Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

JAN 18, 2024 • Nº 84

HIGHLIGHTS

- In 2023, the Brazilian economy exceeded projections, with robust growth in the agricultural sector and an increase in disposable income.
- For 2024, although these factors will have less impact, the reduction in interest rates will help sustain consumption and boost investments.
- The new fiscal rules will need to address the old challenges of fiscal stability.
- The central government is expected to have recorded a primary deficit of R$ 233.3 billion in 2023.
- The recurring primary balance is expected to have been R$ 134.0 billion last year.
- Considering the legal exceptions provided, the government met the 2023 result target.

Report Layout
COMAP/SECOM and SEFPRO/SEGRAF

The results of 2023, the new year, and the challenges of fiscal policy

The Independent Fiscal Institution (IFI), fulfilling its institutional mission, launches the first Fiscal Follow-up Report (RAF, kept here in its original acronym, as will all the acronyms of Brazilian institutions, taxes and programs) for 2024.

2023 was a year marked by government transition and changes in economic and fiscal policy. RAF 84, from January 2024, records that last year was a positive surprise in terms of the performance of the Brazilian economy. Gross Domestic Product (GDP) is expected to grow by around 3%, well above initial projections and expectations of the market and the IFI itself. The slowdown in inflation brought it back to a level close to the upper limit of the inflation target, with the Extended National Consumer Price Index (IPCA) registering a variation of 4.62%, allowing the Central Bank to begin a cycle of interest rate cuts, but in a contractionary posture, given the still high real interest rates.

The significant expansion of agribusiness and the increase in income caused mainly by the increase in public spending on income transfers, on the dynamics of the labor market and on inflation, counterbalanced the effects of monetary policy and created the environment for greater economic growth.

The labor market has experienced a positive moment, with a substantial drop in unemployment, growth in formal jobs and real increases in wages and salaries, although the number of people outside the labor market, for various reasons, remains high, surpassing the figures recorded before the pandemic.

For 2024, the IFI projects a slowdown in the growth rate, with a GDP variation of around 1.2%, slightly less than the one estimated by the Focus Bulletin (1.6%), which reflects market expectations. (**Page 5**)

The RAF also provides a history and analysis of the recent trajectory of the Brazilian fiscal regime, including the Fiscal Responsibility Law (LRF), the Expenditure Ceiling, Constitutional Amendment Bill (EC) No. 126/2022 and, finally, the new fiscal framework (Complementary Law - LC No. 200/2023), known as the Sustainable Fiscal Regime (RFS). The text describes the successive changes introduced over time to the fiscal rules, such as changes to the target, the establishment of exceptions and expenditure rebates and changes to the methodology for calculating results, which have undermined the credibility of the fiscal regime, discouraging expectations. This RAF highlights the importance of guaranteeing the stability of the Sustainable Fiscal Regime and of pursuing the targets set within the new framework approved. (**Page 11**)

RAF 84 also sheds light on the fiscal results for 2023 and the scenario for next year, anticipating the IFI's projection for the conventional and recurring primary balance. Based on the analysis carried out by the IFI, the Central Government's primary deficit will close 2023 at BRL 233.3 billion, according to the above-the-line method. However, this figure includes non-recurring expenses, concentrated in December, relating to the payment of the accumulated stock of court-order debts, following authorization from the Federal Supreme Court (STF), for a total of BRL 92.4 billion. The IFI calculates that the recurring primary deficit will be BRL 134 billion, or 1.2% of GDP, very close to what the IFI had previously forecast (1.0% of GDP). Despite the occurrence of a significant primary deficit, the fiscal target for 2023 will be formally met, thanks to the exceptions, flexibility and reductions introduced by the Transition Amendment Bill, converted into EC [Constitutional Amendment] No. 126/2022 and the 2023 Budget Guidelines Law. According to the IFI, the deductions authorized by current legislation in the fiscal target should be around BRL 261 billion. (**Page 19**)

In 2023, central government revenue stood at 17.4% of GDP, while expenditure represented 19.6% of GDP. There was a drop in revenues from items such as dividends and shares, from the exploitation of natural resources and from concessions, while there was an increase in revenues from the General Social Security System (RGPS). Total conventional spending grew from 17.9% of GDP in 2022 to 19.6% in 2023, due to the increase in spending on court-ordered payments related to social security benefits and other payments that had been held up in the past, on Bolsa Família [Family Allowance] combined with the former Auxílio Brasil [Brazil Aid], on compensation to municipalities and states related to the fall in the Tax on the Circulation of Goods and Services (ICMS), on the national floor for nursing careers and community health agents, and on the new program to encourage students to stay in school and finish high school. (**Page 19**)

The new fiscal regime and the 2024 Budget Guidelines Law (LDO) foresee a zero primary deficit this year with a tolerance band of 0.25% of GDP. Zeroing the primary balance in 2024, starting from a deficit of more than 2% of GDP in 2023, even taking into account non-recurring expenses, will not be an easy task.

Everything will depend on the effectiveness of the set of tax measures proposed by the Federal Government and approved by Congress (taxation of economic subsidies granted by the states, off-shore and exclusive funds, fixed-odds sports betting, changes to the rules on deductibility of Interest on Equity, New Simplified Taxation Regime for Import Tax), naturally dehydrated in the negotiations aimed at their approval during the parliamentary process, which should certainly reduce the initial projection, present in the 2024 Annual Budget Law (LOA), of additional revenue of BRL 69.7 billion. It will also depend on the success of negotiations for the recovery of credits within the scope of the Administrative Council for Tax Appeals (CARF), with an increase in revenue expected in the LOA of BRL 97.9 billion. Reaching zero primary deficit will also be up to the success of negotiations with the National Congress to overcome the impasse surrounding the exemption of the payroll of companies in 17 economic sectors, the reduction in the rate of the General Social Security System (RGPS) for small municipalities and the renewal of benefits for the events sector, which were the subject of a law approved by parliament, vetoed by the Presidency of the Republic, with the subsequent overturning of the vetoes in Congress and the recent issue of a Provisional Measure annulling the effects of the parliamentary decision. And, on top of all this, it will also need efficient management of public spending.

It is clear that 2024 is a decisive year in fiscal terms and one of enormous challenges. Enjoy your reading!

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Review of economic activity in 2023 and outlook for 2024

Rafael Bacciotti

In 2023, the Brazilian economy surprised positively, with historic lows in the unemployment rate and a slowdown in inflation, allowing the Central Bank to begin a cycle of interest rate cuts. The expansion of the agricultural sector and the increase in disposable income cushioned the effects of the contractionary policy. For 2024, a reduction in the strength of these drivers is expected, with projections of a smaller harvest and a moderate increase in the wage bill. Lower inflation will make it possible to cut the Selic rate, supporting investment and consumption, but the risks include the persistence of global inflation and the resilience of services inflation.

The outlook for the growth of the Brazilian economy in 2023 is approximately 3.0%, a considerable increase on the initial estimates made by economic agents at the beginning of this year. According to the Central Bank's Focus Bulletin, average projections for Gross Domestic Product (GPD) growth in January of last year were 0.8%, with a range of a standard deviation between 0.3% and 1.3%. At the time, the Independent Fiscal Institution (IFI) estimated an expansion of 0.9%. The official result will be released at the beginning of March, when the Brazilian Institute of Geography and Statistics (IBGE) will present the System of National Accounts for the fourth quarter of 2023.

As far as the productive sectors are concerned, the initial estimates in the Focus Bulletin pointed to a 5.5% increase in agricultural GDP, 0.2% in industrial GDP and 1.0% in services GDP. However, the most recent projections, based on information available up to the fourth quarter, indicate a more robust performance, with growth rates revised to 15.3%, 1.3% and 2.4% respectively. In all cases, the rates exceeded the range initially forecast (Table 1), with the biggest surprise coming from the agricultural sector.

TABLE 1. PROJECTION FOR GDP 2023 AND COMPONENTS (%) CONTAINED IN THE FOCUS BULLETIN

	2022	Proj. 2023 (January 2023)	Minus 1 standard deviation	Plus 1 standard deviation	Proj. 2023 (January 2024)
PIB	**3.0**	**0.8**	**0.3**	**1.3**	**2.9**
Supply					
Agriculture	-1.1	5.5	2.9	8.0	15.3
Industry	1.5	0.2	-0.8	1.1	1.3
Services	4.3	1.0	0.4	1.6	2.4
Demand					
Household consumption	4.1	1.2	0.3	2.1	2.9
Government consumption	2.1	1.0	0.0	2.0	1.5
FBCF	1.1	1.0	-1.8	3.8	-2.1
Export	5.7	1.8	0.3	3.3	8.2
Import	1.0	3.2	-1.4	7.9	-0.1

Source: Focus Bulletin (Central Bank). Prepared by: IFI.

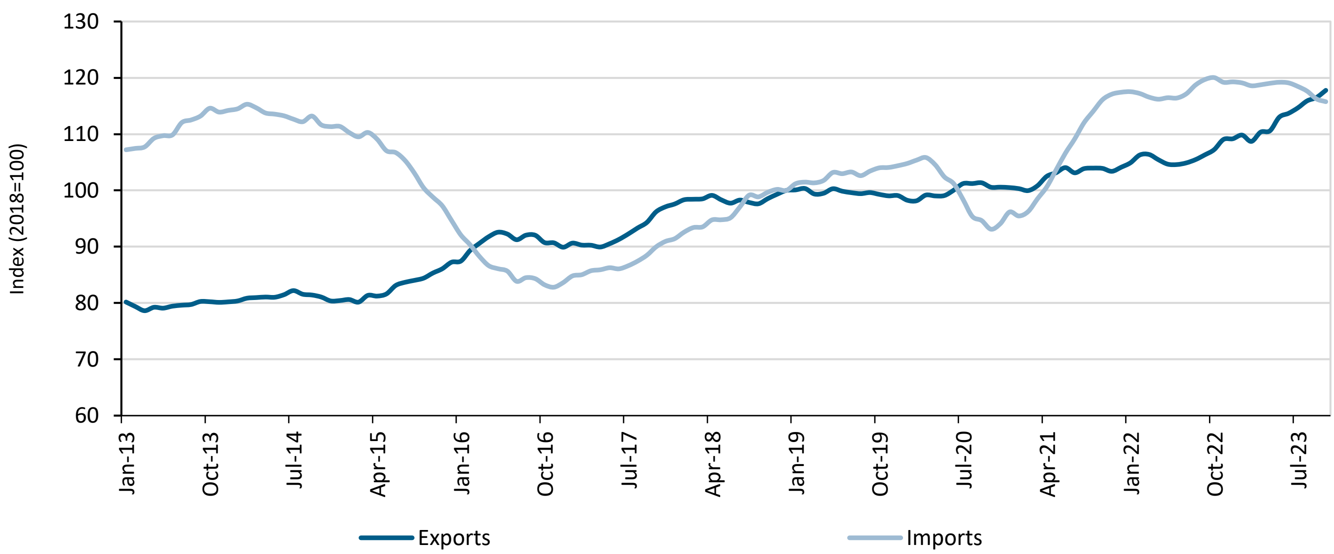
Initial market expectations already indicated an expansion in agricultural activity after the crop failure that occurred in 2022, when the GDP of agriculture showed a reduction of 1.7% compared to 2021. The initial optimism was driven by the prospect of a record grain harvest, especially in the soybean crop. However, the magnitude of this expansion, concentrated in the first half of the year, turned out to be considerably greater than expected. In addition to the direct impact of the increase in agricultural income on GDP, the expansion of the grain harvest has benefited the production chain, boosting other sectors such as storage and transportation. It also contributed to an increase in the volume of exports.

The IBGE points out that the recovery in the productivity of soybean crops in much of the country, as a result of improved weather conditions, is the main factor behind this exceptional result. The challenge of calculating the impact of agriculture on GDP in real time, due to the lack of high-frequency data, seems to be one of the main causes of the significant error in the projections. This becomes more evident when there are substantial variations in the sector's output.

From a demand perspective, the January 2023 estimates indicated growth of 1.2% in household consumption, 1.0% in government consumption, 1.0% in Gross Fixed Capital Formation (BFCF, in the original acronym), 1.8% in exports and 3.2% in imports. The latest projections show positive surprises in household consumption (2.9%) and exports (8.2%), contrasting with a drop in investments (-2.1%) that is sharper than the lower limit of the initial projections.

In the foreign sector, the monthly volume indices published up to October point to a continued decline in imports and an intensification of the positive dynamic in exports. This movement is influenced by the increase in sales of agricultural products, iron ore, and oil, within a context of stronger economic performance globally, particularly from trading partners such as China and the United States. Despite the relatively robust performance of GDP throughout the year, the weak performance of sectors such as the capital goods industry helped explain the downward pressure on imports (Graph 1).

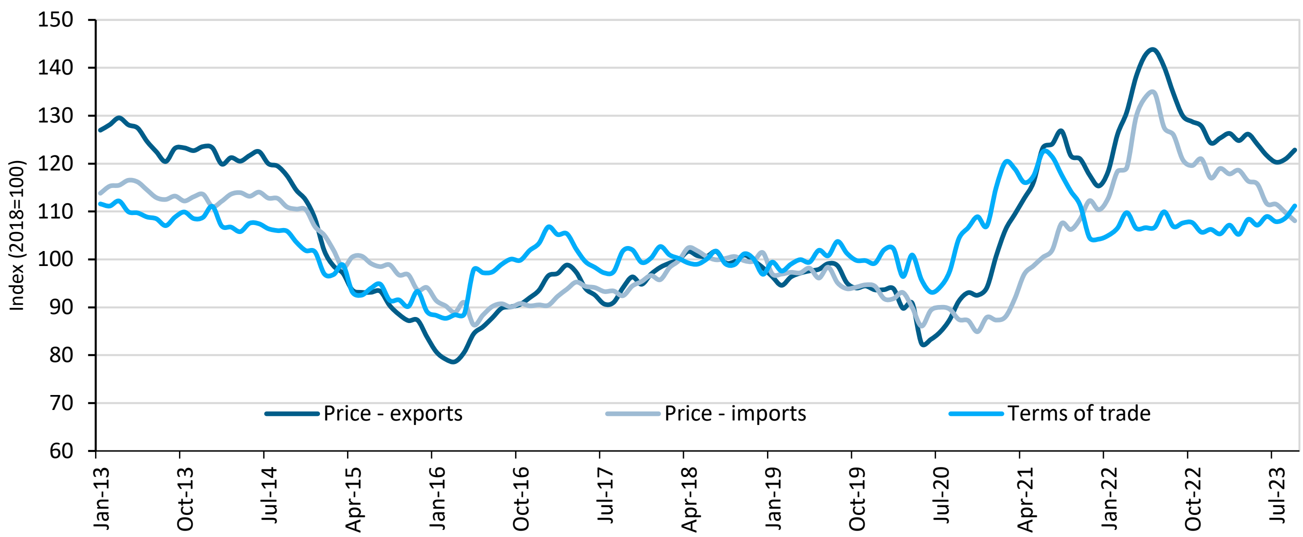
GRAPH 1. VOLUME OF EXPORTS AND IMPORTS (INDEX 2018=100)



Source: Ipeadata. Prepared by: IFI.

At the same time, the evolution of price indices began to result in a slight improvement in the terms of trade, which represent the relationship between the prices of the country's exports and its imports, contributing to an increase in national income. Despite the reduction in commodity prices, they remained at relatively high levels (Graph 2).

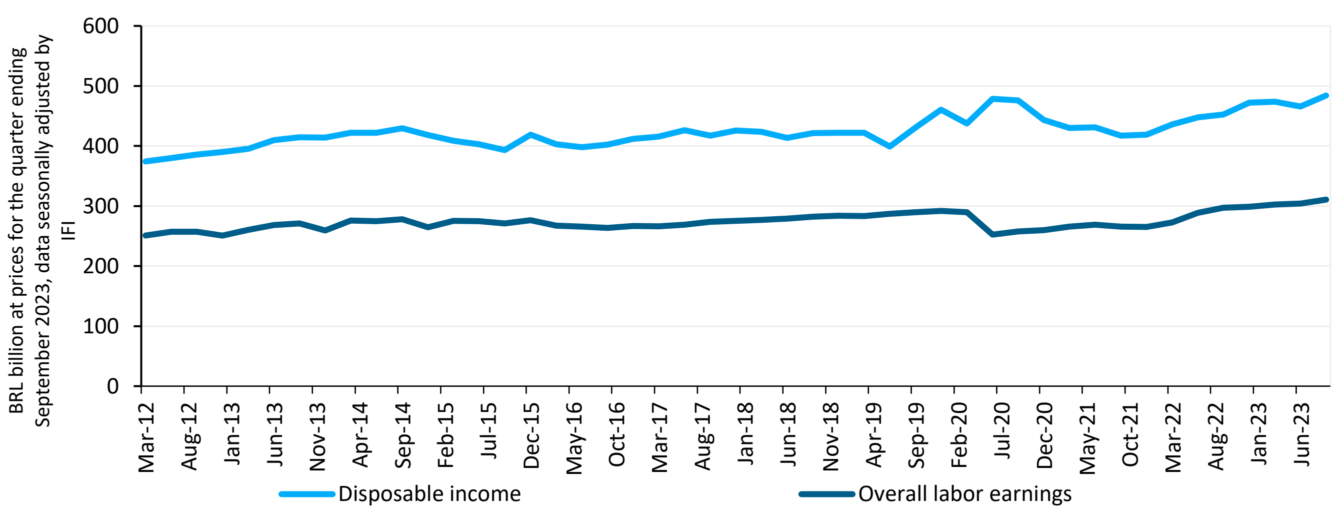
GRAPH 2. TERMS OF TRADE (INDEX 2018=100)



Source: Ipeadata. Prepared by: IFI.

The sustaining of private consumption over the last year can be largely attributed to the increase in disposable income. When considering the accumulated variation over twelve months, the national disposable income of families, which is an indicator calculated by the Central Bank that includes other sources of income besides work, increased by 8.0% in September 2023, with the monthly evolution illustrated in Graph 3. This growth in the indicator, which reached BRL 491.5 billion in the quarter ending in September, is the result of the positive dynamics of the labor market and the fiscal stimulus resulting from the expansion in the volume of social assistance benefits, exemplified by the Bolsa Família [Family Allowance] program.

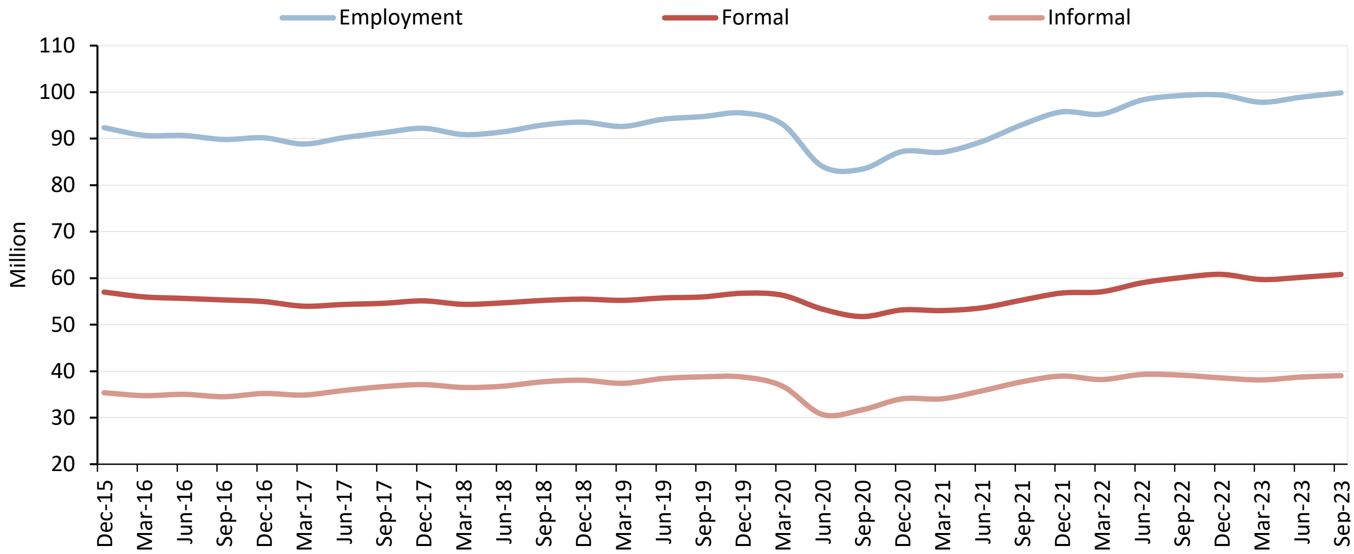
GRAPH 3. NATIONAL DISPOSABLE HOUSEHOLD INCOME AND EFFECTIVE LABOR INCOME (BRL BILLION)



Source: Central Bank and IBGE. Prepared by: IFI.

Data from the PNAD Contínua revealed a positive scenario in the labor market throughout 2023, highlighting the reduction in the number of unemployed and discouraged individuals (those who have given up looking for work due to a lack of opportunities). At the same time, there was an increase in the population with formal employment contracts. As shown in Graph 4, employment growth was concentrated in formal positions, which exceeded pre-pandemic levels, while informal employment remained practically stagnant at the December 2019 level.

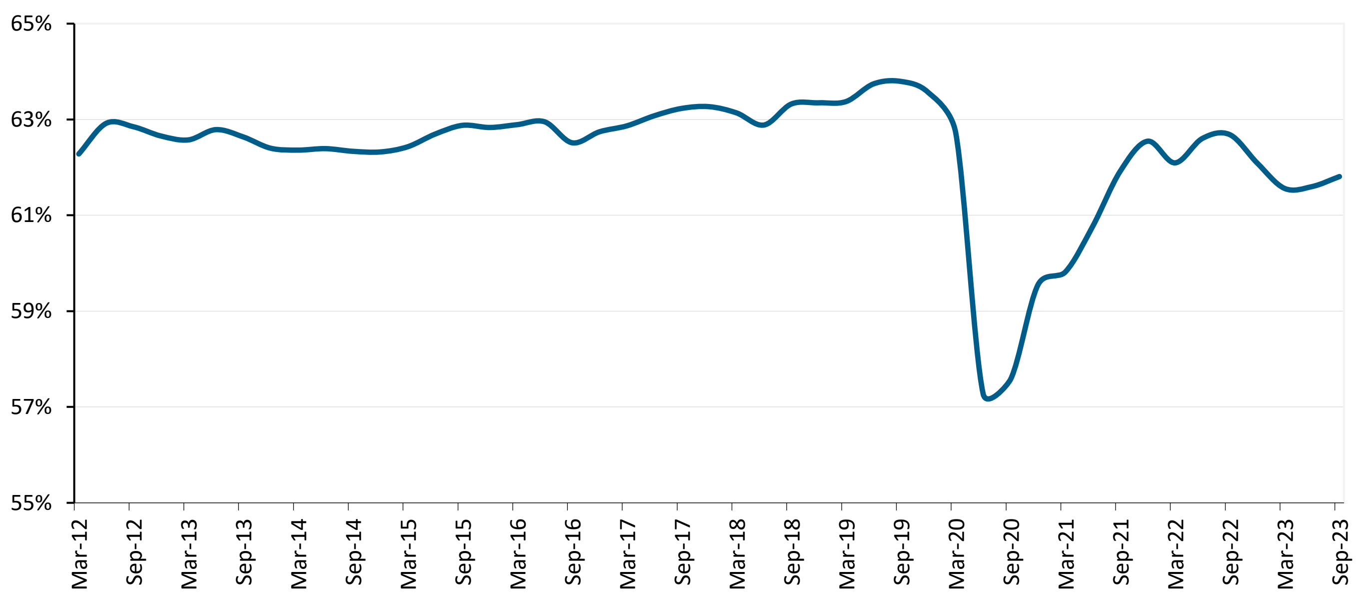
GRAPH 4. EMPLOYED POPULATION



Source: IBGE. Prepared by: IFI.

Despite the reduction in discouragement driven by improvements in economic conditions, including employment and income, the number of people out of the labor force has increased. This dynamic becomes clear as the labor market participation rate remained below pre-pandemic levels throughout the year. In the third quarter of 2023, this indicator, which represents the proportion of people in the labor force in relation to the working-age population, reached 61.8%, showing a slight increase compared to the first half of the year (Graph 5). However, it remains 0.9 percentage points below the same period last year and 1.8 percentage points below the pre-pandemic level.

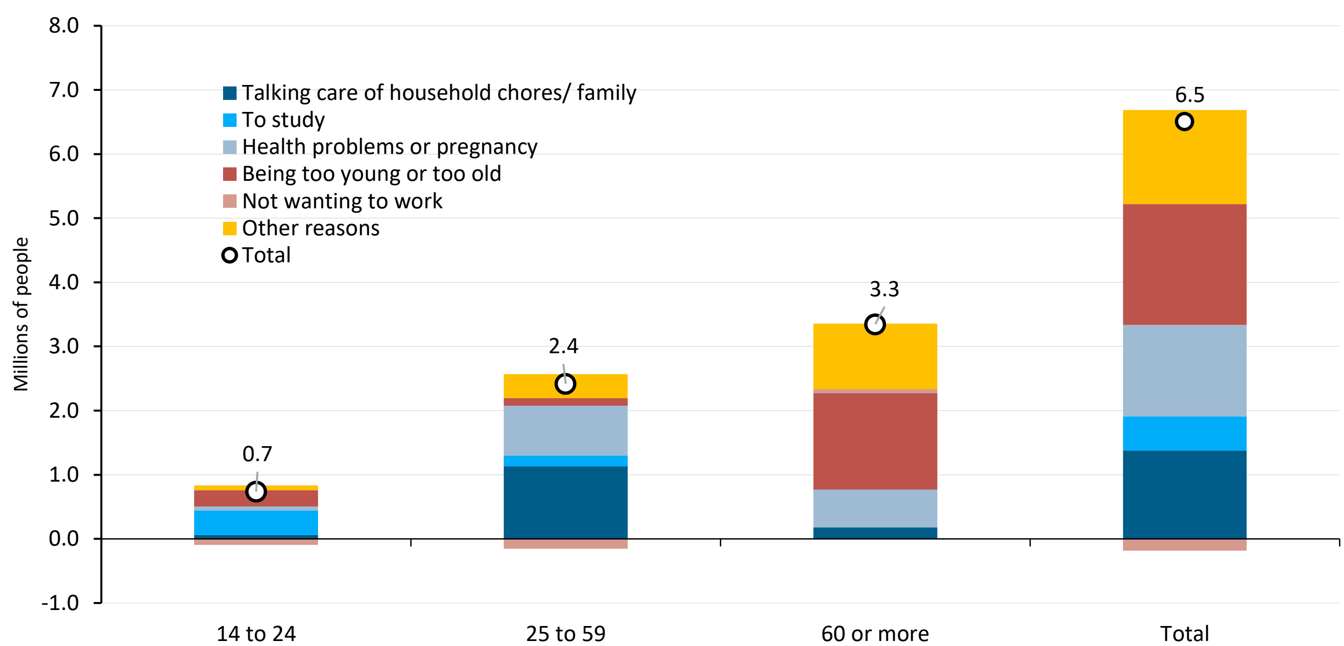
GRAPH 5. PARTICIPATION RATE



Source: IBGE. Prepared by: IFI.

The PNAD Contínua microdata available until the third quarter of 2023 shows that there was an increase of 6.5 million individuals outside the potential labor force compared to the period before the pandemic. The majority are aged 60 or over, followed by people aged 25 to 59 who are exclusively dedicated to household chores (Graph 6)[1]. The possibility of the labor force participation rate returning to the levels seen before the pandemic depends on identifying the extent to which the increase in inactivity is due to temporary and cyclical factors that can be reversed, as opposed to more persistent factors.

GRAPH 6. CHANGE IN INACTIVITY BETWEEN 4Q/19 AND 3Q/23 BY AGE GROUPS AND REASONS FOR NOT LOOKING FOR A JOB



Source: IBGE. Prepared by: IFI.

The relative expansion of hiring and the lower labor force participation have kept the unemployment rate at historically low levels, contributing to exert pressure on wages, including in real terms. The increase in purchasing power resulting from the slowdown in inflation further reinforces the positive scenario for private consumption, which is showing resilience even in an environment in which the real interest rate remains high.

It is worth mentioning that consumer inflation, as measured by the IPCA, ended 2023 with an accumulated increase of 4.6% in twelve months, remaining within the tolerance limit of the target set by the CMN for the first time since 2020. This result was lower than the previous year (5.8% in 2022) and below market expectations at the start of last year (5.34% according to the Focus Bulletin).

This performance is attributed to the more intense deceleration than expected in free prices, which registered an increase of 3.2%, higher than the 9.4% variation in 2022, while the average of market projections at the start of 2023 was 4.9%. Within free prices, there was a drop in food prices (-0.5% in 2023 compared to 13.2% in 2022), a significant slowdown in industrial goods (1.1% compared to 9.6%) and a more moderate slowdown in services prices (6.2% compared to 7.6%).

As far as administered prices are concerned, they rose by 9.1% in 2023, a variation higher than the 2022 result (-3.8%) and above the market consensus (7.0%), reflecting the reversal of fuel and electricity prices.

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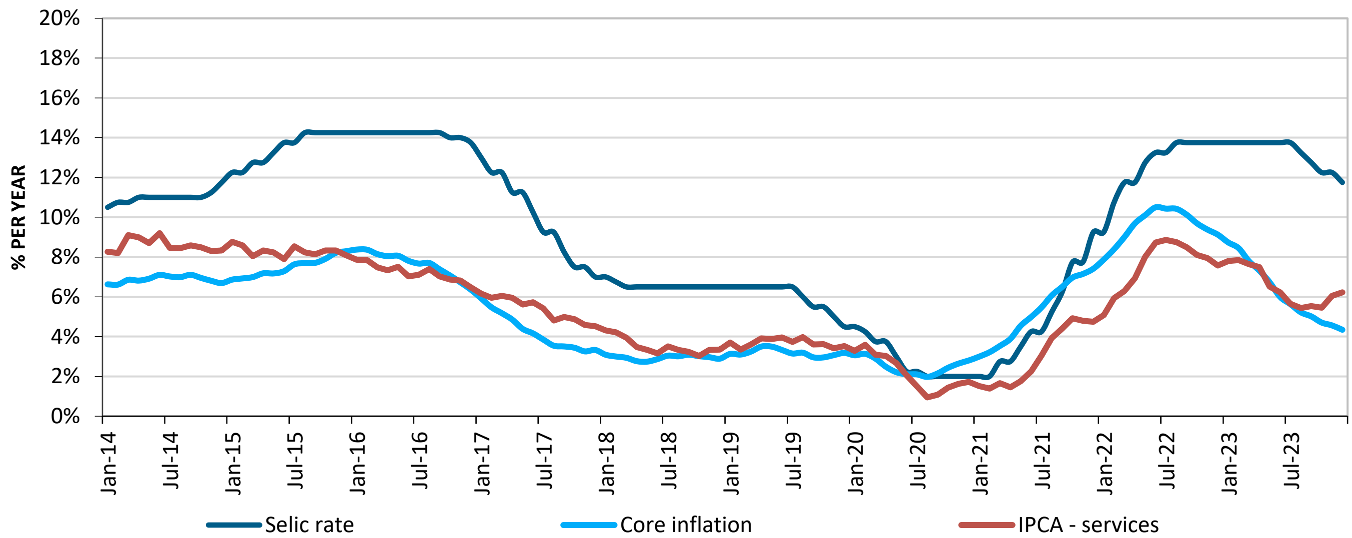
[1] Update of part of the analysis discussed in RAF 81 on the recent performance of the labor market, using microdata from the PNAD Continua for the second quarter of 2023. For more details, see: [http://tinyurl.com/ifi-brasil-raf-81-topicos.](http://tinyurl.com/ifi-brasil-raf-81-topicos)

GRAPH 7. IPCA AND SELIC RATE



Source: Central Bank and IBGE. Prepared by: IFI.

In 2023, the economy performed remarkably well, exceeding the initial projections for the year. The unemployment rate reached historic lows, while consumer inflation began to slow down, enabling the Central Bank to begin a cycle of interest rate cuts (Graph 7). Despite the prospect of stable economic activity in the fourth quarter, GDP is expected to grow by around 3.0%, practically the same rate as in 2022 (2.9%). The significant expansion of the agricultural sector in the first half of the year and the increase in disposable income, partly due to the money transferred to low-income families, mitigated the effects of contractionary monetary policy on aggregate demand.

For 2024, a reduction in the impact of these growth drivers is expected, with projections of a smaller harvest and a more moderate increase in the wage bill and social benefits. However, the decrease in inflation is expected to enable new cuts in the Selic rate, which will support prospects for investments and consumption. The risks of this scenario are considerable, especially the possibility of persistent global inflation, resulting, for example, from the escalation of conflicts in the Middle East, and the resilience of domestic services inflation. The IFI's forecast is for an expansion of 1.2%, slightly below the median presented in the Focus Bulletin (1.6%).

In comparison, Brazil's GDP growth in 2023 should have been slightly higher than the rate of global GDP and the GDP of Latin America and the Caribbean. According to the most recent estimates by the World Bank[2], global growth is expected to slow from 3.0% in 2022 to 2.6% in 2023, influenced by restrictive monetary policies, tighter credit conditions and low levels of global trade and investment. The expansion of Latin America and the Caribbean's GDP is also expected to lose momentum, from 3.9% in 2022 to 2.2%, mainly due to the contraction of Argentina's economy from 5.0% to -2.5%. For the following year, the World Bank estimates that global GDP, Brazilian GDP and the GDP of the Latin American and Caribbean region should grow by 2.4%, 1.5% and 2.3%, respectively.

[2] Global Economic Prospects, available at: http://tinyurl.com/3crn4v2a.

Taking stock of 2023: new rules and old challenges for the Federal Government's fiscal stability

Eduardo Nogueira

The new fiscal rules will have to respond to the old challenges of fiscal stability, which have compromised the credibility of both the LRF and the expenditure ceiling: budget rigidity, growing social demands, and the expansion of mandatory spending and parliamentary amendments. In addition, the macroeconomic horizon does not appear to be as positive as desired, making 2024, and the following years, quite challenging for the conduct of fiscal policy. The big question here is how any adversity will be dealt with, if it eventually materializes.

Historical Background

The behavior of fiscal policy in 2023 began to be designed at the end of the previous year, with the development of the so-called "Transition Amendment Bill", but the problems and challenges that the fiscal rule sought to address have been around for several decades. Before detailing the main points of that instrument and its expected impacts over the next few years, it is necessary to recall Brazil's fiscal context.

The fiscal rules[3] are established to prevent excesses and ensure the viability of the public debt. Although there are extraordinary circumstances that justify temporary deviations from these rules, such exceptions must be based on concrete facts and accompanied by measures to rebalance public finances over time.

Fiscal rules guide the behavior of political agents and control the debt's increasing trends. In the absence of such rules, the expansion of spending would become unsustainable, unbalancing public finances and unfairly distributing the benefits and burdens of indebtedness between generations. These rules and principles are designed to balance the growing social demands with the tax and financial capacities of the state.

Having overcome the issue of inflation, fiscal imbalance was one of the main problems Brazil had to face at the end of the last millennium. The main concern was the lack of clear guidelines for dealing with the increase in debt over the next few years.

In that context, the Fiscal Responsibility Law[4] (LRF) emerged, establishing the concept of responsible fiscal management, which requires planning, control and transparency to avoid risks and correct deviations that affect the balance of public accounts.

The aim was to establish a set of structuring and permanent rules in order to lay stable foundations for growth. The primary balance target was the main fiscal rule to be pursued by the government, but its credibility was undermined due to alterations, reductions, exceptions and the adoption of targets incompatible with the sustainable trajectory of the public debt.

About to complete 24 years, the LRF enjoyed relative stability in the first half of its validity, with only one legislative change, promoted by Complementary Law (LC) No. 131/2009 [5] - which sought to expand the fiscal transparency provisions - and one judicial change, by Direct Action for the Declaration of Unconstitutionality (ADI) No. 2238/2000[6].

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[3] Various authors have discussed the best way to establish rules with the aim of promoting a fiscal environment that creates the conditions to guarantee the sustainability of public debt and the evolution of its design based on experiences in different temporal, macroeconomic and institutional contexts. As an example, we can point to two texts for discussion (TD) published by the National Treasury Secretariat: TD no. 31/2019: *Regras Fiscais: uma proposta de arcabouço sistêmico para o caso brasileiro* [Fiscal Rules: a proposal for a systemic framework for the Brazilian case](http://tinyurl.com/brasil-stn-td-31-2019) and TD No. 35/2022: Reforma do Arcabouço de Regras Fiscais Brasileiro: *Reforçando o Limite de Despesa e o Planejamento Fiscal* [Reform of the Brazilian Tax Rules Framework: Reinforcing the Expenditure Limit and Fiscal Planning](http://tinyurl.com/brasil-stn-td-35-2022) and Technical Study (TS) No. 03/2023: *Regras e mecanismos de ajuste fiscal – Análise comparativa das normas fiscais vigentes no país* [Fiscal adjustment rules and mechanisms - Comparative analysis of the fiscal rules in force in the country](http://tinyurl.com/cd-conof-et03-2023) published by the Budget and Financial Control Consultancy (CONOF) of the Chamber of Deputies.

[4] Available at: http://tinyurl.com/lrf-brasil.

[5] Available at: http://tinyurl.com/brasil-lcp131.

[6] Available at: http://tinyurl.com/brasil-stf-adi2238.

In the following period, the story was completely different, with the LRF undergoing eight legislative changes (LC no. 156/2016[7], no. 159/2017[8], no. 164/2018[9], no. 173/2020[10], no. 177/2021[11], no. 178/2021[12], No. 195/2022[13] and No. 200/2023[14]) and three judicial ones (ADI No. 2324/2000[15] - judged in 2019, No. 6357/2020[16] and No. 6533/2020[17]), most of them to make the existing tax rules more flexible. The increased frequency of alterations may indicate that the original mechanisms were relatively incapable of dealing with the social demands faced during the period.

The year 2014 marked the Federal Government's first negative primary balance since the LRF came into force, a sequence that was only partially broken in 2022, and the years 2023 and 2024 (if the forecasts are confirmed) continuing to show primary deficits.

New Fiscal Regime (NRG) - Expenditure Ceiling

The expenditure ceiling rule was created in the context of the fiscal crisis[18] that the federal entities were going through in the 2015-16 biennium. The slower pace of revenue growth meant that the pace of expenditure had to be controlled in order to guarantee the sustainability of public accounts in the long term.

The new mechanics would be that restricting spending would generate a rebalancing of public accounts, prevent the public debt from growing too much, reduce the risk of investing in the country, lead to a fall in Brazilian interest rates, restore the private sector's confidence in Brazil and attract foreign investment.

The history of constantly changing[19] the primary balance targets over the years in order to formally comply with the LRF rules, without generating primary balances capable of stabilizing the debt, began to undermine the credibility of the rule. There was a belief that a complementary law would not bring the necessary credibility to the new regulation and that it was necessary to constitutionalize a new tax rule. Therefore, Constitutional Amendment (CA) No. 95/2016[20] was enacted, formally called the New Fiscal Regime (NRF) and also known as the "Expenditure Ceiling Amendment".

The Expenditure Ceiling rule, which came into force in 2017 to reverse primary deficits and stabilize fiscal policy for the next 20 years - until 2036, with a review initially scheduled for 2026 - gained initial credibility, but underwent several changes in a short time, which led to its long-term effectiveness being questioned[21], culminating in its repeal seven years after its creation.

Initially, the Expenditure Ceiling had four caveats relating to spending: 1) constitutional transfers regarding: i) the distribution of resources collected as profit sharing and financial compensation related to the production of oil and natural gas, water resources for the purpose of generating electricity, and other mineral resources; ii) the distribution of taxes; iii) the distribution of the "Salário Educação" Contribution [a social contribution intended to finance programs, projects and actions aimed at public basic education]; iv) the Federal District Constitutional Fund (FCDF); and v) the Federal Government's supplementation to Fundeb (the Fund for the Maintenance and Development of Basic Education and the Valorization of Education Professionals); 2) arising from the opening of extraordinary credits; 3) non-recurring Electoral Justice costs for holding elections; and 4) capital increases in non-dependent state-owned companies.

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7 Available at: http://tinyurl.com/brasil-lcp-156.
8 Available at: http://tinyurl.com/brasil-lcp-159.
9 Available at: http://tinyurl.com/brasil-lcp-164.
10 Available at: http://tinyurl.com/brasil-lcp-173.
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15 Available at: http://tinyurl.com/brasil-stf-adi2324.
16 Available at: http://tinyurl.com/brasil-stf-adi6357.
17 Available at: http://tinyurl.com/brasil-stf-adi6533.
18 Available at: http://tinyurl.com/brasil-mf-teto-gastos-gradual.
19 Available at: http://tinyurl.com/fgv-ibre-21ano-smeta-primario.
20 Available at: http://tinyurl.com/brasil-emc95.
21 Available at: http://tinyurl.com/brasil-senado-conleg-td311.

In general, the original ceiling rule was aligned with objective criteria from a technical-fiscal point of view[22], namely: a) expenses that result from the sharing of revenues that belong to other entities; b) expenses that are neutral from a fiscal point of view; c) unforeseeable, urgent and relevant expenses, opened up by extraordinary credit; and, d) seasonal expenses of the Electoral Court. The only relevant exception was related to capital increases in non-dependent state-owned companies.

The Expenditure Ceiling rule had a dynamic that was somewhat similar to the LRF. In the first half of its short existence it underwent only one change:

1) EC No.102/2019[23] - which excluded transfers to the states, the Federal District and the municipalities of part of the amounts collected from the auction of the surplus volumes of oil in the area of the onerous transfer contract signed with Petrobrás, as well as the expenditure for the Federal Government arising from the revision of that contract - in the amount of BRL 74.8 billion (art. 107, § 6, V, Transitional Constitutional Provisions Act - ADCT).

However, when pressured by social demands, initially caused by the Covid-19 pandemic and then under the most diverse arguments, several changes were made to the ceiling:

2) EC No. 108/2020 (*Fundeb Permanente* [Permanent Fundeb] Amendment) [24]- changed the reference to the permanent Fundeb provision (Art. No. 107, §6, I, ADCT), which increased the level of the Federal Government's supplementation to Fundeb from 10% to 23% over 6 years;

3) EC No. 109/2021 (Emergency Amendment)[25]: i) changed the trigger for applying measures to contain increases in mandatory expenditure, which became reaching the 95% ratio between primary mandatory expenditure versus total primary expenditure subject to the ceiling (art. 109, ADCT), and ii) authorized emergency aid expenses of up to BRL 44 billion to be excluded from the ceiling;

4) EC No. 113/2021 (Expenditure Ceiling Update)[26]: i) changed the methodology for adjusting primary expenditure limits, which now take into account the IPCA projected in the previous year to which the budget law refers (art. 107, § 1, II, ADCT), ii) increased the limit allocated exclusively to expenditure on vaccination against Covid-19 or emergency actions by up to BRL 15 billion for the 2021 financial year, and iii) revoked the possibility of changing the method for adjusting the expenditure ceiling, previously provided for in 2026 (art. 108, ADCT);

5) EC No. 114/2021 (New rules for court-order debt payments)[27]: i) limited, until the end of 2026, expenditure on court-ordered payments under art. 100 of the Constitution, which may not exceed the expenditure paid for this purpose in 2016, including the outstanding liabilities, adjusted by the IPCA (art. 107-A, ADCT) - the fiscal space of the amendment on court-ordered payments was BRL 43.5 billion in 2022[28], and ii) excluded the offsetting of accounts provided for in paragraphs 11 (which allows the creditor to offer clear and certain credits that are originally owned or acquired from third parties recognized by the federative entity or by a final and unappealable court decision) and 22 (which authorizes the Federal Government to use amounts from final and unappealable court decisions owed to a public legal entity to amortize debts, due or future) of Art. 100 of the Constitution regarding the expenditure ceiling.

6) EC No. 123/2022 (State of Emergency)[29]: i) created a state of emergency[30] (extraordinary and unpredictable rise in oil prices, etc.) with expenses that could be met through extraordinary credit (not subject to the ceiling) and without compensation, and ii) authorized the creation and expansion of a series of benefits, including the *Auxílio-Brasil* [Brazilian Aid] Program (BRL 26 billion), gas vouchers (BRL 1.05 billion), aid for truck drivers and taxi drivers (BRL 5.4 billion),

[22] Available at: http://tinyurl.com/brasil-cd-conle-conof-02-2023.
[23] Available at: http://tinyurl.com/brasil-emc102.
[24] Available at: http://tinyurl.com/brasil-emc108.
[25] Available at: http://tinyurl.com/brasil-emc109.
[26] Available at: http://tinyurl.com/brasil-emc113.
[27] Available at: http://tinyurl.com/brasil-emc114.
[28] Available at: http://tinyurl.com/ifi-raf60.
[29] Available at: http://tinyurl.com/brasil-emc123.
[30] Available at: http://tinyurl.com/j993hc3h.

public transport for the elderly (BRL 2.5 billion) and compensation for ethanol producing states and distributors (BRL 3.8 billion) (total value of EC No. 123/2022: BRL 41.25 billion);

7) EC No. 126/2022 (Transition Amendment)[31] excepted[32]: i) expenses with socio-environmental projects or projects related to climate change funded with donations, as well as expenses with projects funded with resources arising from judicial or extrajudicial agreements signed due to environmental disasters, ii) expenses of federal educational institutions and Scientific, Technological and Innovation Institutions funded with their own revenues, donations or agreements, contracts or other sources, signed with other Federation entities or private entities, iii) expenses funded with resources from transfers from other Federation entities to the Federal Government for the direct execution of engineering works and services, and iv) expenses with investments in an amount that corresponds to the excess collection of current revenues from the previous year to which the budget law refers (limited to 6.5% of the excess collection of current revenues from the 2021 financial year - BRL 22.9 billion); and

8) EC No. 127/2022 (Nursing Wage Floor Amendment)[33] - set aside current expenses or transfers to health funds for the payment of payroll expenses to comply with the national wage floors for nurses, nursing technicians, nursing assistants and midwives.

So, although the expenditure ceiling rule was elevated to the constitutional level[34] so that it would be more durable and predictable, it did not prevent the approval of constitutional amendments that made tax legislation more flexible. So, something that was initially justified in the critical and absolutely unpredictable period resulting from the advent of the Covid-19 pandemic - came to be used as the shortest way to exempt expenses from the primary balance targets and increase expenses without the burden of identifying the source of funding (revenue increase or expense reduction), even in the context of consecutive primary deficits.

The result of these exceptions was briefly discussed in the IFI's latest Fiscal Follow-up Report[35], but in general terms, the exceptions to meeting the fiscal target in 2023 are expected to be the highest in the last decade.

Transition Amendment (PEC No. 32/2022 - EC No. 126/2022)

The current government, elected in 2022, does not share the view that Brazil's main fiscal problem is spending[36], but rather public revenue, which can be expanded by eliminating subsidies and broadening the tax base, eliminating distortions that make the tax system regressive.

Given that the new direction of fiscal policy was incompatible with the current fiscal rules and that the program that the new government wanted to put into practice could not fit into the 2023 budget, it was necessary to create a Constitutional Amendment to reorient the fiscal rules, given that the Expenditure Ceiling and subsequent amendments had transformed several fiscal rules into constitutional ones.

In a way, the new fiscal policy is a return to what was adopted between 2003 and mid-2016, with a focus on increasing revenue in order to expand public spending and investment, which should serve to recompose public policies and stimulate consumption as well as public and private investment in order to foster continued economic growth.

The first version of the amendment bill[37] provided for the removal of the entire value of *Auxilio Brasil* (renamed *Bolsa Família* [Family Allowance] again) and Gas Aid from the expenditure ceiling rule and the so called "golden rule" for four years. The rapporteur of the bill in the Senate changed the formula to a fixed amount that covered various expenses and reduced the exceptionality period to two years. The amount initially proposed was BRL 175 billion and, during the debates in the Senate, this figure was reduced to BRL 145 billion which, in the 2023 budget, would be outside the fiscal

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[31] Available at: http://tinyurl.com/brasil-emc126.
[32] Available at: http://tinyurl.com/yc4a2hcw.
[33] Available at: http://tinyurl.com/brasil-emc127.
[34] Available at: http://tinyurl.com/2p9a3pt4.
[35] Access RAF no. 83, page 17, at: (http://tinyurl.com/ifi-brasil-raf-83).
[36] Available at: http://tinyurl.com/2tacm753
[37] Available at: http://tinyurl.com/brasil-cn-pec32-2022.

targets and the "golden rule". The Chamber of Deputies later shortened the deadline to cover only the current financial year.

The amendment did not direct the funds directly, but allowed BRL 70 billion to be allocated to Bolsa Família, in order to maintain the value of the benefit at BRL 600 per month (an amount that was paid in 2022, but which could no longer be supported after the end of the emergency period), plus an additional installment of BRL 150 for each child up to six years old in all family groups served by the program.

The additional amount supplemented the amount already in the budget, which was to pay a benefit of BRL 405. Another BRL 75 billion, according to the rapporteur of the 2023 budget, should go to expenses such as health policies (BRL 16.6 billion), including the *Farmácia Popular* [Popular Pharmacy] program and the BRL 6.8 billion increase in the minimum wage, plus BRL 2.8 billion for salary adjustments for public servants in the Executive Branch.[38]. Actions directly aimed at public policies for women, such as combating domestic and family violence, would also benefit from the use of this possibility.

The argument[39] used to defend the measures was that they sought to guarantee the economically disadvantaged population greater well-being during times of transition. Any criticism of the loosening of tax rules was mitigated by the reduction in the volume of resources and the expiration date of some of the exceptions.

Other changes not linked to the granting or extension of social benefits were also made. As a result of the agreement[40] between the party leaderships and the elected government to allocate the funds from the rapporteurs' amendments to the 2023 budget, which were deemed unconstitutional[41] by the Federal Supreme Court (STF), the funds were divided between individual amendments by the MPs and discretionary programs by the Executive (non-mandatory). According to the approved text, the general rapporteur could present up to BRL 9.85 billion in amendments for public policies (50.77% of the BRL 19.4 billion in rapporteur amendments deemed unconstitutional by the STF). The other half was allocated to individual amendments, which will rise from BRL 11.7 billion in 2023 (BRL 19.7 million per parliamentarian) to around BRL 21 billion.

In addition to the increase for the 2023 financial year, the overall value of individual amendments was permanently increased from 1.2% of the Federal Government's Net Current Revenue (RCL) to 2% of the RCL for the financial year preceding the submission of the draft Annual Budget Law (LOA). The amount of expenditure registered as outstanding liabilities that can be considered as the execution of individual amendments was also increased from 0.6% to 1% of the RCL. The distribution is also no longer equal between senators and deputies[42]. From 2023 onwards, the House will have 77.5% of the global value of individual amendments, and the Senate, 22.5% (senators represent 13.64% of parliamentarians).

The transition amendment also left out of the expenditure ceiling expenses funded from own revenues or donations for certain purposes (around BRL 1 billion). The idea is to prevent these revenues from spending cuts in order to comply with the expenditure ceiling, since the increase in revenues obtained through this means does not imply an equal increase in the expenditure limit (these expenses were detailed in the previous topic on the expenditure ceiling). In the initial version, an exception was made for expenditure on transport infrastructure investment projects with funds raised from multilateral organizations. But this exception was excluded from the final version.

[The final version] also allowed the government to incorporate, for investment spending and outside the expenditure ceiling, funds not withdrawn from the old PIS/Pasep funds, intended for workers with a formal contract between 1971 and 1988 and unclaimed for more than 20 years (BRL 26 billion), but workers or beneficiaries will still be able to request them from the Federal Government within up to 5 years.

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[38] Available at: http://tinyurl.com/5n732w5z.
[39] Available at: http://tinyurl.com/mvdjrenj.
[40] Available at: http://tinyurl.com/3u4tm3dy.
[41] Available at: http://tinyurl.com/yc67bhb9.
[42] Available at: http://tinyurl.com/bdf5r2ka.

Taking into account all the exclusions from the expenditure ceiling, the Transition Amendment represented[43] an expansion of the primary deficit from around 0.6% to 2.4% of gross domestic product (GDP), i.e. from around BRL 65.9 billion, according to the proposal in the 2023 Budget Guidelines Law (LDO)[44], to BRL 237.3 billion, of which BRL 171.4 billion (145 + 1 + 25.4) was added without an indicated source of funding.

The amendment also extended, from 12/31/2023 to 12/31/2024, the end date of the DRU [an instrument for withholding federal earmarked revenues] of 30% of the collection of social contributions, contributions for intervention in the economic domain and fees, allowing these funds to be used for other purposes.

Finally, the amendment ordered the President of the Republic to submit to the National Congress, by August 31, 2023, a complementary bill with the aim of establishing a new fiscal regime that is "sustainable in order to guarantee the country's macroeconomic stability and create the appropriate conditions for socioeconomic growth" (EC No. 126/2022, art. 6).

The amendment specified that, after the sanction of the law, eight articles of the ADCT on the ceiling would be repealed. These articles dealt with the general rules of the ceiling; the spending limits for each branch and agency of the Federal Government; the additional restrictions on payroll expenses, the limit on the increase in mandatory expenditure, if the proportion of mandatory primary expenditure in relation to total primary expenditure is higher than 95%; the different floor for mandatory constitutional spending on public health and education; the calculation of the global value of parliamentary amendments by the IPCA; the suspension of the processing of proposals in the legislature for analysis of their compatibility with the expenditure ceiling; and the discharge of the government's obligation to pay future expenses postponed by the application of the ceiling.

New Fiscal Framework (NAF) - Sustainable Fiscal Regime (RFS)

In compliance with art. 6 of the Transition Amendment, the government submitted Supplementary Bill (PLP) No. 93/2023[45], which was transformed into Complementary Law (LC) No. 200/2023. The new regime seeks to guarantee medium and long-term fiscal sustainability, but with the flexibility to accommodate different economic cycles.

The IFI prepared Technical Note (NT) No. 52[46] "Novo arcabouço fiscal: Análise do texto substitutivo ao PLP nº 93, de 2023" [New tax framework: Analysis of the substitute text to PLP No. 93 of 2023] to explain the details of the new fiscal rule that aims to replace the current expenditure ceiling and the changes made in the Chamber of Deputies, covering the following topics: the new system for primary balance targets, the new fiscal framework for controlling BRL growth, the mechanisms for preserving public investments and the changes to the FCDF. [The IFI] concluded that the proposed new fiscal framework compromises fiscal transparency, since it is extremely complex and depends to a large extent on the generation of revenues, which until now have been uncertain.

Some changes were made to the final version of the text after the IFI's analysis, but in general the core of the text remained the same. The new fiscal framework establishes two parameters for the expansion of primary expenditure. Firstly, a maximum BRL increase is set, between 0.6% and 2.5% per year. Secondly, within this initial range, a limit is set on the growth of primary expenditure, which cannot exceed 70% or 50% of the BRL variation in revenue, depending on the achievement of the primary balance target in the previous year (automatic triggers). The higher the real revenue growth, the closer the real expenditure growth will be to the upper limit of 2.5%. The same logic applies to the lower limit (up to 0.6%).

The combination of these two intervals results in a double limit regime for expenditure growth, with the aim of providing the capacity to adjust to scenarios of economic retraction or expansion, in order to carry out a counter-cyclical fiscal

[43] The actual primary deficit depends on the budget and financial execution for the year. In the LOA 2023, the Central Government's primary deficit was projected at BRL 228.1 billion (http://tinyurl.com/brasil-decreto-11415). With the revision of revenue and expenditure estimates for the 5th bimester of 2023, the primary deficit for the year was estimated at BRL 172.4 billion(http://tinyurl.com/brasil-decreto-11811).
[44] Available at: http://tinyurl.com/brasil-cmo-pldo-2023.
[45] Available at: http://tinyurl.com/brasil-cn-plp-93-2023.
[46] Available at: http://tinyurl.com/ifi-brasil-nt-52.

policy. In addition to limits on the growth of real expenditure, adjustment measures are implemented in the event of non-compliance with the primary balance target.

These measures include contingency of discretionary expenses (which remains mandatory, preserving the minimum level of discretionary expenses necessary for the regular functioning of the public administration - 75% of the amount of discretionary expenses authorized in the LOA) during the execution of the budget and restrictions on the increase of mandatory expenses (when it is verified, in the previous year, that the proportion of mandatory primary expenses in relation to total primary expenses was higher than 95%) and the creation of new tax waivers. The government tried to keep spending cuts optional, arguing that the change would prevent the discontinuation of important policies due to sometimes occasional revenue shortfalls, but the final wording kept the spending cuts, but with more caveats than the current model.

With regard to targets, the law establishes that the fiscal target will be set in the LDO, with tolerance intervals of 0.25% of GDP, either upwards or downwards. The LDO will also have to include a medium-term fiscal regime projection for the country and demonstrate the expected effect on the public debt trajectory.

Besides that, the government sought to preserve public investments, which are usually the most affected by spending cuts. Thus, a minimum limit was set for programming in the project and in the budget law, corresponding to 0.6% of GDP (Art. 10). In addition, 70% of the primary balance surplus recorded in the previous financial year in relation to the upper limit of the target tolerance range can be used to expand investments, above the Executive's limit, provided that the target set for the financial year is observed (art. 9).

Similar to the final version of the "Expenditure Ceiling", the RFS already presents, from the start, an extended list of expenses excluded from the limit (listed in Art. 3, § 2). No. 3, § 2), which include: constitutional transfers, extraordinary credits, expenditure of amounts funded with donations or resources from judicial/extrajudicial settlements, expenditure by federal public universities and other entities on teaching and innovation, transfers for engineering works and services, holding elections, certain court-ordered payments, resources from forestry concessions passed on to states and municipalities, transfer of 20% of the real estate disposal. The original wording of the article presented in the government's proposal contained more exceptions (thirteen in total).

The rule also made changes to the LRF, in the provisions dealing with the LDO and the LDO's Fiscal Targets Annex (AMF), such as: expanding the LDO's annual targets from two to three subsequent fiscal years; and presenting the medium-term fiscal framework; the expected effect and compatibility, over a ten-year period, of compliance with the primary balance targets on the public debt's convergence trajectory; the tolerance intervals for verifying compliance with the annual primary balance targets, converted into current values, of minus 0.25 p. p. and plus 0.25 p. p. of GDP. p. and a further 0.25 p.p. of the GDP provided for in the respective LDO project; and the estimate of the fiscal impact, where applicable, of the recommendations resulting from the evaluation of public policies.

Another important point was the prohibition on the LDO providing for a new exclusion of any primary expenditure from the calculation of the primary balance target for the fiscal and social security budgets. The paragraph was vetoed by the President of the Republic, but the veto was overturned[47] and the original text approved by the National Congress was maintained.

Review of 2023 and outlook for 2024 and beyond

The year 2023 began with major challenges in fiscal policy. The new fiscal rules have to respond to the old challenges of fiscal stability, which have compromised the credibility of both the LRF and the expenditure ceiling: budget rigidity, growing social demands and the expansion of mandatory spending and parliamentary amendments.

As we have seen, the transition amendment led to an expansionary fiscal policy. Brazil has gone from a primary surplus of BRL 54.1 billion in 2022 to a probable primary deficit of BRL 233.3 billion (with the full payment of previous court-

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[47] Available at: http://tinyurl.com/fbyvvpse.

ordered debt payments and the advance payment of some 2024 and 2025 expenses), registered even though the economy's performance in the year exceeded expectations[48].

This is a drop of almost 3 p.p. of GDP from one year to the next, which increases the pressure for the following years, mainly through the expansion of mandatory or discretionary expenses that have a strong social appeal and are difficult to reverse. The challenge is even greater considering the apparent intentions to recompose and expand spending on various programs[49].

A new fiscal framework was put in place that was supposed to reverse the initial deficit, anchor expectations and guide the trajectory of the public debt, showing the level of fiscal results consistent with the stabilization of the Gross General Government Debt (DBGG, in the original acronym) in relation to GDP. The exclusive focus on spending was removed and a balance between income and expenditure was advocated in order to make the tax system sustainable.

Government and Congress did not present a clearly defined line of expansionary or contractionary fiscal policy. The government was more concerned with restoring public revenues, presenting several measures in this regard[50], and the National Congress a little less so, as in the case of the payroll tax exemption and the expansion[51] of exceptions to the tax reform.[52]. On the other hand, Congress reduced some of the rules on the execution of expenses presented by the government in the Transition Amendment and in the RFS, although it increased some others, such as the rise in the amount earmarked for parliamentary amendments and the electoral fund[53].

Even if the targets for 2024/2026 are met[54] (respectively zero and a surplus of 0.5% and 1% of GDP[55]), the RFS may not be able to stabilize the debt trajectory[56], unless economic growth continues to outperform in the coming years, as expected by the government (which projects better parameters than market expectations[57]). In addition, there are doubts about the government's ability to expand revenues on a recurring basis[58] in order to free itself from an additional effort to contain spending, especially in the face of a macroeconomic outlook that, so far, is not looking so positive in 2024 and beyond.

The path adopted previously, of constantly changing the fiscal rules if difficulties arise, could lead the fiscal framework to the same fate of compromised credibility suffered by the previous ones. An important difference of the RFS, however, is that the rule is more flexible than the others, and failure to meet the target, in itself, is not a reason for the fiscal framework to lose credibility.

There is the alternative of facing up to the consequences that have been foreseen. As occurs with the conduct of monetary policy, more important than the failure to meet the targets themselves is the response given by the conductor of economic policy. The big question is how we're going to deal with any adversity, if it eventually happens.

[48] Available at: http://tinyurl.com/37pkx2xu.
[49] Available at: http://tinyurl.com/mrdxzvjc.
[50] Available at: http://tinyurl.com/bdcp3rka.
[51] Available at: http://tinyurl.com/4tzaraa7.
[52] Available at: Available at: http://tinyurl.com/hbwbvwww.
[53] Available at: http://tinyurl.com/2p9tmcet.
[54]Using the available ranges and exceptions, and depending on the behavior of macroeconomic parameters.
[55] Available at: http://tinyurl.com/mry7zmu8.
[56] Available at: http://tinyurl.com/brasil-cn-conof-nt-4-2023.
[57] Available at: http://tinyurl.com/brasil-cn-nt-conjunta-02-2023.
[58] Available at: http://tinyurl.com/bdj55nhz.

An analysis of the 2023 primary balance

Alexandre Andrade, Eduardo Nogueira and Pedro Henrique Souza

The information anticipated by the IFI for the central government's primary balance for December, and therefore for 2023, suggests that a deficit of BRL 233.3 billion (2.1% of GDP) was recorded. The increase in the 12-month accumulated deficit between November and December was due to the payment of some expenses in the last month of the year, such as the BRL 92.4 billion in court-order debt payments. Disregarding these atypical effects on the series, the central government's primary deficit should have been BRL 134.0 billion (1.2% of GDP) in 2023.

The aim of this article is to present the anticipation of the central government's primary balance for 2023 based on the information gathered by the IFI on the Siga Brasil Portal. The recurring primary balance is also discussed and some considerations are made regarding compliance with the primary balance target for 2023.

In 2023, according to information from the National Treasury Secretariat (STN) and Siga Brasil, the central government should have recorded a primary deficit of BRL 233.3 billion (2.1% of GDP), resulting from net primary revenue of BRL 1,896.3 billion (17.4% of GDP) and primary expenditure of BRL 2,129.6 billion (19.6% of GDP). The information is shown in Table 2. As will be more fully explored below, there was a significant flow of expenses in December, mainly due to the BRL 92.4 billion court-order debt payments resulting from Constitutional Amendments 113 and 114.

TABLE 2. CENTRAL GOVERNMENT PRIMARY BALANCE - CONVENTIONAL AND RECURRENT (BRL BILLION AND % OF GDP)

Breakdown	2023				
	Conventional	% of GDP	Recurring	% of GDP	Difference between conventional and recurrent (p.p. of GDP)
1. Total primary revenue	2,348.7	21.6%	2,319.8	21.3%	0.3
2. Revenue-sharing transfers	452.4	4.2%	452.4	4.2%	0.0
3. Net primary revenue [1-2]	1,896.3	17.4%	1,867.4	17.2%	0.3
4. Primary expenditure	2,129.6	19.6%	2,001.5	18.4%	1.2
5. Primary balance [3-4]	**-233.3**	**-2.1%**	**-134.0**	**-1.2%**	**-0.9**

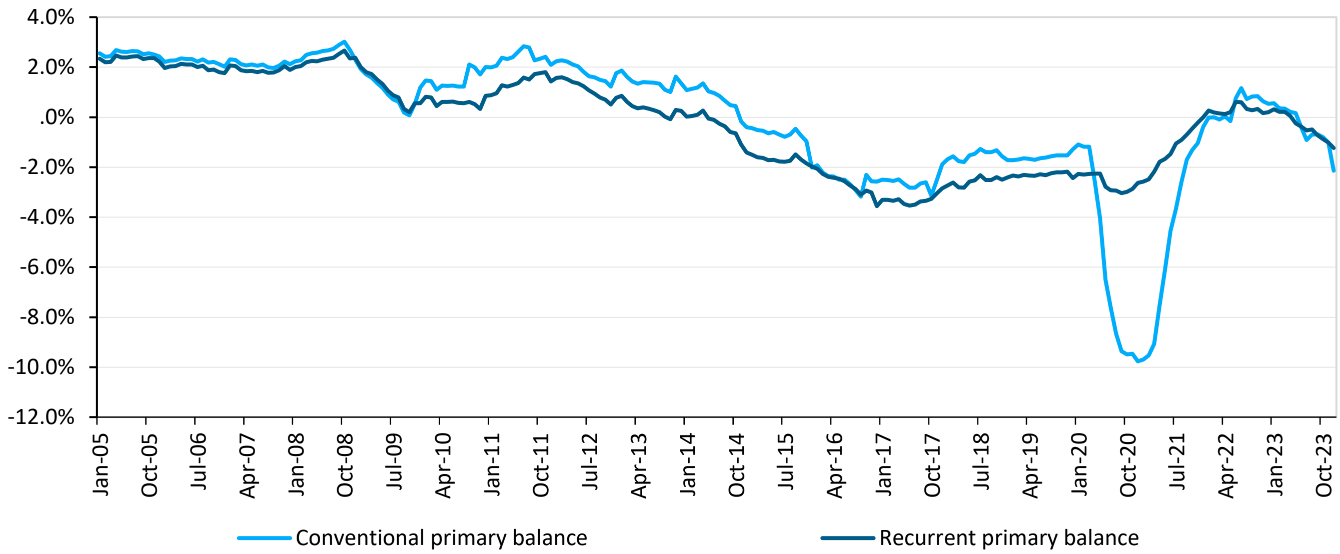
Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

Disregarding the atypical[59] (non-recurring) events in the series, the Federal Government's primary deficit would have been BRL 134.0 billion (1.2% of GDP) last year, in line with the projection published by the IFI (1.0% of GDP) in RAF No. 82[60] of November 2023, in the baseline scenario.

Graph 8 shows the 12-month evolution of the central government's conventional and recurrent primary balances as a proportion of GDP. The figure shows a clear deterioration in the Federal Government's primary balance over the course of 2023 as a result of the weakening of revenues, as explored in previous editions of the RAF, and the increase in spending supported by EC No. 126 of 2022. The conventional primary balance fell from a surplus of 0.5% of GDP in December 2022 to a deficit of 2.1% of GDP in December 2023. The recurring balance, in turn, fell from a surplus of 0.2% of GDP to a deficit of 1.2% of GDP in the period.

[59] The methodology considered by the IFI for calculating the recurring primary balance was initially presented in Special Study No. 17, of December 2021, available at: http://tinyurl.com/5yxhns4u. On the revenue side, the atypical factors disregarded when calculating recurring revenue are, among others, special installment payments (Tax Recovery Program - Refis), some asset concession operations, and temporary reductions in PIS and COFINS [Contribution to Social Security Financing] - for example, the recent fuel tax exemption, atypical IRPJ and CSLL payments. On the expenditure side, the events disregarded are spending on combating the Covid-19 pandemic, onerous transfers and Brazil's Sovereign Fund, advance payments of the Christmas bonus to INSS retirees and pensioners, financial aid to states, municipalities and the Federal District, among others.
[60] Page to access the document: http://tinyurl.com/2rsv5f67.

GRAPH 8. 12-MONTH EVOLUTION OF THE CENTRAL GOVERNMENT'S CONVENTIONAL AND RECURRENT PRIMARY BALANCES (% OF GDP)



Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

Table 3 shows information on primary revenue over the last three years. The information provided allows for a better assessment of the behavior of revenues in the recent period. As mentioned in previous editions of this RAF, in 2022 the Federal Government's primary revenue was boosted by some revenues collected by the Federal Revenue Office (RFB), mainly from Corporate Income Tax (IRPJ) and the Social Contribution on Net Profits (CSLL), and some non-administered revenues [not collected by the Federal Revenue Office], mainly from dividends and shares and the exploitation of natural resources. In 2023, these revenues fell.

At the same time, there has been an increase, as a proportion of GDP, in net revenue for the General Social Security System (RGPS) in recent years, because of the recovery in formal employment and in the mass of income from work. The increase in RGPS revenues in the last year is also explained by the real readjustment of the minimum wage that took place in May 2023, and which, with the policy of real appreciation of the minimum wage instituted by Law No. 14,663 of 2023, should continue in the coming years. RGPS revenues rose from 5.1% of GDP in 2021 to 5.4% of GDP last year.

Revenue-sharing transfers also grew from 2021 to 2023. This increase can be explained by the strong inflow of revenues from the exploration of natural resources in the period, as well as by the sharing of resources relating to the signature bonus from the second round of the onerous transfer.

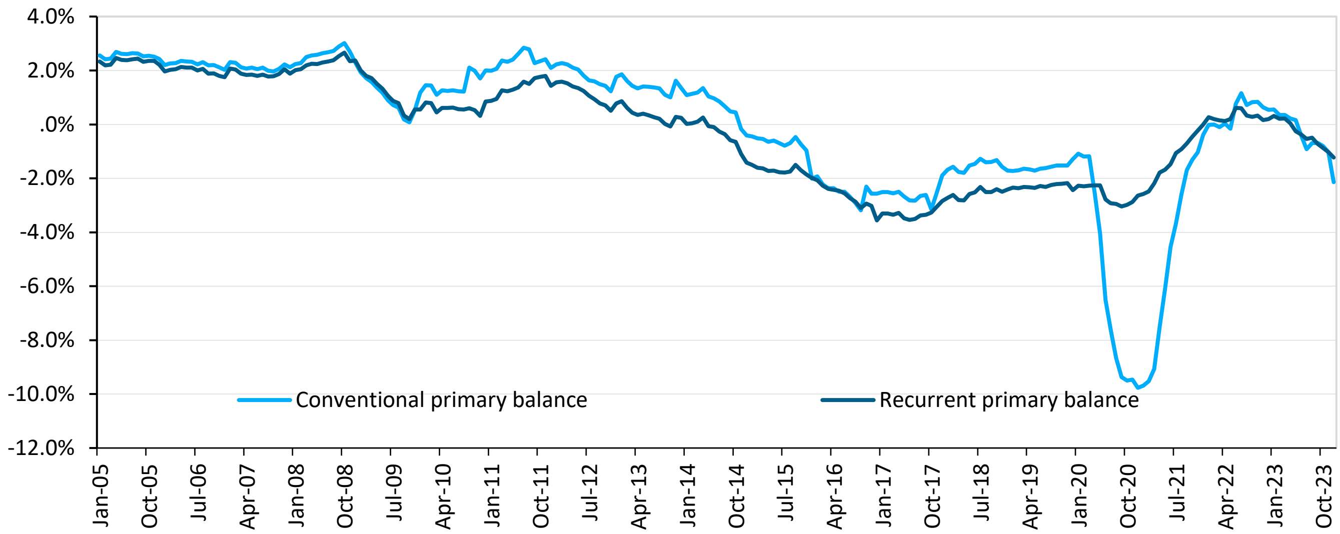
TABLE 3. CENTRAL GOVERNMENT PRIMARY REVENUES (BRL BILLION, REAL % CHANGE AND % OF GDP)

	Jan-Dec/21			Jan-Dec/22			Jan-Dec/23		
	BRL billion current	Real % change	% PIB	BRL billion current	Real % change	% PIB	BRL billion current	Real % change	% PIB
Total revenue	**1,932.6**	**20.9%**	**21.4%**	**2,313.3**	**10.3%**	**23.0%**	**2,348.7**	**-2.9%**	**21.6%**
Revenue collected by the RFB, *except RGPS*	*1,195.7*	*22.2%*	*13.3%*	*1,390.0*	*7.1%*	*13.8%*	*1,438.7*	*-1.1%*	*13.2%*
Tax incentives	*-0.2*	*-*	*0.0%*	*-0.1*	*-*	*0,0%*	*-0.1*	*-*	*0.0%*
RGPS revenues	*462.2*	*4.8%*	*5.1%*	*535.7*	*6.9%*	*5.3%*	*590.5*	*5.4%*	*5.4%*
Revenue not collected by the RFB	*274.9*	*53.4%*	*3.0%*	*387.7*	*30.1%*	*3.8%*	*319.6*	*-21.1%*	*2.9%*
Transfers	**353.5**	**23.1%**	**3.9%**	**457.2**	**19.1%**	**4.5%**	**452.4**	**-5.4%**	**4.2%**
Net revenue	**1,579.1**	**20.5%**	**17.5%**	**1,856.1**	**8.3%**	**18.4%**	**1,896.3**	**-2.3%**	**17.4%**
Total revenue without atypicalities	**1,846.0**	**14.4%**	**20.5%**	**2,216.0**	**10.0%**	**22.0%**	**2,319.8**	**0.1%**	**21.3%**
Net revenue without atypicalities	**1,492.5**	**12.4%**	**16.6%**	**1,766.5**	**8.4%**	**17.5%**	**1,867.4**	**1.1%**	**17.2%**
GDP (current BRL billion)			**9,012.1**			**10,079.7**			**10,874.9**

Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

Graph 9 shows the 12-month evolution of the central government's conventional and recurrent primary revenue, measured as a proportion of GDP. The graph makes it noticeable that recurring primary revenue has not fallen back to pre-pandemic levels. As shown in Table 3, recurring net revenue (without atypicalities) went from 16.6% of GDP in 2021 to 17.5% of GDP in 2022 and decreased to 17.2% of GDP last year. A possible explanation for that was given in RAF No. 81 of October 2023. Graph 5, on page 9 of that report, presented the ratio between the General Market Price Index (IGP-M) and the Extended National Consumer Price Index (IPCA) as a proxy for the economy's relative prices and the indicator suggests that these relative prices remain relatively high.

GRAPH 9. 12-MONTH EVOLUTION OF CONVENTIONAL AND RECURRENT PRIMARY REVENUE (% OF GDP)



Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

Table 4 provides information on the central government's primary expenditure over the last three years. Total conventional expenditure rose from 17.9% of GDP in 2022 to 19.6% of GDP last year. Noteworthy are the increases in (i) social security benefits, (ii) judicial sentences and court-ordered payments (costs and capital), (iii) mandatory expenditures with flow control, and (iv) discretionary expenses.

TABLE 4. CENTRAL GOVERNMENT PRIMARY EXPENDITURE (BRL BILLION, REAL % CHANGE AND % OF GDP)

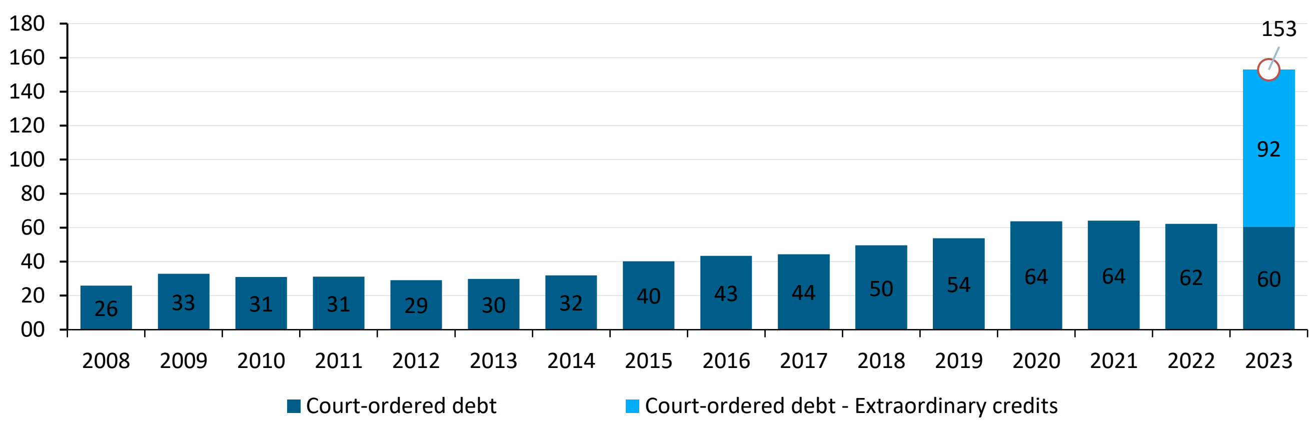
Breakdown	Jan-Dec/21			Jan-Dec22			Jan-Dec/23		
	BRL billion current	Real % change	% PIB	BRL billion current	Real % change	% PIB	BRL billion current	Real % change	% PIB
Total expenditure	**1,614.2**	**-24.0%**	**17.9%**	**1,802.0**	**2.7%**	**17.9%**	**2,129.6**	**12.9%**	**19.6%**
Social security benefits (RGPS)	*709.6*	*-1.8%*	*7.9%*	*797.0*	*3.1%*	*7.9%*	*898.9*	*7.8%*	*8.3%*
Payroll (active and retired personnel)	*329.3*	*-5.9%*	*3.7%*	*337.9*	*-5.6%*	*3.4%*	*363.8*	*2.9%*	*3.3%*
Salary allowance and unemployment insurance	*45.9*	*-28.7%*	*0.5%*	*64.3*	*28.3%*	*0.6%*	*72.9*	*7.9%*	*0.7%*
Continuous Cash Benefit (BPC)	*67.7*	*-0.8%*	*0.8%*	*78.8*	*7.1%*	*0.8%*	*92.7*	*12.4%*	*0.9%*
Extraordinary credits (except PAC)	*117.2*	*-75.0%*	*1.3%*	*47.0*	*-63.0%*	*0.5%*	*2.8*	*-94.4%*	*0.0%*
Compensation to RGPS for Exemption of Payroll Taxes	*7.3*	*-28.9%*	*0.1%*	*3.1*	*-60.6%*	*0.0%*	*0.0*	*-100.0%*	*0.0%*
Supplementation by the Federal Government to Fundeb	*22.0*	*34.2%*	*0.2%*	*32.9*	*37.8%*	*0.3%*	*37.5*	*9.0%*	*0.3%*
Judicial sentences and court-ordered payments (cost and capital)	*18.8*	*-24.7%*	*0.2%*	*17.3*	*-16.2%*	*0.2%*	*71.5*	*292.1%*	*0.7%*
Subsidies, grants and Proagro	*7.5*	*-67.7%*	*0.1%*	*15.3*	*89.0%*	*0.2%*	*21.8*	*35.0%*	*0.2%*
Mandatory	**1,490.3**	**-25.6%**	**16.5%**	**1,649.9**	**1.8%**	**16.4%**	**1,946.3**	**12.7%**	**17.9%**
Mandatory with flow control	***145.2***	***-0.2%***	***1.6%***	***219.1***	***39.1%***	***2.2%***	***326.4***	***42.4%***	***3.0%***
Discretionary	**123.9**	**4.0%**	**1.4%**	**152.1**	**14.0%**	**1.5%**	**183.3**	**15.2%**	**1.7%**
Total expenditure without atypicalities*	**1,493.3**	**-3.4%**	**16.6%**	**1,747.0**	**7.2%**	**17.3%**	**2,001.5**	**9.5%**	**18.4%**
GDP (current BRL billion)			**9.012.1**			**10.079.7**			**10,874.9**

Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

The increase in spending on social security benefits from 7.9% of GDP in 2022 to 8.3% of GDP in 2023 is mainly due to the payment of court-ordered debt, which amounted to BRL 56.5 billion (0.5% of GDP) last year. Discounting the effect of these court-order debt payments on spending on social security benefits, the expenditure would have been 7.7% of GDP in 2023. By way of comparison, in 2022, BRL 27.9 billion was spent on court-order debt payments for social security benefits, corresponding to 0.3% of GDP. If we discount this amount from what was paid that year, social security benefits would have amounted to 7.6% of GDP in 2022.

Spending on judicial sentences and court-ordered debt payments for costs and capital rose from 0.2 percent of GDP (BRL 17.3 billion) in 2022 to 0.7 percent of GDP (BRL 71.5 billion) last year, an increase explained by the payment[61] in December of the stock of court-ordered debt payments resulting from Constitutional Amendments No. 113 and No. 114 of 2021. Graph 10 shows the evolution of expenditure on court-ordered debt in various financial years at December 2023 prices. The amount paid out through extraordinary credits in December, BRL 92.4 billion[62], represents the accumulated stock until 2023 and corresponds, in real terms, to a higher value than the amounts accounted for in budget laws from 2008 to 2022.

GRAPH 10. EXPENDITURE ON COURT-ORDERED DEBT PAYMENTS (BRL BILLION DEC/2023)



Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

The increase recorded in mandatory expenditure with flow control last year (from 2.2% of GDP to 3.0% of GDP) is explained by spending on the Bolsa Família Program and part of the former Auxílio Brasil classified under this heading. In addition, Amendment 126 allowed the payment of BRL 600.00 in aid on a permanent basis. In 2022, part of the expenditure on this aid was classified as extraordinary credits.

The increase in mandatory expenditure with flow control last year is also explained by health spending from transfers made by the Federal Government to states and municipalities for the salary floors for nursing professionals, established in Amendment No. 127 of 2022, and for community health agents and agents to combat endemic diseases, established in Amendment No. 120 of 2022.

Finally, the increase recorded in discretionary expenses in 2023 is explained by the recomposition of expenses in the areas of health, education and transportation, in addition to the Federal Government's contribution to the fund that aims to finance savings to encourage high school students to stay in school until they graduate, in accordance with Provisional Measure No. 1,198 of 2023. The contribution to this fund, amounting to BRL 6.1 billion, was made in December 2023.

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[61] On November 30, 2023, the Federal Supreme Court (STF) ruled on Direct Actions for the Declaration of Unconstitutionality (ADI's) No. 7047 and No. 7064, which questioned the constitutionality of Amendments No. 113 and No. 114. In general terms, these two legal instruments provided for limits on the payment of court-ordered debt between 2022 and 2026. The STF ruling allowed the government to pay the accumulated stock of court-ordered debt in 2022, 2023 and the part that would be accumulated in 2024, not foreseen in the 2024 PLOA, through extraordinary credits.

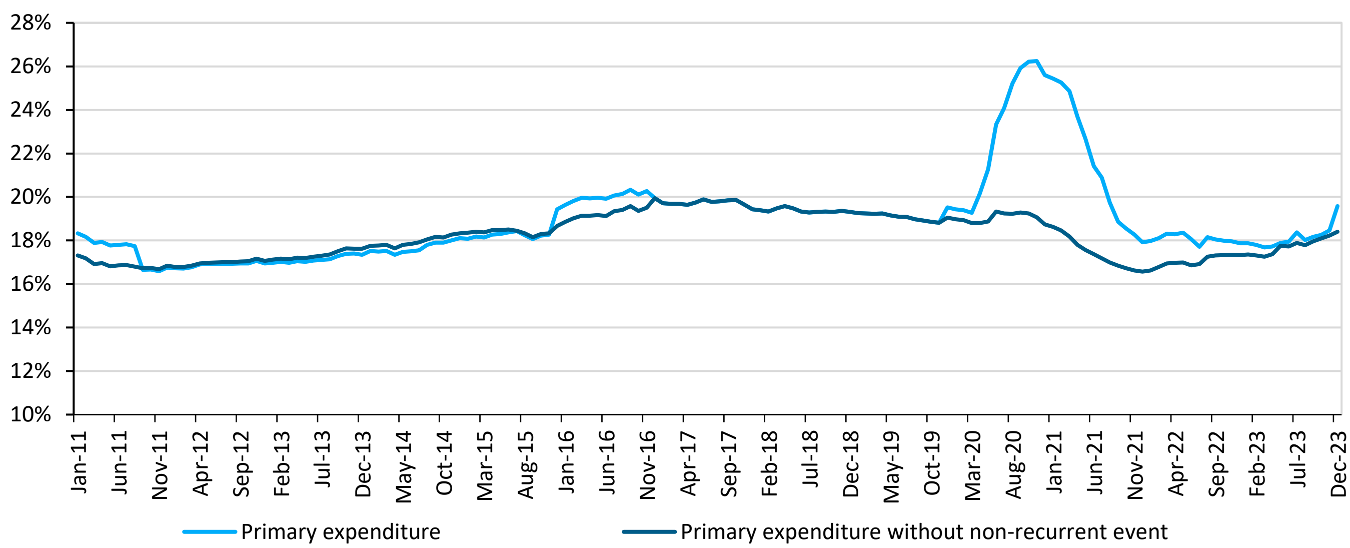
[62] The BRL 92.4 billion considers judicial sentences and court-ordered payments included in social security benefits (BRL 27.7 billion), payroll and social charges (BRL 12.8 billion), Continuous Cash Benefit (BRL 0.4 billion) and cost and capital judicial sentences and court-ordered payments (BRL 51.5 billion).

Graph 11 shows the 12-month evolution of the central government's total and recurrent primary expenditure, measured as a proportion of GDP. The figure shows that there was an increase in primary expenditure last year, when recurrent expenditure reached 18.4% of GDP in December, an increase of 1.1 p.p. of GDP compared to December 2022.

To close this section, some considerations are made regarding compliance with the 2023 primary balance target. In order to meet the BRL 65.9 billion target for the Fiscal and Social Security Budgets (OFSS)[63], it is worth mentioning the exceptions provided for in the legislation.

Art. Paragraph 2 of the 2023 Budget Guidelines Law (LDO) states that the impact of the provisions of paragraphs 11 and 21 of Art. 100 of the Constitution will not be included in the primary balance target. These amounts are equivalent to BRL 308.7 million and BRL 10.0 million, respectively. The LDO-2023 also allows, in its art. 3, § 2, compensation between the targets established for the Fiscal and Social Security Budgets and for the Global Expenditure Program. Given that the deficit of state-owned companies is higher than that approved in the LDO, at around BRL 1.5 billion[64], this amount needs to be deducted from the OFSS limit.

GRAPH 11. 12-MONTH EVOLUTION OF TOTAL CONVENTIONAL AND RECURRENT PRIMARY EXPENDITURE (% OF GDP)



Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

The sole paragraph of art. 3 of EC No. 126, of 2022, states that the expenses resulting from the increase in the spending limit for the year 2023, in the amount of BRL 145 billion, will not be considered for the purposes of verifying compliance with the primary balance target established in the head of art. 2 of the LDO 2023.

In addition, article 65-A of Complementary Law (LC) 101 of 2000 (Fiscal Responsibility Law - LRF) states that federal transfers to other Federation entities, duly identified, to deal with the social and economic consequences in the cultural sector resulting from public calamities or pandemics, will not be included in the primary balance target, as long as they are authorized in addition to the amounts initially provided for by the National Congress in the annual budget law. In accordance with the provisions of LC No. 195 of July 8, 2022, the BRL 3.86 billion in funds related to these transfers will also not be considered for the purposes of verifying compliance with the target.

Art. 17 of LC 201 of 2023, sets aside from the limits referred to in Art. 12 of LC 200, of 2023 (that regulates the New Fiscal Framework), the expenses provided for in the following articles: In Art. 2, BRL 27 billion as full settlement of the amount due resulting from the reduction in the collection of the Tax on the Circulation of Goods and Services (ICMS), of which BRL 6.54 billion in 2023, BRL 10.92 billion in 2024 and BRL 4.78 billion in 2025. In Art. 3, the anticipation of part of the delivery of amounts scheduled for the 2024 financial year in 2023, totaling BRL 2.17 billion. In Art.13, the temporary

[63] According to art. 2 of the LDO 2023 (Law no. 14.436, of August 9, 2022).
[64] According to the evaluation of the 5th Bimonthly Report. Available at: http://tinyurl.com/2cjujdac.

transfer to the Municipal Participation Fund of BRL 4.29 billion. In Art. 14, the temporary transfer to the State Participation Fund, in the amount of BRL 2 billion. And in Art. 15, transfers from the National Health Fund over and above the constitutional minimum - an amount not specified in the law.

Art. 1 of LC No. 201, of 2023, excepts from the limits referred to in Art. 12 of LC No. 200, of 2023, expenses for a program established by specific legislation to encourage students to stay in high school, in the amount of up to BRL 6 billion.

The BRL 92.4 billion in court-ordered debt securities paid through extraordinary credit, as decided by the Supreme Court[65], are also outside the ceiling. Thus, based on the legislation in force, this report forecasts BRL 261.07 billion[66] in deductions from the primary balance target.

We should also add a comment about the unclaimed resources of the PIS/PASEP fund. Verification of compliance with the central government's primary balance target is based on the below-the-line method[67] used by the Central Bank. By this criterion, the transfer of funds (amounting to BRL 26.0 billion in September 2023) from PIS/PASEP to the Treasury's single account does not affect the 2023 primary balance and, consequently, public indebtedness. According to the National Treasury's methodology, which is above-the-line, these resources helped to improve the year's primary balance.

Having said that, given that the deductions from the target explained above are higher than the deficit for the year, the target set in the LDO will be formally met.

To conclude, Table 5 shows a comparison between the primary balance projections presented by the IFI in RAF No. 82, of November 2023, with the figures obtained from the consultation made by the IFI on Siga Brasil and the aforementioned 5th Bimonthly Evaluation Report on Revenues and Expenditure for 2023.

The comparison shows that both the IFI's (optimistic) scenario, which considered court-order debt payments, and the latest bimonthly assessment for 2023, presented by the Executive in November, indicate that the possible expenditure on court-order debt payments in 2023 would increase primary expenditure by around 1.0 p.p. of GDP. The IFI's baseline scenario did not take into account the payment of court-order debts in 2023. The difference between the projection for the primary balance presented at the time and the calculation made with the information collected from Siga Brasil was mostly due to a deviation in the projections for revenues and revenue-sharing transfers to states and municipalities.

TABLE 5. COMPARISON OF THE CENTRAL GOVERNMENT'S PRIMARY BALANCE PROJECTED BY THE IFI IN NOV/23, THE ONE OBTAINED BY CONSULTING SIGA BRASIL WITH THE INCORPORATION OF DEC/23 DATA AND THE EXECUTIVE'S 5TH BIMONTHLY REPORT (% OF GDP)

Breakdown	Forecast by IFI on Siga Brasil	IFI Scenario in Nov/23 (without the payment of court-ordered debt)	IFI Scenario in Nov/23 (with the payment of court-ordered debt)	Executive's 5th Bimonthly Report
Total primary revenue	21.6%	22.0%	22.0%	22.0%
Revenue-sharing transfers	4.2%	4.4%	4.4%	4.3%
Net primary revenue	17.4%	17.5%	17.6%	17.7%
Total primary expenditure	19.6%	18.5%	19.5%	19.4%
Primary balance (above-the-line)	**-2.1%**	**-1.0%**	**-1.9%**	**-1.7%**

Source: Federal Budget Secretariat (SOF), Siga Brasil and IFI.

[65] See: http://tinyurl.com/3e72bvwe.
[66] Federal Constitution, Art. 100, paragraphs 11 and 21 (BRL 0.3 billion and BRL 0.01 billion, respectively) - Compensation between primary targets (BRL 1.5 billion) + Increase in the spending limit for 2023 (BRL 145 billion) + LC 195/2022 (BRL 3.86 billion) + ICMS compensation scheduled for 2023 (BRL 6.54) + Anticipation of part of the compensation scheduled for 2023 (BRL 2.17 billion) + temporary transfer to the Municipalities' and States' Participation Fund (BRL 4.29 billion and BRL 2 billion, respectively) + program to encourage students to stay in high school (BRL 6 billion) + anticipated court-ordered debt payments (BRL 92.4 billion).
[67] The below-the-line method calculates the deficit based on the stock variation of debt between one period and the next. The above-the-line method considers income and expenditure flows when calculating the deficit.

IFI projections

SHORT TERM

IFI projections	2023			2024		
	Dec/23	Jan/24	Comparison	Dec/23	Jan/24	Comparison
GDP - real growth (% p.a.)	2.97	2.97	=	1.19	1.19	=
GDP - nominal (BRL billion)	10,864.73	10,864.73	=	11,525.44	11,525.44	=
IPCA - accumulated (% in the year)	4.64	**4.62**	▼	4.02	4.02	=
Exchange rate - end of period (R$/US$)	5.00	**4.84**	▼	5.08	5.08	=
Employment - growth (%)	1.10	1.10	=	0.90	0.90	=
Payroll - growth (%)	5.55	5.55	=	1.40	1.40	=
Selic - end of period (% p.a.)	11.75	**11.75**	=	9.50	9.50	=
Real interest ex-ante (% p.a.)	6.22	**5.94**	▼	5.33	5.33	=
Consolidated Public Sector Primary Balance (% of GDP)	-1.20	-2.29	▼	-1.17	-1.27	▼
of which Central Government	-1.25	-2.14	▼	-1.07	-1.07	=
Net Nominal Interest (% of GDP)	6.83	6.76	▼	6.22	6.28	▲
Nominal Balance (% of GDP)	-8.03	-9.06	▼	-7.39	-7.55	▼
General Government Gross Debt (% of GDP)	75.03	75.61	▲	78.00	78.69	▲

* **0.00**: *realized values.*

Ângela Silva Brandão (translator).

Federal Senate Translation and Interpretation Service – SETRIN/SGIDOC.

January 30, 2024.

Independent Fiscal Institution

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