Two myths about public accounts

The public sector accounts are constantly discussed in Brazil. One reason for this is that under successive governments of varying political shades, public spending has tended to increase above gross national product, and fiscal adjustment has been carried out by raising taxes rather than cutting expenses. Consequently, the tax burden has been increasing continuously. This apparent lack of fiscal discipline is a weak point in economic performance, which is otherwise quite positive in general terms.

The debate, however, has become slightly repetitive, probably in part because of the powerful political inertia that characterizes Brazil's public administration. Because the recommendations of fiscal experts for reformulating fiscal policy are ignored, they play the role of heralds, proclaiming over and over again the same diagnoses and criticisms. Familiarity closes the ears, and so Brazilians overlook the importance of the issue because the general feeling is that nothing is likely to change — not the conduct of the government, and not the criticisms.

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However, new approaches to the fiscal problems have emerged recently that go beyond the traditional diagnoses. These are ideas that can help provoke Brazilians into facing the crucial question of what features they want their government to have.

Two of these approaches are criticisms of two myths in the debate about public accounts in Brazil. The first relates to the possibility of improving fiscal performance by means of administrative shock therapy that would attack inefficiencies in the Brazilian government to bring about substantial savings. The second myth is that the only reason for low federal government investment is limited public resources because the lion's share of public revenue would simply be directed to current outlays.

Public expenditure evolution

Between 1999 and 2009 federal public spending (excluding interest payments), deflated by official consumer price inflation,[1] increased at an average rate of 7.3% a year, rising from 14% to 18% of GDP over the period. Without doubt this constitutes a significant expansive trajectory. However, showing that spending grew vigorously is not a sufficient basis for concluding that the expansion was extravagant or irresponsible. To understand the sources and causes of the expansion, we have to break down spending.

For this purpose National Treasury monthly expenditure reports are not very helpful. They break expenses down by personnel and social contributions, administrative and capital expenses, transfers from the Treasury to the Central Bank, and Central Bank expenses. Administrative and capital expenses are broken down further into four accounts: expenses for the Workers' Support Fund, subsidies to the economy, welfare benefits, and other administrative and capital expenses.

"Other" expenses are a particularly mixed bag. The category covers important social expenses like grants to support poor families, Ministry of Health expenses with the National Health Fund, and Ministry of Education expenses with the National Education Development Fund (including books, school transportation, and nutrition). Spending for important government responsibilities like public health and school meals are lumped together with those for flight tickets and office supplies.

The analysis of public expenditure can be made clearer by introducing the concept of "restricted administrative expenditure," which consists of administrative spending after retirement pension benefits, grants to poor families, benefits for elderly and disabled adults, unemployment benefits, National Health Fund and National Education Fund expenses, and income transfers.

Expansion of the welfare state

The increase of 4.3 percentage points of GDP in federal public expenses between 1999 and 2009 can be broken down as follows: 1.7 percentage points of GDP for pensions; 1.3 for social expenses; 0.6 for investment; 0.6 for health and education expenses; and 0.4 for personnel expenses. Meanwhile, restricted administrative expenditure actually fell by 0.3 percentage points, from 2.1% of GDP in 1999 to 1.8% in 2009.

Restricted administrative expenditures include all the activities that administrative shock therapy would aim to cut: stationery, travel, consumption goods, and consultancy expenses, among others. Clearly, the relatively small amount of restricted administrative expenses is not sufficient to support a major fiscal adjustment and substantially raise savings. Not only is that the only category of public expenses showing a relative decline over the past decade, it hardly seems likely that the government machinery could function properly on less than 1% of GDP.

The evolution of spending since 1999 also provides evidence that a large part of the increase was due to the political mandate that the Brazilian people democratically conferred on their representatives, during first a center and then a center-left administration, to expand the Brazilian welfare state. This is illustrated by the doubling of social expenses, from 0.6% to 1.3% of GDP, and of education and health expenses, from 0.7% to 1.4% of GDP. Skyrocketing expenses like retirement pensions, which shot up from 5.5% to 7.2% of GDP, might be criticized, but undoubtedly they correspond to what the people want in terms of transfers and benefits guaranteed by the government.

It is evident, therefore, that the dramatic increase of federal public spending between 1999 and 2009 did not result from a wild spending spree in favor of a small group of beneficiaries orbiting the executive branch. Still, like the excessively generous pension scheme, there are huge distortions that deserve to be re-assessed. Generally speaking, however, the increased government spending over the decade tracked the implementation of projects offering society greater and comparatively better essential public services, accompanied by massive welfare

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transfers to the elderly, the poor, civil servants, and all their families.

Thus the passionate urgings that public spending be curbed imply that the current extremely popular model of a welfare state be reviewed and slowed down. This is hardly an encouraging conclusion, but it is a vital issue in the discussion about what size government Brazilians want.

Low public investment

Whatever their political leanings, there is consensus among observers that low federal investment is a serious deficiency of current public policy. Total public investment in Brazil today proportionately is less than half what it was in the seventies, in spite of the enormous increase in the tax burden from about 25% to 35% of GDP.

Until a major effort is made to improve the organization and efficiency of government operations, the federal government will probably invest even less than the small resources it budgets and sets aside today.

Thus it is not surprising that both left and right urge the government to increase its investments, especially in infrastructure. Yet according to most observers, the main limiting factor for expanding public investment is the voracious rise in current public expenses.

In fact, if the federal government were to increase its investments substantially, it would eventually run out of resources and find itself compelled to confront such unpleasant options as raising taxes or cutting current spending. But an interesting study by Mansueto de Almeida, an economist at the Institute of Applied Economic Research, shows clearly that the government is far from reaching that point. Many investment projects for which resources had already been authorized are being held up by a variety of obstacles ranging from bureaucratic and administrative constraints ("red tape") to issues related to procurement and supervision by the Federal Audit Court.

The 2008 federal budget authorized investments amounting to R$54.97 billion (US$27.50 billion), but a mere R$28.3 billion (US$14 billion) was actually carried out that year, and R$18.3 billion of that consisted of payments on investments budgeted in previous years. Thus, actual investment was less than 60% of the amount budgeted.

Almeida's study revealed, surprisingly, that the low implementation rate of government investment projects was related more to internal administrative failures than to such institutional factors as environmental requirements, audits by the Federal Audit Court, and strict procurement procedures. Administrative, budgetary, financial and managerial were the categories ranked highest as constraints by project managers.

More detailed analysis suggests that budget constraints mainly affect small-scale projects; they are not a limiting factor in the financing of large-scale projects for which resources have been authorized in approved budgets. At the same time there is evidence that obstacles to carrying out public investments are not limited to such notorious factors as environmental licenses, supervision by the Audit Court, and procurement procedures. Whether changing these factors would solve the problem of slow implementation of budgeted investments is not at all clear. Until a major effort is made to improve the organization and efficiency of government operations, the federal government will probably invest even less than the small resources it budgets and sets aside today.

[1] Published by the *Brazilian Institute of Geography and Statistics* (IBGE).