The statement of fiscal risks discusses risks related to the debt portfolio and the foreign reserves that are counted in the government's measure of net debt.³⁸ The credit risk of another portfolio of financial assets is reported in a separate section of the same document. Although these disclosures are useful, some of the details more properly belong in the notes to the government's financial statements or reports on debt management.



Sources: Central Bank, *Série Histórica da Dívida Líquida e Bruta do Governo Geral*.

Notes: The negative of debt and net debt are shown. Debt includes all government debt held by the Central Bank.

3.2.3. Guarantees (Good)

75. At the end of 2014, the total stock of recorded government guarantees was R\$ 224 billion (3.9 percent of 2014 GDP).³⁹ Much of this amount relates to borrowing by states, municipalities, and state-owned enterprises that is already included in headline measures of the debt of the public sector (as defined by the government); it does not represent an additional

³⁸ See also the discussion of risks in *Dívida Pública Federal: Relatório Anual*, 2015.

³⁹ *Contas da Presidenta*, 2014, Demonstrativo das Garantias Concedidas, p. 96. There are also more up-to-date reports on a narrower range of guarantees on the website of the National Treasury (<http://www.tesouro.fazenda.gov.br/-/operacoes-de-credito-contratacao-direta-e-concessao-de-garantias>), accessed June 4, 2016.

obligation. Guarantees given to parties whose debts are not included in the headline measures include export-credit guarantees and guarantees given to Eletrobras, Petrobras, and public banks.

76. Guarantees are disclosed, and their issuance is controlled by law. New guarantees, their beneficiaries, the stock of outstanding guarantees, and guarantee calls are disclosed in the annual *Accounts of the President* (Sections 1.9.2–5 in the 2014 accounts). Information on guarantees is also available in the quarterly *Reports on Fiscal Management*. Guarantees granted above the limits set by the Senate are null and void (FRL Art. 40(5)); for the federal government, the limit is 60 percent of net current revenues.⁴⁰

3.2.4. Public-Private Partnerships, Including Concessions (Not Met)

77. Public-private partnerships are widely used, especially concessions. In this report, the term *public-private partnership* is used to include concessions, in which users pay for the service, as well as projects in which the government pays; in Brazil, the term is often used more narrowly to refer only to the second kind of project. The World Bank's Private Participation in Infrastructure database includes 494 projects in Brazil's transport and water and sewerage sectors in the 20 years beginning in 1995.⁴¹ The total estimated investment in these projects is \$133 billion. The largest projects include the Rio de Janeiro, Guarulhos, and Brasilia airports; the Carajás railway; the Sao Paulo and Rio de Janeiro metros; and several toll roads. Brazil's concessions transfer most ordinary risks to the concessionaire, though the government bears risks related to changes in government policy, force majeure, and extraordinary economic changes.⁴² The government also bears risk indirectly through its ownership of BNDES, which provides much of the projects' financing. Projects in which governments pay for the service typically involve fairly predictable payments, but the debt-like obligation to make these payments reduces the governments' flexibility to deal with adverse economic shocks.

78. Public-private-partnership contracts are published and government payments are restricted by law, but no report summarizes the government's total obligations. In some respects, there is considerable transparency about public-private partnerships: in contrast to the case of many countries, the contracts themselves are generally available on the websites of the contracting agencies.⁴³ Yet, summary information on governments' rights and obligations in all

⁴⁰ Senate Resolution 48 of 2007, Art. 9.

⁴¹ The database is available at <http://ppi.worldbank.org/customquery> (accessed May 31, 2016). The projects counted here are those described as concessions and greenfield projects. Projects described as divestitures, management contracts, and lease contracts are excluded.

⁴² Cesar A. Guimarães Pereira, "Public-Private Partnerships (PPPs) and Concessions of Public Services in Brazil," *BRICS Law Journal*, Volume 1, Issue 1, 2014, pages 38–39.

⁴³ Transport concessions, for instance, are available on the website of the National Land Transport Agency (Agência Nacional de Transportes Terrestres) (<http://www.antt.gov.br/index.php>), accessed on May 31, 2016.

public-private partnerships is unavailable, and the projects are not recorded on the contracting governments' balance sheets. The off-balance-sheet assets and liabilities are estimated to be about 5 percent of GDP.⁴⁴ Total government payments in public-private partnerships are limited by law to 1 percent of government revenue in the case of the federal government, and 5 percent in the case of subnational governments.⁴⁵

3.2.5. Financial Sector (Not Met)

79. The risks created by banks are, as in most countries, among the most important. In March 2016, the aggregate liabilities of all financial institutions supervised by the Central Bank were R\$ 7,673 billion (130 percent of 2015 GDP) (Table 3.3).⁴⁶ This amount includes the abovementioned 8.5 percent of GDP that BNDES owes the government. Private banks' liabilities are not guaranteed by the government, but the liabilities may benefit from some degree of implicit support.⁴⁷ Up to certain limits, bank deposits are guaranteed by the Credit Guarantee Fund (*Fundo Garantidor de Crédito*), which is not government-guaranteed, but is too small to deal with the failure of a large bank or a systemic banking crisis. In addition, the treatment of banks' deferred-tax assets creates an explicit contingent liability for the government: if a bank is unprofitable, is liquidated, or becomes bankrupt, its deferred-tax assets are converted into tax credits, and, if the value of these credits exceeds the taxes owed by the bank, the government pays the bank the difference.⁴⁸ On December 31, 2015, the six largest banks had deferred-tax assets of R\$ 233 billion (3.8 percent of 2015 GDP).

⁴⁴ Based on the mission's estimates derived from the projects in the World Bank database with many simplifying assumptions.

⁴⁵ See the law on the public-private partnerships (No. 11,709 of 2005).

⁴⁶ Central Bank database, "Dados Selecionados de Entidades Supervisionadas - IF.data," available at <https://www3.bcb.gov.br/informes/relatorios> (accessed May 30, 2016). The aggregate is the simple sum of the liabilities of the six kinds of financial institution shown in the database.

⁴⁷ For instance, Moody's December 2015 rating of the private bank Bradesco assumes "a high likelihood of government support" for the bank. More generally, the April 2014 edition of the IMF's *Global Financial Stability Report* shows that credit ratings and bond spreads suggest that large banks in advanced economies and emerging markets still benefit from important implicit guarantees.

⁴⁸ The deferred-tax assets arise because provisions for loan losses are not tax-deductible and an expense will only be recognized for tax purposes if the borrower defaults on the loan. Since deferred tax assets that pertain to loan-loss provisions are a contingent liability for the government, they are not deducted from common equity tier 1 capital. Thus, an effect of the law change is to allow banks to report higher capital-asset ratios. See Law No. 12,838 of 2013 and Basel Committee on Banking Supervision, *Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III Regulations in Brazil*, December 2013, pp. 2, 22.

Table 3.3. Brazil: Liabilities of Financial Institutions, March 31, 2016

Liabilities	Amount in percent of 2015 GDP
Total	130.0
of which deposits	35.4
of which guaranteed	17.1
of which owed by public banks	61.7
Sources: Central Bank, Selected Information on Supervised Institutions; Credit Guarantee Fund (<i>Fundo Garantidor de Créditos</i>), Annual Report, 2015, p. 13 (guaranteed deposits); IMF WEO database, April 2016, for GDP.	
Notes: The figures for deposits are for December 31, 2015.	

80. The Central Bank thoroughly analyzes and monitors the banking sector. Bank supervision is well regarded, and banks' capital exceeds regulatory minimums. The IMF Staff Report for the Article IV Consultation completed in March 2015 noted that "banking system soundness indicators" were "encouraging," and the Central Bank recently concluded that "the solvency of the banking system remained at a high level in the second half of 2015."⁴⁹ Banks' capital ratios exceed regulatory requirements for both private and public banks.⁵⁰ Nevertheless, regulatory minimums do not eliminate fiscal risks, and the continuing recession is creating increasingly severe problems for many bank borrowers.⁵¹

81. Fiscal risks from public banks need to be closely monitored given their large size and exposure of the federal government. They have aggregate liabilities of R\$ 3,641 billion (61.7 percent of 2015 GDP), 95 percent of which is owed by Banco do Brasil (BB), Caixa Econômica Federal (Caixa), and BNDES, respectively the first, second, and fourth largest banks in Brazil by liabilities.⁵² As noted above, in the case of BNDES, much of the liabilities are owed to the government, which has made substantial investments in the bank in recent years to allow it to expand. The federal government explicitly stands behind the liabilities of both BNDES and Caixa,⁵³ which unlike BB are wholly government owned. The government has also established a

⁴⁹ Central Bank, *Relatório de Estabilidade Financeira*, April 2016, p. 31.

⁵⁰ Central Bank, *Relatório de Estabilidade Financeira*, April 2016, p. 31 (and Section 2 generally).

⁵¹ Central Bank, *Relatório de Estabilidade Financeira*, April 2016, p. 29.

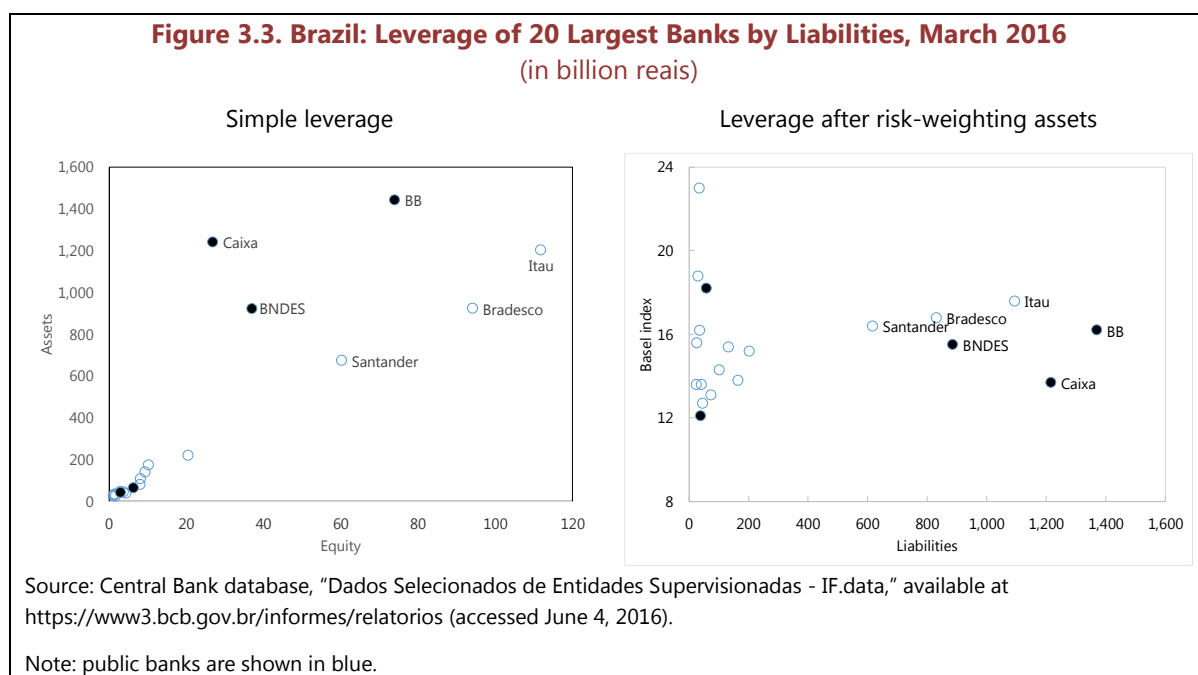
⁵² Central Bank, *Dados Seleccionadas de Entidades Supervisionadas*, data for March 2016. Data are also available in the Ministry of Planning's 2015 report *Perfis das Empresas Estatais 2014*, p. 309, but the most recent data are for 2012.

⁵³ BNDES, *Individual and Consolidated Financial Statements, December 31, 2015 and 2014*, p. 157. BNDES's liabilities are said to be the responsibility of the federal government because BNDES is entirely controlled by the federal government. This suggests that Caixa's liabilities, at least, are also government-guaranteed.

bad bank, Empresa Gestora de Ativos (EMGEA), which bought bad loans from Caixa with a face value of about RS 7 billion from it as recently as 2014.⁵⁴

82. Using the public banks to carry out government policy has generated fiscal risks.

They have all reported profits in recent years, and some of their lending is less risky than that of the private banks. Their nonperforming loans are low, albeit increasing.⁵⁵ But they also carry out public policy and make some high-risk loans, for example to municipalities and the rural sector. Because the interest rates they charge do not reflect these risks, some form of federal government support is probably necessary for them to achieve their policy objectives.⁵⁶ The public banks are also more leveraged than their private counterparts (Figure 3.3), in part because the government has asked them to expand their operations while also taking dividends from them to increase the reported primary surplus.⁵⁷ Overall, the combination of large liabilities, low equity, and rapid public-policy-driven expansion in a weak economy suggests important fiscal risks.



⁵⁴ See note 8 (i) of the auditor's report http://www.caixa.gov.br/Downloads/caixa-demonstrativo-financeiro/NE_BrGaap_3T14_voto_ingles_COMPLETA.pdf.

⁵⁵ Central Bank, *Relatório de Estabilidade Financeira*, April 2016, including Fig. 2.3.6.

⁵⁶ Caixa also funds itself through deposits with capped interest rates which helps its profitability, but this type of financing is being gradually replaced by sources bearing higher interest rates.

⁵⁷ José Roberto Afonso and Gabriel Leal de Barros, *Receitas de Dividendos, Atipicidades e (Des) Capitalização*, FGV-IBRE, April 2013.

83. The central government does not disclose its contingent liabilities related to BNDES, Caixa, and deferred-tax assets. The Central Bank's comprehensive, twice-yearly reports on financial stability present numerous indicators of the soundness of the financial sector, including the results of stress tests that estimate the effect of various shocks on banks' finances.⁵⁸ The Central Bank's website includes comprehensive, easily accessed data on banks' finances, which is also very timely. The most recent statement of fiscal risks also briefly discusses the risk that the government will need to recapitalize public banks. Management of the fiscal risks created by banks, including mechanisms for the resolution of any crisis, may warrant closer coordinated attention by the Central Bank and the Treasury—recognizing that the Central Bank has the expertise to monitor the risks but the Treasury must manage the fiscal consequences of possible problems.

3.2.6. Natural Resources (Not Met)

84. Natural resources have recently become more important for the public finances. In 2005, the World Bank estimated that Brazil had about \$15,000 in natural capital *per capita* (the 26th highest out of 152 countries), most of it in pasture, crops, and forests.⁵⁹ Since then, the volume of known oil and gas reserves has increased by 42 percent.⁶⁰ In 2014, it was reported to be 15 billion barrels, or 0.9 percent of the world's total (by comparison, Brazil's share of the world population is 2.8 percent). The value of these resources has of course declined with the recent fall in the price of oil. The federal government has a direct stake in the government's natural resources through its ownership of Petrobras and its receipt of royalties, but the fiscal importance of natural resources arises mainly indirectly, through general tax revenues. For some state governments, including Rio de Janeiro, commodity-linked royalties and indirect revenues are a particularly important source of revenue.

85. The government publishes a great deal of information on natural resources, though not the value of reserves of oil or mineral reserves. In the oil and gas sector, for example, ANP (the National Agency of Petroleum, Natural Gas, and Biofuels) publishes an annual statistical report that details the country's oil and gas reserves and production, prices, and other information on the sector. It also publishes extensive information on royalties and other government revenues linked to the sector.⁶¹ However, it does not provide an assessment of the value of hydrocarbon reserves. Similarly, Brazil also provides information on other mining activities, including data on production and reserves for key products, as well as royalties. The information on prices is more limited.

⁵⁸The most recent is the *Relatório de Estabilidade Financeira* in Vol. 15. No. 1, April 2016. See in particular Chap. 2.

⁵⁹ See <http://data.worldbank.org/data-catalog/wealth-of-nations> (accessed May 31, 2016).

⁶⁰ See U.S. Energy Information Administration data available at <http://www.eia.gov/cfapps/ipdbproject/iedindex3.cfm?tid=5&pid=57&aid=6&cid=regions&syid=2010&eyid=2014&unit=BB> (accessed June 2, 2016).

⁶¹ See <http://www.anp.gov.br/?pg=82260> and <http://www.anp.gov.br/?id=518> (accessed August 8, 2016).

3.2.7. Environmental Risks (Basic)

86. Droughts and other environmental problems frequently affect public finances. Most recently, the 2014–16 drought caused losses for Eletrobras and thus the government, as well more generally hurting the economy. In 2015, the collapse of the Samarco dam devastated some of the surrounding areas. Floods are also common. Diseases create additional risks, as the recent outbreak of the Zika virus has underscored. Earthquakes, tsunamis, and volcanic eruptions, by contrast, are rare. Although natural disasters can have a severe effect on particular areas, the size of the country means that their effect on public finances at the national level is mitigated. The 2015 edition of the *World Risk Report* ranked Brazil 123rd out of 171 countries in terms of exposure to risk to natural disasters (where a high ranking indicates high risk).

87. The government has published extensive information on natural disasters, though not much on their possible fiscal costs. The statement of fiscal risks does not mention environmental risks. Nor does any other government report routinely discuss their possible fiscal implications. The government has, however, published extensive information on natural disasters and industrial accidents, and their human and economic costs.⁶²

3.3. Fiscal Coordination

3.3.1. Subnational Governments (Good)

88. Several states and municipalities are financially troubled. A few are no longer servicing debts to the federal government that were contracted after they were bailed out following an earlier crisis in the late 1990s. Some are not fully paying wages and salaries. Rio de Janeiro missed payments to the Agence Française de Développement and the Inter-American Development Bank in early 2016.⁶³ The underlying causes of the states' problems include falling revenue, especially in commodity-dependent states like Rio, and rising salary and pension costs.

89. Congress is debating a proposal to restructure states' debt with the federal government. Subnational debt is about 13 percent of GDP. For states the amount was 11 percent of GDP at the end of 2015,⁶⁴ and for municipalities it was 1.8 percent of GDP at the end of September 2015. Three-quarters of municipal net debt is owed by the city of Sao Paulo.⁶⁵ Most subnational debt is owed to the federal government; debt to parties outside general government is

⁶² See *Anuário Brasileiro de Desastres Naturais*, 2013; *Understanding Risk, Entendendo Risco Brasil*, 2012; and other information available at <http://www.mi.gov.br/defesacivil/publicacoes>.

⁶³ "Brazil Mulls Emergency Loan to Rio de Janeiro ahead of Olympics," Reuters, June 9, 2016.

⁶⁴ National Treasury, *Indicadores Fiscais dos Estados*, available at http://www.tesouro.fazenda.gov.br/pt_PT/indicadores-fiscais-e-de-endividamento (accessed May 30, 2016). Data for Paraná, Rio Grande do Sul, and Sergipe are for August 2015 and, for Mato Grosso do Sul, April 2015.

⁶⁵ National Treasury, *Indicadores Fiscais dos Municípios*, available at http://www.tesouro.fazenda.gov.br/pt_PT/indicadores-fiscais-e-de-endividamento (accessed May 30, 2016).

4.1 percent of GDP.⁶⁶ States have asked for some debt relief from the federal government. The option being considered in Congress involves an extension in maturities and some relief in debt service over the next years.

90. Information on the finances of the larger subnationals is available, some of it monthly or quarterly, and subnational borrowing is limited by law. The FRL requires subnational governments to publish quarterly information on their finances (Articles 54–55) and some also publish monthly data. Summary information, including some aggregate or consolidated data, is available from the Central Bank and the National Treasury.⁶⁷ States are required to keep the ratio of their net debt to their net current revenue below 2, and municipalities are required to keep the ratio below 1.2. Subnational spending on personnel is limited to 60 percent of net current revenue.⁶⁸ The adjustment programs between the federal government and states impose additional, generally tighter, limits.

91. Yet there are serious problems with the management of subnational risks, including weaknesses in the quality of fiscal reporting and monitoring.

- The debt limits in the adjustment programs have not always been enforced, partly because the parallel existence of the looser limits under the FRL has undermined them in practice. In addition, some states were allowed to increase their borrowing, with guarantees of the federal government, despite technical assessments that highlighted the risks.
- Weaknesses in fiscal reporting also undermine the ability to assess the fiscal position and risks. Not all states and municipalities comply with their reporting obligations, and information on subnational finances is generally less timely and comprehensive than information on the central governments. The lack of a fiscal council, as envisaged in the FRL, makes it more difficult to ensure that governments implement appropriate reporting standards and that there is effective monitoring of fiscal statistics at all levels of government.⁶⁹
- A key weakness is the reporting on the wage bill, the most important spending item. Personnel spending is measured in different ways in different states (Annex 3), allowing

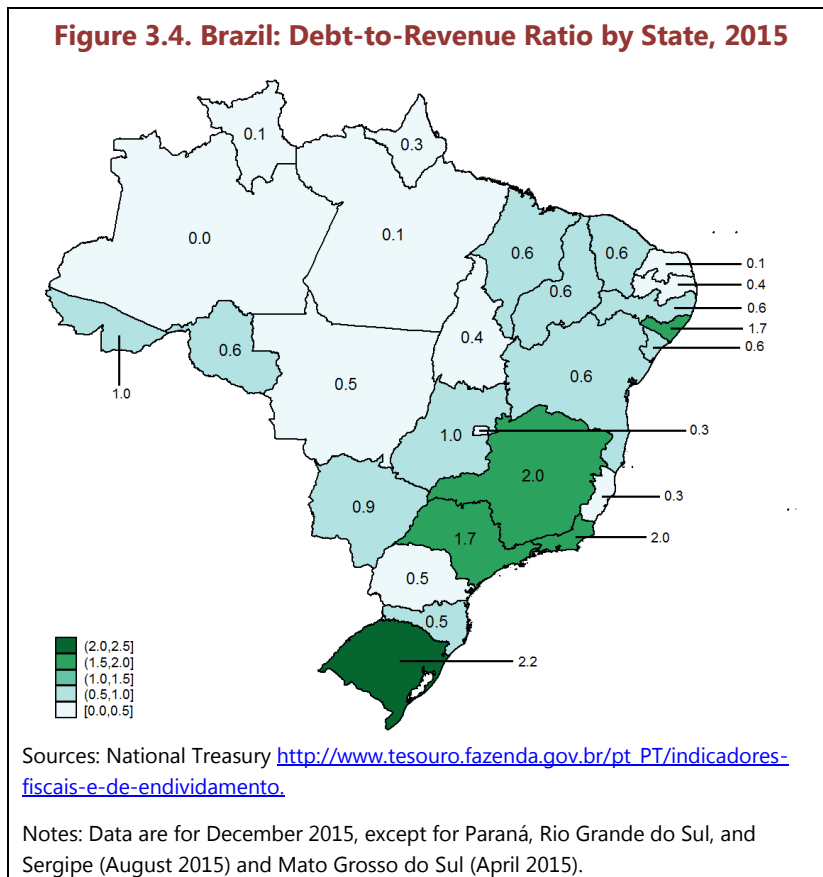
⁶⁶ BCB's *Série Histórica da Dívida Líquida e Bruta do Governo Geral*.

⁶⁷ *Indicadores Fiscais e de Endividamento de Estados e Municípios; Boletim de Finanças Públicas dos Entes Subnacionais; Balanço do Setor Público Nacional*.

⁶⁸ See FRL, Articles 19 and 30, Resolution of the Federal Senate no. 40 of 2001, and, more generally, the National Treasury's webpage "*Indicadores Fiscais e de Endividamento de Estados e Municípios*," http://www.tesouro.fazenda.gov.br/pt_PT/indicadores-fiscais-e-de-endividamento (accessed May 30, 2016).

⁶⁹ The recently created Independent Fiscal Institution by the Federal Senate (November 2016) will not have the mandate or capacity to do such functions.

some to circumvent the limit on such spending.⁷⁰ At the end of 2015, six states had in any case breached the limit (Rio Grande do Sul, Mato Grosso do Sul, Minas Gerais, Paraíba, Goiás, and Rio de Janeiro). Rio Grande do Sul had also breached the debt limit, and Rio de Janeiro and Minas Gerais were close to doing so. Moreover, even when these limits are observed, they have not prevented serious financial problems. Arrears have been reported in Amapá, Amazonas, and Roraima, which, like other states in the north, had very low reported debt (Figure 3.4).⁷¹ In some cases, borrowing rules have exacerbated liquidity problems by limiting borrowing even for government with low debts.



⁷⁰ National Treasury, *Boletim das Finanças Públicas dos Entes Subnacionais*, May 2016, p. 15.

⁷¹ "Gastos com folha de pagamento extrapolam limite dos Estados", *O Estado do São Paulo*, April 30, 2016.

3.3.2. Public Corporations (Good)

92. Public corporations create significant risks. The three federal public banks discussed in Subsection 3.2.5 are the ones with the largest liabilities (Figure 3.5), some of which, as noted above, are owed to the central government. The smaller nonfinancial corporations are consolidated in the accounts of the public sector (as defined in Brazil), so the risks associated with their borrowing are monitored as part of the budget process. The Post Office has nevertheless experienced financial problems, partly because of its pension scheme.⁷² The biggest risks associated with nonfinancial corporations, however, relate to Eletrobras and Petrobras, which are not consolidated in the fiscal accounts.⁷³ They have gross liabilities of 1.9 percent and 11.4 percent of GDP, respectively. Petrobras—where net debt almost quadrupled since 2011—is financially stressed, in part because of corruption, but mainly because of its quasi-fiscal activities (principally, selling petrol at less than the market price)⁷⁴ and heavy borrowing during the oil price boom to pay for the development of the pre-salt oil fields (Box 2). Eletrobras is also financially stressed, partly because of its obligations to provide subsidized public services without compensation (that is, quasi-fiscal activities), though it also suffered from the above-mentioned drought and possibly also corruption. Both companies are highly leveraged, and both are viewed by credit-rating agencies as benefitting from implicit government guarantees.⁷⁵ Another area of concern is the high degree of exposure of public banks to these companies.⁷⁶

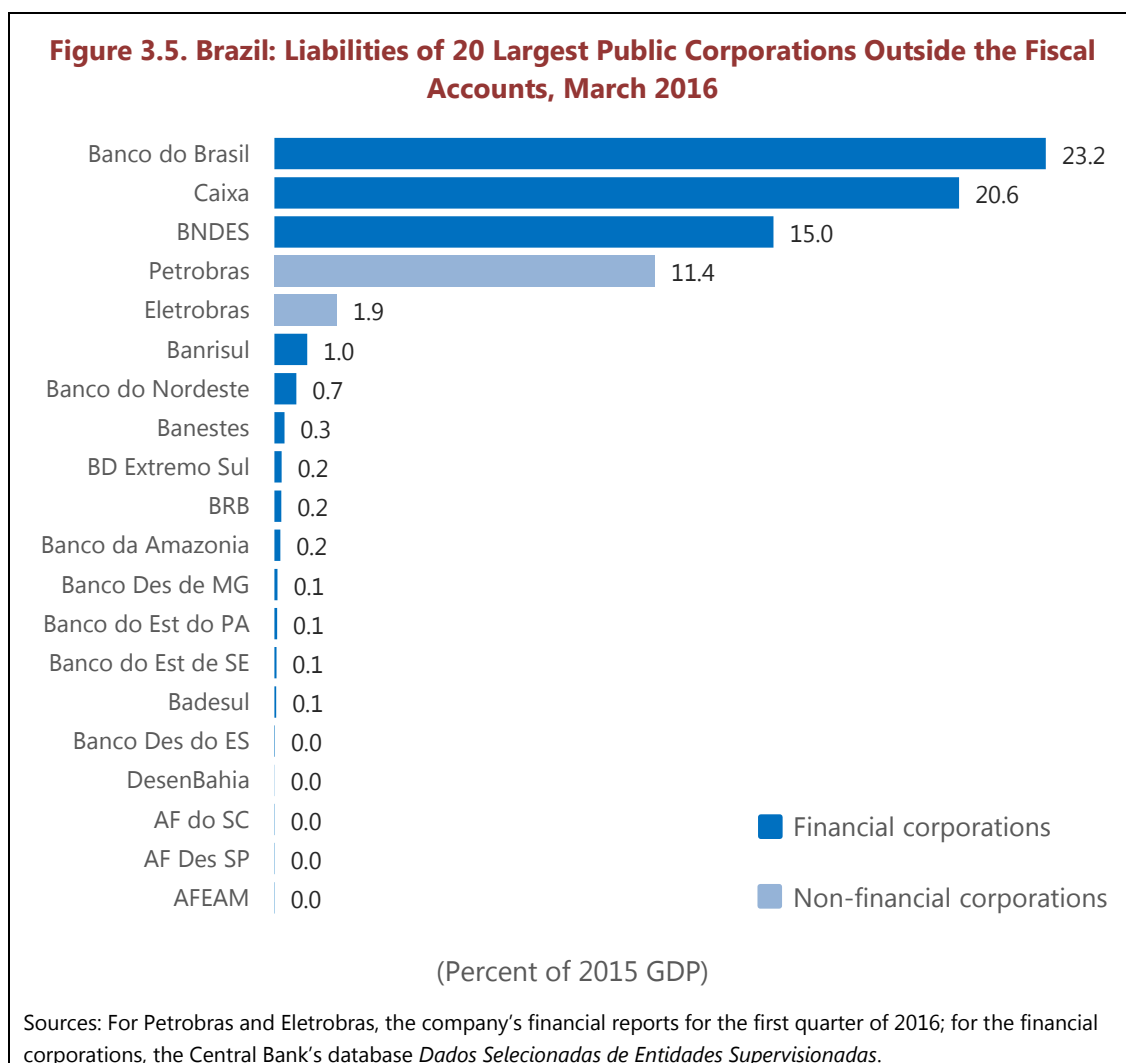
⁷² The Post Office's accounts for 2014 show that, although the company has very little debt (narrowly defined), it has post-employment liabilities of R\$ 8 billion and total liabilities of R\$ 14 billion (0.2 percent of GDP). The company reported negative comprehensive income for the year because of an increase in the post-employment liability.

⁷³ There may also be some implicit fiscal risks related to private companies like Vale over which the government exercises an important influence that falls short of control.

⁷⁴ See, e.g., International Budget Partnership, *The "State-of-the-Art" of State-Owned Enterprises in Brazil*, June 2014, pp. 17–18.

⁷⁵ On February 17, 2016, Standard and Poor's assessed the likelihood of extraordinary support for Eletrobras and Petrobras and "almost certain" and "very high," respectively ("Diversas ações realizadas nos ratings de empresas brasileiras após o rebaixamento nos ratings do Brasil"). Moody's December 2015 credit ratings assume a "high" level of support for Eletrobras and a "moderate" level of support for Petrobras.

⁷⁶ For example, BNDES exposure to Petrobras exceeded prudent limits and the bank has been gradually reducing its exposure.



93. Transfers between the government and public corporations are disclosed, and the government publishes an annual report on the corporations' finances. The annual report and accompanying website produced by the Ministry of Planning and Budget, include information not only on the companies the ministry supervises but also on those supervised by the Treasury. The report contains a discussion of the sector, data on the finances of each of the corporations, and aggregate data on the finances of all nonfinancial public corporations and all financial public corporations. The report is not very timely, but the corporations themselves publish their own financial statements in generally a timely manner. The government has published a series of directives setting out aspects of its ownership policy.⁷⁷

⁷⁷ See the resolutions of CGPAR (Comissão Interministerial de Governança Corporativa e de Administração de Participações Societárias da União) on state enterprises, available at <http://www.planejamento.gov.br/assuntos/empresas-estatais/legislacao/resolucao>.

94. Yet there is no disclosure of the quasi-fiscal activities of public corporations. Given the size of these activities and their complexity in the case of public banks, this is a significant shortcoming. Moreover, although the financial reports of the major companies are generally detailed, informative, and timely, investigations of corruption at Eletrobras have delayed the publication of its financial statements. The audit opinion on BNDES' most recent accounts was qualified because BNDES did not recognize in its income statement its full loss on its shares in Petrobras. Furthermore, Petrobras' report states that the company's problems with internal financial controls are not yet solved, which also caused the delay of its previous annual report.

Conclusions and Recommendations

95. Table 3.3 summarizes the assessment of Brazil's practices in the area of fiscal risks and reveals a number of strengths. It shows that Brazil meets the standard of good or basic practice on 7 of the 12 principles. In particular, good information is available on government guarantees, the governments' financial assets and liabilities, and the finances of subnational governments and public corporations. Statistics on subnational government and the coverage of the statement of fiscal risks have both improved in the past year, and Brazil's performance against the code could be improved fairly easily by further increasing the scope of the statement. In the areas of environmental risks, natural resources, and public-private partnerships (including concessions), Brazil could meet at least the standard of basic practice by adding to the statement brief discussions of the relevant risks.

96. Nevertheless, the disclosure and management of fiscal risks are the weakest area of fiscal transparency in Brazil. The statement of fiscal risks should focus on large risks and their possible effects on the deficit, the debt, and other fiscal aggregates. To achieve this objective, it needs to be transformed. At present, it is a collection of largely unrelated and sometimes excessively detailed discussions of various fiscal issues, some of them relatively minor, which reflects the absence of centralized monitoring and analysis of the risks that the government faces. The statement should become a report that explains clearly and concisely how and why fiscal outcomes could differ from fiscal forecasts. Producing a shorter, simpler, and better integrated statement would require more analysis and more synthesis of existing information. The necessary work could be led by a risk group that would also assess whether the government was managing fiscal risks adequately.

97. Dissemination of long-term fiscal projections in a separate report is a high priority. Building on the existing projections for pensions and social security, this report could project the government's primary balance, nominal balance, and debt over a period of at least 10 years—and ideally much longer. It would assume the continuation of current tax and spending policies, and its purpose would not be to predict the future, but to give the best possible estimate of whether the government's policies were sustainable in the long term. This would help the public better assess the sustainability of Brazil's fiscal position, and it would help policymakers prepare for indispensable reforms. Brazil's high level of public debt and large expected increases in age-related spending make it urgent, from a transparency perspective, to undertake such projections

and to disseminate them. To complement these projections, the government should also take advantage of its fiscal policy statement to indicate the steps it intends to take in the medium term to slow and eventually reverse the growth of public debt (Section 2).

98. The fiscal significance of federal public banks deserves additional disclosures. The relationships between the banks, general government, and the rest of the public sector are large enough to warrant not only additional discussion in the statement of fiscal risks, but also a new chapter in the annual report on public corporations (or a separate publication). This chapter or publication would detail the financial relationships between the government and each of these banks and between the banks and the rest of the public sector. The government should also disclose and quantify the quasi-fiscal activities of the banks, Eletrobras, and Petrobras.

99. Based on the above assessment, the evaluation highlights the following priorities for improving the transparency of fiscal risk disclosure and management:

- **Recommendation 3.1. Create a risk group to provide a centralized overview of fiscal risk management (identify, monitor, and mitigate).**
- **Recommendation 3.2. Improve the disclosure of fiscal risks in budget documents:**
 - a. Present in the statement of fiscal risks a comparison of past forecasts with fiscal outcomes (April 2017) and then develop fan charts based on stochastic analysis (2018 or 2019)—in both cases to give an indication of the extent of fiscal uncertainty;
 - b. Ensure that sensitivity analyses show the effect of the changes in the underlying assumptions on total government spending and revenue, the primary and nominal balances, and government debt (April 2017) and, in the longer term, present more fully worked out alternative scenarios (April 2018);
 - c. Add disclosures of the government’s explicit support of the financial sector and of the risks related to public corporations and subnational governments (April 2017);
 - d. Ensure that all sections of the statement make clear how the risks under discussion relate to the budget and medium-term fiscal forecast (April 2017); and
 - e. Include in the annual report on public corporations produced by the Ministry of Planning and Budget, in collaboration with the National Treasury, a chapter on the financial relationships of the government with each of the federally-owned banks and on the quasi-fiscal activities carried out by the banks and other public corporations (2017).

- **Recommendation 3.3. Improve reporting on the long-term sustainability of public finances:**
 - a. Publish a periodic report on the long-term sustainability of public finances that includes projections of the government's primary and nominal balances and debt, under current government policy, over the next 20 years at least;
 - b. Expand long-term sustainability analyses of the social security and public pension schemes provided in the PLDO with further sensitivity analyses and alternative scenarios; expanding the methodology to include pension funds not yet covered, such as pension funds of public enterprises; and including projections of expected increases in health care expenditure; and
 - c. Complement the fiscal policy statement (Section II) with a section on the policy changes envisaged in the medium term by the government to improve Brazil's long-term fiscal sustainability.

Table 3.4 Brazil. Summary Evaluation: Fiscal Risks

	Principle	Assessment	Importance	Rec
3.1.1	Macroeconomic Risks	Basic: The macroeconomic forecast is accompanied by some sensitivity analysis, and only one alternative scenario.	High: Macroeconomic volatility has large effects on revenue and expenditure, exposing the budget to high uncertainty.	3.2.a
3.1.2	Specific Fiscal Risks	Basic: Budget documentation discusses and quantifies several specific risks, but is not comprehensive, and the link between risks and forecasts is often unclear.	Medium: Several specific risks are important, including explicit and implicit guarantees of public corporations (see below).	3.2.a
3.1.3	Long-Term Fiscal Sustainability	Not met: Long-term projections are published for social security and public pensions, but not for the government's debt and deficit.	High: Aging is putting pressure on medium- to long-term debt levels.	3.3.a, b
3.2.1	Budgetary Contingencies	Good: The budgetary contingency can be used at the discretion of the Executive to meet unforeseen expenditures.	Low: The 2016 LOA set a maximum ceiling of 1 percent of net revenue and the reserve has not been used during fiscal years 2013 to 2015.	
3.2.2	Asset-and-Liability Management	Good: Borrowing is controlled by law, and risks related to debt and financial assets are discussed in, among other places, Annex V of the LDO.	High: Debt of general government is 74 percent of GDP and rising rapidly. Interest rates and refinancing needs are high.	
3.2.3	Guarantees	Good: Guarantees are disclosed in the <i>Contas da Presidenta</i> , among other places, and the stock of guarantees is subject to a legal limit.	Low: Guarantees (4 percent of GDP) are mainly for entities whose debt is already included in the headline measure of public debt.	
3.2.4	Public-Private Partnerships	Not met: Contracts are published and there are limits on government payments, but no summary disclosure of the government's rights and obligations.	Low: Total off-balance-sheet liabilities are estimated to amount to about 5 percent of GDP.	
3.2.5	Financial Sector	Not met: The Central Bank discusses the risks of the sector and reports stress tests, and budget documentation discusses public banks, but government backing of wholly owned banks' liabilities is not disclosed.	High: Banks have aggregate liabilities of 130 percent of GDP; public banks are large, highly leveraged, and used for policy.	3.2.a, b
3.2.6	Natural Resources	Not met: Much information is published annually or more frequently but not the estimated value of natural resources.	Medium: Natural resources, including oil and iron ore, have an important, mainly indirect effect on public finances, especially those of some subnationals.	
3.2.7	Environmental Risks	Basic: Extensive information on natural disasters has been published, though not with a focus on possible fiscal costs.	Low: Fiscal vulnerability at the national level to environmental risks appears relatively low.	
3.3.1	Subnational Governments	Good: Many but not all subnationals publish quarterly financial data. The Treasury and Central Bank publish summaries and aggregate data. Debt is regulated, but not always effectively.	Medium: The gross debt of subnational governments is about 13 percent of GDP, most owed to the federal government. Many states are financially distressed.	3.2.a
3.3.2	Public Corporations	Good: The budget includes transfers to and from public corporations, and an annual report on the sector is published, but there is no report on quasi-fiscal activities.	Medium: The liabilities of Eletrobras and Petrobras are 13 percent of GDP (see 3.2.5 for public banks). Both companies are financially stressed.	3.2.a,b

Annex 1. Fiscal Transparency Action Plan

Recommendation/Action	2016	2017	2018	2019	2020	Responsible Agency
1.1: Expand the institutional coverage of fiscal reports						
Expand the institutional coverage of fiscal reports to incorporate all public corporations and provide an overview of the fiscal performance of the entire public sector	Consolidate all missing units (Sistema S, Conselhos Profissionais, Reclassified PCs) into CG fiscal statistics	Consolidate Petrobras and Eletrobras into nonfinancial PS (incomplete) fiscal statistics	Consolidate BB, CEF, BNDES, and BCB into PS (incomplete) fiscal statistics	Consolidate remaining nonfinancial public corporations into PS (incomplete) fiscal statistics	Consolidate remaining financial public corporations into PS fiscal statistics	
1.2: Expand the coverage of balance sheets and flow statements						
a. Expand the coverage of balance sheets to reflect the full market value of government infrastructure, subsoil assets, and pension entitlements of all government employees		<ul style="list-style-type: none"> - Estimate pension entitlements of military and subnational RPPS based on actuarial studies - Recognize market value of government property holdings in GG balance sheet 	Adopt IPSAS 32-like recording of PPPs/concessions in accounting and statistics		Recognize subsoil assets in GG and PS balance sheet	
b. Recognize flows associated with missing assets and liabilities	Estimate annual accrual of pension liabilities to civil servants	Recognize annual accrual of pension liabilities to civil servants	Recognize flows associated with PPPs/concessions		Recognize depletion and valuation changes in subsoil assets	
1.3: Introduce reassurances of integrity in the compilation of fiscal statistics						
a. Setting up a permanent inter-agency committee for harmonized classifications in macroeconomic statistics	Sign MOU between STN, BCB, and IBGE.	<ul style="list-style-type: none"> - Hold first meeting of the permanent inter-agency committee (ordinary meetings on a quarterly basis; - Review the statistical treatment of relationship between federal government and PCs (nonfinancial and financial). 	Disclose information on quasi-fiscal activities (explicit and implicit, including subsidized lending).			

Recommendation/Action	2016	2017	2018	2019	2020	Responsible Agency
b. Record Treasury-Central Bank transactions according to best international practice	Recognize Treasury-BCB relationship in fiscal statistics, according to international standards	Revise all other fiscal reports, getting them in line with the fiscal statistics.				
c. Conducting regular consistency checks between different macroeconomic datasets		Develop data model to check consistency between GFS and BOP/IIP, and MFS	Implement consistency checks, and disclose summary results in the national publication of GFSY data			
d. Including reconciliations of key fiscal aggregates within and between the different fiscal reports.		<ul style="list-style-type: none"> - Include reconciliation between RTN and GFSY submission in the national publication of GFSY data - Include table with GFSM 2014 data in the RTN, including reconciliations table 	Include reconciliation between RTN and GFSY submission in the national publication quarterly GFS data	<ul style="list-style-type: none"> - Include reconciliation between BGU's main financial statements and GFSY submission in the national publication of GFSY data - Publish the RTN in full compliance with GFSM 2014 		
2.1. Publish a full-fledged medium-term fiscal policy statement						
a. Publish a fiscal policy statement to disclose the government's fiscal strategy for the budget year and the medium term and the fiscal space available to implement new policies.	Add to the Presidential message attached to the 2017 PLOA a concise (no more than a few pages) overall view of the government's economic and fiscal strategy for the medium term	Annex to the 2018 PLDO a full-fledged fiscal policy statement, including an overview of the government's economic and fiscal strategy for the medium term and a detailed presentation of the medium-term macroeconomic scenario and its alternatives				STN SOF

Recommendation/Action	2016	2017	2018	2019	2020	Responsible Agency
b. Develop a Medium-Term Budget Framework	- Prepare a first assessment of the medium-term expenditure baseline based on a bottom-up analysis of policies' costs - Evaluate multiyear commitments related to long-term contracts and investment operations	Develop an internal MTBF to prepare the 2018 PLDO	Publish a detailed and indicative MTBF as an annex to the 2019 PLDO	Submit to Congress approval, as part of 2020 PLDO documentation, a detailed MTBF setting mandatory budget ceilings to prepare the LOA		SOF STN
2.2. Create a fully functioning independent fiscal council						
a. Create a permanent independent institution to assess government's fiscal policies and performance, and promote sustainable public finances	Create a high-level group in charge of designing the independent institution	Integrate findings of the high-level group into the draft organic law for public finances	Operationalize the institution	Publish the institution's first reports		
b. Improve the credibility of the government's fiscal forecasts	Set up an internal working group in charge of reviewing the credibility of fiscal forecasts and compare the government's fiscal forecasts with the ones published by independent and/or market analysts in the Presidential message attached to the 2017 PLOA.	Compare the government's fiscal forecasts with the ones published by independent and/or market analysts as part of the fiscal policy statement Publish a comparison of previous forecasts with outturns and explain the gap between them.				SOF STN
2.3: Initiate a full review of the existing legal framework and prepare an organic budget law						
a. Consolidate the legal framework into a single law to increase the overall transparency of the budget process	Initiate a full review of the legal framework for public finances, including an analysis of its gaps with international standards and good practices	Prepare a draft organic law for public finances and submit it to an extensive public debate	Adopt the new legal framework			

Recommendation/Action	2016	2017	2018	2019	2020	Responsible Agency
3.1 Create a risk group to provide a centralized overview of risk management						
Create a risk group		Form risk group to improve management (identify, monitor, and mitigate) and disclosure of fiscal risks	Put the risk group in charge of preparation of statement of fiscal risks			MoF, Min Planning
3.2. Improve the disclosure of fiscal risks in the budget documents						
a. Enhance the contents of the statement of fiscal risks		<ul style="list-style-type: none"> - Include in the statement of fiscal risks (2018 LDO): <ul style="list-style-type: none"> (i) a comparison of past forecasts with fiscal outcomes (ii) sensitivity analyses on key fiscal aggregates. - Ensure all sections make clear how risks under discussion relate to the budget and fiscal forecasts 	<ul style="list-style-type: none"> - disclosure of the support for banks and risks from public corporations and subnationals - Include fan charts and fully developed alternative scenarios in the statement of fiscal risks (2019 LDO) 			SOF, STN
b. Improve the annual report on public corporations			Add to the annual report on public corporations a chapter on the financial relationships of the government with federally owned banks and on the quasi-fiscal activities			DEST, STN

Recommendation/Action	2016	2017	2018	2019	2020	Responsible Agency
3.3. Improve reporting on the long-term sustainability of public finances						
a. Publish a periodic report on the long-term sustainability of public finances		Add to the Presidential message attached to the 2018 PLOA a section on long-term sustainability of public finances, including a projection of the government's debt under current government policy over the next 10 years at least	<p>Attach to the 2019 PLDO a new full-fledged report on the long-term sustainability of public finances that includes projections of the government's primary and nominal balances and debt, under current government policy, over the next 20 years at least</p> <p>Complement the fiscal policy statement (see 2.1.) with a section on the policy changes envisaged in the medium term by the government to improve Brazil's long-term fiscal sustainability</p>			STN SOF
b. Expand long-term sustainability analyses of the social security and public pension schemes provided in the PLDO		Include new sensitivity analyses and alternative scenarios to the 2018 PLDO existing annexes on long-term projections of social security and public pensions schemes	<p>Attach to the 2019 PLDO a new report on long-term projections of health care expenditure</p> <p>Attach to the 2019 PLDO a new report on long-term projections of the fiscal impact of pension funds of public enterprises</p>			Ministry of Social Security STN SOF

Annex 2. Transactions Between the Treasury and Central Bank

The institutional relation between the Central Bank of Brazil (BCB) and the National Treasury is characterized by a number of distinctive features. Over the past decade, this particular setup interacted with external and domestic economic developments (e.g., exchange rate variations, fiscal deficits), resulting in sizable impacts on the balance sheets and fiscal flows of the two institutions. These include: (i) more than 20 percent of public debt now being issued for monetary policy purposes; (ii) the high balances of the government deposits at the Central Bank, which partly reflect large unrealized profits of the BCB; and (iii) the interest bill of the central government, which reflects costs of the BCB interventions in the foreign exchange markets.

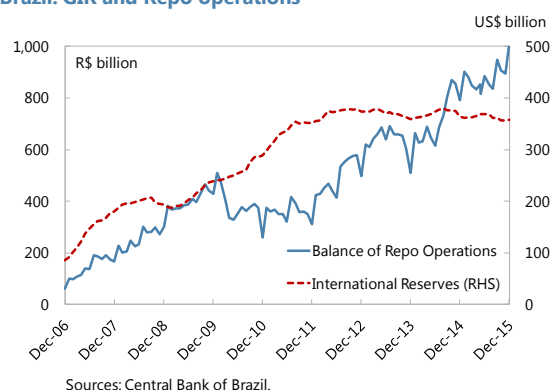
This complex relationship (Figure A2.1) and, in some cases, the accounting and statistical treatment, could be strengthened to improve transparency. This annex describes in more detail the operations and how they are recorded. While there is an ongoing debate on reforming the relationship between the Treasury and the BCB, policy issues are beyond the scope of this report.

The Relationship between the Treasury and Central Bank

Monetary and exchange rate policy and fiscal policy are the key drivers of the level and dynamics of public debt:

- The FRL prevents the BCB from issuing own debt securities, and the BCB has been using securities issued directly by the National Treasury for liquidity management. At end 2015, about 20 percent of public debt was used as collateral for repurchase agreements, or repos (*compromissadas*). The key drivers of the fast increase have been the sizeable reserve accumulation since 2006 and the high interest rates (BCB has to issue repos to absorb liquidity when it pays interests on the repos).
- The public sector debt statistics of the BCB consider the Central Bank to be part of the central government, a feature dating back to 1991—reflecting the legal framework in Brazil. Public debt securities held by the Central Bank under outright ownership are not considered as central government (or general government, GG) debt since 2008; only those that are used as collaterals for repos (*compromissadas*) are included in debt statistics. This contrasts with the treatment in the GFSM, where the Central Bank is considered a public financial institution, and, as such, its entire Treasury securities holdings are considered a liability of the GG.

Brazil: GIR and Repo operations



The gains and losses of the BCB have an asymmetric treatment. Losses are covered through bond issuances by the Treasury, while profits are credited into the TSA. The law also provides for the possibility to retain up to 25 percent of profits, which has been done occasionally (e.g., in 2013). The profits received by the Treasury are earmarked and can only be used to pay debt, preferably the debt held by the BCB. In addition, the results of the BCB are separated into those originating from foreign exchange operations and those resulting from other operations (Law 11.803, 2008), and the two are not consolidated.⁷⁸ This implies that in the same period, the Treasury may need to issue bonds to cover losses under one criteria and, at the same time, have profits credited in the Treasury Single Account (TSA).

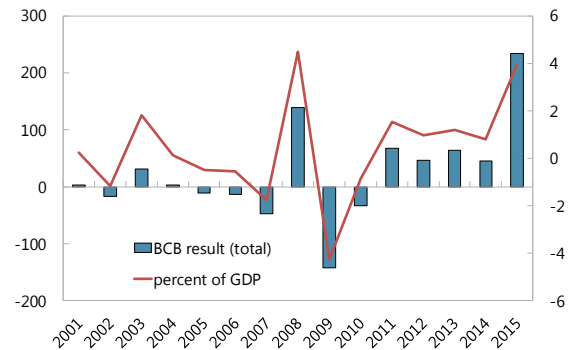
With the large foreign exchange (FX) reserves accumulation, the BCB's results have become more volatile over time. Since 2010, profits averaged about 1½ percent of GDP per year, a great part of it composed of volatile unrealized gains from the revaluation of FX assets. The large increase in government deposits at the Central Bank stems mainly from these accumulated (but unrealized) profits of the BCB. Moreover, government deposits, regardless of their origin, accrue interest remuneration (different from the remuneration of FX reserves) to the government, which is not earmarked.

The treatment of the transactions between the BCB and the Treasury also makes it difficult to assess the fiscal position and debt dynamics of the central government (CG). It could also hamper the BCB's capital position when unrealized profits are distributed.

- As discussed in more detailed below, many of the effects of the operations of the BCB are immediately reflected in the interest bill of the central government. This accounting of the BCB operations in Brazil makes it difficult to assess the individual fiscal situation of two very different units of the public sector, the CG and the Central Bank. For example, the BCB intervenes in foreign exchange markets, including through FX derivatives (commonly known as "FX swaps"). The cost (or gains) from the FX swaps are reflected monthly as net interest expenditure in the

Central Bank of Brazil: Profit/Losses

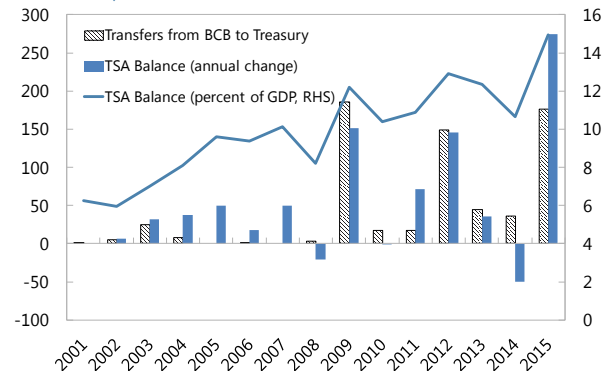
(R\$ billion and percent of GDP)



Sources: Central Bank of Brazil.

Balances of the Single Treasury Account

(R\$ billion and percent of GDP)



Sources: Central Bank of Brazil.

⁷⁸ Profits from both operations and from FX valuation average around 0.5 percent of GDP since 2008. However, profits from FX valuation are much more volatile, varying from plus 4 percent of GDP to -4 percent of GDP.

interest bill of the central government. This complicates the assessment of debt dynamics and the cost of public debt.⁷⁹

- The distribution of unrealized BCB profits also hinders the assessment of net debt dynamics of the central government. For example, net debt of the CG may fall sharply as cash deposits increase, thanks to the distribution of unrealized gains of the BCB. These operations thus result in fluctuations in the assets and liabilities of the CG that are not linked to changes in CG fiscal balances. This treatment of unrealized profits could also come at the expense of negatively affecting the capital of the BCB.^{80,81} Furthermore, the asymmetry between the instruments to compensate for losses (issuance of debt securities) and the absorption of gains (deposits in the TSA) have resulted in an increasing stock of gross government debt.
- The authorities are considering changes to the relationship between the Treasury and the Central Bank.

Transparency in the Fiscal Statistics

While the relationship between the Treasury and BCB is reflected in the different public reports, the treatment varies and tends to differ from international practices:

- The fiscal statistics in the Treasury reports (RTN) only present limited information on the impact of the transactions (e.g., interests paid by BCB on government deposits and transfers related to gains/losses of the FX derivatives). However, a memorandum table in the report presents more details on the accrual and transfers of BCB profits.
- The fiscal statistics reported by the BCB reflect the fact that the BCB is considered part of the CG. Most BCB operations are immediately reflected in the central government interest bill and not as non-interest transactions, according to international statistical standards (Table Annex 2.1). In addition, the transfer of unrealized gains/losses from exchange rate valuation associated with international reserves is treated as other economic flows.

⁷⁹ In 2015, the net exposure through FX swaps reached USD 110 billion, or about 30 percent of international reserves. The total cost of the FX swaps was 1½ percent of GDP. In 2016, the net FX exposure has been reduced to below USD 30 billion and the gains from FX swaps amounted to about 1⅓ percent of GDP (through mid-December).

⁸⁰ See “Profit Distribution and Loss Coverage Rules for Central Banks” by Brunea, Karakitsos, Merriman, and Studener, 2016, Occasional Paper, European Central Bank, and “Do Central Banks Need Capital?” by Peter Stella, 1997, IMF Working Paper.

⁸¹ It should be noted, however, that under law the Treasury has to compensate the BCB for any realized losses in order to protect the BCB’s capital.

Annex 2. Table A2.1. Treatments of BCB Results in Fiscal Statistics

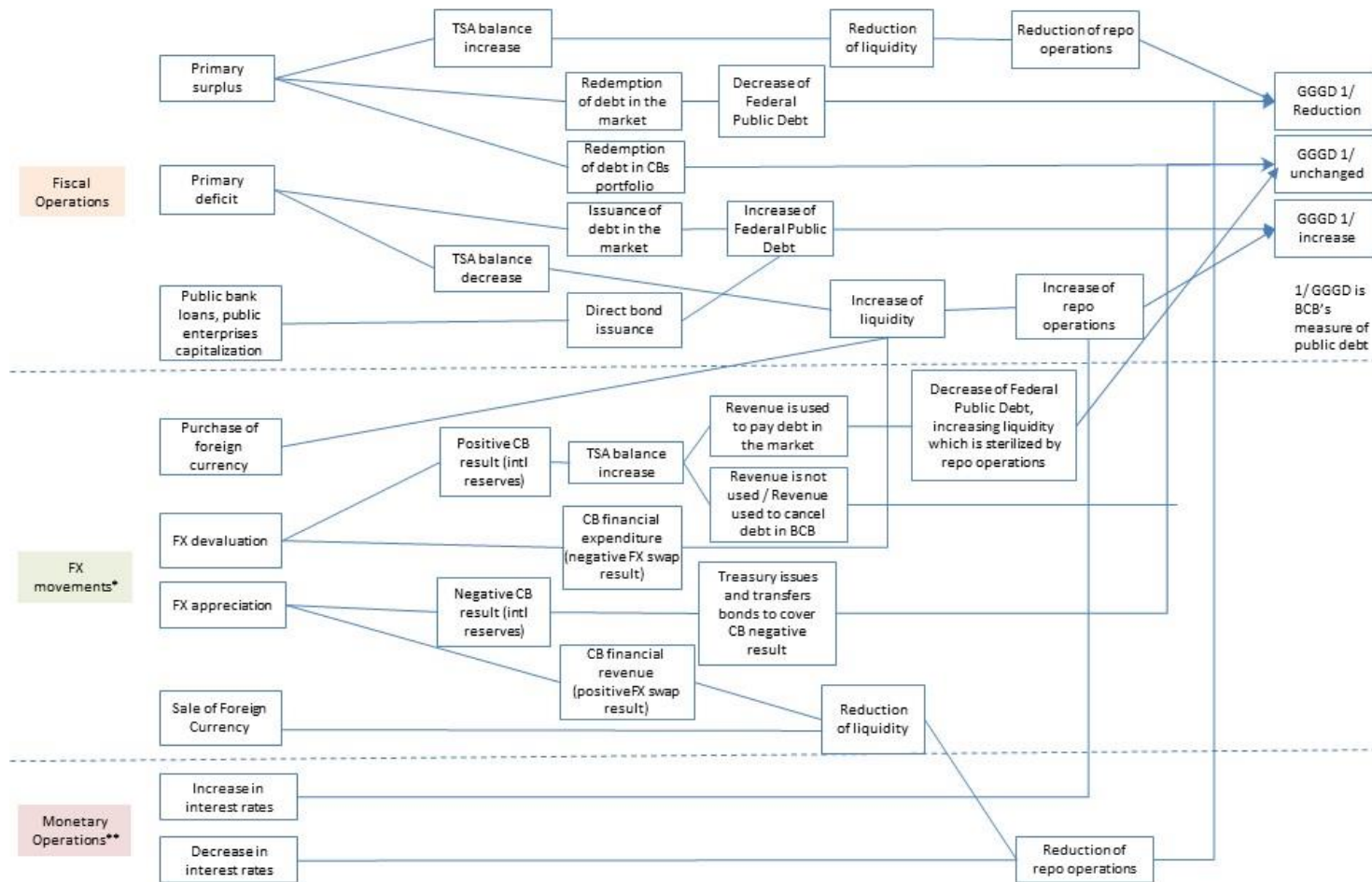
	BCB Reports	2008 SNA/GFSM 2014
BCB accounting result	Affects interests of Central Government (CG)	Impact on primary balance of CG: - dividends to CG (gains); - subsidies from CG (cover losses)
Exchange rate effects:		
FX swaps operations	Affects interests of Central Government	Impact on primary balance of CG: - dividends to CG (gains); - subsidies from CG (cover losses)
Carrying cost of international reserves (IR)	Affects interests of Central Government	
Valuation changes in IR	Does not affect fiscal results (only other economic flows)	No impact on primary balance of CG: - withdrawal of equity by CG (gains); - capital injection from CG (losses)

Source: Central Bank of Brazil (Notas de Imprensa de Política Fiscal).

- The Balance Sheet of the Union (BGU) records all the flows between the Treasury and the BCB, as the monetary authority, as cash flows (in both the budgetary and cash flow statements) and as accrued changes in net worth (in the statement of changes in net assets/equity); however, the accounting classification structure does not permit disclosing the split between the revenue and financing components of those transactions.
- Data submitted for the GFS yearbook database reflects some of the relationship between the two institutions (e.g., interests paid on the government deposits, and interests paid by the Treasury on securities held by the BCB); however, it does not reflect the stocks or flows related to profits or losses of the Central Bank in accordance with international statistics standards. Under the *GFSM 2014*, the profits due to current operations of central banks transferred to government units should be recorded as dividends, and the compensation of losses due to current operations of central banks should be recorded as subsidies to public corporations. However, a different treatment applies to the transfer of unrealized gains/losses due to valuation effects on the FX reserves. The *GFSM 2014* prescribes that one-off payments based on holding gains should be recorded as withdrawals of equity (an analogy can be made for compensations for holding losses, which should be recorded as equity injections).

The complex relationship between the two institutions requires greater transparency to better inform policymakers and the public in general. To a large extent the differences with international practices arise from the fact that in Brazil the Central Bank is considered part of the central government and not as a separate unit of the public sector. The present reporting makes it difficult to identify the benefits/costs and risks associated with policies. It also complicates international comparisons on key fiscal aggregates, like public debt and the primary/overall fiscal balances.

Annex 2. Figure A2.1. How Fiscal, Monetary and Exchange Rate Policies Affect Public Debt



* Scenario where FX swaps corresponds to 1/3 of international reserves
 ** Considers only liquidity effects

Annex 3. Differences Across States in Complying with the Fiscal Responsibility Law

The FRL determines different ceilings for the spending on personnel for the three branches of power (executive, legislative and judicial) and all levels of government (federal, states and municipalities). Total personnel expenditure is defined as the sum of expenditures incurred for both active and inactive workers, and thus includes expenditures for pensions, in-kind benefits, and social security contributions.

Annex 3. Table A3.1. Limits for the Spending on Personnel
(in percent of net current revenue)

	Federal	State	Municipalities
Legislative	2.5	3.0	6.0
Judicial	6.0	6.0	-
Executive	37.9	49	54.0
Other	3.6	2.0	-
Total	50.0	60.0	60.0

Source: Government of Brazil.
Note: Legislative includes the Court of Accounts. Other includes the Prosecutor Office for the federal government and states. In the case of the federal government it also includes spending with the DF and ex-territories (Amapá and Roraima).

In the case that any of these limits are reached, subnational governments (SNGs) have a period of eight months to bring spending back within the limit. Otherwise, they lose all of their voluntary federal transfers and permission to contract credit from either the private or public sector. Two exceptions to this rule are credit operations to refinance existing securities debt and credit operations that assist in reducing personnel expenditures.

In practice, it has been difficult to evaluate whether states are complying with the FRL's limits. The reason is that the interpretation of the law by the states' courts of accounts has differed. Decisions of the court of accounts have, in effect, allowed SNGs to circumvent the limit on personnel spending. The main court decisions have addressed the following issues which affect compliance with the personnel spending limit are as follows:

- **Removal of the income tax in workers' wages as an expense/revenue.** As an employer, the SNGs pay their employees a gross salary, of which a part is retained for the payment of the income tax. Yet, some states do not take this amount into account, either as an expense or as revenue.
- **Exclusion of social security and pensions as an expense.** Some states do not compute the expenditure with social security and pensions as personal spending, under the argument that this type of expenditure cannot be restricted by the government. In the case of the state of Rio de Janeiro, the government directs the revenue from royalties to the state pension fund.

As the fund covers the state's payments of social security and pensions, the amount is not recorded as spending on personnel, yet the payments of the royalties are recorded as revenue. In some states the spending on social security and pensions of the legislative and judicial branches are classified as part of nonwage spending for the executive branch, distorting the reporting on the spending with personnel.

- **Exclusion of in-kind benefits to employees and outsourcing.** Some states, in addition to the exclusion of some in-kind benefits (meals and housing, among others), do not record the spending with outsourced workers and contracts with individual service providers.

Table A3.2 below shows that different interpretations regarding the reporting on personnel spending create sizeable differences in assessing SNG compliance with the FRL. The table indicates that the fiscal reports released by the states used to verify their compliance with the FRL, and the report released by the Treasury. Table A3.2 shows that in some states the difference in 2015 was more than 140 percent.

Annex 3. Table A3.2. Total Spending on Personnel by the States
(in reais 2015)

State	Spending on Personal (PAF)⁸² (A)	Spending on Personal (RGF)⁸³ (B)	Ratio (A)/(B) In percent
Acre	2,382,171,622	2,296,412,536.87	103.73
Alagoas	3,715,295,962	3,259,335,787.91	113.99
Amazonas	6,161,007,733	6,161,062,233.18	100.00
Amapá	2,047,454,408	2,052,589,230.35	99.75
Bahia	15,787,409,427	15,630,199,957.79	101.01
Ceará	8,201,595,203	8,209,276,700.78	99.91
Distrito Federal	9,114,724,532	9,100,834,330.54	100.15
Espírito Santo	6,564,010,145	6,398,808,182.52	102.58
Goias	10,016,772,150	8,751,032,554.98	114.46
Maranhão	5,929,303,346	5,680,808,489.96	104.37
Minas Gerais	33,985,829,223	29,603,664,704.24	114.80
Mato Grosso do Sul	5,663,188,098	4,591,452,093.61	123.34
Mato Grosso	6,714,438,202	6,880,997,277.77	97.58
Pará	10,251,636,584	9,114,453,990.36	112.48
Paraíba	5,158,535,325	4,931,629,953.74	104.60
Pernambuco	10,670,615,247	10,957,956,177.56	97.38
Piauí	4,699,266,820	3,466,201,841.26	135.57
Paraná	17,996,421,695	16,249,955,649.22	110.75
Rio de Janeiro	31,681,147,761	21,396,958,206.76	148.06
Rio Grande do Norte	4,908,300,201	4,624,510,839.68	106.14
Rondônia	3,310,441,104	3,140,028,449.74	105.43
Roraima	1,648,690,541	1,509,903,446.15	109.19
Rio Grande do Sul	21,814,228,213	17,513,207,540.70	124.56
Santa Catarina	11,597,122,693	11,288,613,294.59	102.73
Sergipe	3,758,298,332	3,037,924,179.50	123.71
São Paulo	71,202,978,692	75,034,692,688.29	94.89
Tocantins	3,997,579,616	3,974,965,747.80	100.57

⁸²Data release by the Treasury on the document Boletim das Finanças Públicas dos Entes Subnacionais (2016).

⁸³ RGF stands for Relatório de Gestão Fiscal.

Annex 4: Technical Note on Table 0.2

Sources and methods

Methodological framework

As described in the footnote to Table 0.2, this table presents estimates compiled in accordance with the *GFSM 2014*, and adopts the accrual basis of recording for transactions and market valuation for stocks to the extent possible.

These estimates attempt to present a broad overview of Brazil's public sector finances, by complementing data published in the various fiscal reports with IMF staff estimates for the most material data gaps, in reference to the *GFSM 2014* framework. Given the limitations in data sources and time available for their compilation, this exercise results in just an approximate picture of the public sector finances.

In the GFSM presentation, transactions that increase net worth are recorded as *revenue*, while transactions that decrease net worth are recorded as *expense*. The *net operating balance*, which provides a measure of the sustainability of the policies of each group of units, corresponds to the difference between revenue and expense, and, as such, excludes transactions in nonfinancial assets.

The *net investment in nonfinancial assets* (acquisitions less disposals less consumption of fixed capital) does not change the net worth of the public sector, but affects the financial resources available to it, so it must be subtracted from the net operating balance when calculating the *net lending/borrowing* (also referred to as fiscal balance). This represents the amount that the government has available to lend or must borrow to finance its nonfinancial operations. Total expenditure can be derived as the sum of expense and net investment in nonfinancial assets.

Primary sources of information

Estimates for transactions of general government and its subsectors were based on the noncash data disclosed in the joint STN/IBGE publication "Government Finance Statistics and Government Sector Account, 2014." For coverage completion, transactions and stock positions pertaining to the small "Sistema S" units and professional councils were added, based on publically available accounting information.

Estimates for stocks of assets and liabilities of general government and its subsectors were based on two sources of information:

- STN's data submission for the 2014 edition of the IMF's Government Finance Statistics Yearbook, for data on assets in currency and deposits, debt securities and loans and on

liabilities in debts securities and loans (these data are derived from BCB's Press Release on Fiscal Policy);

- Financial statements of federal government (BGU) and general government (BSPN), for all other assets (including nonfinancial) and liabilities; and
- Financial statements of FGTS, "Sistema S" units and professional councils, for assets and liabilities of the extrabudgetary central government subsector.

Estimates for transactions and stocks of public corporations of the central level (excluding the Central Bank) were based on the corporations' accounting information available in DEST's database. Data for the Central Bank was sourced from its financial statements.

Estimates for transactions and stock positions of subnational public corporations were based on the financial statements of the largest corporations.

Coverage adjustments

The institutional coverage of the public sector and its subsectors in Table 0.2 differs from that in the main fiscal reports (STN's Central Government Primary Balance and BCB's Press Release on Fiscal Policy), in the following respects:

- The administrative functions ("autarquia" component) of the Central Bank was excluded from the central government; in accordance with the institutional unit approach of 2008 SNA and *GFSM 2014*, the Central Bank as a whole was included in the public corporations' subsector;
- FGTS, "Fundo Remanescente do PIS/PASEP", "Sistema S" units and Professional Councils were added to the extrabudgetary central government subsector, because these nonprofit institutions are considered to be controlled by the government, following the control criteria of 2008 SNA and *GFSM 2014*;
- Three public corporations (Casa da Moeda do Brasil, DATAPREV, SERPRO) were reclassified into central government, because they provide most of their output to the government; two other corporations (CODERN, TELEBRAS) were also reclassified into central government due to their nonmarket orientation (over a sustained period, their operating revenue covered less than half of their operating costs); in addition, EMGEA was reclassified because it acts with strong public financial support and effectively on behalf of the government when handling the "bad" assets it acquires from public banks.
- Petrobras and Eletrobras were added to the nonfinancial public corporations' subsector, because they are considered to be controlled by the government following the control criteria of 2008 SNA and *GFSM 2014*;
- Finally, public financial corporations, both central subnational, were added to complete the coverage of the public sector.

Sources and methods for staff estimates

1. Subsoil assets

The estimation of the value of the reserves of non-renewable natural resources was based on a set of the most relevant resources for which there was available information on volumes of reserves and price benchmarks. The value of the oil and gas reserves were computed by multiplying the volumes of reserves by the reference prices (both based on data provided in ANP reports) and an estimated government share of 60 percent (past studies for Brazil suggested a government share around this magnitude).

The same methodology was adopted for the most important metals for which there was public data (iron ore, copper, bauxite, gold, and niobium). The reserve data was from DNPM (Sumário Mineral 2015), the prices data were from WEO, Bloomberg, and USGS. As international experience shows that the government take for metals is lower for oil and gas, we assume it to be at 40 percent.

2. Pension entitlements and related transactions

The primary data source for the stock of civil servants' pension entitlements was the "Prestação de Contas da Presidenta da República." This document includes the entitlements of civil servants in both the federal level (a provision in BGU's balance sheet) and subnational level (a note in the section related to the outcomes of Program 2061 – Social Security).

The pension entitlements for military personnel of the armed forces were estimated by IMF staff using data from the actuarial projections published in the annexes to the PLDO.

The accrual of pension entitlements (transaction) of 2014 was derived according to the following formula:

- (1) Accrual of pension entitlements in 2014
Equals
- (2) Change in stocks of pension entitlements between 2013 and 2014
Plus
- (3) Benefits paid in 2014
Minus
- (4) Actual contributions received in 2014
Minus
- (5) Actuarial gains and losses in 2014

The stocks of 2013 and 2014 (item 2) were derived from the data sources described above. The 2014 actual flows of benefits paid and contributions received (from employee and employer) in each level of government (items 3 and 4), were provided to the mission by STN. The actuarial

gains and losses in 2014 were estimated by IMF staff, taking into consideration the changes in life expectancy tables published by IBGE. Due to unavailability of data sources, the mission assumed that there were no other actuarial gains and losses in 2014.

In summary, the treatment of “unfunded employment-related defined benefit pension schemes” prescribed by the *GFSM 2014* (see the manual’s Appendix 2 for details) requires that:

- Actual contributions received by the scheme, be treated as an increase in pension entitlement liabilities (a below-the-line transaction);
- Actual benefits paid by the scheme, be treated as a decrease in pension entitlement liabilities (a below-the-line transaction);
- The “service” costs (i.e., the increase in pension entitlements associated with the wages and salaries earned in the current period), be treated as compensation of employees; this is broken down into two sub-components:
 - Actual employer social contributions, paid by the employer unit to the scheme; and
 - Imputed social contributions (calculated as a residual, i.e., the total service costs net of actual contributions);
- The “financing” costs (i.e., the increase in pension entitlements due to the fact that the benefits are one period closer to settlement), be treated as property expense.

The accrued pension entitlements calculated above (item 1) correspond to the sum of the “imputed social contributions” and “property expense” components, described in the previous paragraph.

As discussed in the data sources section of this annex, the starting point for transactions of general government and its subsectors was the STN/IBGE publication “Government Finance Statistics and Government Sector Account, 2014”. The GFS tables in this publication follow the format of the GFS Yearbook Questionnaire, which break down the flows of social contributions and social benefits between social security and employment-related (civil servant specific) pension schemes. Since STN and IBGE still have not adopted the 2008 SNA and *GFSM 2014* recommended treatment of employment-related pension schemes, the current recording reflects mostly cash flows. The only exception is the imputation of social contributions (both in revenue and expense), corresponding to the difference between benefits paid and actual contributions received (this treatment was only applied to central government).

To convert this recording into a *GFSM 2014*-compliant recording, the mission performed the following adjustments:

- Exclude actual contributions from revenue;
- Exclude payments of social benefits from expense;

- Add to expense the difference between the accrued pension entitlements calculated above (item 1) and the value currently recorded as social contributions (which includes three components: the employee's contributions, a component of the recorded wages and salaries; the employer's contributions; and the imputed contributions).

3. *Government-controlled PPP assets and related liabilities and transactions*

Estimates on the value of PPP assets/liabilities and related transactions were obtained from the World Bank's Private Participation in Infrastructure database (as of May 31, 2016). This database includes data on total annual commitments and the value of physical assets. Due to unavailability of data, no estimates were done for consumption of fixed capital or revaluations related to these assets.

As discussed in Section 3.2.4, only projects described as concessions and greenfield projects were considered. They were deemed to be classified as government assets primarily because the government is bearing a substantial financial risk, as owner of BNDES, which provides much of the projects' financing. Other supporting factors include: (i) the assets are supposed to revert to government ownership at the end of the contract; (ii) the government also bears risks related to changes in government policy, force majeure, and extraordinary economic changes.

According to the *GFSM 2014*, if the government bears the majority of the risks related to a PPP contract, it should record in its accounts the investment in assets. At the same time, a liability of the same size of the asset needs to be imputed, to account for the fact that the government has acquired an asset without immediately paying for it (i.e., there were no immediate cash implications).

For more detailed description on the statistical and accounting treatment of investment undertaken via PPP arrangements, consult Appendix 4 of *GFSM 2014* and the appendix of the [PPP Fiscal Risk Assessment Model \(P-FRAM\) user manual](#).

4. *Relations between the Treasury and the Central Bank*

The explanatory notes to the BGU and the financial statements of the Central Bank provide detailed information on the main operations between the National Treasury and the Central Bank (these are explained in detail in Annex 2 of these report). Table 0.2. reflects the transactions and stock positions related to that relationship according to the GFSM framework.

The statistical treatment of these relations was one of the topics analyzed by a mission from the IMF's Statistics Department in 2010. The final report of this mission contains an in-depth description of that treatment along with illustrative numerical examples.

5. *Value of land owned by states and municipalities*

During the FTE mission, government accountants alerted to the fact that land was largely undervalued in the balance sheets of states and municipalities. This was due to the delay in implementation of the underlying accounting and valuation standards by most units in those two levels of the government.

Given the unavailability of information, the mission opted to add a rough, but conservative, estimate of that undervaluation, equivalent to 2.8 percent of GDP, to the stock of land. Given the extensive ownership of land by subnational governments in Brazil, this estimate is likely underestimated.

Elimination of intra-public sector transactions and stock positions

Material reciprocal transactions and stock positions within the public sector were eliminated to the extent allowed by the available data sources (consolidation columns of the tables in “Government Finance Statistics and Government Sector Account, 2014”; Table 9 of BCB’s Press Release on Fiscal Policy; and Financial Statements of concerned units). The table below describes which elements were eliminated at the various levels of consolidation.

Annex 4. Table A4.1. Brazil: Reciprocal Transactions and Stock Positions within the Public Sector

Consolidation Level	Transactions	Stocks
Central government	<ul style="list-style-type: none"> • Interest paid by Treasury to FGTS • Treasury grants received by reclassified SOEs 	<ul style="list-style-type: none"> • Treasury bonds held by FGTS • Equity stake at reclassified SOEs • Treasury accounts payable to FGTS (“pedaladas”)
General government	<ul style="list-style-type: none"> • Interest paid by states and municipalities on Treasury loans • Interest paid by Treasury to states • Treasury grants to states and municipalities 	<ul style="list-style-type: none"> • Treasury loans to states and municipalities • Treasury bonds held by states
Public sector	<ul style="list-style-type: none"> • Taxes paid by public corporations • Interest paid by Treasury to the Central Bank and public banks, holding Treasury bonds • Interest paid by BNDES to Treasury, FAT, and FGTS • Interest paid by other public corporations to FGTS • Interest paid by public nonfinancial corporations to public banks • Dividends paid by public corporations, including the Central Bank. 	<ul style="list-style-type: none"> • Treasury bonds held by the Central Bank • Government’s equity stake at public corporations • Treasury Single Account • Government units deposits at public banks • Treasury, FAT, and FGTS loans to BNDES • Loans from public banks to nonfinancial public corporations • Treasury accounts payable to public banks (“pedaladas”)

Reconciliation between FTE and National Fiscal Reports

The main fiscal reports used for policy discussions – STN’s Central Government Primary Balance and BCB’s Press Release on Fiscal Policy – adopt a cash basis for recording for revenue, expenditure and financing, with the exception of interest, which is on an accrual basis (as a result, the stocks of financial assets and liabilities are shown in nominal values). Furthermore, the institutional coverage of these reports follows a national definition, which is not fully compliant with the sectorization principles of the 2008 SNA and *GFSM 2014*.

The table below reconciles the fiscal balance of those reports with that of the FTE (which is a result of the estimates described in the previous section of this annex).

Taking into account the limitations in the source data for IMF staff estimates on transactions related to accrual of RPPS entitlements and PPP investments, they are shown in Table 0.2 as a memorandum item, without a direct impact on the headline net lending/borrowing number. An “augmented” net lending/borrowing, considering the estimated impact of the adjustments is also presented as a memorandum item.

Annex 4. Table A4.2. 2014 Public Sector Balance—Reconciliation between FTE and National Fiscal Reports
(in percent of GDP)

	Budgetary central government	Extrabudg. central government	Central government	State governments	Local governments	General government	Nonfinancial public corporations	Nonfinancial public sector	Financial public corporations	Central bank	Public sector
Primary balance (above-the-line, cash)	-0.3										
Statistical discrepancy	-0.1										
Primary balance RTN, NotImp Bacen (below-the-line, cash)	-0.4	0.0	-0.4	-0.2	0.1	-0.5	-0.1	-0.6			
Net interest expenditure (accrual)	-4.4	0.0	-4.4	-0.8	-0.2	-5.4	-0.1	-5.5			
Overall balance RTN, NotImp Bacen (modified cash)	-4.8	0.0	-4.8	-1.0	-0.1	-5.9	-0.1	-6.0			
Coverage adjustments	-0.4	0.5	0.1	0.0	0.0	0.1	0.0	0.1			
Cash-Accrual adjustments on recognized transactions	-0.4	0.0	-0.4	0.1	0.2	0.0	0.1	0.1			
Net Lending/Borrowing EFP (modified accrual)	-5.5	0.5	-5.0	-0.9	0.1	-5.8	0.0	-5.8			
Petrobras			0.0			0.0	-1.2	-1.2			
Eletrobras			0.0			0.0	-0.1	-0.1			
Net Lending/Borrowing FTE (with expanded NFPS)	-5.5	0.5	-5.0	-0.9	0.1	-5.8	-1.3	-7.1			
Other adjustments	0.4	0.0	0.4	0.0	0.0	0.4	0.0	0.4			
Public Financial Sector									0.8	0.1	0.9
Public Sector Net Lending/Borrowing FTE	-5.2	0.5	-4.6	-0.9	0.1	-5.4	-1.3	-6.7	0.8	0.1	-5.8
<i>Additional accrual adjustments</i>	-1.2	0.0	-1.2	-3.4	-1.2	-5.8	0.0	-5.8	0.0	0.0	-5.8
<i>PPP Investment</i>	-0.6		-0.6	-0.5	0.0	-1.1		-1.1			-1.1
<i>Accrual of pension entitlements</i>	-0.5		-0.5	-2.9	-1.2	-4.7		-4.7			-4.7
Augmented Net Lending/Borrowing FTE	-6.3	0.5	-5.8	-4.3	-1.1	-11.2	-1.3	-12.5	0.8	0.1	-11.6

Note: The main fiscal reports used for policy discussions – STN’s Central Government Primary Balance and BCB’s Press Release on Fiscal Policy – adopt a cash basis of recording for revenue, expenditure and financing, with the exception of interest, which is on an accrual basis (as a result, the stocks of financial assets and liabilities are shown on nominal values). Furthermore, the institutional coverage of these reports follows a national definition, which is not fully compliant with the sectorization principles of the 2008 SNA and *GFSM 2014*. This table reconciles the fiscal balance of those reports with that of the FTE.