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MACROECONOMIC AND BUDGETARY ASPECTS OF THE PUBLIC EXPENDITURE

Maurício Saboya*

The Brazilian economy is undergoing a transition towards a situation of consolidated macroeconomic stability. As in any successful transition process, elements of a former order (exchange rate and real domestic product instability, and high interests rates) gave way to elements of the new order (low and steady inflation rates, floating exchange, fiscal balance and institutional development). In this period, when conditions are created for sustained economic growth, fiscal adjustment plays a very important role. The maintenance of significant primary surpluses in the public sector through the last eight years, as well as the possible start, as of 2003, of a cycle of sustained reduction of the public debt to Gross Domestic Product (GDP) ratio, are signs of a lasting commitment with long-tem fiscal balance. This attitude of responsibility as regards management of public accounts, supported by a legal-institutional framework, of which the Law of Fiscal Responsibility is a key element, has certainly contributed to Brazil's resumption of the development path.

However, there are reasons to believe that the quality of the Brazilian fiscal adjustment has been inadequate in the last years. The continuous growth of non-financial expenditures of the Federal Government, and increased budgetary rigidity – that is, increase of earmarked revenues and obligatory expenditures – are reflections of the lack of quality in the country's fiscal effort. The increasing primary surpluses are being achieved through revenue increases, mainly from social contributions. The latter, in spite of recent changes in some calculation bases, continue for the most part to "cascade", distorting resource allocation and undermining the productivity and competitiveness of the national industry. The result is an increasing tax burden (37.8% of GDP in 2005, a record level), which moves towards an upper limit bearable to society. Finally, due to the increased budgetary rigidity and obligatory expenditures of the Federal Government (payment of social security benefits, personnel and social burdens, etc.), the fiscal policy is losing room for manoeuvre and its power to act as an effective stabilization instrument. A side effect of this process is the reduction of public investments, with perverse consequences on economic growth.

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For the non-financial current expenditures of the Federal Government, including social expenditures and, among them, the major role of the benefits paid by the National Institute of Social Security (INSS), criteria to increase fiscal flexibility must be established, contemplating three goals: social policy, stabilization and economic growth. Obviously, this is not about conferring less weight to the drivers and specific goals of the social policies (social justice, equity, combating poverty and inequalities), but rather about evaluating social expenditures from a macroeconomic perspective as well, considering not only stabilization and growth but also efficiency and effectiveness. The great challenge is to identify and promote cuts in the social expenditure segments (starting with Social Security) that are inefficient, ineffective and unproductive. To this end, it is crucial to develop instruments for analysis of social expenditures, from this broader point of view.

The main groups of expenses (social expenditure, investments, subsidies, transfers) must be evaluated vis-à-vis their redistributive impacts and their possible production disincentive effects. In short, for every situation there is an optimum combination of various types of expenditure, since each one of them has positive and negative characteristics as regards fiscal development. The role of the analysts, in this case, is to assess whether the combination of budget headings is appropriate for the economic system in question, or if there are imbalances in the division.

Brazilian society needs to discuss the functions, the profile and the size of the desirable State. The challenge is to match the consolidation of macroeconomic stability (which requires fiscal responsibility and sustainability) with social protection and the tackling of poverty and inequality. These issues are at the core of the discussion concerning efficiency and effectiveness of public expenditure in Brazil.

The papers contained in this first part hereby presented is an attempt to encourage discussion concerning the interactions between fiscal policy alternatives and economic development. After eight years of fiscal adjustment, since the Fiscal Stability Program (1998) initiated a phase of achievement of significant primary surpluses in the public sector, it is vital to reflect upon the quality of the Brazilian fiscal adjustment. In this aspect, a consensus has lately emerged among public finance analysts: it is necessary to study the efficiency of government spending, in order to design specific public expenditure policies aimed at optimising their economic and social returns. It is in this spirit that the first part of this volume presents five brief articles addressing the links between public expenditure and economic growth from different perspectives.

The first article, by Professor John Toye, provides an overview of the problems faced by Great Britain in the process of development of its public expenditure control system, and outlines the current system and its links with macroeconomic policy. In this aspect, the British experience can be very useful for the improvement of the public expenditure control system in Brazil.

The second article, entitled "Fiscal Adjustment, Stability and Growth", discusses the conditions under which the expansion of the government's current spending would be harmful to economic growth. In line with what several experts in this area have been saying, the authors conclude that the impacts of public expenditure on economic growth depend crucially on the composition of this expenditure, with the increase of public investments and expenditures that promote income redistribution (i.e. reducing social inequalities) having a significant positive impact on growth.

The third article, entitled "Government Current Account saving: a new fiscal policy proposal", discusses the advantages of "replacing the fiscal target based on primary surplus with a target based on government current account saving" as a means to combine the maintenance of fiscal austerity with the increase of public investments. Using a sophisticated methodology, the authors simulate courses for the public debt to GDP ratio in different scenarios and conclude that replacing the primary surplus target with government current account saving target would not substantially alter the course of the debt to GDP ratio. However, the latter alternative has the advantage of providing a higher rate of economic growth, and is thus preferable.

The fourth article, "Budgetary Rigidity in Brazil and Rules for Increasing Fiscal Flexibility", advocates the adoption of rules to increase fiscal flexibility that restrict the growth of the Federal Government's expenditure and allow for increases of primary surplus and/or public investments. On the assumption that fiscal inflexibility is very high, regarding both revenues and expenditure, and that this causes a kind of "trap" that hinders the consolidation of macroeconomic stability, the author proposes that the obligatory non-financial current expenditure of the Federal Government should be made more flexible by means of rules that impose cuts and/or limits to the expenditure segments considered inefficient, ineffective or unproductive. In particular, this involves an evaluation of social expenditures, especially the payment of social security benefits, that takes into account not only social policy criteria, but also macroeconomic policy criteria (stabilization and growth).

Finally, the fifth article, "Social Security and Efficiency" provides an overview of the criteria of social security expenditure efficiency. Efficiency

is simply the attribute of a process capable of producing "a result with the minimum error, effort, resources, energy and time". In the specific case of public welfare, the discussion on efficiency must take into account the balance between social benefits resulting from government transfers to retirees and pensioners and the social costs of maintaining the social security system, both in the form of dead-weight (reduction of the size of the markets and loss of welfare by the economic agents), and in the form of administrative burden. As regards the dead weight, the possibility of the social security system affecting decisions in the labour market, as well as affecting the savings and investments decisions of the economic agents, poses important questions regarding the impact of Social Security on economic growth.