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Reforming fiscal governance in Brazil

A path to strengthen the national IFI and fiscal rules

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Summary

Abbreviations and acronyms

CMO	Joint Budget Commission
DBGG	General Government Gross Debt
DLGG	General Government Net Debt
EU	European Union
IFI	Independent Fiscal Institution
FGF	Fiscal Governance Framework
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPCA	National Broad Consumer Price Index
LDO	Budget Guidelines Law
LOA	Annual Budget Law
LRF	Fiscal Responsibility Law
MTEF	Medium-term expenditure framework
OECD	Organization for Economic Cooperation and Development
PEC	Constitutional Amendment Bill
PPA	Multiyear Plan
SGP	Stability and Growth Pact
STN	National Treasury Secretariat

Introduction

The imperative role assumed by fiscal policy as a state response in different moments of crisis – either financial or health crises – explains the long and continuous debate around its best design. As in the post-2008 crisis, the frequent concern in the post-pandemic era relates to the optimal dose of stimulus and the ability of the fiscal regulatory framework to avoid excessive deficits and debt burden – a major problem in Brazil. The recommended balance between simplicity, flexibility, and enforceability is still pursued, as it seems to be an inevitable condition for such framework to succeed.

The efforts of several economies to manage the so-called "deficit bias" of fiscal policy have converged, to a certain extent, to a set of rules designed for better monitoring, control, and transparency of public finances. Nevertheless, fiscal rules alone have not proved sufficient to guarantee fiscal responsibility, which is at the origin of the Independent Fiscal Institutions (IFIs). The fiscal rule frameworks have evolved significantly in response to the global financial crisis and the IFIs played a relevant role in this process. Its contribution as a strong and independent public source of critical evaluation and advice on fiscal policy has been promptly and broadly recognized. Despite being young, the Brazilian IFI already has an international reputation, publicly highlighted by the International Monetary Fund (IMF), and is the only non-member country included in the Organization for Economic Cooperation and Development (OECD) IFI Database.

Even with considerable heterogeneity and no decision-making powers, national IFIs managed to obtain substantial experience and expertise in monitoring fiscal policy, while providing sound analysis that usually influences the fiscal debate. However, their mandate still lacks broader autonomy since it seems not to be enough when it comes to preventing fiscal problems. In that sense, the IFI by itself is not a guarantee of bulletproof public finances, but one among many instruments within a larger structure of fiscal governance.

Taking fiscal governance as a solid and complete system of rules, tools and procedures aimed to ensure the prudent management in the public sector, a reform in the fiscal governance worldwide is needed. In Brazil, the expenditure ceiling approved in 2016 as single fiscal anchor has been progressively weakened by the joint challenge imposed by the real rigidity of the limit and the strong indexation of the expenditure, while spending review efforts have been absent. Doomed to not survive for the foreseeable long horizon (20-year term, with revision after 10 years), allocation problems multiplied throughout the Brazilian budget, especially after the fiscal stimulus provided in the face of the COVID-19 pandemic. Without a credible medium-term expenditure plan, successive deviations from the fiscal rule made it clear that the way in which expenditure control is operated matters. A new anchor to replace the spending cap is currently under discussion in Brazil. In the context of a new president and legislative changes rising public spending, the pressure to change the fiscal framework to better support macroeconomic sustainability has increased.

This paper aims to contribute to the ongoing discussions on a stronger and more functional fiscal framework, which is essential for improving fiscal stability in Brazil. In this process, the role of the Brazilian IFI in supporting fiscal policy should be enhanced, while the Brazilian fiscal anchor to be approved must innovate with instruments oriented towards fiscal discipline. Considering the call to reform the fiscal governance in Brazil, why and how should we work to strengthen the Brazilian IFI and the Brazilian fiscal rules? What are the instruments capable of building new standards of fiscal responsibility in Brazil? Which obstacles and limitations do we have to overcome in this process?

To answer such questions, the chapters are structured as follows:

- Chapter 1 - Fiscal governance: a path to fiscal sustainability
- Chapter 2 - Reforming the fiscal governance framework in Brazil
- Chapter 3 - Making the Brazilian IFI stronger

1. Fiscal governance: a path to fiscal sustainability

What can be understood by "fiscal governance"? And why is this something desired?

Fiscal or budgetary governance refers to the processes, laws, structures, and institutions in place for ensuring that the budgeting system uses the available resources effectively, efficiently and in a sustainable manner (OECD, 2015). In practice, the current fiscal governance framework (FGF) across the globe involves a complex set of fiscal constraints. This includes anchors, operational rules, numeric targets, upper limits (binding expenditure ceilings, for instance), multi-annual fiscal planning, among others. Such mechanisms became more necessary with the structuring of the European Union, with its distinctive combination of common monetary policy and decentralized fiscal measures (European Commission, 2013). Preventing national fiscal policies, under misaligned monetary policies, from disseminating adverse spillovers to other countries proved to be a tough coordination task.

By imposing a common framework of budgetary surveillance to all member states, the EU's Stability and Growth Pact (SGP), with its preventive and corrective arms, seemed to be a solution for such a challenge. However, considering the difficulties in effectively enforcing the fiscal regulations established at the European level by the SGP, the enhancement of fiscal governance at the national level had increasingly attracted much interest (European Commission, 2010).

As the fiscal arrangements can still vary widely across economies considering institutional, political, and cultural factors, the principles of good budgeting have disseminated and served as a guidance for coherent public finances at all levels of government in many countries. The undoubted relevance of fiscal governance for budgetary outcomes explains, then, why we observed worldwide development of a set of commitments, practices, and organizations supporting the formulation and execution of fiscal policy.

Despite this framework's contribution to deliver macroeconomic stability and sustainability of public finances, weak fiscal governance is not a recent issue. Vulnerable fiscal performance has been linked to poor fiscal governance, placing the attention of researchers and policymakers on a variety of factors that underpin its effectiveness and credibility. Most countries had built insufficient fiscal buffers in good times before episodes of crisis. For example, in the context of the 2008 global stress – severe economic downturn and significant private sector imbalances –, fiscal institutions failed to avoid major increases in public debt after governmental support was provided to the struggling financial sector (IMF, 2013). The fiscal rules were, then, tested, especially those that did not specifically anticipate extraordinary economic conditions.

The economic consequences of state responses to the global financial crisis and the COVID pandemic revealed that FGFs lack some improvements. The common concern over how they can be strengthened to ensure fiscal discipline and stability led to important revisions in FGFs in the past. They need to be particularly solid ex-ante, since avoiding the buildup of fiscal imbalances is more effective and sometimes easier than remediating them ex-post (Eyraud and Wu, 2015). The successive changes aimed at several goals, including (i) strengthening of the economic underpinnings of the rules-based system, (i) better alignment between fiscal targets and debt target, (iii) more flexibility combined with deeper enforcement mechanisms, and (iv) more precision in the definition of rules (Andrle et al., 2015).

Such reforms have brought progress, but also complexity. Remaining gaps are most striking in the intricate design of fiscal rules – with consequences for effective monitoring and public communication – and weak enforcement mechanisms. The ultimate objective of the FGF should be to ensure fiscal responsibility in the form of public debt sustainability. In that sense, it seems appropriate to discuss how the FGF can be improved while enforcement is strengthened. There are some options for simplifying this framework while enhancing its overall effectiveness. It is not a matter of new targets or a redefinition of objectives, but of strengthening and guaranteeing fiscal governance through its instruments.

In Brazil, the set of regulations to which the budget is subject cannot account for its fragility. Inversely, Brazilian fiscal governance suffered from a rapid accumulation of constitutional modifications motivated by fiscal issues during the past decade. The benefits of innovations and adjustments, which were clearly required, were more than offset by the "inflation of fiscal norms", which led to a costly and dysfunctional normative complexity. Political demands drove opportunistic revisions to the Brazilian Federal Constitution, neglecting valuable opportunities to reconsider or even repeal problematic regulations. A broad interpretation of the Constitution as well as the applicability of the prior legislation were overlooked more than once.

No country in the world has amended its constitutional budget chapter more than Brazil, and this is not a coincidence. Couri and Bijos (2022) highlight some of the reasons: i) the high level of details in the constitutional text makes amendments the only option in some cases; ii) the hierarchy of laws requires constitutional amendments to ensure legal security; iii) the budgetary rigidity guaranteed by constitutional commands inhibits any control that is not also done by amendment; and iv) there is the perception that, once in the Constitution, the sign of commitment to a fiscal rule is greater.

Given this scenario, reforming Brazil's FGF is particularly difficult and urgent. As in the European case, finding a balance between simplicity, flexibility, and enforcement is still quite critical for the effectiveness of budgetary governance. Before going through the proposals under analysis to build a new fiscal framework in Brazil, this chapter presents below the current main fiscal rules in the country. Also, two pertinent instruments of fiscal governance are discussed as worthwhile budgetary approaches when it comes to ways to strengthen the fiscal position of Brazil.

CURRENT FISCAL RULES IN BRAZIL

Since the number of rules may vary depending on the definition of "fiscal rule", the discussion here is confined to those often taken into account for the purpose of international comparison, such as the Fiscal Rules Dataset from the IMF[1]. According to the IMF, a fiscal rule is a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates (Lledó et al. 2017). They can promote fiscal discipline and limit the "deficit bias" by inhibiting the tendency of governments to run excessive deficits, as policymakers may have distorted short-term incentives to opt for a suboptimal fiscal trajectory now, followed by later austerity (Eyraud et al., 2018).

The set of rules in the Brazilian context consists of commands with different attributes, some of them having constitutional force, such as the Golden Rule. This rule was set in the Federal Constitution of 1988 (Article 167) and requires that credit operations (including financial revenues) cannot exceed capital expenditures (including amortizations). It follows that the government cannot issue bonds to pay for operational expenses, such that new borrowings should only finance public investment or refinance public debt. Some escape clauses allow extraordinary credits to cover unforeseeable and urgent expenses, such as those arising from war or public calamity. The Brazilian package with fiscal stimulus measures to address the socioeconomic effects of COVID-19 was one of these exceptions.

The intergenerational pact, which requires public investments to benefit both present and future generations, is one of the theoretical presumptions that underlie the Golden Rule. This rule would also protect the level of public investment, which is threatened by the allocative dilemma in the face of limited public resources, in addition to the existing bias towards expenditure increase in democratic nations. Another argument for this rule is that public expenditures often pay for themselves due to the multiplier effect they produce, preventing the long-term buildup of public debt.

Over time, technical and operational inconsistencies have demonstrated that the rule failed to accomplish these objectives by not completely preventing detrimental fiscal practices. The observance of the Golden Rule did not ensure increased public investment or a reduction in current deficits. Furthermore, the fact that some present expenditures, like education, have an effect on future generations, as well as how government investments affect future output, were not taken into consideration. More troubling, Brazil's implementation of the Golden Rule enabled it to be fulfilled even though public investments were being exceeded by debt growth. This is due to the significant amount of financial revenues that the Brazilian federal government has access to, including the positive results

1 Available at: https://www.imf.org/external/datamapper/fiscalrules/map/map.htm

of the Central Bank's foreign exchange operations that transferred to the National Treasury. Such revenues helped the government to comply with the Constitution's mandate, even though the control of public debt and fiscal balance was hampered (Nunes et al., 2020).

The Complementary Law 101/2000, in place since May 2000 and often known as the Fiscal Responsibility Law (LRF, in the Portuguese acronym for *Lei de Responsabilidade Fiscal*), is another significant regulation. This law established standards, conditions, and limitations for numerical fiscal indicators, as well as new mechanisms for monitoring public spending. Personnel expenditure, for instance, is limited to 50 percent of net current revenue for the federal government, and 60 percent for states and municipalities. Within each level of government, the law further defines limits for the executive, legislative, and judicial branches, and other offices. LRF and Article 169 of the Federal Constitution set down the penalties to be applied when these boundaries are exceeded, but the pro-cyclical incentives of this limit have drawn considerable criticism.

The LRF has set that permanent spending obligations cannot be created without permanent (i) revenue increases or (ii) spending cuts. With respect to public debt, this law additionally reinforced the Senate's constitutional competence to set debt limits for all levels of government. Nevertheless, the only restrictions in force at the present are for states (200 percent of net current revenue) and municipalities (120 percent of net current revenue) as there was never an agreement reached on a limit for the federal government, which is often a key variable in determining its solvency.

Another fiscal rule, like the Golden Rule, is the primary balance target, which was established through an agreement with the IMF in 1999 and ratified by the LRF a year later. Based on this rule, the government committed itself to set and pursue a budgetary outcome compatible with the stabilization and reduction of the debt over a predetermined time horizon, preventing a situation of fiscal insolvency. According to the LRF, the Budget Guidelines Law[2] (LDO, in the Portuguese acronym for *Lei de Diretrizes Orçamentárias*), which is written and approved specifically for each fiscal year, would also include an Annex of Fiscal Targets. The Annex must list measurable annual targets in current and constant values for the budget balance (for the current year and indicative targets for the next two years), expenditure, and debt. This means that the budget's formulation and implementation each year should be consistent with the primary balance targets set in the LDO for that year. To be explicit, note that the targets can be modified annually[3].

Further adjustments to the target may only be made through new legislation approved by the National Congress, signaling a rigidity that calls for permanent prudence. The practical outcome, however, is the setting of targets that are not particularly pertinent and have no explicit connection to the desired debt levels (reinforced by the absence of debt limits at the federal level). Sanctions in case of non-compliance with the target are ruled out by the LRF, which stipulates a set of measures

2 The Budget Guidelines Law is not the budget per se. The official budget is a separate document, called Annual Budget Law (LOA, in the Portuguese acronym for *Lei Orçamentária Anual*).

3 The Brazilian primary balance target is not listed as a budget balance rule in the IMF Fiscal Rules Dataset according to the standards outlined in the IMF manual. Only rules with targets fixed in legislation and fiscal arrangements for which the targets can only be revised on a low-frequency basis and binding for at least three years are considered as fiscal rules (Davoodi et al. 2022).

that should be adopted in case such a risk is identified, as contingency spending. This mechanism can restrict financial commitments and transactions in the event of revenue frustration, but it also has the potential to loosen prior contingencies in the event of extraordinary revenues, leading to an ineffective and poorly planned allocation of public spending.

This rule also suffers from the procyclical nature noted above, since it is not a target tied only to structural factors. Cyclical fluctuations in both revenues and expenditures can support or hamper the achievement of the target. Taking this target as given, the absence of structural reforms on the spending side, which could reduce the excessive rigidity of mandatory expenditures, leads to harmful incentives in the process of rebalancing public accounts. In order to accomplish the target, the government must either increase the tax burden or decrease public investments, as was often the case throughout previous fiscal adjustment episodes. The history of Brazilian accounts also reveals how adverse incentives for creative accounting have encouraged inappropriate manipulations, such as the exclusion of some investments from the primary balance target.

Lastly, the Constitutional Amendment (EC, in the Portuguese acronym for *Emenda Constitucional*) No. 95 approved in 2016 established that a spending cap would remain in place for the following 20 years. With some exceptions, this single operational rule limited real primary government spending as of 2016, i.e., it stipulated that nominal spending could grow thereafter in pace with official inflation measured by the National Broad Consumer Price Index (IPCA, in the Portuguese acronym for Índice Nacional de Preços ao Consumidor Amplo). This severe limitation, established in 2016 as indicated above, followed an accelerated growth of public spending, and allocation issues have built up from the program's origins. The spending cap early became binding, facing high budget rigidity, fast growing mandatory expenditures and strong indexation. The extended time horizon and the modest spending review initiatives reinforced the challenge.

The rule's credibility has been damaged by several deviations, especially after the fiscal stimulus provided in response to the COVID-19 pandemic, exposing the lack of a medium-term planning. Using the public calamity clause, the government established a "war budget" in 2020 to account for increased pandemic-related spending, as many countries around the globe. In Brazil, however, there was no strategy to tackle back the raised expenditure, especially with social transfers. The burden of not prioritizing and planning has been absorbed by non-essential expenses. Public investments were extensively used as an adjustment variable, bringing their level to historical lows, insufficient to replace the depreciation of public capital.

In December 2021, a constitutional amendment changed the rule's scope (setting an inside limit for court order expenditures) and the index for adjusting the expenditure ceiling for inflation. In 2022, new and increased expenditures outside the spending cap were approved, despite the dedicated legislation banning such practices during the pre-election period. This sequence of manipulations clearly demonstrated that the approach to controlling spending matters more than the establishment of a limit by itself, especially when some expenses have vegetative growth above inflation or are subject to multiple pressures.

A Transition Constitutional Amendment was enacted by the end of 2022 to deal with the implications of "fiscal bombs" left behind by the government and to accommodate the electoral promises of the president-elect. The spending ceiling has been raised, new exceptions to it have been allowed, and the government assumed the obligation to send to the Congress, by the end of August, a proposal to replace the current spending ceiling rule with a new fiscal rule. As the fiscal pressure is expected to increase further, the imperative to reform the fiscal structure to further promote macroeconomic and fiscal soundness has become much more urgent.

Brazil is now debating a new anchor to replace the spending ceiling, including reforms with diverse scopes. The following chapter provides a review of the main proposals. As we have seen that the rule *per se* does not automatically guarantee fiscal stability, the call for explicit efforts towards budgetary commitment has become more urgent. Apart from the strong pressure on expenditures from the economic agenda communicated by the current government, events that boosted budget revenues in 2022 are unlikely to occur again this year. Consistently high interest rates, in turn, foreshadow a delayed impact on the cost of public debt service, and justify the great repercussions, among the news and economic agents, of the signals transmitted by the newly elected government. Table 1 provides a summary of the main characteristics of the rules just discussed.

Table 1. Fiscal rules in Brazil

I. Golden Rule	• Regular spending should be funded mainly by tax revenues. • Thus, government should increase borrowing only to invest.
II. Debt and payroll limits	• Personnel expenditure limited to 50% of net current revenue for the federal government, and 60% for states and municipalities. • Net debt limited to 200% of net current revenue for states and 120% for municipalities. There is no limit at federal level.
III. Primary balance target	• The annual Budget Guidelines Law (LDO) sets measurable annual targets for the budget balance, such that the later preparation and implementation of the budget each year should be aligned with it.
IV. Spending ceiling	• Limits for 20 years primary federal expenses of a given year to previous year's limit corrected by the official price index (IPCA).

MEDIUM-TERM EXPENDITURE FRAMEWORKS (MTEFS)

Both international and past national experience demonstrated that governments must integrate expenditure rules into their budget process, specifically by using a medium-term strategy. Some institutional and procedural reforms were expected to happen in Brazil, for the country to successfully implement the spending cap, as stated in the IMF's technical assistance report, *Supporting Implementation of the Expenditure Rule Through Public Financial Management Reforms* (Curristine et al., 2017), developed at the Brazilian National Treasury's request. At that time, recommendations were made for the approval and implementation of a new Public Finance Law, to support the newly born spending cap. However, such a law has not been implemented as of today.

The expenditure rule would then eventually reflect a dramatic shift to a more medium-term approach, as the same report claimed. It was the first time in Brazil that a legally binding medium-term fiscal regulation was put into effect. LDO's primary balance was still in effect, but only for the budget year. The targets for the forward years are changed in the following LDOs, as is customary. The expenditure rule was designed to fix the prevalent short-term focus of budget preparation, potentially reorienting the focus towards medium-term fiscal planning (Curristine et al., 2017). Nevertheless, this did not occur, and the budgetary myopia prevailed. After all, the long-term spending cap did not culminate in the expected and required medium-term planning, one of the reasons why its failure occurred at such an early stage.

It may be argued that the required planning tools were not available. However, the Brazilian fiscal framework does include a Multiyear Plan (PPA, in the Portuguese acronym for *Plano Plurianual*), which is released in the first year of each government cycle and outlines the major strategic goals and initiatives of the federal administration for a four-year period. In practice, however, the PPA does not operate as a policy pillar for the budgeting operation. Both the PPA and the LDO have components of a medium-term fiscal framework, but while the PPA does not rely on a realistic macro-fiscal scenario and does not guide the budget closely, the LDO offers little detail on the projections and policy decisions needed to meet the fiscal targets.

The long-term impact of current decisions tends to be overlooked under the short time horizon of the Annual Budget Law (LOA, in the Portuguese acronym for *Lei Orçamentária Anual*), so that consistent fiscal planning and strategic planning of expenditures are discouraged. Constraining decision-making to the annual timescale culminated in unplanned and inefficient budget allocations, driven by short-sightedness and neglection of optimality in the usage of public resources. The integration between the PPA and the annual budgets has proven challenging, even though a substantial proportion of the government policies involving revenues and expenditures has implications for many years ahead, beyond the typical cycle of the LOA. Some of the causes include (i) the PPA's significant methodological instability over time, (ii) institutional discrepancies between the several organizations in charge of each budget piece, and (iii) limited political attention to its simple programmatic and non-authoritative nature (Couri and Bijos, 2022).

This underlines the imperative for Brazil to adopt a new fiscal governance instrument: a comprehensive medium-term expenditure framework (MTEF), allowing for the evaluation of the country's fiscal space and giving its economic policy a strategic orientation. MTEF is part of a broader fiscal approach within the medium-term framework, which goes beyond a technical instrument designed to forecast fiscal aggregates in the medium term (Annex Figure 1). Instead, it is mainly an institutional framework for setting multiyear fiscal objectives and ensuring they are respected in budget formulation, approval, and execution (IMF, 2017).

A longer timescale for the budget aims to guarantee that long-term effects of spending decisions are accounted for. Medium-term frameworks are also crucial to support the execution of fiscal rules, as compliance requires a good amount of medium-term planning effort. A spending cap becomes a weak tool to enforce fiscal restraint when there are no additional restrictions. Expenditure rules are recognized by the international community as having a greater impact on fiscal sustainability when paired with other sorts of medium-term rules, which Brazil is not doing right now. For instance, without a medium-term debt anchor, Brazil has frequently taken the risk of an increase in public debt as the spending restriction was breached in different situations.

The appeal of MTEFs rests in their potential to integrate the frequently conflicting short-term objectives of macroeconomic stabilization with the budget's medium- and long-term goals, thereby improving policymaking, planning, and service delivery. A typical MTEF consists of a top-down resource package consistent with macroeconomic stability and broad policy priorities, combining (i) a bottom-up estimate of the current and medium-term costs and (ii) an iterative process of decision-making that reconciles such costs with available public resources. This entails ensuring that spending is constrained by overall resource realities and priorities. Additionally, it mandates that the process for determining ceilings must provide decision-makers with enough flexibility to promote strategic decision-making and management (Holmes and Evans, 2003).

Through the implementation of MTEFs, the government is able to extend the fiscal policy perspective beyond the annual budgeting cycle, as such frameworks address the creation, implementation, and supervision of multiyear fiscal policies. MTEFs are also frequently regarded as a useful instrument for enhancing budget results' predictability and resource allocation, by reducing the common pool resource problem. Although empirical studies have indicated that MTEFs alone are unlikely to tackle the problems of fiscal discipline for a government where budgetary procedures have structural deficiencies, they are still regarded as crucial to a successful performance budgeting. Government initiatives can be directed by explicit, empirically supported decisions thanks to strategic planning within MTEFs (Martí, 2019).

Although Brazil has created several medium-term instruments over the years, they are hardly sufficient or well-coordinated to constitute a solid medium-term framework (Curristine et al., 2017). Brazilian medium-term budgeting is still insufficient to support performance-based budgeting. National fiscal governance should be reformed in a way that offers a systemic approach to resource allocation, in line with growing priorities, and relating necessary resources to desired outcomes. In addition to being more stable, a responsible government benefits future generations by integrating budgeting, planning, and policy through a strategic and long-term approach.

Accordingly, Couri and Bijos (2022) propose a new fiscal and budgetary framework for Brazil based on a solid formulation of a medium-term fiscal scenario and the MTEF experience of established democracies across the world. Replacing the problematic PPA currently in place, this robust scenario should be aligned with the establishment of multiyear public debt targets, under the coordination of the central government. From this point, the expenditures and revenues required to meet such debt targets, as well as the fiscal space available for allocations in the medium term, would be calculated. Along this method, the mentioned allocative myopia could be reduced and make room to a more strategic understanding of the budgetary process, while society and the government are encouraged to debate in advance what will be the fiscal destination of the available budget space in the upcoming years.

This MTEF design should therefore be in line with government strategic planning efforts and very close to another instrument of fiscal governance: the periodic public policy analysis – broadly known as spending review, which is the topic covered next.

SPENDING REVIEW

Along with MTEFs, the spending review practice is widely advocated by the IMF, the World Bank and the OECD as part of the core set of modern public finance management tools. Both instruments have significant combined power, enabling the short- and medium-term harmonization of fiscal goals and public policy priorities. The interaction of the spending review with the budgeting process is an ongoing trend in developed countries. The few OECD economies that have not yet embraced spending review already have the tool on their fiscal reform agenda, since it is acknowledged as an international best practice. Like the development of IFIs, the spending review attracted attention within the OECD, as some economies pursued fiscal consolidation following the global crisis in 2008.

The strategic capacity of such a fiscal governance tool is undoubtedly helpful in the use of performance information in public resource allocation decisions, which have turned out to be a challenging task given the incrementalist budget culture concentrated on the short term. The political influence behind such choices is just one of many interconnected factors that have the potential to explain the symptomatic context of budget rigidity and inefficient spending in Brazil. The constrained budget ends up being concentrated in well-organized and narrow interests as a consequence of many sources of pressure, causing less control over the expansion of mandatory expenditures and tax waivers. Also, new spending proposals tend to receive disproportionally more attention than baseline expenditure reviews.

The spending review entails a systematic reexamination over all public spending, whether mandatory or discretionary, with the purpose of reducing its amount or identifying opportunities for improving expenditure prioritization and reallocating available resources. In this institutionalized process, periodic assessments of public policies' costs, benefits, and purposes are employed to determine how much funding should be allocated for each policy at any given time. The instrument relies on rigorous performance evaluation of programs, processes, and government agencies, to conduct (i) efficiency reviews, focused on savings through improved efficiency, and (ii) strategic reviews, focused on savings achieved by reducing services or transfer payments (Robinson, 2014).

It is worth noting that finding potential sources of fiscal savings is a crucial component of a spending review program, and that efficiency evaluations are an input for this transparent management approach. In the context of the Brazilian spending cap, Afonso and Ribeiro (2020) emphasize, for instance, the necessity to discuss whether spending on salary bonus payments could be replaced with the expansion of minimum income programs, and whether this change would make the budget more aligned with the goal of reducing inequality. The spending review system entails a coordination effort in public administration capable of producing efficiency gains that are most advantageous to the society.

Thus, the spending review's ultimate purpose is to allocate public resources to programs that have a larger social impact. The mandate to periodically evaluate current expenditures (as a sort of "budgetary basis") prevents its uncritical perpetuation over time (Couri and Bijos, 2022). The outcomes of this strategic budgetary perspective would be favorable for the state's effectiveness in providing day-to-day services to society, as well as for Brazilian economic stability over the long term. The failure of the spending cap in Brazil as a tool of structural fiscal adjustment by itself serves as a vivid reminder that fiscal rules must hold internal optimization procedures.

Ex ante assessments of public policy also enable the identification of a range of reforms capable of fostering budgetary economies while preventing abrupt fiscal adjustments. These are typically characterized by linear expenditure cuts, carried out blindly and reactively. Accordingly, it is advised that the spending review be adopted in conjunction with a medium-term financial plan. It is crucial to determine (i) the amount of expenses that is considered sustainable over time and (ii) the adjustments required to make this amount fiscally feasible. The spending review is the best available instrument for doing so (Afonso and Ribeiro, 2020).

Senate Bill of Law n. 428 of 2017 was submitted in Brazil as an attempt to formalize budget reviews as federal government procedures. According to this legislation, the President of the Republic should annually submit to the National Congress a Periodic Expenditure Review Plan in the form of a specific annex to the government plan (referred to in Article 84, XI, of the Constitution). Recent LDOs[4] have likewise promised to make progress on this issue, but the normative predictions have made no visible practical impact and have materialized as vague and shortened documents, without any known political repercussion (Bijos, 2021).

The pandemic further exposed the federal government's inability to review structural public spending, since it missed a poll of possible spending reductions that could, for instance, help to cover for the emergency package required by the health, economic, and social crisis. Due to the absence of a prepared adjustment, combined with the overall limitation of the spending cap, the Brazilian legislature became used to push for multiple reductions in discretionary spending during the discussion of the Project of the Annual Budget Law (PLOA, in the Portuguese acronym for *Projeto da Lei Orçamentária Anual*), without providing qualified justification. Recent efforts have gone even further, with cutbacks to mandatory spending as well, forcing the approval of supplemental credits because of budget insufficiency.

4 According to the federal LDO for 2019, Article 21, § 3, the Executive should send the Congress a "plan of review of expenditures and revenues" for the period from 2019 to 2022. The LDO for 2020, on the other hand, restricted itself to requiring, in its Article 117, that the Executive submit to the Congress a plan for reviewing tax benefits with a forecast of reduction in annual revenue equal to 0.5% of GDP through 2022. In the same spirit, the Constitutional Amendment No. 109 of 2021, Article 4, stipulates that the President should send to Congress a proposal for the gradual reduction of federal incentives and benefits of tax nature with the aim of keeping such benefits to a maximum of 2% of the GDP over a period of eight years. However, this plan still waits for approval from the Congress.

Therefore, there is still plenty of room to develop domestic fiscal governance, so that Brazil may adopt and benefit from the spending review as a stabilizer and permanent feature of the budget construction process. It is critical to promote and develop a budgetary environment that is more appropriate to strategic allocation discussions and principles of medium-term fiscal frameworks. If successfully accomplished, this prospective posture supports the MTEF's planning goals, previously discussed.

How can fiscal governance help Brazil when dealing with global challenges?

If effectively implemented, both instruments (MTEF and spending review) could strengthen the overall fiscal governance in Brazil, making the budget more realistic and prepared to tackle some global challenges. As the world faces growing uncertainty, Brazil should take advantage of this transitional time to advance its reform agenda. In the last couple of years, Brazil benefited from rising commodity prices, strong global financial circumstances, and unusual legal spending limitations, primarily on personnel costs. The world is being called to conduct effective reforms and enhance the condition of its finances to safeguard itself from upcoming significant risks, and Brazil requires explicit effort on that.

Performance budgeting is more than just a tool for making budget adjustments based on previous performance – like medium-term spending planning is not only about broadening projection horizons. These instruments' integrated performance enables a more consolidated view of the budget, both in terms of the time dimension and the trade-off of public policy. Each economy must practice allocative optimization since there are not enough resources available to satisfy all of society's demands. These demands are more suppressed in developing nations like Brazil, which continues to struggle with extreme poverty, including hunger and a lack of access to essential services such as basic sanitation. For such countries, addressing natural disasters and climate risks in fiscal planning and budgeting frameworks in advance is even more necessary.

Strengthening the financial resilience to disasters implies working on instruments focused on (i) better risk management, able to counter significant negative impacts on people's well-being, and (ii) economic development with lower costs. Assistance from the federal government to local governments may lead to considerable implicit contingent liabilities. Despite efforts to establish precise guidelines for assistance and damage compensation, disaster-related liabilities often exceed what many governments have pledged to pay, particularly when catastrophes take place. Even though fiscal risk assessment methods may differ across governments (some opt for quantitative methods forecasting future potential worst-case scenarios, while others stick to a more qualitative and past based discourse), the objectives are very similar for all. Most aim at increasing the visibility of disaster-related contingent liabilities in the fiscal policy-making process. Additionally, greater internal interaction between risk managers and financial authorities increases synergies helpful for annual budgeting decisions (OECD, 2019).

Climate-related events have also drawn the attention of several countries to the urgency of strategically incorporating programs into the budget to support the achievement of environmental and climate objectives. Since the budget process plays a key role in setting priorities and resources for government action, any progress toward these goals involves a discussion of finding fiscal space. Beyond setting national targets and participating in global commitments, or guaranteeing resources exclusively directed at protecting the environment and mitigating climate change, several OECD countries have adopted a comprehensive green budget. As the OECD (2020, 2021a) defines, green budgeting refers to the use of budgetary policy-making tools to support the achievement of environmental and climate goals, such as (i) evaluating the environmental impact of budgetary and fiscal policies and (ii) assessing their coherence towards the delivery of national and international commitments.

Green budgeting can also contribute to evidence-based policies on sustainable growth. In Brazil, this debate is still modest, and few budgetary actions dedicate resources to preventive measures. To assist society and subnational governments during emergencies, extraordinary credits have been used at the federal level repeatedly. An effective budgeting strategy that might be used to prevent such shocks involves a reserve fund to be accumulated over time, allowing more immediate reaction capacity, and avoiding excessive or insufficient emergency allocations. Besides environmental taxes, some innovative approaches include fund-raising based on sustainable bonds, exclusively applied to green projects.

Budgeting techniques like green budget tagging – which includes any budget tagging procedure that thoroughly evaluates and identifies budget measures relevant to climate or environmental objectives – are required to enforce environmental strategies (OECD, 2021a). Green budget statements to inform relevant stakeholders also provide policymakers with a clearer understanding of the environmental and climate impact of budget choices. As the uncertain growth impact of green public spending entails challenging trade-offs in fiscally weaker countries, better regulatory policy as well as loosening fiscal frameworks to promote green policies are decisive towards a 'green fiscal pact'. In times of budget consolidation, which often results in major public investment cuts, a 'green golden rule' could, for instance, exclude net green investment from the fiscal indicators used to measure fiscal rule compliance (Darvas and Wolff, 2021).

Nowadays, in order to prevent or mitigate damage to the environment, society, and the global economy, green budgeting usually adopts four key, mutually reinforcing building blocks (OECD, 2021b): 1) a strong strategic framework; 2) tools for evidence generation and policy coherence; 3) reporting to facilitate accountability and transparency; and 4) an enabling budgetary governance framework. OECD countries typically use a variety of green budgeting tools and approaches (Annex Table 1). In 2020, 14 out of 35 OECD countries reported practising green budgeting and half of those underpin their strategic framework with high-level political commitment or a budget law, while slightly fewer go through administrative practice, all of which are effective approaches to green budgeting. The four most reported tools include *ex ante* or *ex post* environmental impact assessments, environmental cost-benefit analysis, carbon assessments and carbon pricing instruments.

A modern budget framework linking strategic planning and budgeting also proves to be convenient when it comes to demographic transition. Without considering the effects of the current demographic transition, resilient growth is inconceivable. Brazil, like many other nations, is already experiencing the pressure on recurrent spending driven by the demography, particularly regarding the public pension system. Declining tax revenues and recurrent fiscal imbalances are already a reality for some governments. Maintaining the existing fiscal governance, in the absence of sustainable flow prospects, results in extreme uncertainty and a rise in public debt. Fiscal policy must then be redirected in situations of aging and slower population growth to address both inequality and further pension burdens for governments, while also preventing a wider impact on economic development. Adjusting fiscal policies before aging sets in is relevant so that the effort occurs at a gradual pace, lessening the burden across generations and preventing policy discontinuity.

The later demographic transition in Brazil, when compared to European countries, does not alleviate the need to reform the social security system. Besides the age issue, the recent (and ongoing) digital revolution has intensively changed the labor market we were used to. Due to remote work and the gig economy, labor has crossed the classical frontiers, both geographic and organizational. In today's reality, where work is no longer synonymous with employment, the reorganization of service provision has obvious impacts on social security systems whose contributions are still based on an outdated model, as is the case in Brazil.

When discussing the threats to the long-term sustainability of the Brazilian social security system, there is yet another aggravating issue that results from the country's unique tax structure, which promotes the organization of individual workers as legal firms. The existing retirements and other social benefits are paid in a pay-as-you-go basis using payments from active employees. As the current generation pays the benefits of the previous generation, future generations are expected to continue the pact. Yet, this new arrangement of labor allows decreased social security revenue collection. The intertemporal balance of contributions and benefits is thus increasingly difficult, requiring a special focus on the pension system, which is the item of expenditure that currently weighs most heavily within the Brazilian federal budget.

The country's fiscal position suffers, therefore, from growing pension deficits doubly driven by the unfavorable demographic change and the obsolete nature of its financing model. Credible medium-term fiscal frameworks, which use demographic parameters for their longer-term projections, naturally allow a broader view of this trend, by anticipating the intertemporal sustainability and the needed fiscal room in the medium and long run. Spending review also shows to be a helpful tool, since it makes it simple to identify tax policies that encourage costly distortions to the funding of social security. Changing the contribution type solely is not the only way to fix such problems in the current system though. Tax incentives to increase labor force participation, especially for women and the elderly, also allow offsetting of some of the impacts of demographic transition.

Brazil still ranks poorly in educational quality and figures among the countries with the highest rates of violence, while suffers from an overburdened universal health system (SUS, in the Portuguese acronym for *Sistema Único de Saúde*). Thus, thinking about future challenges may sound incoherent and not a priority. However, precisely these most vulnerable populations will be most exposed when adverse scenarios come true. The social consequences left by the pandemic, in the midst of a scenario of inflation and high interest rates, have aggravated the hunger and debt statistics in Brazil. Working towards the normalization and stability of macro-fiscal conditions, despite its reduced popular appeal, is a necessary step to ensure the successful and long-lasting resolution of social issues.

Even if indirectly and not immediately, a prudent budget, which anticipates and creates alternatives to avoid or soften shocks, ends up diluting the social impact and the financial effort to be demanded in time and conditions that are often difficult to predict. Regardless of the fiscal rule in force, the budgetary discipline resulting from structurally strengthened fiscal governance allows the minimization of risks that will eventually prove costly to the government and the society. The cost of anchoring the post-crisis macroeconomy increases in an environment characterized by noise and uncertainty. By shifting the focus to emergencies – such as the pandemic and climate tragedies – the prioritization effort undertaken by each government is undermined. This illustrates the relevance of the medium-term scope for foreseeable expenses, as well as for non-recurring events capable of compromising the predictability provided by the MTEF.

After the previous federal administration, –which incorporated the Ministry of Planning and Budget (MPO, in the Portuguese acronym for *Ministério do Planejamento e Orçamento*) into the Ministry of Economy, the government that began in 2023 re-established the former body as a separate entity. The mission of bringing planning to the budget, through the long-term perspective, involves both a technical and political discussion that will be articulated with the National Congress, where the budget pieces prepared by the MPO are voted on. Although it is a sensitive issue, given the polarization that has intensified in recent Brazilian elections, the redesign of the MPO and the reform of the fiscal framework (discussed in the next section) constitute a valuable window of opportunity. Reforming the fiscal governance to handle internal and global issues calls for sustainable guidance, in line with the set of budgetary best practices under construction around the world.

Reformulating fiscal governance entails more than mere systemic adjustments in light of previous errors. Regardless of the operational rule to be implemented as a control mechanism, the new Brazilian fiscal framework must consider global challenges that will most likely be on its horizon as well, with unavoidable impacts on the government's budget. The climate transition will continue to require more expenditures and investments, as well as the recent labor market configuration and the aging population will force the country to rethink its social protection system. Hard-to-control geopolitical issues and the ongoing digitalization process promise further uncertainty by interfering in the global supply chain. If the pressure for more spending seems an insurmountable obstacle, it is crucial to start thinking now about dealing with it in an optimized way. A fiscal governance framework that relies on MTEF and spending review tools is clearly better prepared for this challenge, which is why Brazil should move in this direction.

2. Reforming the fiscal governance framework in Brazil

The COVID-19 pandemic has accelerated the pace of fiscal reform worldwide. Following the extraordinary expenses required by the pandemic, the topic that intersects so closely with the financial market is currently being discussed in several countries. In the aftermath of the crisis, central governments were demanded to sustain economic recovery while allocating resources to minimize the impact of lockdown on poverty and inequality. Massive fiscal stimulus measures were put into place and fully endorsed, although they were hard to reverse. As the compatibility of such measures with the regulatory framework varied among countries, the effectiveness of the national fiscal governance framework – usually stressed during crisis episodes – also proved to be different across the economies.

A temporary deviation from fiscal rules under special circumstances is allowed and intended to help countries respond more quickly to unforeseen and urgent expenditures. In Brazil, even though the spending ceiling has such extraordinary exceptions for short-term situations, certain expenditures found a way to extend their duration beyond the COVID stabilization period. If all the fiscal frameworks were put to test during the pandemic, the Brazilian spending cap has certainly failed to accommodate the shock as well as to provide a path to normalizing public stimulus. Particularly in light of the absence of planning and budgetary discipline, the dysfunctionality of the Brazilian fiscal structure in promoting, at least, a rational and efficient allocation, became more apparent. Additionally, the use of the public budget for elections in 2022 occurred despite the customary limitations imposed by the election legislation. The Brazilian budget kept increased social transfers, despite compelling evidence of frauds and inefficiency. At the same time, public investments remain low and the perspective of an increase in debt-to-GDP ratios calls for greater commitment to fiscal consolidation.

In that sense, it is worthy to remember that reforms in fiscal governance are first and primarily political processes, not simply technical ones, as evidenced by worldwide experience. Further, they require political engagement from the authorities and the watchdog role of civil society. The EU fiscal governance structure has experienced some recent improvements, but its compliance and enforcement remain fairly weak (Romhanyi, 2023). Brazil could learn from it, starting by following up the international common-sense as it converges to the medium-term framework. This framework also requires a feasible and simple operational rule, able to work for economic stabilization by supporting countercyclical fiscal policy, while holding a strong link to a fiscal anchor. Once an exempt time has passed, the operational guidance should be reliable enough to reverse the loosened conditions. Also, automatic fiscal stabilizers could reduce fluctuations in economic activity without the need for discretionary government actions.[5]

Strengthening the design, compliance and enforcement of the Brazilian fiscal governance framework became a priority in recent debates, not only because of the government's transition period but also because of the expenditure growth expected under the new government's agenda. With public debt at high level, once compared to other emerging economies, it seems desirable to redesign the fiscal governance framework to prevent a further accumulation of fiscal imbalances and better promote fiscal and macroeconomic stability. A system that triggers automatic and inevitably cooperative responses, as well as less flexible sanctions, would reduce opportunistic interpretation of rules and contribute to stricter enforceability of the framework.

A new fiscal framework that would increase the flexibility and the simplicity of the spending cap is under discussion. General budget guidelines have also been announced by the new government's team. Recently, the MPO publicly affirmed its intention to recover the medium-term planning as a practice, beyond the Ministry itself. Within the first months of the new administration, the establishment of a new Secretariat for Monitoring and Evaluation of Public Policy as a core component of this Ministry stands out in this regard.

There are also many alternatives on the table for the implementation of a new fiscal rule in Brazil, since the demand for credible fiscal strategies to restore budgetary sustainability is clearly rising. The scope of such reforms is many times ambitious and the extent to which they will lift the quality of fiscal governance in Brazil remains to be seen in practice. This chapter outlines the main proposals presented until February 2023.

The new government's proposal

The newest of the available proposals has been recently sent by the newly elected government to the National Congress. The typical quietness of the beginning of governments was set aside by the strong expectation for the mechanism to replace the spending cap, especially because of the authorization, by means of the EC No. 126, at the end of 2022, for spending expansion in the transition phase between governments. This document (i) authorized BRL 145 billion in extra spending, above

5 Although some features are notoriously desirable, this paper does not intend to discuss in depth the ideal framework for the current Brazilian scenario, limiting itself to analyzing the available proposals. Undoubtedly, such a discussion is hugely pertinent, and a paper entirely devoted to this purpose is highly recommended.

the current expenditure ceiling, and (ii) established the submission of a proposal, for a new sustainable fiscal regime, by August 31st, in the form of a Bill of Supplementary Law (PLP, in the Portuguese acronym for *Projeto de Lei Complementar*). The PLP has been submitted in advance, in an environment marked by strong concerns regarding the fiscal commitment to be assumed by the new government. In this scenario, not only the broader social agenda for which the new government is known stands out, but also the constant changes in the spending cap that have turned it ineffective in its original mission of controlling expenses. The electoral period, in turn, made such reform inevitable as both candidates who went to the second round promised policies that did not fit into the budget within the ceiling as we know it.

Given the certainty regarding the replacement of the spending cap with a new legal mechanism, the speculation in the first months of this government fell entirely on the design of the new rule to be proposed. On April 18th, PLP 93/2023[6] was officially submitted to the Congress, setting limits for spending growth and primary balance targets aimed at the stabilization of the federal public debt in 2026, the last year of the current president's term. The public debt, however, does not appear as an operational target, but as an objective. The main constraint, set on the spending trajectory, has two numerical limits to be respected by the Union (Executive, Legislative and Judiciary), the Public Ministry of the Union and the Public Defender of the Union.

The first restriction is linked to compliance with the primary balance target, which must be disclosed in the Fiscal Targets Annex of the LDO, for the year to which it refers and the three following ones, having tolerance limits of 0.25 p.p. of the GDP above and below the target. Besides the interval, another degree of flexibility provided in the proposal is the permission given to each government, in its first year in power, to set its own targets and parameters for the following four years. More than simply reducing the horizon of the rule in place, this feature enables calibrations in the expenditure ceiling to deal with different economic and political cycles without weakening or even discontinuing the rule.

In the initial general rule, valid for the years 2024 to 2027, real expansion of expenses each year is restricted to 70% of the real growth in primary revenue for the last twelve months ending in June of the previous year. If the primary balance falls below the lower bound of the band, the restriction is more severe: expenses in the following year may grow only by 50% of the increase in revenue. The logic of this general rule is to attenuate the link between the expansion of spending, on the one hand, and the expansion of revenues caused by economic growth, on the other hand. Such a mechanism would lead to the generation of surpluses and consequent reduction of the public debt, signalling fiscal responsibility without compromising the social agenda.

It is worth noting that the proposal considered the stable part of revenues as the basis for this rule, leaving out of this criterion revenue categories considered "more volatile", such as those from concessions, permissions, extraction of natural resources, and dividends. This definition prevents further careless fiscal expansion, as it ensures that the central government's primary expenditures, which are mostly permanent and mandatory, are financed by regular revenues, such as those arising

6 Available at: https://www.camara.leg.br/proposicoesWeb/prop_mostrarintegra?codteor=2260147&filename=PLP%2093/2023

from taxes and social contributions. On the other hand, the operational rule conditioning the real growth of expenditures to the dynamics of revenues demands a concentrated effort to raise revenues permanently – a challenge in a country with an existing high tax burden. This effort, already publicly acknowledged by the Brazilian Finance Minister Fernando Haddad[7], has prompted the discussion of a package of revenue recovery measures such as removing tax exemptions and redefining tax credits, as well as setting new taxes on bases where there are regulatory gaps, such as sports betting.

If the government's primary balance turns out above the upper bound of the target, the surplus can be used to reinforce investments. Even so, there is a limit for the application of this excess: BRL 25 billion valid between 2025 and 2028, to be adjusted by inflation. To preserve strategic investments in times of lower revenue growth, public investments will also have an annual floor, based on the 2023 budget forecast (approximately BRL 75 billion), also with monetary correction over time.

The second constraint is set to avoid distortions and to cushion economic shocks, with minimum and maximum limits for real primary expenditure growth, between 0.6% and 2.5%. Thus, even if Brazil faces difficulties meeting targets and collecting taxes or contributions, real growth in spending cannot be less than 0.6%. In the opposite case, in more favorable times, in which Brazil manages to considerably increase revenue collection, real growth in expenditures cannot exceed 2.5%. In practice, this interval works as a new spending ceiling, more flexible than the previous one as it allows expenses to grow above inflation – which is prohibited by the current rule, as mentioned in Chapter 1. Apart from these limits and in compliance with constitutional minimums, health and education expenses are set to be at least 15% and 18% of net current revenues, respectively.

Other expenses would also not fall within the limits proposed in this new fiscal rule, such as (i) transfers to subnational entities to pay the new nursing wage floor, (ii) expenses with socio-environmental and climate projects, and (iii) expenses of public universities, as long as they are funded with their own revenues, donations, or partnerships. Exceptions that already existed in the original version of the spending cap were maintained, such as constitutional transfers to states and municipalities, non-recurring expenses of the Electoral Justice and extraordinary credits (in cases of compliance with the constitutional requirements of relevance, urgency, and unpredictability). The exception regarding capital increases in non-dependent state-owned companies now applies only to non-financial companies. Thereby, public banks such as *Banco Nacional de Desenvolvimento Econômico e Social* (BNDES) and *Caixa Econômica Federal*, which were outside the ceiling, are now included within the limit.

Based on the quarterly results of budget execution, if it is verified that the estimate of revenues or expenses does not support the achievement of the primary balance target for that year, the government will no longer be obliged to promote a limitation of commitments to spend and of financial movements, a mechanism that becomes only optional. The new framework provides, however, that by the end of February, the Executive Branch must evaluate compliance with the previous year's primary balance target in a public hearing at the Joint Budget Commission (CMO, in the Portuguese acronym

7 https://x.gd/G95nX

for *Comissão Mista de Orçamento*). If the target is not met, which would no longer constitute a violation of the LRF, the President of the Republic must send a message to the National Congress by May 31 with the reasons for the non-compliance and the corrective measures. The Central Bank, in turn, must submit to the National Congress, within 90 days after the end of each semester, an assessment of compliance with the objectives and targets of the monetary, credit and foreign exchange policies. The analysis should clarify the fiscal impact and cost of operations and the results shown in the balance sheets.

The National Treasury of Brazil's proposal

The National Treasury Secretariat's (STN, in the Portuguese acronym for *Secretaria do Tesouro Nacional*) technicians presented a new proposal for a fiscal rule for the Brazilian case in a Discussion Paper published last year[8]. They introduce the proposal by emphasizing the objectives of (i) strengthening sustainability, (ii) orienting fiscal policy to the medium term, (iii) reducing the pro-cyclicality of the current fiscal framework, and (iv) increasing the planning capacity of the public administration. The starting point would be transparent medium-term fiscal projections, which would serve as the basis for the specification of a primary balance target. An annual publication of fiscal projections is proposed for a ten-year horizon, in such a transparent and detailed form as to allow for external analysis and replication. Such improvement would be important (i) to ensure the framework's credibility and (ii) to subsidize the analysis of the impact of different macroeconomic scenarios and different public policy choices.

The proposal is based on a single operational expenditure rule, linked to a debt anchor translated into prudential bands. The limit for real growth of federal expenditure would be pre-conditioned on the level and trajectory of the General Government Net Debt (DLGG, in the Portuguese acronym for *Dívida Líquida do Governo Geral*). According to the authors, this metric is the one that best reflects the impacts of fiscal policy and minimizes constraints to monetary policy or public debt management. Thus, they propose a rule where the higher the debt level, the lower the real growth of expenditure. Similarly, for a given level of debt, if debt is on an upward path, the expenditure limit will be lower than if debt was on a downward path[9].

Furthermore, it is suggested that such real spending growth be fixed biannually with the aim of improving predictability and planning of the fiscal policy, in contrast to fixing it for a single fiscal year. The authors argue that this plan would make expectations anchoring easier, as well as provide more stability for the medium-term execution of public spending, particularly investments. The decision to use a two-year timeframe is justified since, if longer than two years, the framework would not be

8 Available at: https://publicacoes.tesouro.gov.br/index.php/textos/issue/view/texto35

9 In a fiscal scenario where the net debt is above 55% of the GDP, for example, there would be the possibility of real growth in expenditures of 0.5% p.a. in the case of debt reduction trajectories, or of no real growth in the case of debt increase trajectories. For a debt between 45% and 55% of the GDP, real growth of expenditure could be 0.5% p.a. (in case of debt increase) or 1% p.a. (in case of debt reduction). Finally, for a debt below 45% of the GDP, real expenditure growth of 1% p.a. (in case of debt increase) or 2% p.a. (in case of debt reduction) would be allowed.

responsive enough to changes in the fiscal scenario, generating less adherence of expenditure growth to debt conditions. Furthermore, the two-year timeframe reduces the chance that irregular changes in the trajectory and level of debt, which are not always a result of fiscal choices, will have a long-term impact on the expenditure cap.

The proposed biannual frequency implies lower costs for reducing the pace of expenditure increase in the event of debt expansion, which appears to be especially significant in the Brazilian case, given the country's highly rigid budget. By recognizing that the impossibility of real growth in primary expenditure under the current spending cap is the source generating pressures for changes in the current framework, the proposed flexibilization incorporates the possibility of real, but not unrestricted, growth. The rule uses spending and debt for an automatic adjustment mechanism, since public spending that exceeds what is deemed reasonable now will be restricted in the future, repaying all excess consumption.

Given the differences in composition and the expectations of service provision by each branch of government, the proposal also considers the possibility of differentiating the limits for the Executive Branch and the others. For instance, the country's demographic transition has a direct negative influence on the Executive Branch because of the rise in demand for social security and health services. The other branches, on the other hand, are less affected by these structural changes and are more affected by changes in their personnel policies, as 83% of their expenses are associated with it. With regard to this particular expense, each branch sub-limit could be established in accordance with its own personnel dynamics-related parameters, although without ever being able to exceed the general percentages of the other expenses of the Executive Branch.

The primary balance would then lose its current configuration as a target with a sanction in case of non-compliance and would start acting as an incentive (i) for its maintenance in the positive field, as well as (ii) for an effort to collect revenue, in two ways. First, via reputational cost, as non-compliance would require a public explanation by the Minister of Economy, similar to the scheme adopted in the inflation target system. Second, via bonuses, allowing for an extension of spending limits when the primary balance is positive and on an upward trajectory, or when it is above a given threshold. Consequently, there would be a "bonus" on the limit of expenditure growth of 0.5 percentage points in addition to the limit defined by the level and dynamics of debt. The purpose of this second mechanism is to persuade the government to account for how tax waivers affect revenue collection and the primary balance, imposing a cost like the penalty of lower future real growth of expenditure.

The framework also considers the existence of: (i) triggers, which aim to lower the growth rate of mandatory expenditures subject to the ceiling when they reach 90% of the expenditure limit, helping to prevent the pressure on discretionary spending and maximizing spending quality; and ii) escape clauses, related to the establishment of extraordinary credits, as in the current expenditure ceiling.

Although they agree with the current rule on the use of extraordinary credits, the authors highlight that a problem related to the escape clause refers to the non-limitation of such values. They propose, then, to establish a limit beyond which extraordinary credits would imply the activation of a trigger that prevents the expansion of mandatory spending. Such a strategy is critical (i) for transparency and control, (ii) to ensure that its activation is proportional to the crisis and strictly tied to its impacts, and (iii) to smooth the intertemporal adjustment. In this sense, they suggest that its use be discussed and justified, not just when it is activated, but also in the explanation provided by the Minister of Economy if the primary balance target is not achieved.

Finally, the proposal intends to redirect the emphasis of Brazilian fiscal planning from the short to the medium term, through clear communication of the fiscal policy strategy, supported by credible, transparent, and detailed projections, allowing the anchoring of expectations with a positive impact on the government's cost of financing. It becomes vital, then, to address public policy decisions in an intertemporal perspective, beyond the current or next year's budget, as the proposal to parameterize expenditures shifts the attention to public debt. Under the proposed structure, changes to revenues and expenses would influence the expenditure limit two or more years ahead. In this setting, reliable estimates are crucial for assessing and tracking the long-term impacts of policy decisions on the trajectory of public debt.

The Secretariat for Economic Policy's proposal

In December 2022, the Secretariat for Economic Policy published a technical note[10] proposing an improvement to the current spending cap rule by incorporating the GDP evolution rule, taking the debt-GDP ratio as a parameter.

The authors argue that the spending cap has been implemented to stop the pattern of increases in spending followed by increases in tax collection, which characterized public finances in the first two decades of this century. As they identify the spending cap as an instrument rather than as an end, any refinement of the rule should maintain this control purpose, even if in a less rigid form. The refinement of the rule would therefore keep an expenditure rule as the guiding principle, although it would become more flexible thereafter, especially (i) to deal with pressures from revenue growth and (ii) to reduce pressures to withdraw or loosen the rule on a discretionary basis. Such flexibility should thus be broad enough to make it more sustainable in the long run and limited enough to ensure public debt sustainability.

While highlighting the growth of public spending as the main fiscal issue to be addressed, there would be room for growth of primary spending in real terms, but spending could not grow, at least not systematically and continuously, at rates higher than real GDP growth. By this new rule, the target variable would be the debt-GDP ratio, measured in relation to the General Government Gross Debt (DBGG, in the Portuguese acronym for *Dívida Bruta do Governo Geral*), given its wide use in the public finance literature that evaluates the sustainability of national debt. The preference for rules over discretion in the design of public policies would then be one of the guiding principles. This means that

10 Available at: https://www.gov.br/fazenda/pt-br/centrais-de-conteudos/publicacoes/conjuntura-economica/estudos-economicos/2022/ni-uma-proposta-de-aprimoramento-do-teto-de-gastos.pdf/view

real increases in the spending cap should be made in accordance with predetermined rules rather than arbitrary decisions.

The authors' note identifies some weaknesses, such as the absence of a countercyclical mechanism in the formulation of the spending cap, hindering its stabilizing action – via fiscal stimulus – in times of recession or economic depression. It also highlights disincentives of the spending cap to certain policies that improve fiscal sustainability, such as the demobilization of public assets (concessions or privatizations) or expenditure-saving structural fiscal reforms. In the first case, if the expenditure cap is close to being reached, the resources from the demobilization of public assets cannot be spent according to the current rule, limiting the use of the fiscal benefits arising from these policies. No rationale is provided for the second case.

Finally, their note emphasizes the strong compression of discretionary spending, while the growth trend of mandatory spending has been maintained, given that the structural reforms that could have curbed it have not materialized to the necessary degree. This serves to justify the last guideline pointed out for the rule improvement proposal, which can be summed up in four key components:

1. permanent real growth of the spending cap, when and as the GDP grows above a certain threshold: 2% when the reference debt is below 60% of GDP or 1% when debt is between 60% and 80% of GDP. Such a rule would be suspended whenever debt represented more than 80% of GDP;
2. temporary real growth of the spending cap, when the economy goes into recession, so that there is a rapid response capability. Two consecutive quarterly GDP declines would therefore open the possibility of extraordinary credit in the average proportion of the declines, with the value of the expenditure cap serving as the basis for calculation;
3. in the case of asset demobilizations, or the approval of expenditure-saving structural fiscal reforms, part of the amount calculated (50%) would be absorbed by the National Treasury and would immediately reduce public debt. Another part (up to 25%), related to infrastructure projects, would be excluded from future spending cap accounting. The remainder (25%) would be destined to social spending, to be carried out in installments or not, according to legislation to be established by the Congress; and
4. the entire real growth of the spending cap should be allocated to discretionary spending, so there would be a gradual increase in the proportion of discretionary spending in relation to the total budget. As a result, there would be a gradual loosening of the budget, making it more adaptable to society whose economic, social, and demographic changes call for greater budgetary adaptability.

Giambiagi and Pires (2022)'s proposal

In 2022, two public accounts experts and researchers offered another remarkable proposal in a discussion paper[11]. The authors begin by recognizing the challenging task of sustaining the spending

11 Available at: https://portalibre.fgv.br/texto-discussao/perspectivas-fiscais-para-decada-dilemas-e-escolhas

cap as it is now through 2026. They claim that even if such a decision resulted in a policy that was at first well-received by the market, the negative impacts on the evolution of discretionary spending would ultimately increase the risk of new breaches in the rule, leading it to lose even more of its credibility. Hence, it would be urgent to guarantee room for discretionary spending, especially given the authors' belief that private investment is not enough to generate growth.

Their proposal to reformulate the expenditure ceiling includes some compromises along with a modest real increase in annual government spending. This commitment would manifest as adjustments to spending, particularly the elimination of salary bonuses payments to low-income employees ("abono salarial", the name of the program in Portuguese). There would also be an expansion of the expenditures subject to the rule, i.e., the incorporation of the following ones (currently not under the cap) below the cap: (i) expenses of Fundeb[12], (ii) other constitutional transfers, (iii) expenses of the Electoral Justice system, and (iv) the capitalization of state-owned companies. The authors' reasoning in this case is the prevention of behaviors that work against the logic of the ceiling, like favoring particular expenditures simply because they are exempt from the rule.

As of 2024, the authors propose a new ceiling: a sort of "mobile ceiling" with an increase in the annual spending limit of 1.5% above the adjustment of the IPCA already foreseen in the law. Additionally, it would establish a specific "sub ceiling" for personnel expenses, of 0.4% beyond inflation, but still within the global ceiling. This sub ceiling is based on their recognition of an unsustainable dynamic of falling personnel expenses as a proportion of GDP in Brazil. Considering only 2017 to 2022, in the authors' calculation, real variation in personnel expenses was -10.4%.

In addition to reducing the amount of spending out of the ceiling, some expenses would have their own expansion rules, such as health and social security expenses, which should maintain the parametric levels of the expansion of total spending. A third group of expenses with its own rule, among which are unemployment insurance and court order expenditures, should present zero real expansion, just following inflation. The new rule would also contemplate additional correction mechanisms, in case the fiscal adjustment process does not prove to be sufficient to correct the debt trajectory in the analyzed period. Besides, ensuring structural sustainability of the ceiling would involve correcting the difficulty to activate the current ceiling triggers. The new idea is that these triggers will be activated when a primary deficit considered "prudent" is exceeded, a level yet to be established. In addition, there is a provision for well-defined and temporary escape clauses so that, in exceptional cases, the Constitution will not have to be changed to increase spending, preserving the credibility of the rule.

The change should be presented now in 2023 and implemented starting in 2024, according to the authors' suggestion. The idea also encourages the restoration of policy as a device of negotiation. The adjustment measures and the change in the ceiling are a part of what Giambiagi and Pires (2022) refer to as a "great political pact", which would also include (i) a slight increase in tax burden (roughly 0.5% of GDP) compared to the level anticipated for 2022, (ii) a gradual rise in public investment, and (iii) a partial reorganization of social spending, including a program targeted at informal workers.

12 This is the Portuguese acronym for the educational program called "Fundo de Manutenção e Desenvolvimento da Educação Básica e de Valorização dos Profissionais da Educação".

Even if the proposal eased restrictions in the period 2024-2026 only moderately, it would, on the other hand, direct structural adjustments to the period 2027-2031. Growth percentages of the ceiling and of other specific expenses should be indicated by the constitutional amendment for the initial year and until 2031. Following such a period of debt trajectory adjustment, each government should determine the expenditure parameters it wants to work with – always in the first six months and every four years, in accordance with an expenditure target system that ensures the consistency of the public debt trajectory. In this way, each incumbent would propose the parameters for fiscal management at the beginning of its mandate, which would be in force until the first year of the following administration.

PEC 34/2022 (Elas no Orçamento's proposal)

One more proposal under discussion has been presented by the group "Women in the Budget" (PEC 34/2022)[13], an initiative formed by women specialists in public finance. Besides listing the history of ineffectiveness of the current spending cap and the Golden Rule in the last four years, evidenced by recurrent episodes of fragility of the fiscal mechanisms, the group presents a series of general governance parameters for a new fiscal framework, based on a Sustainable Fiscal Regime.

According to this proposal, in the first year of each mandate, the Executive would propose, and the Federal Senate would deliberate over, the goals of the Sustainable Fiscal Regime, which spells out the priorities for fiscal space and constitutes four-year commitments to the entire nation. The instruments involve: (i) medium-term federal debt target; (ii) economic and social development strategy for a minimum horizon of 12 years, with guidelines, priorities, targets and key indicators; (iii) framework of priority government deliverables guided by the government's long-term development strategy; (iv) medium-term expenditure framework, compatible with the medium-term debt limit, and including four-year primary expenditure ceilings for the programs of continued duration and for the priority deliverables of the respective framework; and (v) direct and indirect spending review, aimed at optimizing continued programs and finding fiscal space for long-term priorities.

Some permanent exceptions to any global spending cap are also proposed, to ensure spending on (i) cash transfer programs for families in poverty and extreme poverty, (ii) projects to combat climate change (when funded by donations), and (iii) the operation of federal education and research institutions (when funded by own revenues, donations or agreements). The proposal does not stipulate the immediate extinction of the current spending cap, but only when the laws that would implement such definitive fiscal rules are approved, as "the Sustainable Fiscal Regime will be detailed through infra-constitutional provisions".

According to the draft PLP, still to be officially presented, the commands would be indicative for the two fiscal years after the year of its publication, and mandatory as of the third fiscal year. Additional deadlines are provided, such as the installation of the Fiscal Management Council (as stated many

13 Available at: https://legis.senado.leg.br/sdleg-getter/documento?dm=9216975&ts=1669759233360&disposition=inline

years ago in art. 67 of the LRF) within sixty days of the publication of the referred Supplementary Law (LC, in the Portuguese acronym for *Lei Complementar*), through articulation of the Federal Executive Branch. It would be up to this Council, within one hundred and eighty days of its establishment, to coordinate the preparation of the National Fiscal, Budgetary and Financial Governance Code, based on the consolidation of the rules provided in the LC itself, in the LRF, in Law 4.320/64, in the Budget Guidelines Laws, and in other rules pertaining to public finances.

The draft also proposes that the Sustainable Fiscal Regime be supported by the following rules:

1. until the Senate sets a limit for the federal public debt, the debt-to-GDP ratio in the last year of the incumbent's term should not be greater than in the first year of the same term. Some exceptions are made to this rule, in order to safeguard from effects such as those arising from monetary policy, debt refinancing, situations recognized by the legislature, among others;
2. in scenarios where GDP increases, the real variation in primary revenues would be used to finance priority projects and reduce the public debt stock in accordance with LDO-defined proportions;
3. the LDO would also establish, in the first year of the incumbent's mandate, expenditure limits and primary balance targets for the overall period of three fiscal years, while the partial results of fiscal and budgetary management would be evaluated annually in the LDO;
4. an analytical assessment of expenses corresponding to the government priorities, to be part of the PPA, would include initiatives for (i) the control of expenses resulting from judicial sentences and (ii) the strengthening of fiscal risk management;
5. the LDO would also indicate annually, in an annex dedicated to review direct and indirect spending, government actions and revenue waivers with evidence of low cost-effectiveness or exceeding the financial capacity of the public administration, which should be considered by the legislature for possible revocation or adoption of remedial measures;
6. the annual budget programming would observe the principle of realistic management of revenues and expenses, preventing the underestimation of expenses, as well as the inclusion of actions with low national or regional effectiveness;
7. finally, the Fiscal Management Council would coordinate the development of a proposal to revise the tax system with the objective of making it (i) sensitive to gender, race and ethnicity, and (ii) focused on the protection of employment, productive income and the provision of social value.

3. Making the Brazilian IFI stronger

Along with the fiscal rules, the IFIs represent part of the recommended system in fiscal accounts, known for its credible, feasible, and sustainable approach. The emergence of fiscal authorities around the world marked a significant institutional innovation for the fiscal framework, particularly in the environment of increased volatility under which they were constituted, after the global financial crisis. Among the rationales for the establishment of these institutions as fiscal “watchdogs”, there are (i) the incapacity of numerical rules to regulate the discretionary nature of fiscal policy and prevent the reckless administration of public accounts; and (ii) the extended reliance on the “exceptional circumstances” clauses, which has been a risk factor for the stability of fiscal frameworks. The clauses are hardly prepared to revert to a rules-based approach when public debt is already excessive (EUIFI, 2021).

Significant improvements in transparency and quality of public debate in the budgetary field were facilitated by IFIs during the past years. The provision of realistic macroeconomic and fiscal predictions was especially necessary during the COVID-19 pandemic, as the IFIs had to step in to offer realistic scrutiny of scenarios after emergency spending programs. Since fiscal policy remains essential when addressing volatility and crises, the IFI’s continuous monitoring of budget compliance has become crucial to safeguard the sustainability of public finances while balancing flexibility with enforceability. Ultimately, the political cost to governments of implementing more unbalanced fiscal policies has increased, as the analyses of this reputable and meticulous authority have acquired greater prominence in the news.

This is the reason why current fiscal governance configurations usually include independent fiscal authorities as a relevant instrument to support sound fiscal policy, even though there is still work to be done to make such institutions more effective and lasting. The IFIs are unable to do all the work alone, particularly in light of the pandemic’s difficulties as well as other upcoming challenges. In addition to the fact that IFIs are typically new and heterogeneous institutions, there are several methodological issues that arise when attempting to empirically assess their impact on fiscal performance. These issues arise, among other factors, from the fact that IFIs are not the only components of the institutional framework charged with the duty to promote sustainable fiscal policies (Lledó, 2018).

Although fiscal authorities clearly remain important partners in the post-pandemic recovery, there is still room to strengthen their role, which in turn will help strengthen the fiscal governance structure. At the same time, the fiscal governance reform calls for an authority in charge of guiding and following such a process. In order to advance in terms of fiscal governance, a stronger IFI is therefore critical. Among the previously mentioned efforts to reform the current EU fiscal governance structure, there are some proposals specifically devoted to enhancing the EU IFIs role.

The Network of EU IFIs[14] is actively promoting this debate by addressing shortcomings in the European framework while outlining how to operationalize stronger national IFIs. In the interest of improving public account transparency and predictability, the Network advocates that enhanced mandate and capability are indispensable. As important determinants of improved and more sustainable fiscal outcomes, institutional arrangements and, ultimately, sufficient political commitment are also emphasized. Although many of the recommendations are intended to assist the European IFIs towards greater coherence at EU-level, some concerns about fiscal governance as a whole can be extended. Lessons could be drawn for the Brazilian case, especially considering common challenges most IFIs share, despite being largely heterogeneous across countries. To ensure prudent fiscal policy fostered by an effectively functioning Brazilian IFI, some minimum national framework standards can be identified, which is the topic discussed next.

Working to develop and protect the Brazilian IFI

Despite its youth, the Brazilian IFI is already recognized as a domestic authority and is the only non-member nation listed in the OECD IFI Database[15]. Its capacity to conduct independent unbiased assessments of national fiscal dynamics and to promote transparency and predictability could, however, be used more effectively in the Brazilian fiscal framework. Within the ongoing effort to restructure the fiscal rule, and by consequence, the national fiscal governance framework, it should be a primary concern to work to enhance and protect the Brazilian IFI. Experiences from economies with longer records of this type of authority show the early years are of the utmost significance to shape their course. Well-designed fiscal councils are a necessary condition for improving fiscal performance, although the lack of political commitment to a medium-term goal and, in some cases, to the councils' mandate, might limit long-lasting improvements (Hagemann, 2011).

In the post-pandemic era, most of the countries are striving to restore sustainable and resilient public finances while dealing with inflation and interest rates higher than expected. Brazil is one of them and its national IFI could also benefit from a broader and more independent mandate. This holds regardless of the direction the future fiscal reform takes or of the new instruments to be adopted, as

14 Publications available at: https://www.euifis.eu/publicationsfilter/pp.

15 Available at: https://www.oecd.org/gov/budgeting/ifi-database.htm

they all can work together simultaneously contributing to fiscal consolidation. The government's short-termism is naturally followed closely by the media, precisely where the IFI has the greatest capacity to influence the public debate, given that it is not a decision-maker by nature. To enhance its role, which is not a simple or rapid process, the Brazilian IFI could work to build unrestricted operational autonomy as well as a more prominent position in the public debate, which relies on some key steps. Following one of the major references on this topic, the OECD's 2014 list of guiding principles for IFIs[16], some suggestions can be drawn for the Brazilian case.

A stronger legal basis would be useful for the Brazilian IFI, which was established in 2016 through the Federal Senate Resolution n. 42[17]. Considering that a national law could be better suited for institutions of this nature, as observed in other countries, some concerns arise from the fragility of this statutory foundation. IFIs should be the outcome of broad political ownership, commitment, and consensus at the national level (Principle 1.1), such that higher-level legislation specifies their mandate (Principle 3.1). Having a robust statute not only demonstrates political commitment to such organizations but also upholds their independence and makes more challenging for them to be abruptly terminated due to political pressures. The American Congressional Budget Office (CBO) and several other pertinent IFIs were established by laws approved by the President (Rodrigues and Conti, 2020). The vast majority (89%) of OECD IFIs are provided in primary legislation, protecting its mandate and the leadership appointment process.

The Brazilian IFI should have guaranteed and unrestricted access to all relevant information. Accessing government information is crucial to the work of IFIs, thus it should be guaranteed in legislation and, if necessary, reaffirmed through protocols or memoranda of understanding (Principle 6.1). Three-quarters of OECD IFIs have access to information guarantees in legislation, in Memorandums of Understanding, or both. Participation of the Brazilian IFI in committees addressing internal issues, related to government fiscal data and budgeting processes, could also assist and ensure its analytical capacity. Additionally, the information sharing system must operate properly to safeguard the IFI's performance and improve the conditions for public accountability. It is advised that the Brazilian legislation explicitly specifies any limitations on access to government information.

Ensuring sufficient and stable resources, both human and financial, as well as flexibility to manage its own budget is another condition to preserve the Brazilian IFI's functional autonomy. The IFI's contribution is meant to be robust and enduring as a component of an economy's institutional structure, regardless of the context or the political party in power. In practice, however, even in the case of existing well-functioning institutions, their independence and autonomy cannot be taken for granted (EUIFI, 2019). This is why IFIs should be given funds that are proper for them to fulfil their mandate in a credible manner (Principle 4.1). Some measures can be implemented to protect IFI budgets and insulate them from political pressure, such as publishing appropriations and approving multi-annual funding commitments. While some of the OECD countries outline the IFI budget as a separate line

16 Available at: https://www.oecd.org/gov/budgeting/OECD-Recommendation-on-Principles-for-Independent-Fiscal-Institutions.pdf

17 Available at: https://legis.senado.leg.br/norma/582564/publicacao/17707278

item, other countries set out in legislation that the IFI funding can only be cut under exceptional circumstances properly justified.

A step further that would endorse the Brazilian IFI's authority throughout the budget process is the obligation to take into account its contribution, which could become a legal requirement. This somehow relates to the recommendation of a closer relationship between IFIs and the legislature, given its critical accountability functions (Principle 5.1). Almost all OECD IFIs send key reports to the legislature and provide evidence in parliamentary hearings. It is worthy to mention that the IFI's formal role of monitoring fiscal compliance is doubly desirable, since it is not only relevant for its own strengthening as a fiscal guardian, but also because it supports economic decisions. As a forceful institution, a stronger Brazilian IFI would support the reduction of historic procyclicality and the prevention of macroeconomic volatility. Once integrated with other instruments of fiscal governance, such as the MTEF and the spending review, the coordinated use of all of them could be even more advantageous.

The following recommendations are not directly derived from the OECD guidelines for IFIs in general but reflect local needs and the Brazilian institutional configuration. They are of tentative and preliminary nature, and do not exhaust the discussion on this matter.

Strengthening this institution in Brazil necessarily involves making its production more tangible and useful in the sense that it can be used by the government on a broader and more regular basis. The likelihood of not always pleasing the government in power can raise attempts to restrain IFIs, since assessments of the fiscal dynamics are often not binding. Bypassing internal incentives to limit the IFIs' potential calls for wider publicity about their independence and practical role as well. To carry out their duties successfully at any and all times, the IFIs must count on a fiscal governance system also committed to safeguarding their activities and budget from political interference and pressure. IFIs consolidation processes require, then, ensuring their technical, financial, and operational independence (Von Trapp and Nicol, 2017).

An active communication by the Executive to promote the Brazilian IFI would both legitimate the institution and help to set expectations regarding the government's observance of budgetary discipline. IFIs typically have a limited effect on enhancing the conduct of fiscal policy under a framework lacking planning and a longer horizon, as in the case of Brazil. A significant proportion of the IFIs' contribution is precisely quantifying the effects of pertinent fiscal events and creating corresponding budget scenarios. Nevertheless, when the long perspective is disregarded in favor of urgent matters that are generated mostly by lack of planning itself, this knowledge becomes less valuable. Warnings issued by institutions like the IFI are less compelling when the future has little significance in the budget-building process. Therefore, the work of the national IFI would benefit from a shift, in the Brazilian government culture, towards longer-term policies.

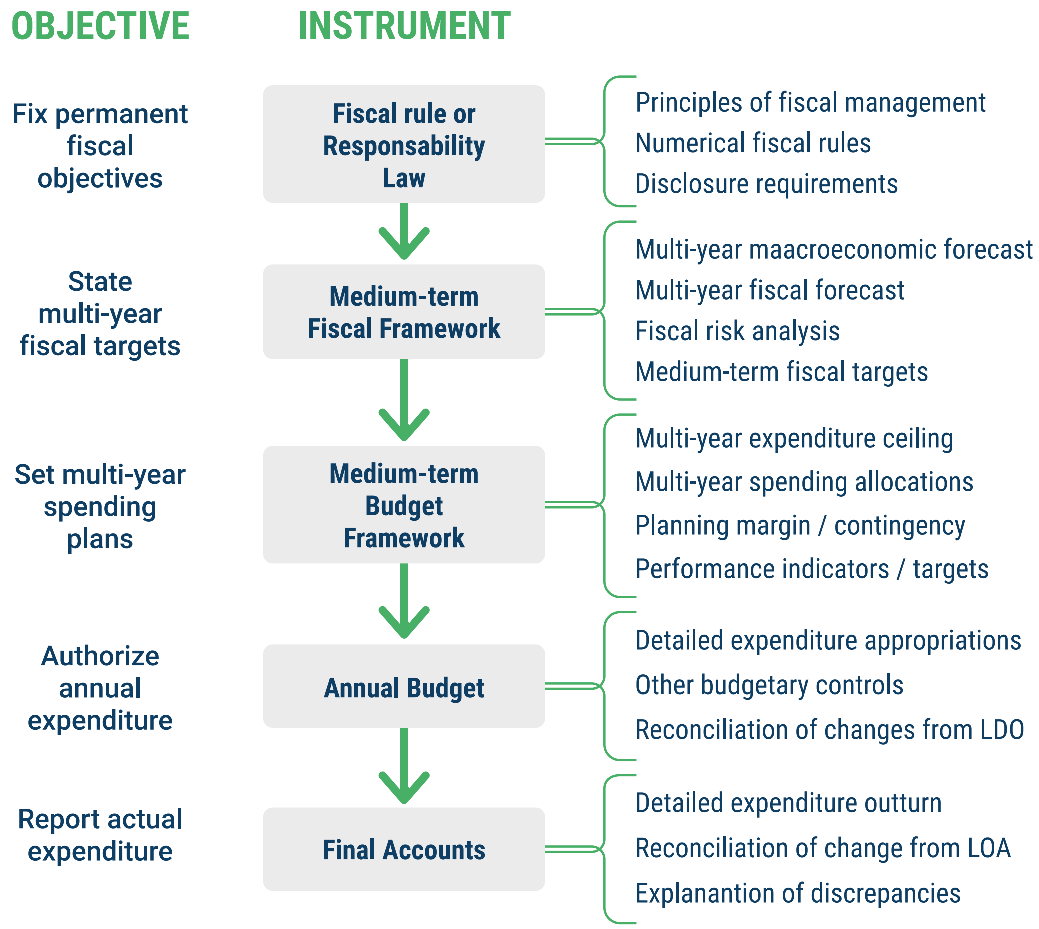
Strengthening the role of the Brazilian IFI at domestic level also includes making its scope broader enough to cover subnational matters. Promoting transparency and accountability in the whole public sector cannot rely only on supporting sound fiscal policy at the federal level. This may require a formal vertical extension of the Brazilian IFI mandate, as a key partner in the performance budgeting surveillance. In Brazil, a significant federal impasse dominates the Union's relationship with states and municipalities. The lack of balance between the distribution of attributions to provide public services and the autonomy to collect taxes is reflected in frequent cases of intragovernmental judicialization. As such, enhancing the reputation of IFIs in order to improve their influence on budget execution requires an impartial approach that supports all levels of government equally. Subnational policymakers will benefit from the granularity of the assessments, which also enable wider and longer-term thinking on the balancing of public budgets.

The mandate of the Brazilian IFI could be further extended horizontally to support both legislative houses. The Brazilian IFI was founded as a body connected to the Federal Senate, despite its independence to carry out its legal duties in accordance with global best practices. Worthy to note that its production also adds significantly to the work of the Chamber of Deputies, which is the other legislative house and the one that most directly represents the demands of society in the bicameral Congress. In addition to legal questions regarding the constitutional portfolio of the Senate's private competence, international experience has shown the advantages of a wider scope of action. The Brazilian IFI could gain from another design, reinstalled as a congressional body, assisting both houses of Congress in their legislative efforts.

Several economies and international organizations are currently engaged in building a solid foundation for the efficient operation of IFIs. Brazil should follow this effort while working on a new fiscal rule, as an empowered IFI and the new fiscal framework could be mutually beneficial. The IFI's stronger role may ultimately increase the chances of the newly proposed rule being successful.

4 . ANNEX

Figure 1 - How Medium-Term Frameworks Fit Within the Broader Fiscal Framework



Source: (Curristine et al., 2017), *Supporting Implementation of the Expenditure Rule Through Public Financial Management Reforms.*

Table 1 - Commonly used tools by countries practicing green budgeting (2020)

Country	"Ex ante or ex post environmental impact assessments (individual measures)"	"Environmental cost-benefit analysis (individual or all measures)	Carbon assessments	Carbon pricing instruments including fuel and carbon taxation, emissions trading systems)"	Environmental tax reform	"Ex ante or ex post green buget tagging measures)"
Austria	●		●			
Canada	●	●		●		
Colombia	●	●	●	●	●	●
Denmark	●	●	●	●	●	
France	●	●	●		●	
Ireland	●	●	●	●		●
Italy	●	●	●			●
Luxembourg						●
Mexico						●
Netherlands	●	●	●	●	●	
Norway	●	●	●	●	●	●
Portugal	●			●	●	
Sweden	●	●	●	●	●	
United Kingdom	●	●	●	●	●	
OECD Total						
• Yes	12	10	10	9	8	7

Source: (OECD, 2021b), Government at a Glance 2021.

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