

Opinion

Tax Rules and Public Choices: Risks and Opportunities in 2019



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The country will arrive on the eve of 2019 at a crossroads on the medium-term future of the public accounts; its main tax rules threatened due to the difficulty in equating its needs and ambitions, on the one hand, and capabilities and sustainability, on the other. Whether by the control of its compulsory expenses or by the increase of collections – which does not necessarily mean increase of the tax burden–, the tax effort required to stabilize the public debt trajectory is of approximately R\$ 300 billion, which corresponds to nearly 6% of the GDP.

It is not about a tax effort concentrated on a fiscal year to eliminate an inventory problem, but a continuous effort to rebalance the income and expenditure flows, in a lasting manner, in that order of magnitude; leaving the annual deficit that, after 2014, has repeatedly exceeded the hundred billion reais and generating even greater surplus. It is not a simple task and it may expose a hard distribution conflict among social groups, in the collection of revenues and public expenditure.

Since 2015, the greatest part of the deliberate effort to rebalance the public accounts has been focused on the discretionary primary expenditure, in order to offset the effects of accelerated growth in compulsory expenditure. There are, however, problems and traps in this strategy. The problems are critical, as they combine insufficiency and impossibility of increasing the adjustment for this path of action. Insufficiency because, even if no discretionary expenses were incurred, the compulsory expenditure would follow its unsustainable growth trajectory, thus violating short-term tax limits. And impossibility because, as discretionary expenditure includes items that are essential to the operation of public bodies and their policies, such expenditure cannot be reduced far beyond the current levels – it is impossible to imagine a health unit functioning without hygiene and maintenance, a court without security, a police station without electricity.



The traps of this strategy are no less negligible. A relevant part of this adjustment is affecting the public investment, which is neither replaced nor increased by private investments. The result is reflected on the decreasing rates of fixed capital gross formation and, therefore, on insufficient growth rates of the economy, which is especially critical for a country of low average income. It is worth remembering that, in addition to being unequal, the wealth available in the country is not relatively high: regarding the limitation of the indicator, at the end of 2017, Brazil was the 71st country in the world considering the relationship between GDP and population, according to the estimate of the International Monetary Fund.

Notwithstanding this scenario of degradation of public finances, at the same time of the adoption of some measures for tax con-

traction expenditure, including revisions of programs based on financial and credit subsidies, measures that imply the maintenance of tax exemptions at high levels have continued to be implemented or renewed. Taking into account only the items corresponding to the so-called tax expenditure, as classified by the Federal Revenue, at the federal level, the granting of benefits is estimated in approximately R\$ 270.4 billion in 2017, corresponding to 4.12% of the GDP.

It is a high amount but, even so, it does not reach the total reduction of the tax burden. There are measures that cannot be classified as tax expenditure and that represent billionaire collection losses, additionally, there have been a series of amnesty and remission programs that affect the availability of public resources. In an environment of a relatively sta-

ble tax burden, this means that the distribution of tax effort is subject to distortions of several orders and natures, harming the collectivity in favor of specific groups.

This scenario is aggravated by the exemption programs that, despite the intention behind them, are rarely evaluated, or even associated with objectives and goals explicitly stated. Approximately half the total tax expenditure does not even have a responsible management body, thus escaping not only from the allocative dispute of the budget cycle, but also from any expectation of critical review. These aspects have been repeatedly pointed out by the TCU (Federal Court of Accounts) in comprehensive supervisions or supervisions focused on specific resignations, evidencing the need for a more effective reaction by the society and its representatives.

The convergence of the recession, of the decrease in tax collection, of the continuous increase in compulsory expenses and of the maintenance of tax exemptions in high levels have generated a dynamic imbalance between expenses and revenues since 2014, whose reversal has not yet been consolidated and which results in accelerated growth of public debt: the Gross Debt of the General Government reached, at the end of 2017, the level of 74% of the GDP. However, this debt does not correspond to a legacy of infrastructure, or great investments in human capital and innovation that could change the level of competitiveness of the country.

Not coincidentally, the so-called Golden Rule of the Federal Constitution, whose purpose is to avoid public indebtedness to finance the current expenditures, has only been fulfilled due to atypical measures, mainly BNDES' (National Development Bank) funds return to the National Treasury. For 2019, however, there is a consensus that the Federal Government will have to use the exception provided for in the rule itself, requesting the National Congress to approve additional credits by absolute majority. From the legal perspective, the goal will be achieved; in its essence, however, we will continue in the opposite direction, as the country will issue government securities to finance current expenses, such as social security, payroll and debt interest, following an unsustainable trajectory.

At this point, therefore, it is clearly impossible to comply with the restrictive tax rules, in a substantive way, simultaneously with the rules of creation and

increase of public expenses. In other words, there is an incompatibility between the provisions of the legal system that, on the one hand, demand expenses, and, on the other hand, seek to limit these expenses. And, before the rules, the actual issue is: the unsustainability of the public debt trajectory in case of maintenance of the current fiscal dynamics.

Therefore, inexorably, the next Presidents of the Republic and the legislature of the National Congress will have to start 2019 willing to direct a huge medium-term settlement of accounts, under penalty of leaving it to inflation, with all its damaging consequences to the growth of the economy and to the guarantee of social rights.

Edmund Burke said: "Those who don't know their own History are doomed to repeat it." Bringing it to our context, perhaps this is the central point of the crisis in public finances: looking back, it is past time for us to know, understand and learn from our past, or to accept to repeat the same mistakes from time to time. Perhaps, we have shown so far little capacity to assimilate all historical lessons, learn from what leads us to crises and what makes us achieve relevant successes – and with that, we may have missed some opportunities to move forward consistently.

The difficulties are clear, but not insurmountable, and proof that the country can deal with these obstacles is in our recent History. Approximately 30 years ago, during the 80s, we experienced a terrible State crisis – a time when, in fact, the ubiquity of the word crisis made it seem that it was a condition immanent to

the nation, demanding from every Brazilian the ability to conform to no hope for a better future. The current news remind us of that time, as if we had gone back three decades, to a circumstance in which Brazil was an impossible country, in which people no longer believed in the country of the future that never arrived.

But this is not because the objective data tell us that. There is no evidence that we regressed to that point, on the contrary. However, our human, psychological experience leads us to this collective mistake; the country experienced the summit of hope, the impression that the future had finally arrived, and, suddenly, discovered that it was not exactly true. The collective certainty of the lost decade of 1980 seems, to everyone, truer than the conviction of developed Brazil of the first decade of this century. We went from the euphoria to depression and, from this current perspective, we cannot clearly distinguish between the past and the possible future.

Approximately 30 years ago, we restored democracy in Brazil, consolidating institutions and freedoms in the current Constitution. And approximately 20 years ago, we overcame the macroeconomic degradation and conquered a currency: if we go back to the end of the 1980s, we will remember a time when inflation surpassed 1,700% in a single year, resisting at absurd levels to periodic packages, until the "*Plano Real*" (Real Plan) took us to a new level of civilization in terms of economy. Today, we are back to an inflation below 4% per year, and our people have already shown that no longer tolerate the continued loss of the value of our currency.



Less than 10 years ago, the Federal Supreme Court decided, unanimously, to prohibit the practice of nepotism in the country, based on the principle of morality. In historical terms, it was yesterday. Our time is not the time of History. The daily news afflicts the good citizens who are led to hopelessness to the point where we forget how far we have progressed in our democratic governance: in the establishment of a Rule of Law; in the formation of professional qualified bureaucracies, especially in the scope of the government careers; in the availability of information and transparency to society; in the mechanisms of social participation and accountability.

In terms of economy, by analyzing the behavior of the product, it is undeniable that the country experiences a new lost decade. Regarding *per capita* figures, we

are returning to the levels of the beginning of the decade, and it will take us years to re-establish after this wasted time. But we are not the same country of the 1980s. We are a better country and we cannot forget it. Development does not follow a linear trajectory. It is an irregular walk, with accelerations and decelerations, with progress and setbacks, with overruns and stumbles. However, we cannot deny our progress. And by saying it, we are not praising the conformism, we are not ignoring the harshness of the crisis that afflicts millions and millions of unemployed Brazilians, we are not failing to realize the crudity with which our institutions were and are vilified. On the contrary: we are recognizing what we already have and all that we still need to accomplish as a people.

Finally, it is time for reflection. In the year we celebrate 30 years

of the Constitution and 18 years of the Fiscal Responsibility Law, we will have general elections and the opportunity for public debate about the country and its future. It is from this debate, technically informed, but essentially political – as noted by Schmitter, politics is peaceful resolution of conflicts – that a better country can emerge. We can avoid this debate and seek once more short-term illusions that lead to crises and lost decades; or we can face it, to make better choices from the collective point of view. We will face challenges ahead, on innovation, productivity and inclusive growth, but there is a precedent issue: rebalance the public accounts and ensure that the debt returns to a sustainable trajectory, to enable macroeconomic conditions required for a sustainable growth and resources to ensure social rights.