Brazilian States Fiscal Sustainability

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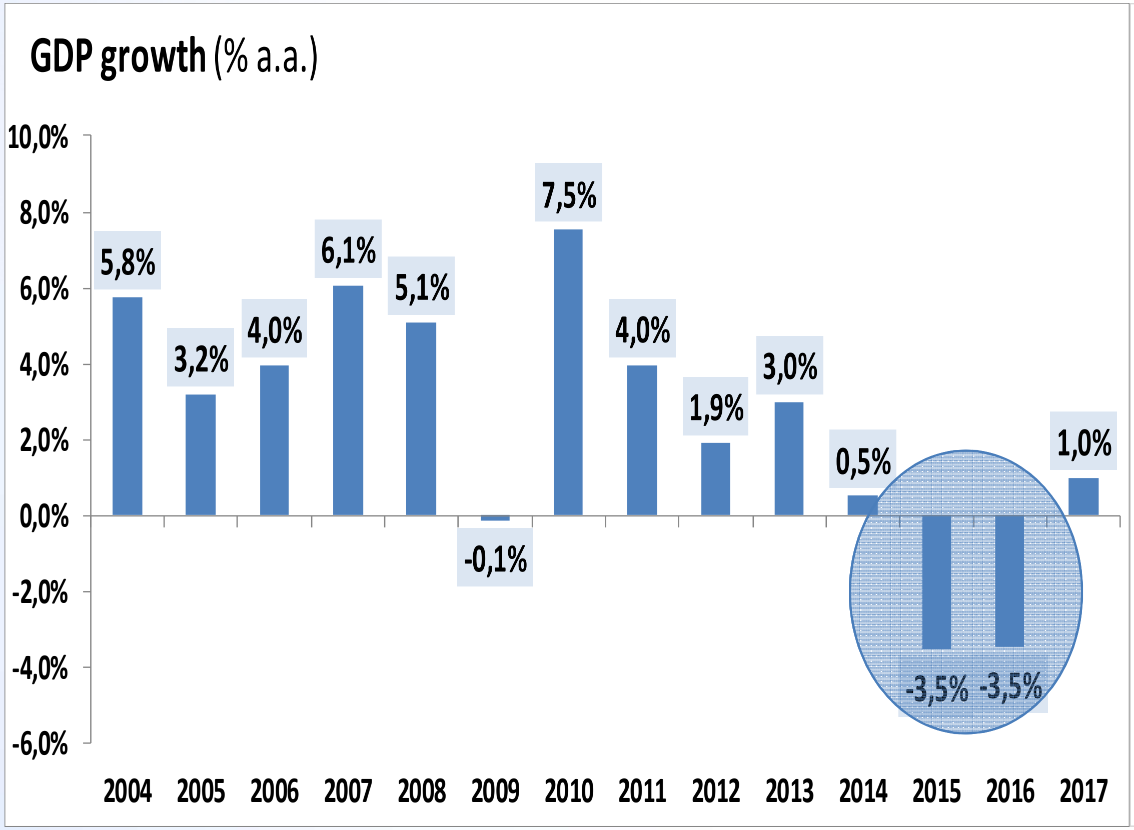
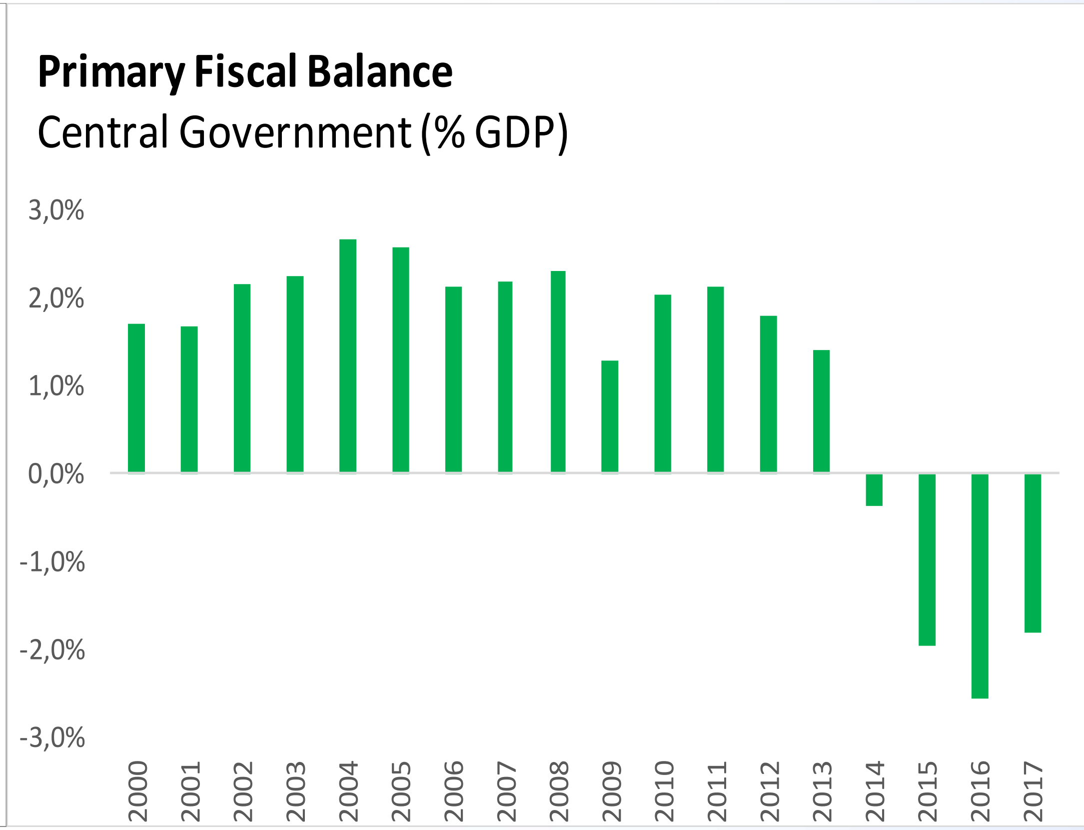
Agenda

- Introduction
- Institutional framework
- Fiscal Outlook: a critical situation
- What brought us to this point?
- What to reform?
- Perspectives
- Conclusion

Introduction – Macro Outlook

- Fiscal crisis → Recession → Fiscal crisis
- Central government with large fiscal imbalances

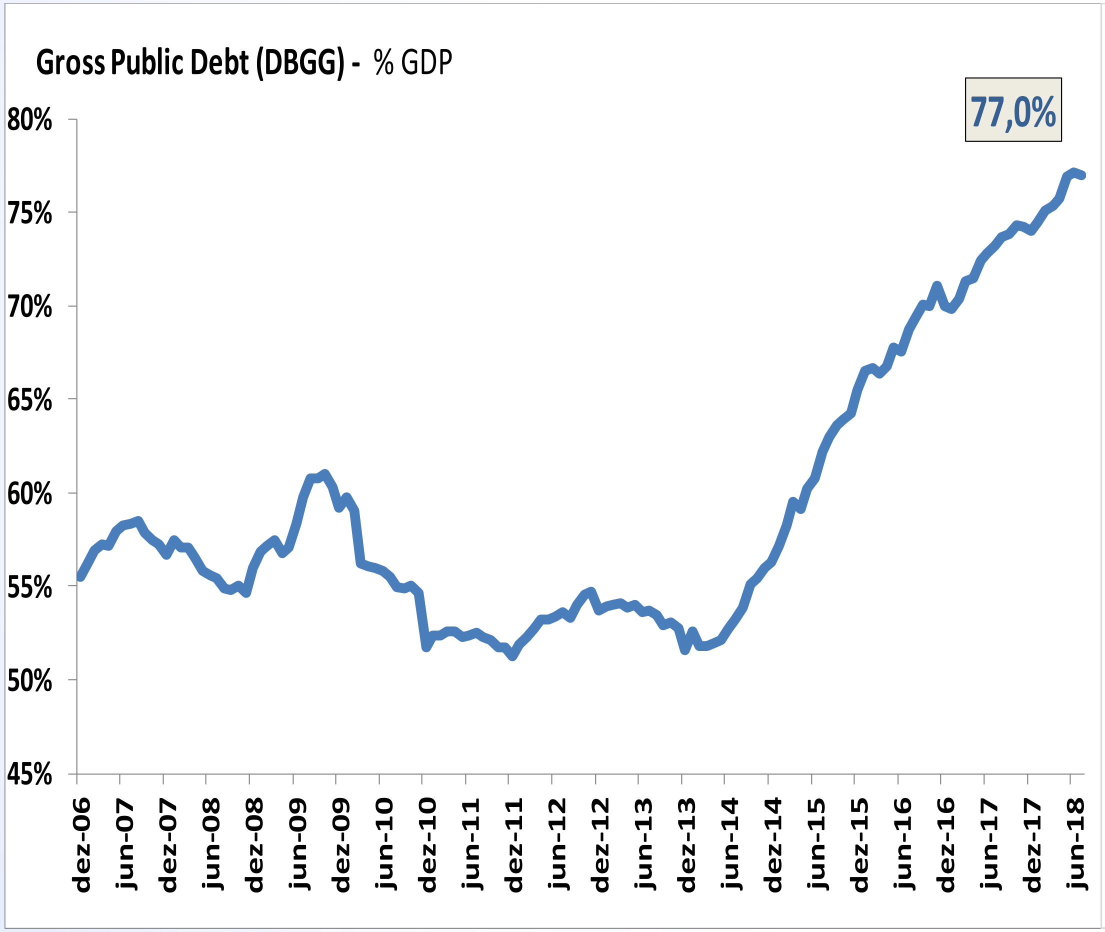


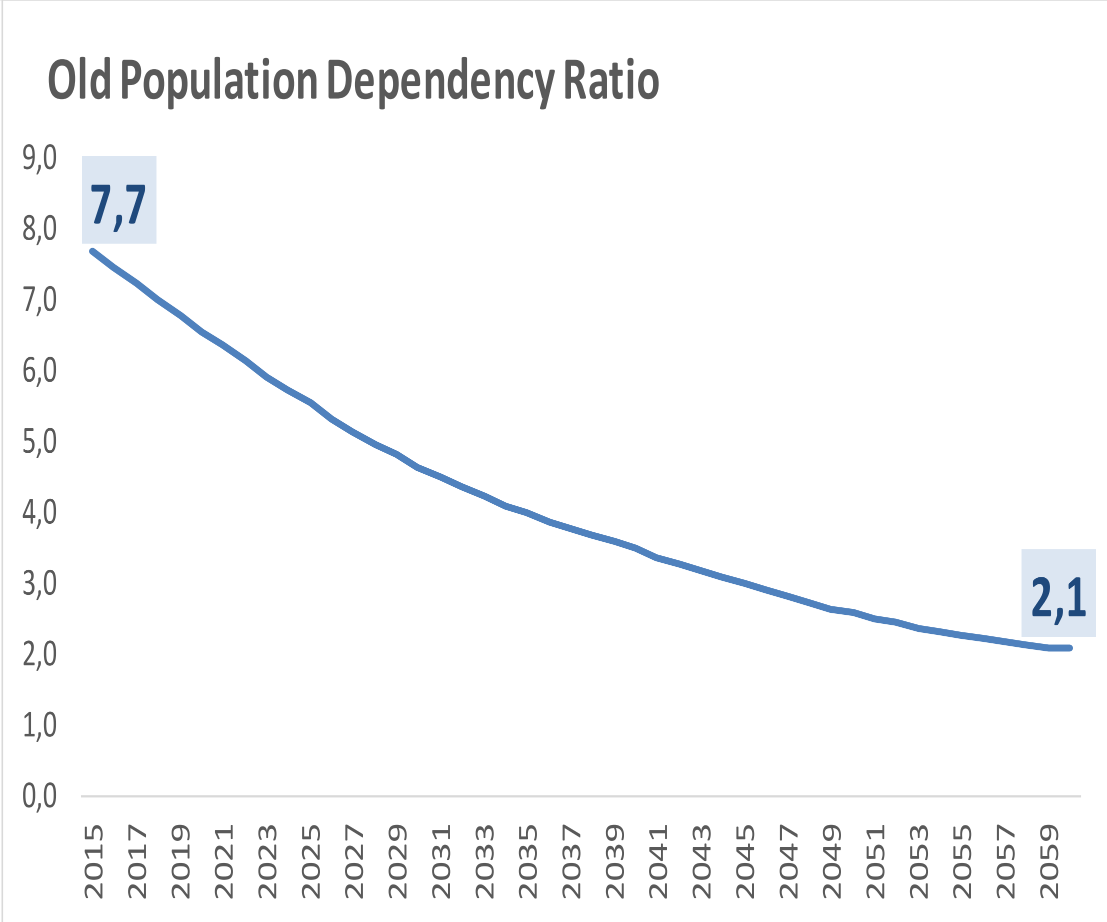


Source: IBGE, STN

Introduction – Macro Outlook

- Public Gross Debt on all-time high and above other emerging
- Aging population makes things worse





Source: BCB, IBGE

Institutional Framework

→ 20 years of a framework that used to work

- States public debt very high during 90's
- 1997: Agreement with the Central Government (CG)
- Good for both parts
- "Programa de Ajuste Fiscal"
- Restrictions on indebtness
- 2000: Fiscal Responsability Law (FRL)
  - Two main fiscal rules
  1) D/R < 200%
  2) Personnel/R < 60%

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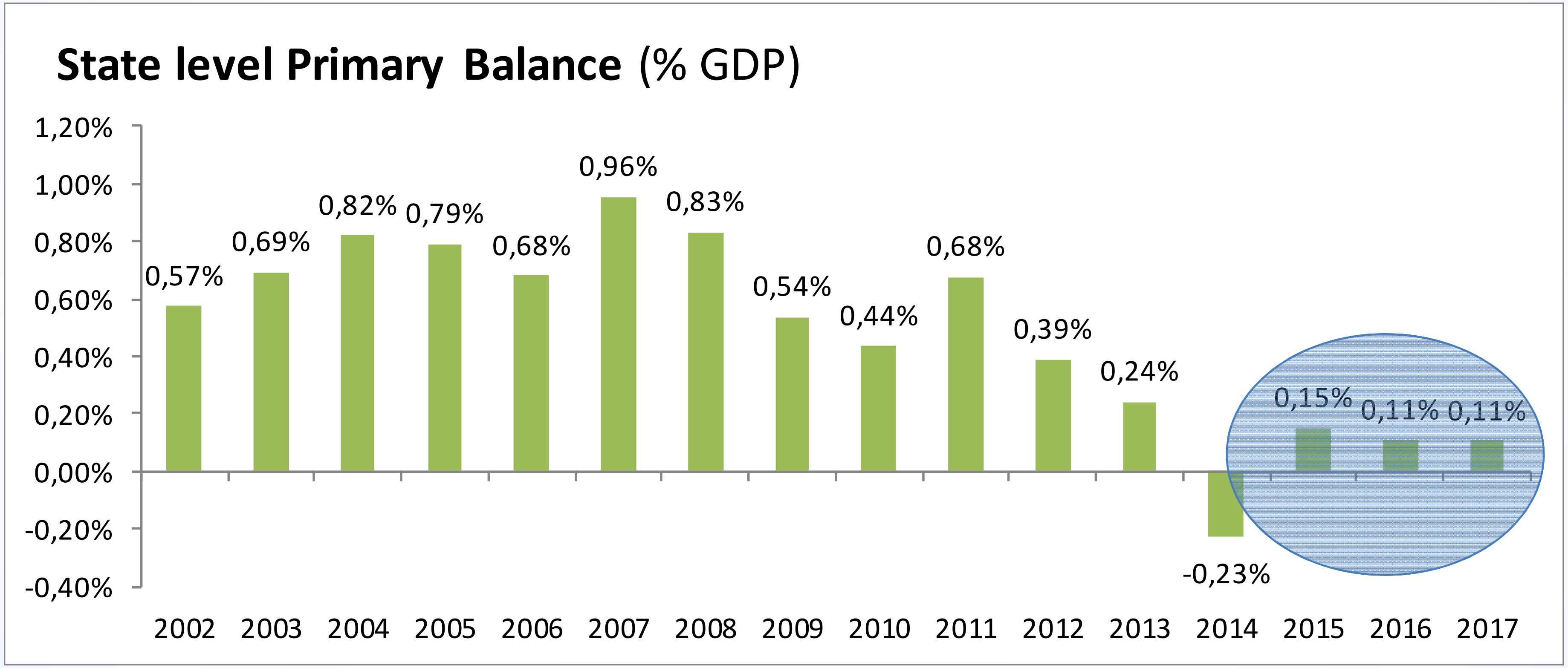
Fiscal Outlook

- 1997-2008 → Phase 1: Good outcomes
- 2009-2018 → Phase 2: Deterioration → chaos



From 2015: Not realistic nor healthy

Fonte: BCB

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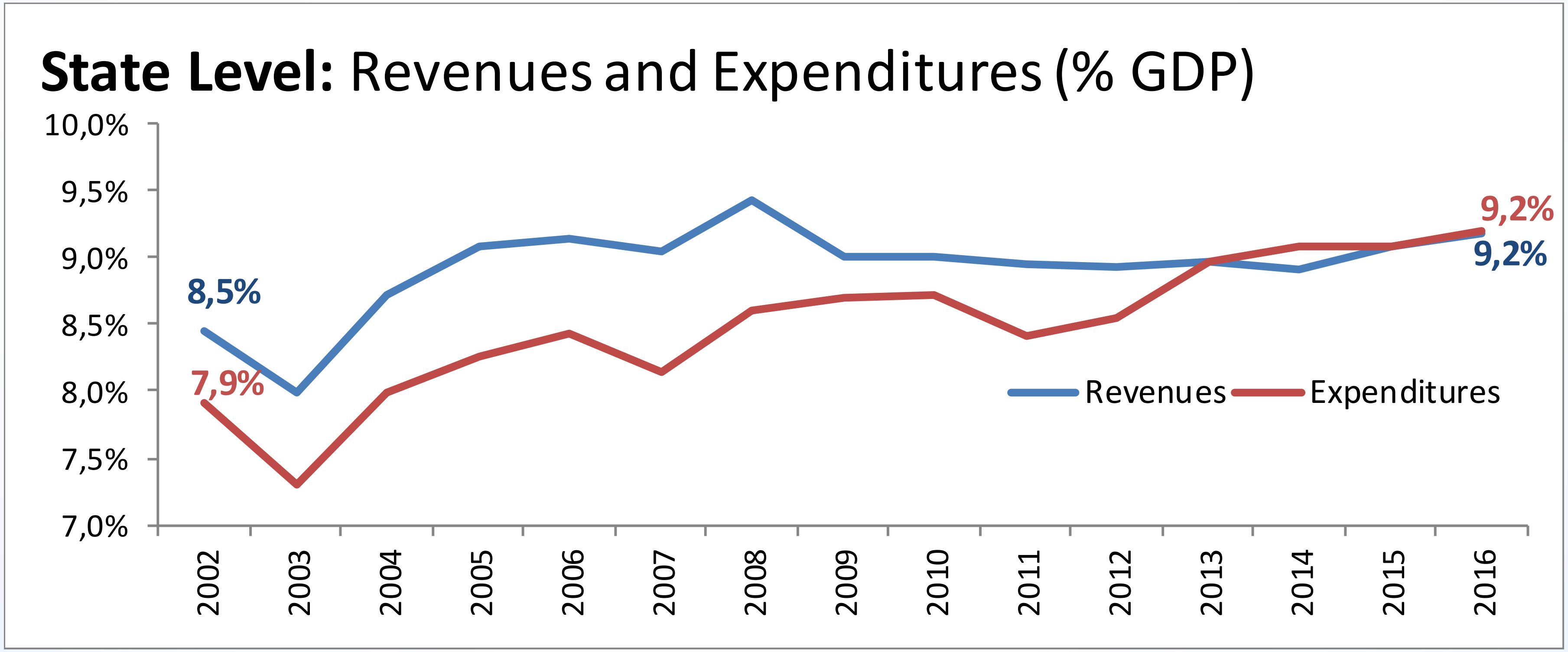
Fiscal Outlook

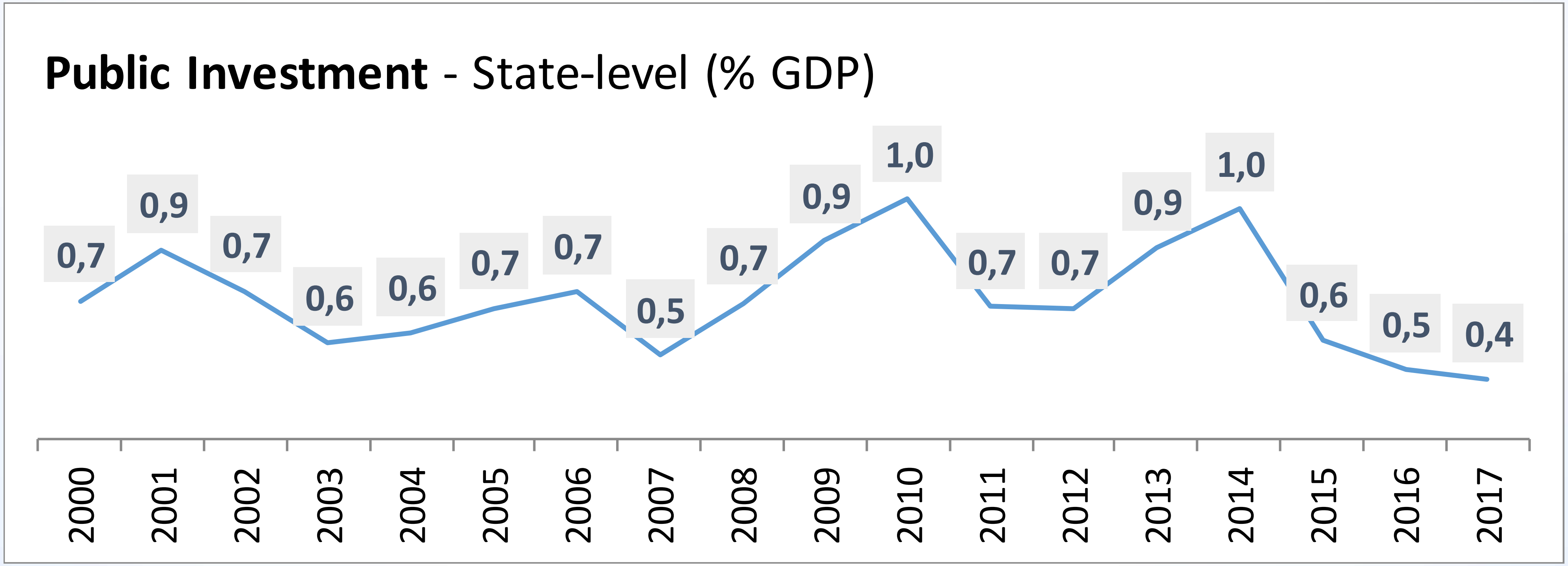
- Revenues and expenditures growing together until 2010s
- Expenditures: personnel (employees and pensions) → difficult do adjust
- Numbers are “tricky”: creative accounting



Fonte: STN

Fiscal Outlook

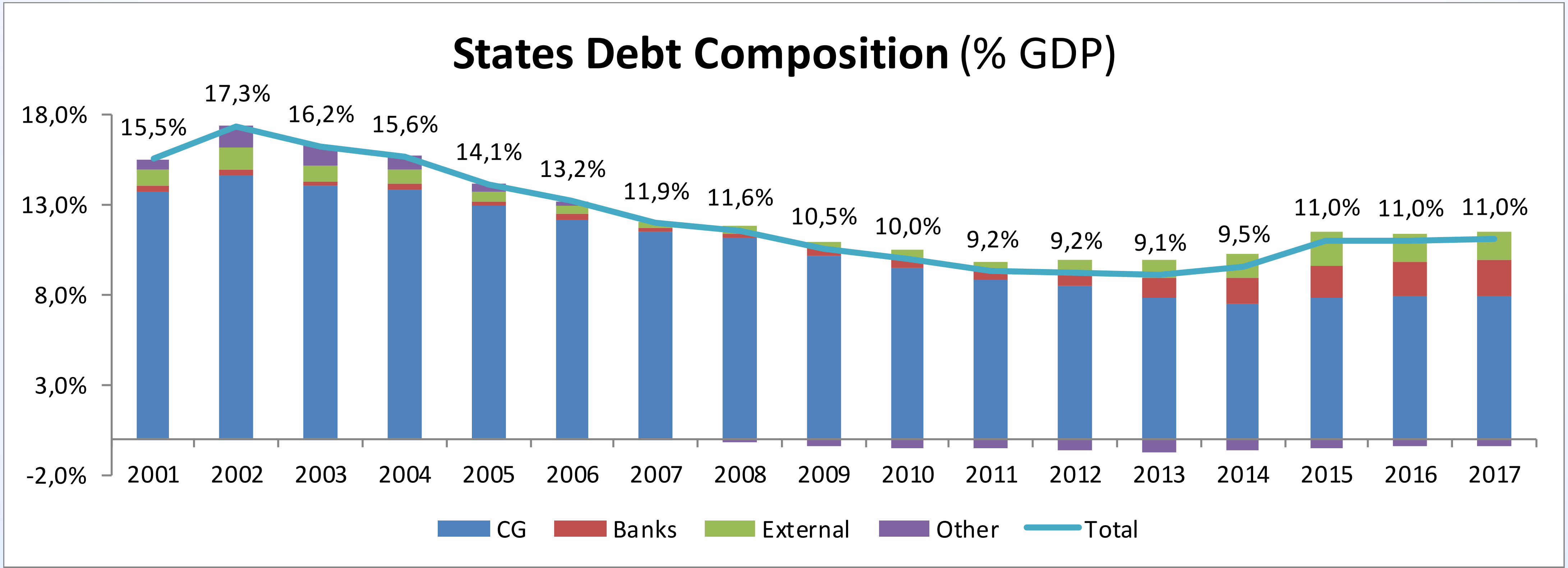
- Situation became critical: cash-flow serious problems
- New help from the CG (20 years lengthen debt)
- They also raised taxes and cut investment



Fonte: IBRE

Debt Evolution

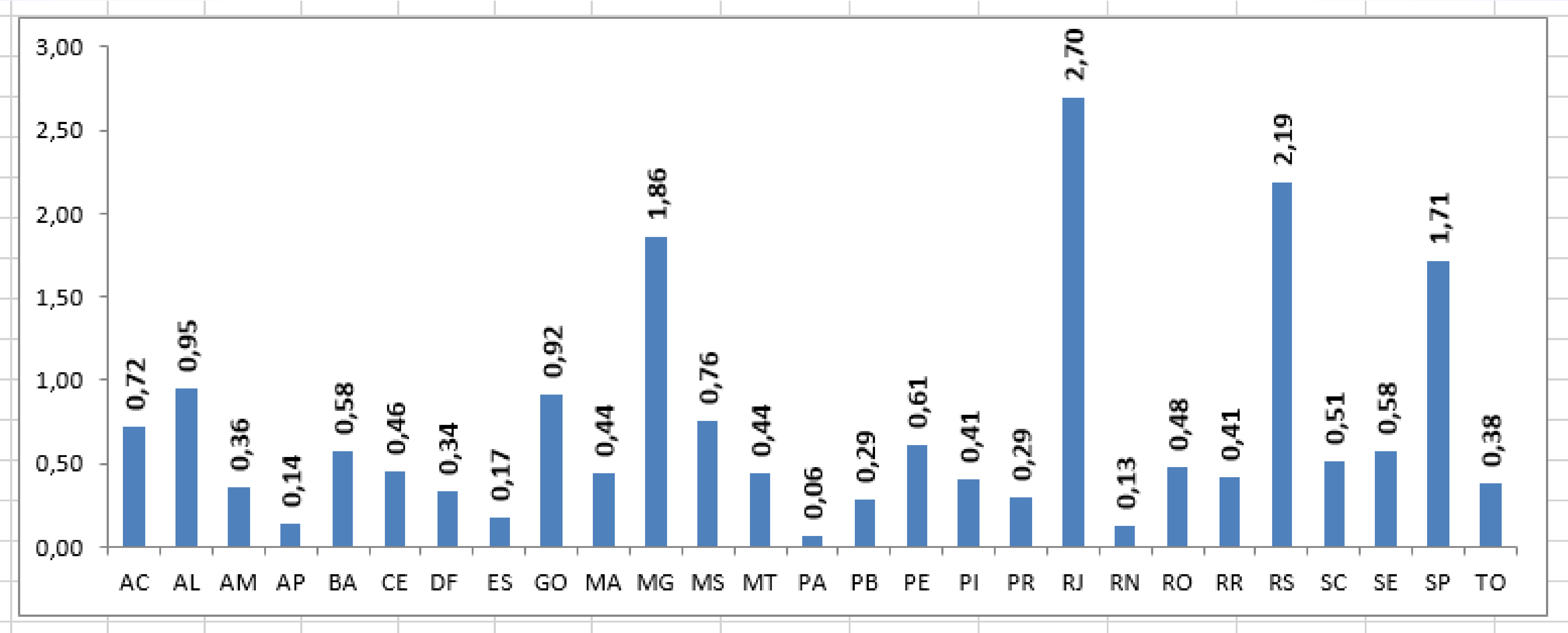
- Debt growing again from 2014
- Debt composition: very concentrated on CG debt
- But Banks and External debt were used from 2012
- Exchange rate risk



Fonte: BCB

Debt Evolution

- RJ and RS: above the FRL limit
- MG on the way



Fonte: STN

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Debt Evolution

- SP + RJ + MG + RS = 80% of debt
- Others have much lower debt

	R$ bilhões	% do PIB	% do total
São Paulo	269	4,1%	36,0%
Rio de Janeiro	141	2,1%	18,9%
Minas Gerais	108	1,6%	14,5%
Rio Grande do Sul	79	1,2%	10,6%
Goiás	18	0,3%	2,4%
Bahia	18	0,3%	2,4%
Paraná	15	0,2%	2,0%
Santa Catarina	14	0,2%	1,9%
Pernambuco	13	0,2%	1,7%
Outros	72	1,1%	9,6%
Total Estados	747		

Fonte: BCB

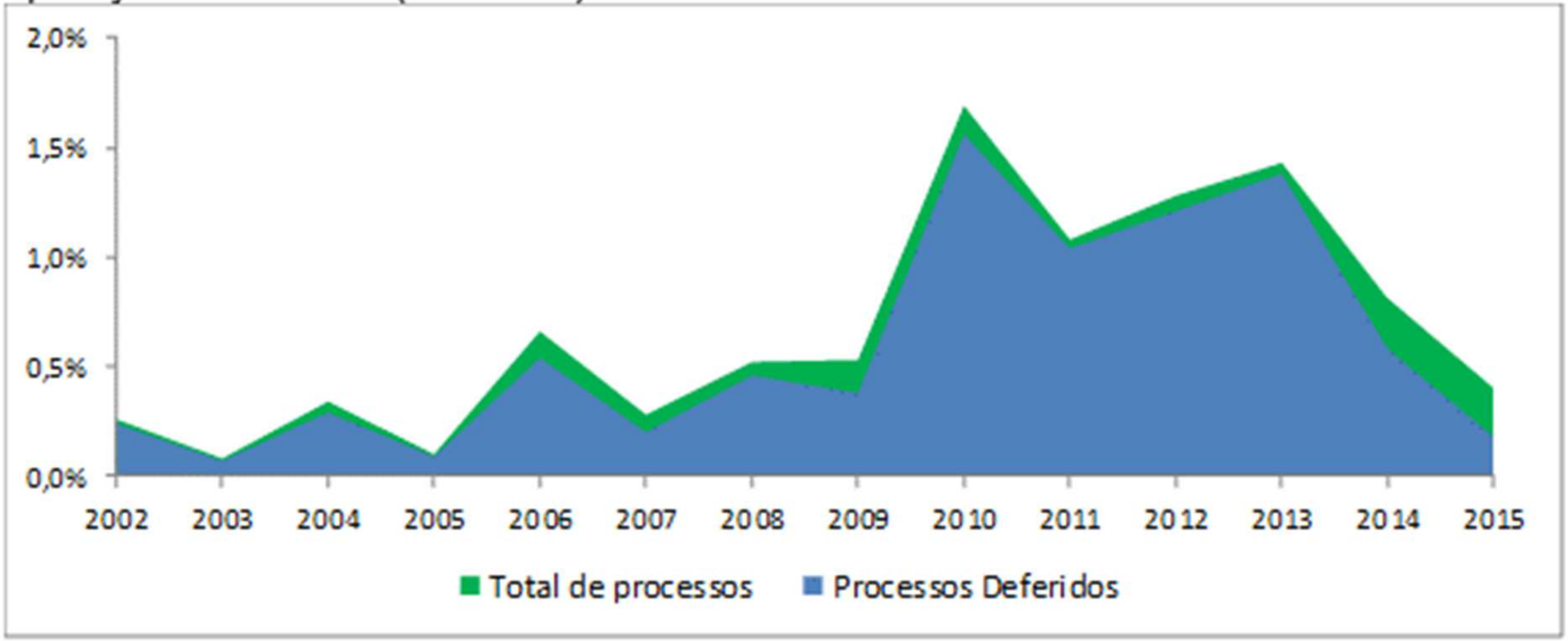
Debt Evolution

What brought us to this point?

Reason 1: Institutional deterioration

- Restrictions on credit were relaxed (2008 crisis, Big events):
  ➔ Credit operations (domestic and foreign banks) allowed the increase on expenditures

Gráfico 3 – Pedidos de verificação de limites e condições para contratação de operações de crédito (% do PIB)

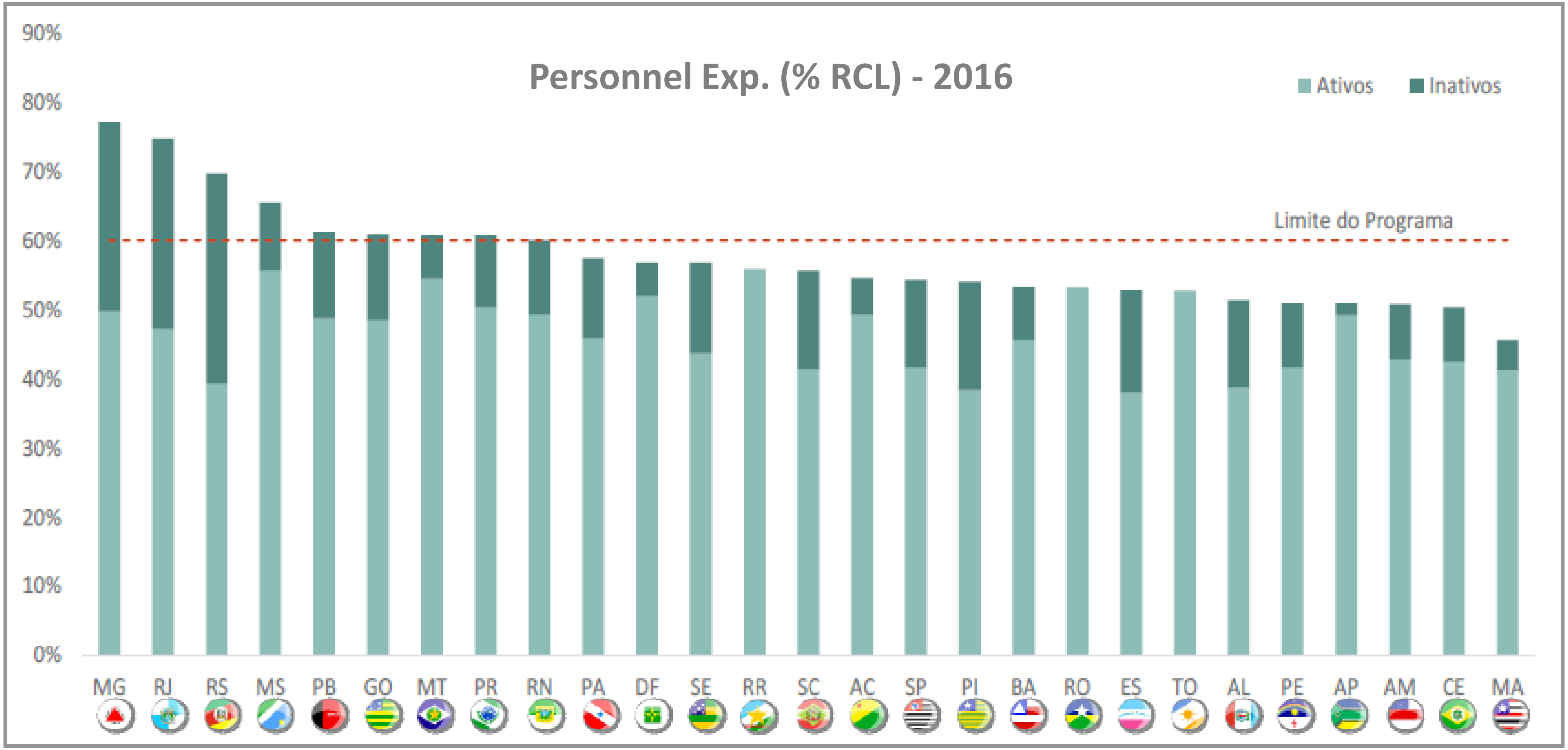


Fonte: Brochado (2016) a partir de dados do STN e BCB.

Fonte: STN

Reason 1: Institutional deterioration

- Creative accounting helping states to meet FRL targets
- Personnel Exp (% RCL) above 60% in some cases

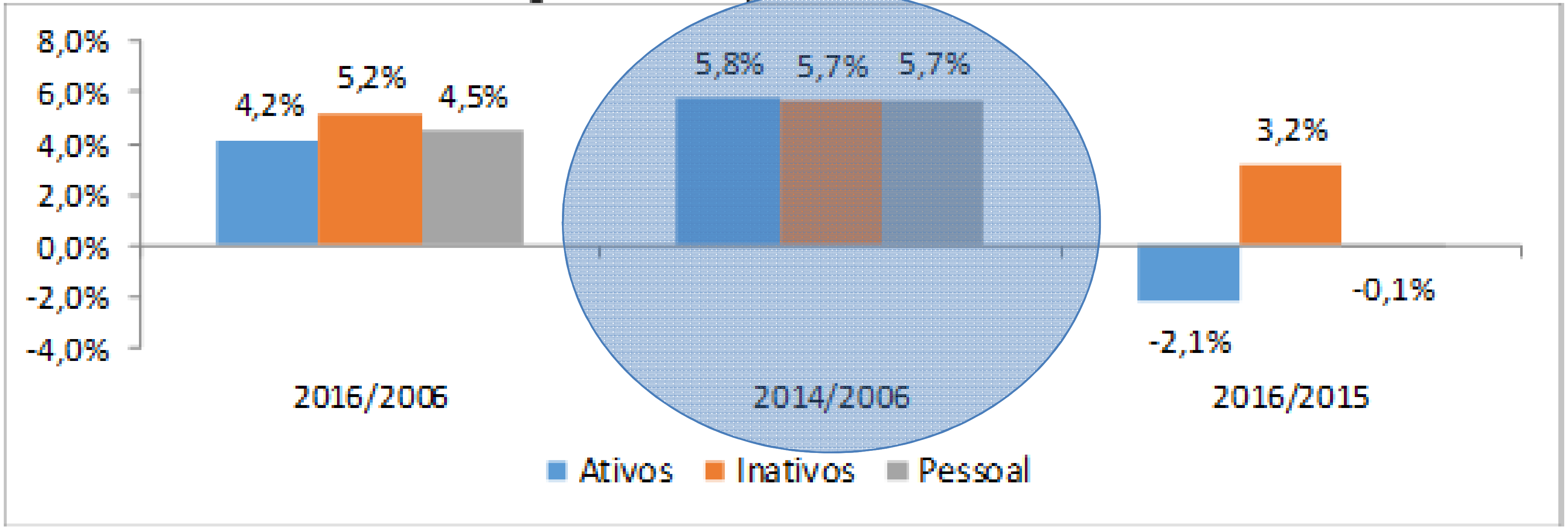


Fonte: STN

Reason 2: Personnel Expenditures

- Personnel expenditures growing 5,7% in real terms between 2006-2014 (Above revenues and also GDP)
- 2015/2016 adjustment shows where the challenge is

Gráfico 9 – Crescimento dos gastos com pessoal: 2006 a 2016



Fonte: Santos et al (2017b)

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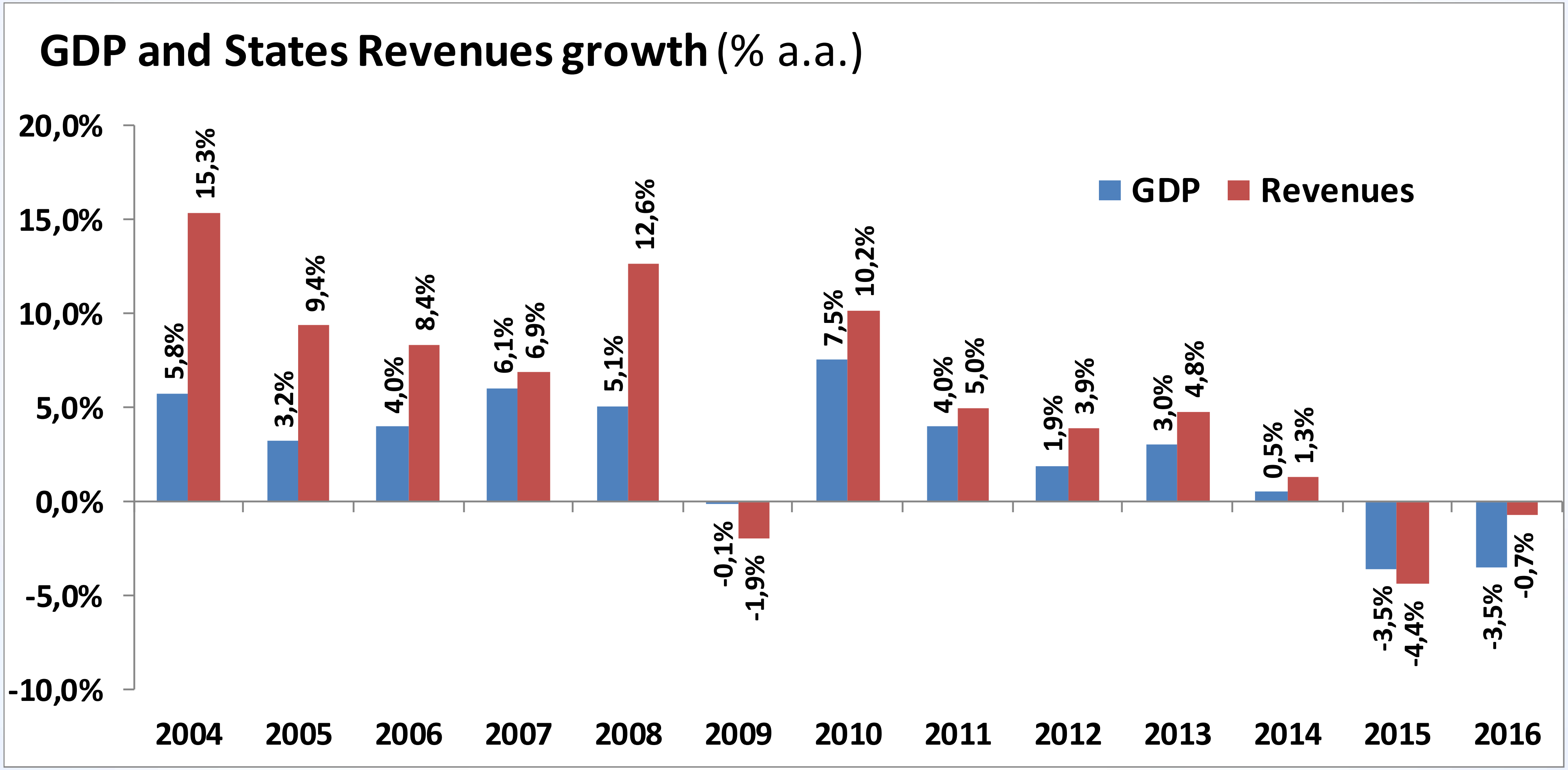
Reason 3: 2015/2016 Recession

- Big Recession exposed faster the structural problems



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What to reform? 1 - Institutional

Future

- Common accounting standards (Gestão Fiscal Council)
- Personnel Management Policy Reform (more flexible tools)
- Other

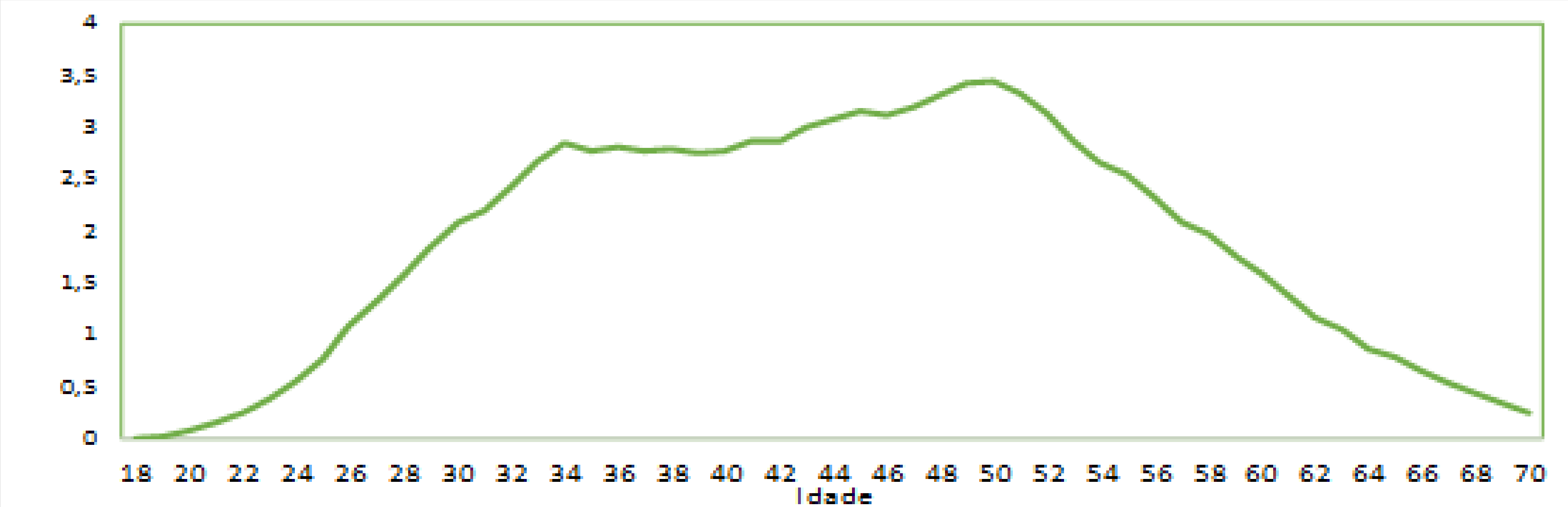
Current

- New “Programa de Ajuste Fiscal”
- “Regime de Recuperação Fiscal”
- Sistema de Garantias da União
- Instituição Fiscal Independente

What to reform? 2 – Pension Reform

- Pension Reform
- Aging Population + high salaries pressuring pension expenditures
- State Pension Systems have a worse age structure than population in general

Gráfico 10 – Distribuição etária dos servidores estaduais em 2015



Fonte: IPEA

Perspectives

- We run some simple exercises to have a big picture (until 2030)
- Simulation from the primary balance
- Assumption I: Market consensus for the macro scenario
- Assumption II: Revenues (elasticity = 1)
- Assumption III: expenditures

	2010	2011	2012	2013	2014	2015	2016
Revenues	350,0	391,2	430,2	477,6	514,7	544,8	574,9
Expenditures	338,7	367,8	411,2	478,0	524,3	543,9	575,0
Personnel	184,7	207,3	235,2	260,7	289,5	327,8	340,8
Investments	49,5	42,8	44,6	61,3	67,5	43,0	42,9
Other	104,5	117,7	131,5	155,9	167,4	173,2	191,3
Balance	11,3	23,5	19,0	-0,4	-9,6	0,9	-0,2

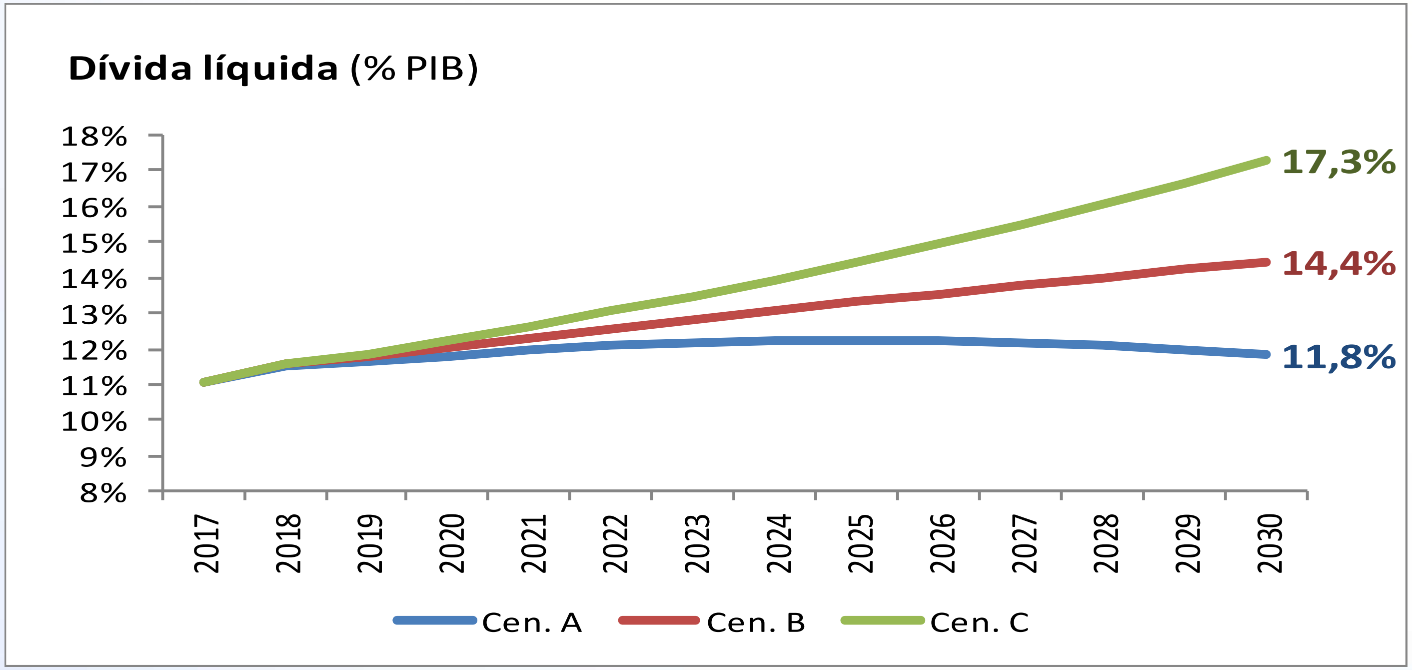
R$ current billions

Fonte: STN

Perspectives

Exercise 1: states can rollover debt all the time

Conclusion: If (i) they are very sucessful in control all other expenses than pensions and (ii) the pension reform has success reducing the growth rate of retired population, primary balances can be achieved in the medium term and debt/GDP can even reduce



Obs: Pensions annual tax growth:

A) 2,5%
B) 3,5%
C) 4,5%

Others: 2,0%

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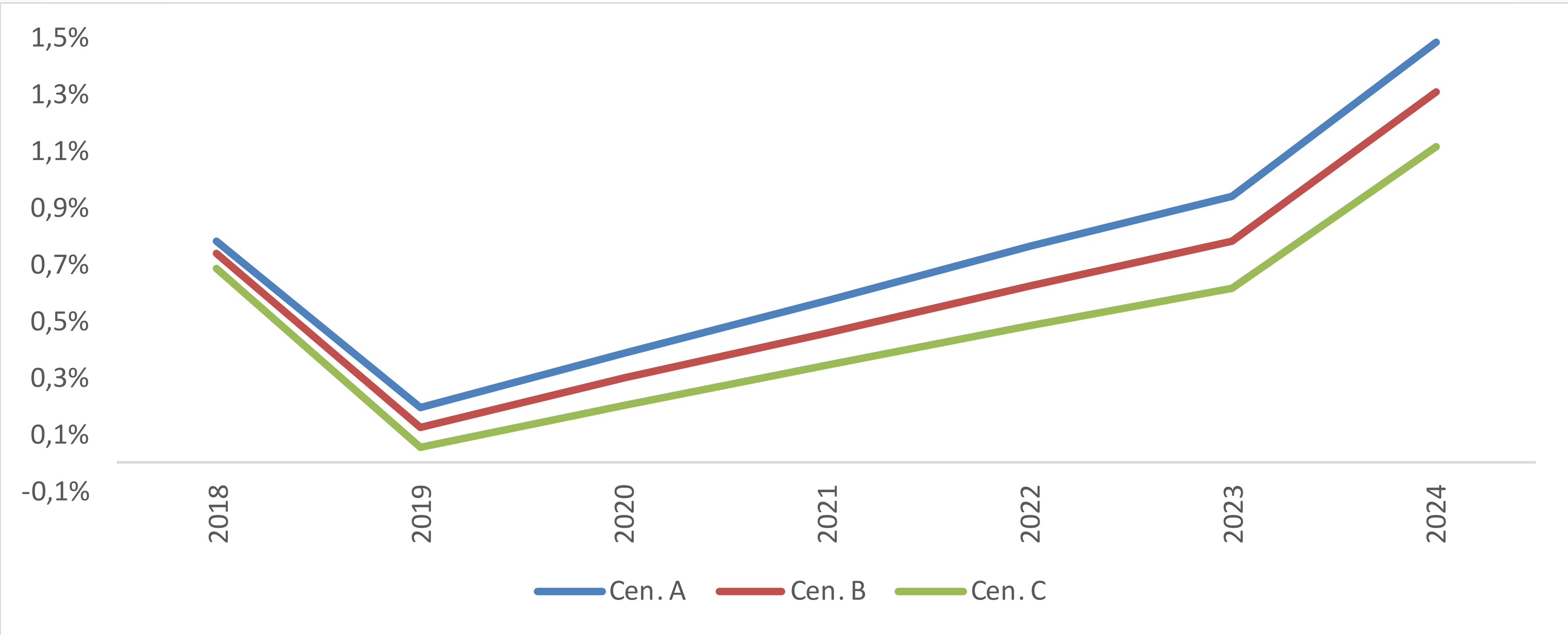
Perspectives

Exercise 2: States must repay the debt following the maturity structure (with the adjustment in investment)

Conclusion: The investment go to almost zero, even with all other expenses (but pensions) constant in real terms



Perspectives

- This means that they will have to rollover debt in the coming years
- But the National Treasury is controlling much more now (Sistema de Garantias da União)
- So, it makes important to be solvent (Pension Reform again?)
- If economy growths faster it will help a lot

Conclusion

- Brazilian States Fiscal situation deteriorated in the past years
- Fiscal imbalances are severe, “cash-flow problems”
- New waivers from the CG
- States have a large fraction of expenditures on personnel
- Aging population will continue to be an issue
- Reforms on Institutional framework are necessary (and going on)
- Pension Reform and economic growth: mandatory
- We see the demand for credit in the medium term, but the States must be seen as solvent