COMMENTS ON SESSION 1
NATIONAL FISCAL FRAMEWORKS: THE EXPERIENCE

Ernesto Rezk[*]

Comments to the paper "Fiscal Rules, What Does the American Experience Tell Us?" by Byron Lutz and Glenn Follette

What stems from Lutz and Follette's paper is, in the first place, some dissatisfaction with fiscal rules' performance in the United States, basically at the federal level of government, and also question marks on whether the situation may worsen.

From the policy performance side, the concern for large budget deficits and rising public debt levels clearly boosted interest and concentrated efforts in studying:

- the effectiveness of budgetary rules;
- balanced budget rules for operating budgets;
- the limits on borrowing;
- the way public expenditures are financed.

In considering that fiscal policy in the United States is carried out in a federal setting, the fiscal scenario falls short of being homogenous given to:

- the asymmetric situation of federal and subnational governments with respect to constitutional and statutory restrictions related to fiscal discipline;
- a federal debt being proportionally higher and more variable than those of state and local governments, which in turn renders proportionally larger deficits, even though debt levels vary significantly across states.

For that, and owing to constitutional or statutory balanced budget rules, fiscal responsibility performs better at the state than at the federal government level, in spite that a trade-off is seen to arise between government levels' fiscal responsibility and countercyclical behaviour.

The above mentioned asymmetries have in turn consequences as:

- balanced budget rules affect the conduct of fiscal policy over the cycle, for what countercyclical policies are mostly performed by the federal government and the pattern of states' fiscal policy becomes more pro-cyclical;
- incentives emerge for seeking less cyclical revenue sources or for setting stabilization funds.

In sum, the message so far conveyed by the authors that states' constitutional budget rules are binding, that they impose restrictions on the fiscal conduct of state governments and increase in turn pro-cyclicality seems prima facie true, although one may wonder whether creative accounting and overly optimistic projections may not be actual ways to sidestepping balanced budget rules.

In suggesting that statutory budget rules proved to be ineffective, or at least insufficient, at the federal level, the authors carried out an interesting and rich review of diverse stabilization acts, enacted as of 1974.

The point is stressed that the 1974 Budget Control and Impoundment Act (BCIA):

- responded not only to the concern with increasing deficits but also with conflicts between the executive and legislative branches;

* National University of Córdoba, Argentina.

- for what the Houses' budget committees had the task of outlining the policy path for the coming 5 years and of setting targets for appropriations and reconciliation bills.

Nevertheless, and in spite of expectations, this Act fell short of curbing exploding deficits.

Following the failure of the BCIA, the 1985 Balance Budget and Emergency Deficit Control Act (also called the Gramm-Rudman-Hollings Act) amounted to a new attempt to checking deficits by:

- instituting annually projected deficit targets; and
- creating a sequestration mechanism whereby outlays would be cut in order to meet the targets.

Despite all, the budget process based on the GRH rule could not overcome the distortion caused by overly optimistic economic and technical assumptions and called for new instruments to be designed.

Coming next, the 1990 Budget Enforcement Act (BEA) changed the focus common to preceding acts since now:

- efforts were directed to restraining budget decisions rather than budget outcomes;
- the PAYGO rule was resorted to; that is, the set of used taxes and mandatory spending laws would not permit the deficit to increase;
- annual limits were imposed to discretionary spending;
- tax increases and mandatory spending cuts would be conducive to reaching budget balance.

Enforcement mechanisms were implemented in order that the BEA could satisfactorily meet its objectives:

- bills violating PAYGO rules or spending caps were subject to parliamentary obstacles;
- excesses in budget authority or projected discretionary spending immediately triggered sequesters, as well as changes in taxes and mandatory spending that increased deficit.

An evaluation of the Budget Enforcement Act's performance showed that:

- despite BEA rules proved to be more durable than the explicit deficit targets (GRH), its effectiveness was not at all clear and its results were deemed insufficient;
- more serious a drawback, BEA's difficulties to dealing with deficits arising from technical and economic assumptions placed it validity at stake.

President Clinton's plan to balance the budget in five years, based on tax increases and mandatory spending cuts (MEDICARE), and the continued adherence to revised and extended discretionary caps, were reflected in turn in the 1993 Omnibus Budget and Reconciliation Act. This Act was complemented by the 1997 Tax Reduction and Balanced Budget Act whereby:

- president Clinton implemented his second term fiscal plan, aimed at reaching budget balance by 2002 by extending discretionary caps and carrying out severe reductions in MEDICARE and other entitlements.

Two important matters are worth quoting here, the first one concerning the importance of elucidating whether surpluses in the period (tight fiscal policy) stemmed from budget rules, or from the executive and Congress' decisions, and the second one is that the American experience rendered scarce evidence of statutory budget rules' effectiveness while it did not rule out in change the influence of policymakers' preferences.

In ascertaining the manner in which states' budget rules contribute to fiscal consolidations, it must be noticed that:

- constitutional and statutory balanced budget rules add to court rulings on borrowing limits at the states' government level;

- variants include governors proposing balanced operating budgets, legislatures passing balanced operating budgets and budgets balanced at the end of the fiscal year with no possibility of carryovers;
- in order to meet balanced budget rules, legislatures may reduce expenditure or increase revenues and governors may reduce outlays or resort to short term borrowing which bridges the budget gap;
- however, and as mentioned above, main challenges stem from manoeuvres usually known as creative accounting practices.

As the questions can be raised of whether balanced budget rules are associated with differences in state fiscal behaviour, or to what extent states' debt levels are sound when assessing the efficacy of fiscal rules, it is quoted that:

- correlations between usual ratings and debt levels suggest that tighter budget restrictions are associated with lower debt levels, for what one may assume that covenants are binding at the state level;
- states with strong rule states maintain larger balances than those with weak rule; in consequence, it can be deduced that the former exhibit stronger fiscal positions than the latter;
- finally, despite constitutional rules are seen to be more effective in getting lower debt levels and smaller deficits, the cost in terms of an increase of states' budget outcome pro-cyclicity should not be totally ignored.

Comments to the paper "Fiscal Rules and Fiscal Policy in Brazil" by Ana Teresa Holanda de Albuquerque

As amply analyzed by the author, as of the nineties Brazil resorted to varied policies, whose targets and instruments sought to get the country's fiscal consolidation; among these, the following four are particularly worth mentioning:

First, programmes aimed at carrying out large scale privatizations, taking place mainly from 1991 through 2002 and focused on:

- the central government level: industrial and mining firms, ports, railroads and state owned firms from energy and telecommunication sectors;
- subnational privatization programmes including many state owned banks.

In valuing the performance, let it be pointed out that the attraction of foreign direct investment, devaluation of *real* delayed until 1999 and state owned enterprises' deficits no longer impacting upon public budgets may be counted as some of the programmes' main achievements.

Second, the recognition of extra budgetary unrecorded liabilities, occurring in the period1996-2000, whereby:

- state owned firms employees' legal claims were transferred to the central government, as well as bad performance loans of states' financial institutions and the fiscal impact of the private banking system restructuring;
- interest rate subsidies were introduced on housing loans.

Third, the 1997 Subnational Debt Restructuring Programme by which it was intended to meet:

- the problems large scale decentralization caused to states by bringing about the reduction of the public sector primary balance and the consequent deterioration of states' fiscal performance;

- the situation originated in states' sluggishness to adjust to the new low inflation scenario and in theirs resorting to high interest loans for solving cash flow difficulties.

In response to states' fiscal crisis the central government mounted a comprehensive debt restructuring plan that included up front and interest rate subsidies and the banning of future bailouts among government levels. Nevertheless, the once and for all bailout was conditioned to states performing adjustments including primary surplus targets and spending ceilings; limits for future borrowing were also set as well as states' current revenues as a guarantee for service payments.

Fourth, the Fiscal Responsibility Law (FRL) enacted in 2000 stood itself, without any doubt, as the cornerstone of the Brazilian Fiscal Consolidation Plan (following the 1994 Macroeconomic Stabilization Plan) in so far as its mechanisms aimed at ensuring compliance of proposed fiscal targets, control of fiscal aggregates and enhancement of transparency and fiscal consolidation stimulus in all three government levels.

- The FRL, Instead of fixing fiscal targets, set ceilings for debt levels and expenditures in personnel, in terms of the government level's net current revenues.
- The FRL mandated, seeking to enhance transparency, that compliance reports of previous year's fiscal targets (primary balance, PSBR and net debt) and fiscal targets for the coming three years be annexed to pluriannual budget and annual budget guidelines laws; a risk report with an assessment of contingent fiscal liabilities had also be added to the latter.
- Concerning fiscal rules to be met by budgetary laws, it was particularly worth mentioning the requirement that new permanent spending had to be accompanied by increases in permanent revenues or by permanent spending cuts.
- Strict compliance and governance provisions mainly accounted for the success of the FRL. In this connection, when limits were not met, or gaps not done away, state governments were neither permitted to issue new debt nor entitled to receive discretionary transfers or credit guarantees from the central government.
- Likewise, apart from the bailout prohibition among government levels, administrative, financial, political penalties and even prison could applied to public officials failing to obey the FRL ruling.
- Transparency was additionally enhanced by obliging government levels to release bi-monthly reports on budget execution and four month reports on compliance of the FRL parameters.
- Actuarial reports on the social security system of the public and private sectors had also be sent to the Congress together with the annual budget guidelines.

Notwithstanding the fact that the programmes and instruments resorted to by the government, in particular the Fiscal Responsibility Law, marked and inflection point in Brazilian fiscal and budget rules, the question arises of whether the improvement of the situation will be enduring or, as feared by some public sector specialists, there are still red lights in the Brazilian fiscal horizon.

Those analysts in charge of following the Brazilian macroeconomic performance do not hesitate in pointing out that:

- the accelerated economic growth, as of 2003, helped in maintaining an average primary surplus of 3 percentage points of GDP in the period 2004-08, based mainly on increases in the revenue side;
- in proof of that, it is stressed that the tax burden rose from 28.7 per cent of GDP, in 1999, to 34.7 per cent in 2008. At the same time, public spending (wages, social programmes and pension payments) also kept a rising pace during the period;

- current public spending amounted to 20.9 per cent of GDP in 2008, the main component being transfers to families (*i.e.*, the Bolsa Familia programme). Increases in civil servants' wages above the inflation rate and growing pension payments, owing to the early retirement age, also explained the growth of public spending;
- in 2010, central government's revenues fell short of spending requirements, for what revenues from oil sales (PETROBRAS) had to be transferred to the Treasury in order to exhibit a primary surplus of 2.16 per cent of GDP.

In the light of the above mentioned features, it seems clear that the main challenges in the Brazilian fiscal front may be summarized as the need of:

- reducing the present debt level/GDP ratio;
- improving the expenditure allocation by enhancing public savings (share and quality of public investment);
- placing a limit to the growing gap between pension payments and contributions;
- revising the inflexibility of the central government budget, as an important part of revenues are earmarked to specific programmes and mandatory expenditure;
- simplifying the tax system and alleviating the tax burden upon taxpayers.

Finally, and given the level of integration of the country's economy to the world economy, it seems important to highlight Brazilian's fiscal responses to 2007 and 2008 international crises; in particular, the performance of built-in flexibility and the response of active fiscal policies:

- in the first case, the effect of automatic stabilizers was not very important, reaching in the 2009 budget 0.27 p.p. of GDP due to tax losses from manufacturing and 0.17 percentage points of GDP due to more unemployment insurance payments;
- the discretionary fiscal policy did not either play an outstanding role as tax deductions only amounted to 0.8 percentage points of GDP whereas mandatory spending was raised by 1.21 percentage points of GDP. Nevertheless, this sufficed to explain why 2010 revenues could not meet expenditure requirements.