Fiscal crisis possible in 2010



Everardo Maciel

Former secretary to the Federal Revenue Service; tax consultant

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"The emergence of a fiscal crisis next year would not be a surprise," says Everardo Maciel, former secretary to the Federal Revenue Service, currently a tax consultant. Although agreeing that some of the tax exemptions are justifiable, Maciel argues that the international crisis should not lead to a relaxation of fiscal responsibility standards. The federal government, he says, has been neglecting personnel expense management and that is the shortest way to a fiscal crisis. Skeptical about a recovery of tax revenue in the second half of the year, Maciel affirms that revenue always falls faster than gross domestic product (GDP). And he adds: "In crisis situations, revenue suffers not only from the slowdown of economic activity, but also from tax evasion. The priority of businesses turns to covering their payroll and paying suppliers" at the expense of meeting their tax obligations.

The Brazilian Economy — As part of the government's anticyclic policy, tax exemptions have been granted for motor vehicles, home appliances, and building materials; more recently, exemptions have been extended for yet another quarter, starting July 1st, and they now cover capital goods as well. Furthermore, bread and flour have been exempted from social contributions. To what extent can this policy continue without compromising fiscal responsibility, which today represents one of the fundamental strength of the Brazilian economy?

Everardo Maciel — Some tax exemptions can be justified as tools to stimulate demand in a crisis situation. However, one should not forget that they have a negative effect on tax collections in a country that has not yet attained a sustainable fiscal balance. A loss of tax revenues compounded by increased current expenditure will, without any doubt, jeopardize realization of the primary surplus target, and consequently will result in a higher public debt-to-GDP ratio. In fact, according to the latest statistics published by the Central Bank, net debt of the public sector increased by 0.9% in May from the previous month and totaled R$1.2 trillion (US$600 billion) — 42.5% of GDP. This is the worst result in the historical series, pointing to a trend of deterioration. In

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November 2008, the net public debt-to-GDP ratio was 37.7%.

Federal tax revenue fell 6% in real terms in May, compared with the same month in 2008 — the worst result since 2003. The real decline from April compared to May this year was no less than 14%. This was the seventh time in a row that federal tax revenue showed a decline. This is in part due to the economy's slowdown, compounded with a decrease in the rates of the tax on industrialized products (IPI) for certain sectors. It corresponds to a loss of about R$10.9 billion (US$5.5 billion) in federal revenues. In a recent address in Brazil, Danny Leipziger, an economist and chairman of the Commission for Growth and Development, an institution linked to the World Bank, stressed that it is necessary to recover to precrisis revenue levels to sustain Brazilian state investment in the areas of health, education and infrastructure. In your view, will it be possible to achieve this target with an economic recovery starting in the second half of the year?

I appreciate your quoting Danny Leipziger, someone I admire. I do not believe that one can be certain about the possibility of an economic recovery in the second half of the year. All the predictions on the current crisis have proven to be profoundly misleading. Nonetheless, if it happens, I think that revenues will not recover at the same pace as GDP growth.

When can one expect to see a recovery of federal revenues, considering that Brazilian society does not accept the idea of a heavier tax burden?

From the data at hand, it is clear that the fall in federal revenues has been larger than the fall in GDP. In crisis situations, revenue suffers not only from the slowdown of economic activity but also from tax evasion. The priority for businesses turns to covering their payroll and paying suppliers. Meeting tax obligations. particularly in Brazil, becomes secondary.

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With tax revenue falling, Planning Minister Paulo Bernardo announced, without offering details, that budget cuts are being considered. Because it is almost impossible to cut the civil servant payroll, there will be cuts in other expenditures associated with administration, but investment in the Program for Growth Acceleration will not be touched. Will this be feasible only if the government goes for more drastic measures, such as temporary suspension of the federal civil servant wage raise, as has been aired in the press?

Apparently, the idea of postponing the wage raise for federal civil servants has been abandoned. As there is practically nothing else to cut in terms of public investment, I fear that the victim will be the primary surplus. Fiscal responsibility seems more and more to be giving in to measures that are eminently political. Elections always threaten fiscal balance. In my opinion, the emergence of a fiscal crisis next year would not be a surprise.

According to the Central Bank, in the 12 months ending in May, the primary surplus was R$66.9 billion (US$33.5 billion), or 2.3% of GDP. For January-May, it totaled R$31.9 billion (2.7% of GDP), although it must be added that, for the first time ever, the government decided to exclude the government oil company (Petrobras) from the calculations.

In your view, could the primary surplus decline to 2% at the end of 2009? This would be well below the levels seen in the past few years, though still acceptable in a time of crisis.

Predictions are always risky in the present circumstances. Based on published data, the primary surplus in the 12 months ending in May is already below the published target of 2.5% of GDP. Two months ago, the target was 3.8% of GDP. The international crisis should not lead to the relaxation of fiscal responsibility standards, particularly when that is due to liberal increases in current expenditures. The federal government has been neglecting personnel expense management. That is the shortest way to a fiscal crisis.

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However, this may have an upside. According to a recent study of the Brazilian Institute for Tax Planning, the tax burden in the first quarter of the year recorded 38.5% of GDP, 0.5% less than in 2008, although the level is still very high. This positive result reflects the tax exemptions. Is that a correct conclusion?

This calculation lacks technical significance, and some newspapers give too much importance to information of this nature. In order to know the tax burden as a proportion of GDP, we will have to wait until, after the end of the year, the Brazilian Institute of Geography and Statistics (IBGE) publishes data on GDP and total revenue at the three levels of government. Only then will we be able to determine the tax burden for the year. That would be a valid calculation.

This leads us to the draft tax reform currently being debated in Congress; the draft has been severely criticized and has not made any progress. It is unlikely it will be passed during Lula's term in office. What are its major flaws?

The "tax reform" project is an abundant collection of inconsistencies and errors. I will mention a few, in different areas. The first aspect that I would like to underline is the rigidity. The project seeks to introduce changes to the tax system through the constitutional channel; that will make the national tax system even more rigid. Absurdly, it goes so far as to incorporate tax rates into the constitutional text.

Another aspect deserving attention is the misuse of functions. The project gives the Finance Policy Council (Confaz), an administrative organ composed of representatives from the Finance Secretaries of the states, the power to lay down regulations for the sales tax for goods and services (ICMS) and to establish, in practice, the tax rates for goods and services. This is a clear-cut case of misuse of the legislative function.

Additionally, the draft tax reform includes an unusual merger of the Contribution for the Financing of Social Security (Cofins), the Social Integration Program (PIS), and education salaries. As a result, a unique "tax on costly operations with goods and services" would be created. Detailing of the actual structure of the tax, which is unlike anything in any other country, is left to future legislation. The issue remains thus open.

In my opinion, the draft tax reform also opens the way for greater tax evasion. It adopts

the principle of destination for the ICMS tax, though in a mitigated form, without taking into account the problems that may result, such as an increased propensity for tax evasion due to the considerable difference between in-state and inter-state tax rates.

The project has been severely criticized, particularly by the exporting states, which feel punished by the system suggested. In addition to the economic aspects — there is an interest in promoting exports — there are also political interests involved. What are your views?

The other absurdity is the creation of what I call the "ICMS exchange." The proposal currently being debated in Congress subjects the taxpayer to tax administration in all states, as the fiscal interest in interstate operations would be located outside the territory of the taxpayer. Actually, in its present form, the draft would result in significant tax losses for the net exporting states, which would, in principle, be offset by an indefinite fund, whose operation is described as the ICMS exchange.

You are among those who have argued that there would be no "fiscal war" involving the federal units if current legislation were effectively enforced. Why is that?

The 1975 Complementary Law no. 24 clearly prohibits the concession of any fiscal benefits without prior unanimous approval by the members of the Finance Policy Council (Confaz). What happens in practice, however? There is a kind of sloppiness on the part of the governments at disadvantage, supported by long-lasting indifference on the part of the Public Prosecutor's Office and of the Judiciary. Condemning the fiscal war is a major national hypocrisy.

How does the tax reform draft propose to eliminate the dispute between states on attracting businesses by granting a variety of incentives?

By trying to prohibit the tax war, the tax reform draft eternalizes illegalities practiced in the past. One might say that tax wars will be over because there is no gunpowder or interest left. Nothing is said about the Complementary Law, which should curb the practice.

A migration from investment funds to savings accounts is already taking place because of the better yields offered by savings accounts — 6% a year plus the referential rate (TR), in addition to tax exemptions and absence of administration fees. One of the alternatives discussed is reducing taxes on investment funds to avoid problems placing government bonds. It would be a patchwork solution, but the issue would remain unresolved. Is it not time to change the system of savings account yields by fixing them at one or two points below the Central Bank's policy rate, for instance, instead of taxing amounts above R$50,000 from 2010? Could the government also resort to tax exemptions for investment funds?

Without any doubt, a review of savings accounts yields is long overdue. They are completely out of line with the other modalities of fixed-rate investments. Indeed, the confiscation of savings accounts that stigmatized the Fernando Collor

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administration has blocked any attempt to introduce innovations — an argument widely exploited politically. I oppose any rate cuts for investment funds because this would discourage investment in the real sector of the economy, which would be more heavily taxed than the financial market.

What do you suggest to settle this messy issue, inherited from inflationary times, that would extend some degree of guarantee to the small saver?

I believe it would not be convenient, particularly in terms of investor confidence, to introduce changes to the rules governing current savings accounts, especially where taxation is concerned. An alternative could be to close existing accounts to new deposits and create a new guaranteed and tax-exempt savings account for small savers, with yields similar to those offered by financial markets.

Successive reductions in interest rates determined by the Central Bank's Monetary Policy Committee (Copom), culminating in a 9.25% yearly rate in June, have reduced government expenditures associated with service on public debt. Apart from its effects, such as stimulating the economy in general, and considering the declining trend of inflation, which this year should be in the neighborhood of 4%, would that not be another reason for the Copom to announce further cuts to the interest rate?

This is an issue that should be treated with extreme caution. Cuts in interest rates should always be conditioned on meeting inflation targets. There remain many doubts about the future of our economy. Often, the policies adopted by the Central Bank do not please everyone, but they have been characterized by prudence, a fact recognized internationally.

The inclusion of more activity sectors in SIMPLES (the Integrated System for Payment of Taxes and Contributions by Small and Micro-sized businesses), limited solely by turnover, would help promote entrepreneurship and curb the informal sector in the country. Why is this facility the privilege of only a few sectors?

In fact, only a few sectors are excluded from SIMPLES. Most of them are in the field of personal services, activities which are very similar to those of individuals. Those are reasonable restrictions, in my opinion.

Has the merging of the Federal Revenue Service with the Social Security Revenue Service been showing positive results from the point of view of oversight and control?

This merger was a wise decision from the point of view of fiscal administration. Positive results have already been seen . . . because the advances achieved by the Federal Revenue Secretariat have been passed on to the Social Security Revenue Service. Some problems remain, particularly in the area of service to taxpayers, but nothing that cannot be corrected over time.

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