BALANCED BUDGET AND FINANCIAL SUSTENTABILITY

- Notes on Brazil* –

*Fernando Facury Scaff*** *and Francisco Sergio Silva Rocha****

Index:

Resumen:

Después de una década de inestabilidad económica y financiera, que no terminó con la aparición de una nueva Constitución en 1988, Brasil logró en 1994 estabilizar la moneda y en 2000 crear un estándar para la adopción de la responsabilidad fiscal en Brasil, que se produjo con el advenimiento de la Ley Complementaria 101, también llamada la Ley de Responsabilidad Fiscal - LRF, que estableció el requisito de equilibrio presupuestario en el ordenamiento jurídico brasileño.

El sistema adoptado por esta norma establece que anualmente se ha establecido por otra norma, la LDO - Ley de Directrices Presupuestarias (producida por cada entidad federativa) las metas anuales para la inflación, los ingresos, gastos, resultados de lo superávit primario y la cantidad nominal de la deuda para el año al que correspondan y para los próximos dos años.

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** Fernando Facury Scaff is a professor at the University of São Paulo – USP and at the Federal University of Pará - UFPA, PhD in Law and a lawyer.

*** Francisco Sergio Rocha is a professor at Faculdades Ideal, PhD in Law and a federal labor court justice.

El Senado también desempeña un papel activo en este sector, pues debe permitir las operaciones de crédito interno y externo de las entidades federales, y establece los límites de su deuda.

La lectura del presupuesto equilibrado legal no se corresponde con una ecuación de la contabilidad y las matemáticas con el fin de eliminar, sin un criterio determinado, el déficit público. La posibilidad de actuar en déficit es una expresión de la política económica, de los resultados tiene que superar una crisis o alcanzar ciertas metas establecidas por la sociedad, como en Brasil, la erradicación del analfabetismo.

El equilibrio presupuestario está subordinado al concepto de sostenibilidad financiera y se debe considerar en un marco que coincide con la acción del Estado en el mediano y largo plazo, más allá del período de doce meses de duración equivalente al presupuesto de la norma y el uso de todos los elementos financieros disponibles, tales como ingresos, gastos, créditos (plazo de gracia, pago de intereses), etc.

Hay sanciones económicas y políticas que deben aplicarse en caso de incumplimiento de los objetivos establecidos conforme a lo dispuesto en la Constitución y la Ley de Responsabilidad Fiscal en el Brasil.

El Derecho en su conjunto sufre las influencias de la globalización, entre ellos el Derecho Financiero, pues regula las relaciones financieras entre entidades públicas y agentes privados. Estos enlaces no deben obediencia más que a las generaciones presentes sino también para el futuro, tal como se aplica a los instrumentos financieros que a menudo tienen este efecto ante las generaciones futuras, tales como la elevada deuda, los gastos tributarios o largo plazo el gasto público en los gastos rígidos como en personal (al menos en Brasil, debido a la irreductibilidad de los salarios).

Se deduce de esta observación que las reglas relativas a las relaciones entre el Gobierno y Parlamente ya no debe estar subordinada únicamente a la política de la época actual, pero también se han vuelto sus ojos a esta sostenibilidad financiera, que tiene una lógica intergeneracional.

La autonomía local de las unidades subnacionales no deben ser entendidas como soberanía, y la dinámica financiera también debe estar subordinada a los intereses de lo Estado Nacional. En Brasil no tenemos nadie como la Unión Europea supranacional.

Por último, el concepto de un presupuesto equilibrado no puede ser entendido como una camisa de fuerza que requiere que las entidades públicas tienen la misma cantidad de ingresos y gastos, el cierre de estos números con plena identidad. Este concepto debe entenderse como

uno de los muchos instrumentos de sostenibilidad financiera, por lo que cualquier desequilibrio del presupuesto anual es una herramienta para el logro de las metas sociales establecidas democráticamente y sostenibles en el mediano y largo plazo.

Abstract:

After more than a decade of economic and financial instability, which did not end with the emergence of a new Constitution in 1988, Brazil managed to stabilize the currency in 1994 and to create a regulation for the adoption of fiscal responsibility in Brazil in 2000, what occurred with the Supplementary Law 101, also called the Fiscal Responsibility Law - LRF, which established the requirement for balanced budgets in the Brazilian legal system.

The system adopted by this regulation provides that it shall be annually established by another regulation, the LDO - Budget Guidelines Law (regulation conveyed by each federal entity) the annual targets for inflation, revenues, expenses, primary and nominal results and public debt amount for the fiscal year to which they relate and for the next two.

The Federal Senate also plays an active role in this sector, since it must allow the domestic and foreign credit operations of the federal entities, as well as set limits to their debt.

The legal reading of balanced budget does not correspond to an accounting and mathematical equation with the aim to eliminate, without a certain criterion, public deficit. The possibility of acting in a deficit is an expression of economic policy that presents results destined to overcome moments of crisis or reach certain goals set by society – such as, in Brazil, the eradication of illiteracy.

The *balanced budget* is subordinate to the concept of *financial sustainability* and should be considered in a framework that corresponds to the state role in the medium and long term, beyond the period of twelve months equivalent to the effectiveness of the budget rule and using all the financial elements available, such as revenues, expenses, credit (grace period, form of payment, interest). There are economic and political sanctions that have to be applied in case of noncompliance with the established targets as provided by the Constitution and the Brazilian Fiscal Responsibility Law.

Law as a whole is influenced by globalization; among such influences is the Financial Law, which results from financial relations among public entities and private agents.

These relations do not owe allegiance only to the present generations but also to the future ones, since the financial instruments applied at the present almost always have this effect

before future generations, such as high debt, long-term fiscal renounces or public spending on rigid expenses such as personnel (at least in Brazil, due to the irreducibility of wages).

It follows from this observation that the rules pertaining to the relations between Government and Parliament should no longer be subordinate *only* to the policy of the present time, but also have their eyes turned to this financial sustainability, which has an intergenerational logic.

Local *autonomy* of subnational entities should not be understood as *sovereignty* and their financial dynamics should also be subordinated to the interests of the Nation State. In Brazil, we do not have the supranational dimension existing in the European Union.

Finally, the concept of a *balanced budget* cannot be understood as a straitjacket requiring public entities to have the same amount of revenue and expenditure, closing these numbers with full identity. This concept must be understood as one of the many instruments of financial sustainability, so that a potential annual budget imbalance can be a tool for achieving social goals established democratically, sustainable in the medium and long term.

I. The Brazilian situation and regulatory framework in the advent of the Constitution of 1988 and the emergence of the Fiscal Responsibility Law

01. Excluding the period in which Brazil was a Portuguese colony[1], 07 Constitutions were in force in this country throughout its history[2], in which there were alternating periods of authoritarianism and democracy, in varying degrees[3].

In 1985, the most recent authoritarian period of Brazilian history ended; it begun in 1964 due to the fact that the militaries were lacking the economic and political base that had given them support. The argument of a "communist threat" no longer frightened society and there was a search for the *new*, seeking to oxygenate the existing power structures at the time. All the tiredness of the 1964 military coup led to the "Diretas-Já" (Direct Elections Now) campaign in favor of presidential elections - a political milestone in contemporary Brazil.

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[1] From April 21, 1500 until the date of its independence and transformation into Empire, September 7, 1822.

[2] The first and only Brazilian Constitution of the Empire dates from 1822. Later, there was the first Republican Constitution, of 1891, which was followed by the ones of 1934, 1937, 1946, 1967 and 1988.

[3] Despite these concepts have a high degree of inaccuracy, we can classify these periods throughout the republican history of the country as follows: authoritarian periods or with "facade democracies" for lack of free elections: 1891-1934; 1937-1946 and 1964-1985. Therefore, democracy, also in varying degrees, was experienced by the Brazilian society in the following periods: 1934-1937; 1946-1964 and 1985 to the present day.

In the economic realm, among other problems, inflation stood at a very high level. Between 1984 and 1985, the annual inflation rate was over 230%. In 1988, the year of completion of the constitutional works, inflation almost reached the stratospheric figure of 933% per year. Several economic plans for fighting inflation were executed, achieving poor results. Economic growth was very low, and a default on foreign debt was declared in February 1987.

After several years it is possible to see, recalling that time, how agitated, politically and economically, were the years between 1985 and 1988, which include the constituent phase of 1987/1988 that reflected in the final result: the Constitution of the Federative Republic of Brazil of October 5, 1988, with various and detailed provisions in its economical-financial part, truly being one of the most thorough in the world.

The current Brazilian Constitution is a historical product of a movement of opposition to the military regime that had implemented a model of authoritarian centralization of powers since 1964, strengthening the powers of the Federal Government, reducing the autonomy of the federated entities and created a system of political and administrative centralization.

02. However, the emergence of a new Constitution was not enough to tackle the economic and public finance problems existing in Brazil. Even after the promulgation of the Constitution, inflation continued plaguing the Brazilian economy, reaching more than 2,700% in 12 months, between February/89 and January/90.

This inflation was a strong instrument for the realization of public spending, since costs were hired based on the nominalism of currency and revenues were tied to monetary variations. Within this context, any measure of effective organization of governmental activity in public finances was inevitable because the state budget was also based on nominalist precepts, which already proved to be outdated one month after its approval. Revenues grew at the same rate of inflation, since they were indexed, but expenses were fixed in view of the existing nominalism.

Even as a reaction to the constitutional model of the authoritarian regime, our current Constitution intended to regulate differently the distribution of power among federal entities. The first article of the Constitution proclaims that Brazil is a federal republic formed by the indissoluble union of the Federal Government, States, Municipalities[4] and Federal District. After that, it

[4] The reference to municipalities does not seem right, since they are not federal entities, but decentralized units of the States, and these are effectively federal entities. In this context, see José Afonso da Silva in

considers the federative form of the State to be an immutable clause[5], especially protected against the action of the derived constituent power. The concern regarding the existence and effectiveness of the federation continues with the assertion of autonomy[6] of the entities that are members of the political-administrative organization of Brazil and the regulation of powers which will be exercised by the Federal Government, States and Municipalities.

A concern is noted in establishing a harmonious relationship between the centralizing force and decentralization, creating a system that combines the possibility of acting as a unit and the respect for the local mode of organization and the disciplining of matters they have to regulate, depending on the distribution of legislative powers and actions taken by the Federal Constitution[7].

Evidently, there is not just one federation model, and the historical reality of each society defines the form of state organization, which may have different levels of political and administrative decentralization within the same form of State[8].

This distribution of legislative and collection powers among the Federal Government, Member States and Municipalities was established combining the existence of private competencies of the Federal Government, States and Municipalities, along with common competence for execution and, finally, concurrent legislative competence for the first two.

The system of division of federal powers is complex and aims at establishing a harmonious balance between the political-administrative entities, preserving the autonomy of the federative regime, without neglecting the need to establish rules allowing the performance of each federative entity in matters involving the conduction of national life.

The regulation of the Brazilian federative division establishes the tax power of each federative entity, as well as the distribution of values collected[9] as a form of financial cooperation between the autonomous entities of the Federation[10].

"Curso de Direito Constitucional Positivo" - 32 edition - Edt. Malheiros - São Paulo. Contrary to this view, see Celso Ribeiro Bastos. Curso de Direito Constitucional. Edt. Saraiva. - São Paulo.

[5] Federal Constitution. Article 60, Paragraph 4 – "Paragraph 4 - No proposal of amendment shall be considered which is aimed at abolishing: I - the federative form of State".

[6] Federal Constitution. "Article 18. The political and administrative organization of the Federative Republic of Brazil comprises the Federal Government, the States, the Federal District and the Municipalities, all of them autonomous, as this Constitution provides."

[7] See articles 21 to 25 and 30 of the Federal Constitution.

[8] The Brazilian federation has fluctuated in varying degrees since our first republican Constitution in 1889 up to the present Constitution, representing different ways to regulate the determining elements of the federative form of the State, according to José Afonso da Silva, op cit.

The autonomy of the political-administrative entities guarantees them the possibility of administrating public resources allocated constitutionally to execute their own activities. In this task, the budged of each federal entity shall define their spending due to the election of priorities and programs they intend to reach/implement, as well as the option of the degree and type of debt necessary for the development of activities and/or financing of investment. Each federative entity has the task of establishing their own budget, respecting the principle of legality and autonomy of each political unit, without the supervision or accountability of the other.

Despite the existence of financial control mechanisms in the Constitution, the 1990s experienced the need for public deficit reduction and more effective control of the relation public debt/GDP. The conditions of debt deteriorated in the late 1980s and it was no longer feasible to sustain the finances of the subnational entities without the support of the Federal Government to renegotiate the domestic debts.

04. In 1994, with the adoption of the Real Plan, inflation began to be controlled and the real extent of the economy and the debt of public entities could be seen. The situation of subnational entities was no longer manageable in view of the excessive government expenditures, especially those related to personnel costs, and increasing domestic public debt tied to high rates of official interest, regardless of whether or not the new primary deficits existed. The reduction of the inflation process helped to make the expansion of the debt with the disappearance of a number of mechanisms noticeable, since public accounts could no longer be adjusted with delays in payments or adjustments below the inflation and the result was a visible deterioration of the public finances of the subnational entities.

It should be noted that the way our federative organization is structured contributed to this process of degeneration. Although already announced in the end of the dictatorial period, the subnational governments had high share in the total spending, but their political leaderships were essential parts in the institutional arrangement, composing the political base and defining the spaces for maneuver in Congress, consisting of an important factor that should be considered in the power structure - especially after a long process of authoritarian government. The restoration

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[9] Federal Constitution: article 153 for the Federal Government; article 155 for the States and the Federal District and article 156 for the Municipalities.

[10] This division integrates the concept of cooperative federalism introduced in our constitutional model in the Constitution of 1934, expanding gradually until reached the current model. For more details see José Afonso da Silva, op cit., Pg. 730.

of democracy gave greater weight to state political leaders as representatives of the political pact and expanded their power in the fight of the central government against the financial deterioration of the states[11].

Thus, the increasing importance of subnational governments in the political process and dependence on the Central Power in relation to the state delegation as a way to maintain the base of political support was increased by the absence of an accountability parameter by the respective processes of debt.

It is not possible to forget the importance of the participation of state banks and State owned companies at the state level in this context. State banks focused a high proportion of loans to states themselves, compromising the health of their operations, besides directing part of their assets to state debt securities, increasing fundraising by these governments and causing the expansion of their debts. In summary, the state banks financed the electoral maneuver of the state politicians that, among other factors, obtained loans for the realization of current expenses, including personnel.

Public companies, on the other hand, used administrative freedom to capture new resources. The triangular operations, in which a private company conducted a credit operation with the state bank to finance a work that was already contracted by the state company, that should actually have to honor the financial commitment; the non-inclusion of its credit operations within the limits of debt, as well as recurring delays in the payment of obligations, among other operations normal at the time, created loopholes through which it was possible to solve part of the cash problems of the states, leaving, however, other issues for the future to disrupt public finances[12].

The problem to be faced concerned both imbalance in the internal adjustment, as well as the lack of efficient control mechanisms of the debt of subnational entities. The ease of access to credit in their own banks helped to cover current spending and restrained the consequences of withdrawal of domestic and foreign funding sources in view of the then existing crisis [13].

The financial breakdown of local governments permitted the gradual change of the situation, with increasing participation in the Federal Government in the creation of control

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[11] Lopreato, Francisco Luiz C. - O endividamento dos governos estaduais nos anos 90. Texto para Discussão. IE/UNICAMP n. 94, March 2000.
[12] Lopreato, Francisco Luiz C. op cit. 2000.
[13] To assess the level of debt of States and Municipalities in the period, see relevant study of the Central Bank at http://www.bc.gov.br/?BOLFINPUB

mechanisms and the formulation of policies for administrative and financial reorganization. An extremely important point in this period was the "purchase" of the debt of States and Municipalities by the Federal Government in order to consolidate it and fund it directly, which occurred by Law 9.496/97, which established the Program for Fiscal Adjustment - step prior to the adoption of the Fiscal Responsibility Law[14].

The peculiar way in which the federative pact was structured is changed and the very correlation of forces among the entities is modified to allow an operation of the Federal Government to establish a State model.[15]

05. Attention then turned to a new phase, whose milestone was the advent of the LRF - Fiscal Responsibility Law (Supplementary Law 101/2000), which established rules for public spending - particularly in regard to personnel costs - and the debt of subnational entities. The attack on other economic evils began: the systematic *deficit in public accounts*, either of the sub-national entities or of the Federal Government itself.

In April 1999, in the exposé of reasons for the Supplementary Law, which became the Fiscal Responsibility Law, was expressed that the new legislation was part of the set of measures of the Fiscal Stabilization Program – PEF. Its goal was the "drastic and rapid public deficit reduction, and stabilization of the amount of debt relative to Gross Domestic Product of the economy", intending to establish a system of responsible fiscal management[16].

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[14] To analyze the correlation between the Law 9.496/97 and the Fiscal Responsibility Law, it is recommended to read the text *As Razões da Lei de Responsabilidade Fiscal*, Celso de Bastos Correia Neto, *In:* Revista Tributária e de Finanças Públicas, vol. 95, pp. 63 and ff, Nov./2010.

[15] "The analysis of the debt renegotiation program showed that their goal was beyond the fiscal adjustment of the state governments and aimed to create a new institutional arrangement in the Country. The changes opened a transition phase of the federal agreement rules and affected the correlation of forces between the government spheres. These points are not always recognized because the agreements dealt with the fiscal adjustment and transformation of the role of the State as a single issue, when analytically two processes are present; although, overlapping, they keep their degrees of autonomy. The renegotiation has become an indispensable factor for the institutionalization of the relations between the government spheres and the resumption of the spending capacity of the state governments. The high stock of debts in the end of the 80s, coupled with high real interest rates in the subsequent years, compromised the financial situation of the states, especially when the end of inflation restricted the degrees of freedom in the administration of public accounts and threatened the sustainability of the federal arrangement. The Federal Government took advantage of this precarious state financial framework to carry out its development strategy grounded in the release of market forces and expanding control of macroeconomic management." Lopreato, Francisco Luiz C. - Op cit. 2000 p. 39.

[16] On the conception and policies that give rise to the Fiscal Responsibility Law see Lei de Responsabilidade Fiscal: 10 anos de vigência – questões atuais. Fernando Scaff e Maurício Conti (Orgs.) Conceito Editorial: 2010.

The Fiscal Responsibility Law was created with the aim of restoring balance in the finances of States and Municipalities and its provisions are intended primarily at the execution of this purpose. Control mechanisms for personnel costs and social security were created, including civil servants. Voluntary transfers to States and Municipalities and to the private sector were regulated and linked to the existence of specific limits, budget availability and prior legal authorization for its occurrence, predicting the possibility of suspension of transfers to subnational entities in the event of noncompliance with the goals and forecasts for destination of expenses. Furthermore, Article 35 of the Fiscal Responsibility Law prohibited the possibility of loans by state banks to state governments - which led to the privatization of many of these financial institutions that now have no role in the market.

The restriction measures and control of public spending were efficient in balancing the accounts, especially, of the subnational entities. The rules authorize the adoption of a set of disciplinary measures by the Federal Government, in the expectation of framing the spending of the States and Municipalities within the limits previously established. For this factor, the public sector debt took a turn downward. The net external debt, which reached 45% of GDP in 1983 and 33% in the period of 1999/2003, turned into a tendency to drop until the rate of minus 4.00% in 2012. The domestic debt, even without the expressive significance of the foreign debt, showed descending indexes in the debt/GDP: 28.79% (2009) and 24.36% (2011) for the Federal Government and 12.55% (2009) and 11.45% (2011) for the States and Municipalities[17].

It seems clear that the performance of the Government supported by the LRF has been useful to balance the public accounts and reduce the vulnerability of Brazil before the current global economic crisis in course.

06. Brazil was not the only country that adopted mechanisms for fiscal responsibility. The origin of the national LFR is present in countries like New Zealand, Australia and the UK. According to Tereza Ter-Minassian[18], the common origin does not prevent a favorable comparison to Brazil in relation to other laws of similar nature. The Brazilian law has elements of advantage such as its acceptance by the community and the introduction of improvements in the budgeting process in order to promote transparency and regulation. There is also the presence of

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[17] Data from the Economic Policy Secretariat of the Ministry of Treasury.

[18] "A Lei de Responsabilidade Fiscal do Brasil sob uma perspectiva internacional" in Lei de Responsabilidade Fiscal – histórico e desafios. Cadernos FGV Projetos, year 5, n. 5, December, 2010. Rio de Janeiro/RJ.

elements of flexibility due to the fact that the primary outcome is reviewed and specified by the Budget Guidelines Law - LDO, which is an annual budget law, prior to the Annual Budget Law - LOA, which facilitates the adoption of adjustments in view of economic conditions, along with institutional and personal sanctions in the event of noncompliance with its rules.

It can be stated, therefore, that fiscal responsibility in Brazil arose with the Fiscal Responsibility Law in 2000, which is a landmark for the *financial sustainability* presented in recent years. This is a milestone for the control of debt and the fight against irresponsible public spending of subnational entities, and an important macroeconomic indicator for the national financial balance. The constitutional regulations were not sufficient to introduce the desired fiscal responsibility, but allowed that this goal was achieved by means of ordinary and Supplementary laws.

The requirement for financial balance seems to be a parameter that arises in the context of world constitutionalism with a status of permanence, and not only to solve cyclical economic problems. Here, the situation was decisive for the construction of a regulatory framework that allowed Brazilian financial stabilization.

II – A brief comparison between the *balanced budget* rules in Spain and Brazil

07. The Brazilian Constitution of 1988 does not bring in its core any rule that obliges the achievement of a *balanced budget* by the government. There is nothing in the Constitution that resembles the wording of article 135, items 1 and 2 of the Spanish Constitution, according to changes introduced by Amendment of 11/27/2011:

> Artículo 135 –
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> 1. Todas las Administraciones Públicas adecuarán sus actuaciones al principio de estabilidad presupuestaria.
> 2. El Estado y las Comunidades Autónomas no podrán incurrir en un déficit estructural que supere los márgenes establecidos, en su caso, por la Unión Europea para sus Estados Miembros. Una ley orgánica fijará el déficit estructural máximo permitido al Estado y a las Comunidades Autónomas, en relación con su producto interior bruto. Las Entidades Locales deberán presentar equilibrio presupuestario.

The requirement for *balanced budgets* in Brazil arose with the Fiscal Responsibility Law (Supplementary Law 101/00), and is an important instrument for the realization of a true *financial sustainability* in our country. As laid down by its Article 1:

> Article 1. This Supplementary Law establishes public finance rules enforcing responsibility in fiscal management, under Title IV, Chapter II of the Brazilian Constitution.
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> § 1. Responsibility in fiscal management presupposes well-planned and transparent actions to prevent risks and correct deviations that may affect the equilibrium of public accounts, by compliance with revenue and expenditure results targets, observing limits and satisfying conditions regarding tax breaks, generation of personnel and social security expenditures, among others, consolidated and security debt, credit operations, including those involving revenue anticipation, guarantees issued and outstanding liabilities.

The figure of the "organic law" in Brazil meets a function different from that of the Spanish ruling. In this case, it is the Budget Guidelines Law, an ordinary annual law of each federative entity, which will determine the balance between revenue and expenses and must obligatorily submit an Annex of Fiscal Goals. This Annex is extremely relevant since it will set annual targets for revenue, expenses, nominal and primary results and the amount of public debt for the fiscal year to which they relate and for the next two.[19] These limits are set by subnational entities of our federation (Federal Government, States and Municipalities), and there is nothing similar in supranational character, *i.e.*, in community character.

08. Item 3 of article 135 corresponds to several articles of the Brazilian Constitution, respecting certain adjustments, in particular due to the existence of a National Federative State in Brazil as opposed to a constellation of nations in Europe.

> Art. 135 –

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[19] Article 4 of the LRF.

> 3. El Estado y las Comunidades Autónomas habrán de estar autorizados por ley para emitir deuda pública o contraer crédito. Los créditos para satisfacer los intereses y el capital de la deuda pública de las Administraciones se entenderán siempre incluidos en el estado de gastos de sus presupuestos y su pago gozará de prioridad absoluta. Estos créditos no podrán ser objeto de enmienda o modificación, mientras se ajusten a las condiciones de la ley de emisión. El volumen de deuda pública del conjunto de las Administraciones Públicas en relación con el producto interior bruto del Estado no podrá superar el valor de referencia establecido en el Tratado de Funcionamiento de la Unión Europea.

In the Brazilian system of laws there are regulations similar to those mentioned above, since:

a) The Annual Budget Law - LOA of each federative entity shall include the provision of credit operations, even if in anticipation of budget revenue[20].
b) The adoption of parliamentary amendments to the budget project with the use of resources originally allocated to the payment of debt servicing is forbidden[21], and its contingency is prohibited[22];
c) The realization of credit operations exceeding the amount of capital expenses is forbidden. This provision is extremely healthy, since it impedes that loans are taken to pay current expenses[23], although it has some perverse features that will be better explained below.

09. Item 4 of Article 135 of the Spanish Constitution establishes an exemption rule to the requirement to comply with a balanced budget, as a result of natural disasters, economic recession or extraordinary emergencies:

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[20] Federal Constitution: article 165, §8 and article 5, §§1, 2 and 3, LRF.
[21] Federal Constitution: article 166, §3, II, "b".
[22] LRF, article 9, §2.
[23] Federal constitution: article 167, III.

> 4. Los límites de déficit estructural y de volumen de deuda pública sólo podrán superarse en caso de catástrofes naturales, recesión económica o situaciones de emergencia extraordinaria que escapen al control del Estado y perjudiquen considerablemente la situación financiera o la sostenibilidad económica o social del Estado, apreciadas por la mayoría absoluta de los miembros del Congreso de los Diputados.

Such rule has no correspondence in the Brazilian Constitution, although it is possible to extract the same flexibility due to the limits of the deficit and debt being established by an annual law, which is the LDO - Budget Guidelines Law. Thus, year after year, these limitations are established allowing more accurate calibration of this equation.

10. Item 5 of Article 135 of the Spanish Constitution assigns the role to establish the boundaries of the debt and deficit between subnational entities and penalties arising from noncompliance with an organic law.

> 5. Una ley orgánica desarrollará los principios a que se refiere este artículo, así como la participación, en los procedimientos respectivos, de los órganos de coordinación institucional entre las Administraciones Públicas en materia de política fiscal y financiera. En todo caso, regulará: a) La distribución de los límites de déficit y de deuda entre las distintas Administraciones Públicas, los supuestos excepcionales de superación de los mismos y la forma y plazo de corrección de las desviaciones que sobre uno y otro pudieran producirse. b) La metodología y el procedimiento para el cálculo del déficit estructural. c) La responsabilidad de cada Administración Pública en caso de incumplimiento de los objetivos de estabilidad presupuestaria.

In Brazil, this function is assigned to a Senate Resolution - legislative House of our bicameral Parliament which represents the member States[24]. It includes:

a) The obligation to hear the Federal Senate to conduct foreign credit operations[25];
b) The establishment of a limit to the overall amount of domestic and foreign consolidated debt by resolution of the Federal Senate for all federal entities[26] and for the security expenditures of the subnational entities[27];
c) The Federal Senate also establishes the overall limits and conditions for the Federal Government to provide domestic and foreign loan guarantees[28];

In regard to the penalties, the Constitution establishes the possibility of intervention of the Federal Government in a Member State and of the latter in Municipalities when there is a delay in the payment of public debt existing for a period no longer than two years, except for force majeure[29]. This is a constitutional rule that has never been applied, in spite of repeated defaults of several subnational entities before the Fiscal Responsibility Law. It is inapplicable due to the established rigor - the intervention of a higher federative entity in a minor one.

The penalties established by the Fiscal Responsibility Law for noncompliance with the limitations on public debt are more efficient. This regulation determines that as long as the excessive debt lasts, the subnational entity will be impeded of performing domestic or foreign credit operations, including for anticipated revenues, and if the excessive debt remains, the smaller entity will be impeded of receiving voluntary transfers from larger ones[30].

11. Item 6 of article 135 of the Spanish Constitution obliges subnational entities to comply with the principle of budget stability.

> 6. Las Comunidades Autónomas, de acuerdo con sus respectivos Estatutos y dentro de los límites a que se refiere este artículo,

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[24] Senators are elected by the majority principle, and each Member State and the Federal District elect three representatives. Federal Constitution: Article 46.
[25] Federal Constitution: article 52, V.
[26] Federal Constitution: article 52, VI e VII.
[27] Federal Constitution: article 52, IX.
[28] Federal Constitution: article 52, VIII.
[29] Federal Constitution 35, V, "a" and 35, I
[30] LRF, art. 31, §1, I and §2.

> adoptarán las disposiciones que procedan para la aplicación efectiva del principio de estabilidad en sus normas y decisiones presupuestarias.

In Brazil, the budget regulations set forth in the Brazilian Constitution are forced upon subnational entities, which do not have *sovereignty*, but merely autonomy. It is also observed that the LRF is a supplementary law, which characterizes it as a *national law* and not only a federal law (*i.e.*, it reaches the whole country, and not only the Federal Government as a federative entity) - which is why the subnational entities are equally bound to comply with it.

12. To end this brief comparison, it appears that the rules recently introduced in the Spanish Constitution exist in a greater or lesser degree in the Brazilian legal system, provided that two characteristics are observed:

a) Not always, the regulations are constitutional, since many of them appear in the Fiscal Responsibility Law;

b) The supranational issue does not exist in Brazil, a characteristic of the European Union. But the Brazilian federative relationship allows the models to be compared - in spite of the subnational entities not having the essential requirement of National States, which is sovereignty.

III. What is meant by *Balanced Budget* and *Financial Sustainability* and what is the introduction of this Principle in the legal system for? What are the penalties in case of its violation?

13. Defining what is *balanced budget* is one of the most difficult tasks in terms of financial law[31].

Subject to the classical economic theory, a balanced budget implies that income and expenditure have to be identical, preventing the emergence of *public deficits*. There may be *surpluses*, according to this view, but never *deficits*. However, even here, there is a difficulty, since the dynamics of budget activity leads to two different moments: the budget forecast and the budget implementation. It may happen that the budget forecast is aligned between revenue and

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[31] For the analysis of this topic, it was extremely useful to read *Finanças Públicas e Direito Financeiro*, by António Sousa Franco, pp. 365-390. (Coimbra, Ed. Almedina, 4th edition, 2007).

expenditure, but will implementation follow this path? And if it does not follow, what is the penalty?

On the other hand, the Keynesian theory that goes against classical economics indicates the need for deficit budgets to combat the economic crises that periodically devastate the economy. Therefore, in line with this current, unbalanced budgets seek to combat crises and constitute a powerful element of the capitalist system for economic uplift. For these theorists, the existence of a rule, constitutional or not, requiring the attainment of a balanced budget is a straitjacket to be avoided at all costs, since the cyclical imbalance helps to reactivate the economy. Or, to use very common expressions in Brazil, it would be a “rule for the English to see” (equivalent to the expression “window dressing” in English), or even a rule that “will not stick”.

How can this particular situation be solved once the legal rules mentioned above establish the need to implement a *balanced budget*? Should this rule be read with the accounting-mathematical eyes? We do not think so. This rule should be construed as a legal text, and then, a legal rule allowing its association with reality and allowing their integration with social dynamics would arise.

14. We understand that the most appropriate way for this legal analysis to be done on *balanced budgets* is from the distinction between different types of revenues, expenses and public debts that must be analyzed in the light of *different budget periods*, which must obligatorily exceed the rigorous range of 12 months.

Only after the combination of these elements, is that it will be possible to understand the concept of *balanced budget*, which, in turn, must be conjugated to another concept, the one of *financial sustainability*. These two concepts appear identical, but they are not. It is not necessary to demonstrate that the concept of *financial* is broader than *budget* – the latter is contained in the first. For its perfect understanding, the type of revenue, expenses and credit involved should be analyzed in the respective budget as well as the period of time under analysis.

One should not only analyze *revenue versus expenses*. It is imperative that in this comparison, among many other things, credit operations and the form of its payment, fiscal renounce and so on be analyzed.. Without the whole financial package, the analysis will be deprived of facticity. A State does not rely only on revenue, tax or otherwise. One deeply important element in budget is *public credit* that somehow does not correspond to revenue, being characterized more as a *cash flow*, since it is a loan and must be paid back, plus interest and other possible legal charges.

Therefore, this third element - credit - is extremely relevant to understand the difference between *balanced budget* and *financial sustainability*.

It is observed that this distinction was, somehow, intuited by the Spanish Constitution, when differentiating the concept of "*estabilidad presupuestaria*" linked to "todas las Administraciones Públicas" (Article 135, item 1) from the concept of "*equilibrio presupuestario"* mandatory for "las Entidades Locales" (Article 135, item 2).

The same can be seen in the Brazilian regulations, since next to *balanced budget* required by article 1 of the LRF[32], there is provision for the existence of an Annex of Fiscal Goals that must be delivered annually by the Budget Guidelines Law - LDO, with projection for the two subsequent fiscal years[33]. The notion of balance is presented as a necessary *means* to achieve the desired purpose, namely, the satisfaction of social interests through the performance of public expenses. Its instrumental feature allows the application of the provisions in accordance with the objective to be achieved. This consideration allows us to understand the principle of balance within a broad framework, which entails the existence of a cycle of deficit budgets to obtain the desired economic recovery, or even the possibility of sustaining the cycle of deficit budgets to meet the constitutional law which requires the reduction of social and regional inequalities. Therefore, it is possible to fix different limits in Annex of Fiscal Goals, so as to implement counter-cyclical economic policy, leaving the notion of equilibrium for a time limit that exceeds the mark of annual budget.

That means, the accounting and mathematical balance of *revenue versus expenses* is not enough. It is imperative to verify that such revenue - including public loans and fiscal renounce - are sustainable in the medium and long term and will not compromise the expenses that shall be performed - including interest on obtained public loans - in the medium and long term.

15. To demonstrate the difference between the rigid balanced budget in its accounting and mathematical equation and financial sustainability we use some examples.

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[32] "The responsibility for fiscal management requires a planned and transparent action, which risks can be prevented and deviations capable of affecting the balance of public accounts can be corrected by meeting the goals of results between revenues and expenditures and compliance with limits and conditions regarding the renounce of revenue, generating expenses with personnel, social security and other consolidated and securities debts, credit operations, including on anticipated revenues, guarantees and enrollment in amounts to be paid."

[33] Article 4 of the LRF.

Let's imagine a situation in which, to close the public accounts the government of a certain country obtains a public loan to be paid in short-term - to pay, say, in the following fiscal year - and with high interest rates. The public accounts of that fiscal year will close (they will have *balanced budget* in the classical concept), but they will not be *sustainable* over the medium term. In the following year, when in addition to interest the principal must be paid, the imbalanced budget will be present.

Another example that can be given is the use of *fiscal renounces*. These are granted by governments under the argument that in the near future it will leverage new public revenue; nevertheless, it may be that the companies receiving fiscal renounces generate a demand for public services impossible to be rendered by the government precisely because of the granted fiscal renounce. This is very common in Brazil, especially in Amazonia, when large economic projects benefit from tax incentives from subnational governments and thereby generate a high demand for public services (sanitation, education, hospitals, etc.) because of the people who move to that location in search of jobs and life opportunities. These subnational entities are unable to meet the new demand for public services and push companies that received the incentives to bear these costs - which often come out to be more expensive than the obtained tax incentives.

It is necessary to examine the issue of *balanced budget* in light of *financial sustainability*. To tie the revenues and expenditures in a fiscal year is not enough. It is necessary that *public finances are sustainable* in the medium and long term.

The examples are evident. Let's look at it through the lens of the performed *public spending*. If the countercyclical policy pursued by a government with a Keynesian tendency seeks full employment through mandatory continuing costs, such as rising wages - which are irreducible in Brazil - or increasing employment in the public sector - the civil servants in Brazil can only be dismissed by serious misconduct, with strict rules - the conditions for a *persistent imbalanced budget* will be present. In this example, the mistake is in the type of expense, rigid, which can hardly be withdrawn after a certain period and incorporates the permanent public sector spending generating pressure to increase revenues. On the other hand, if public spending is on activities that do not possess this rigidity, there may be contraction after the crisis period. That is, *the type of public spending* is equally important to analyze the countercyclical government policies.

On the other hand, we observe what the classical economists call the *golden rule* and which was adopted by the Brazilian Constitution: there can only be debt for the realization of capital expenditure[34]. The concept of *capital expenditure* leads to *capital goods* – that means, nearly equivalent to that of new works, buildings, constructions; something that is an embedded asset value, which increases the tangible capital. *It happens that many public investments do not materialize in capital goods*, but in intangible values, such as education, training, technological training, disease prevention, etc. Therefore, if the Brazilian government decided to get a public loan to eradicate tropical diseases such as yellow fever, dengue, malaria, it would be disobeying the *budget golden rule* provided by the Constitution, such as public health campaigns are not characterized as a *capital asset*, despite its incontestable value in social terms. This is a problem faced by the application of this rule.

This becomes more difficult when the planning of government action occurs within an elective office - as in Brazil nowadays. The Brazilian budgetary process consists of 3 laws: PPA - Multi-Year Plan, which lasts 04 years (the same time of the mandate of the Heads of the Executive Power in the federal, state and municipal spheres last, although there is no coincidence of the beginning and end[35]), the LDO - Budget Guidelines Law (annual law, that among other functions should set a balanced budget as required by the LRF) and LOA - Annual Budget Law (which sets spending and estimates revenue). As seen, the planning of government action in Brazil is made for a maximum of 04 years, which is an extremely limited period of time for this highly important function.

Anyway, not to dwell further in the examples which speak for themselves, to conceptualize *balanced budget* it is necessary to consider other variables besides static analysis of revenue and public expenditure. It is necessary to analyze the function of public credit, the payment form and the interest charged, the quality of public spending and fiscal renounces, in short, see the whole picture spread in time for us to consider not only an accounting and mathematical reading of this provision, but its *financial sustainability* in the medium and long term.

Financial sustainability is, therefore, a broader term than *balanced budget* in the accounting and mathematical understanding of the term. In order to have *financial sustainability* it is necessary to establish a period of time of medium and long term, and that all financial data that is available to the public entity is analyzed jointly, and there may even be periodic *public deficits*

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[34] Federal Constitution: article 167, III.
[35] Federal Constitution: article 35, § 2, I of the Temporary Constitutional Provisions Act (ADCT).

aiming at certain social goals and to obtain the necessary *balanced budget* within the established period of time. This is a dynamic analysis of the financial phenomenon and not a static analysis, limited to a period of 12 months. The concept of *financial sustainability* is closer to a *film* than to a *photograph*, the latter being more in tune with the logic of *balanced budget* considered as an accounting and mathematical equation.

IV. What is changing in the Government-Parliament relations and between the State sovereignty and territorial autonomy?

16. The world is undergoing major economic, political and social transformations. Within this perspective is that a change in the concepts of sovereignty, territory and people is processing. And, along with this,, there was a substantial change in the conception and role that the Law plays in society.

The center of decisions of a country is greatly affected by events decided in other parts of the world by public and private agents of other citizenships, without any social responsibility with what is in development in that country and, many times, far from the possibility of being achieved by the decisions of local Powers.

The sovereignty of a country is no longer as it used to be, compared to the time when Jean Bodin coined the concept. Sovereignty is more relativized than ever. Therefore, the definition of Law as an object of application of state norms (sovereignty), on a given geographical area (territory), in order to regulate relations between people (people), is kept in check, being necessary to think Law globally as an instrument of development among nations, focusing on the global human dimension.

From here a whole new framework of discussion arises, since the Law we have been using is a Law conceived and designed to work within a matrix determined by the concepts of sovereignty, territory and people that no longer exist today as before, largely modified by technology and by the increase of the exchange system.

This deeply affects Financial Law, which is a Law heavily centered on the notion of territory and sovereignty. Globalization of Financial Law is the result, to a large extent, of the credit relationships that occur irrespectively of borders between public entities and private agents.

Thus, modifications caused by the intersection between the rigid territorialism of Financial Law and the globalized world is that it has generated many perplexities that leave more questions than answers among the scholars of Law. Hence, it is necessary to talk about different

dimensions of rights so that we can think of global solutions to local problems. Such an analysis should be of particular emphasis in regard to fundamental rights.

Historically, fundamental rights emerged as a defense of the citizen against the State. This conception was inserted into the analysis of the struggle against Absolutism, combative of the total centralization of Power. The emergence of the idea of *freedom* and *equality* is from this time, since once these *individual* guarantees were conquered the *natural order* would be in charge of making sure that welfare and prosperity came with it. It was believed that the natural order of the market would allow development to emerge. It was verified that such pretension was a fallacious claim. The natural order only favored those who had economic power, causing the gap to be greater for those who only had their labor as an element of market exchange. Individual solutions were not sufficient to resolve social issues. Given the lack of implementation of this formula for fundamental rights and guarantees, it was necessary to widen the space for understanding the fundamental rights.

The next step was the expansion of those rights in order to reach men as workers, allowing that their rights related to this condition could be exercised and guaranteed by the law. Hence, the achievements of social rights arose in various jurisdictions in the planet, among them Brazil, in the early 20th century. The application of social rights as fundamental rights started to be contemplated. It is not only a question of rights of the individual against the State, but the man inserted into the system of economic production.

However, the evolution of legal studies found the concern for the collective to be insufficient; being also necessary that Law occupied itself with the diffuse interests of society, which are those that reach an indeterminate and indeterminable group of people. Such are the injuries caused by air pollution, traffic congestion, etc., that it is not possible to determine the amount of people affected by the damage. The same occurs with excessive public debt, leading to *financial unsustainability* of various countries that are interconnected in our globalized world and can cause problems beyond national borders. The individual and collective solutions cannot resolve this type of question, being it necessary to develop appropriate mechanisms to operationalize its prevention and sustainability.

Add to the question of *diffuse interests* the concept of *future generations*. And from it a new understanding of fundamental rights emerges. The rights of the unborn *also* have to be considered. The greatness of the human being is projected into the future, not only with the civilian dimension of the unborn child, but of a whole future (and not even conceived yet) generation of human beings.

It is within this precept that the Right to Economic Development is placed, which is "an inalienable human right and that equality of opportunity for development is a prerogative both of nations and individuals that make up the nations" (Declaration on the Right to Development , UN, 1986, preamble). The protected interest is not the one of the current generation, but its preservation for future generations. It no longer is *an individual's interest against the State*, or only inherent to a certain *community*, but a *diffuse* interest and that includes not only current but future generations. It is this new dimension of fundamental rights that must be present in our mind when interpreting the law of *balanced budget as an instrument of financial sustainability* and not as an accounting and mathematical equation.

17. The right of future generations cannot be violated by the political game happening *here* and *now*, by the political struggles of the present. It is necessary that financial limits are adopted for the economic sustainability of Nation States in order to avoid that these generations are forced to bear enormous costs for maintaining the State *lato sensu*.

The political struggle between the Government and Parliament, as well as local autonomies must be subordinated to fiscal responsibility in the conduct of public affairs[36]. Public spending that can obtain parliamentary majorities must be subordinate to the rule of *financial sustainability* deferred over time. Will the granted wage increases be sustainable? Will the construction of soccer stadiums to host the 2014 World Cup, where soccer will not be played locally, be sustainable? How will such public spending be maintained and why is it interesting for the present and future generations? Answering these questions by looking only at the present generation is no longer enough. The analysis of intergenerational public expenditures is required with an eye to financial sustainability.

It is not enough to consider the convenience and opportunity of funding and public spending. It is necessary to analyze its quality. This is the challenge to Nation States in their domestic political game - government and Parliament – and with the subnational entities. Everyone should be required to comply with *financial sustainability* of medium and long term, while *balanced budget* is only one of the elements to be analyzed in this group and subordinated to its wider scope.

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[36]Not to mention the possibility of a broad role of the Judicial Power in Brazil in the shaping of public spending by additive decisions. In this regard see: Scaff, Fernando Facury. Sentenças aditivas, direitos sociais e reserva do possível. In SARLET, Ingo Wolfgang; TIMM, Luciano Benetti. Direitos fundamentais, orçamento e "reserva do possível". Porto Alegre: Livraria do Advogado, 2008.

Therefore, it is relevant to include regulations in the system of laws (constitutional or otherwise) relating to *financial sustainability*, aiming at protecting future generations. The rule requiring the need for *balanced budgets* cannot be read as an accounting and mathematical equation, but it has to be inserted in the financial policy context aimed at achieving financial targets of medium and long term, which allows the adoption of periodic public deficits.

V. What is the introduction of this Principle in the legal system for? What are the penalties in case of its violation?

18. The adoption of the principle of a *balanced budget* in a legal system, seen as an instrument of *financial sustainability* and not with an accounting mathematical reading, is used to assign fiscal responsibility to the national and subnational governments.

Knowing that many of the budget problems are like *time bombs*, assembled at a time, but that explode in a different one, the adoption of principles of *fiscal responsibility* are of paramount importance to the advent of good public governance.

Public credit is deferred tax. Tax renounce is equivalent to public spending. The future generations will bear the costs of the spending realized today based on loans to be paid in the future. The *intergenerational nature of financial sustainability* has to be the focus of the problem. Irresponsible governments that increase rigid public spending financed by public loans - even if long-term - should be restrained from doing so. Here the focus is the quality of public spending aiming at its balance.

19. The noncompliance with this balanced budget should be subject to economic sanction rules.

The rule of *balanced budget* being adopted, the budgets must be *projected* in a balanced way - not in the accounting mathematical sense of the expression, but as an instrument of *financial sustainability*.

However, it may be that the existence of an imbalance in the *budget execution* is determined. In this case, the Brazilian solution, as described above, is the application of relevant economic sanctions such as the prohibition of performing domestic and foreign credit operations, including for anticipated revenues, and the prohibition of receiving voluntary transfers[37].

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[37] LRF, article 31, §1, I and §2.

However, there are other very interesting precepts, such as the *prudential* mechanisms of debt control, whether in view of excessive spending on personnel or in terms of public debt[38].

That is, the financial control bodies are obliged to *warn the government* when:

a) the amount of total personnel expenses exceeded 90% (ninety percent) of the established limit;

b) the amount of consolidated and securities debts of credit operations and the provision of guarantees are above 90% (ninety percent) of their respective limits;

c) the spending on retirees and pensioners is above the limit set by law; or

d) events which jeopardize the costs or results of programs occur or if there is evidence of irregularities in budget management. This form of *prudential control* is very important to avoid legal disputes and problems in regard to the public sector debt.

VI. Conclusions

20. After more than a decade of economic and financial instability, which did not end with the emergence of a new Constitution in 1988, Brazil managed to stabilize the currency in 1994 and to create a regulation for the adoption of fiscal responsibility in Brazil in 2000, which occurred with the Supplementary Law 101, also called the Fiscal Responsibility Law - LRF, which established the requirement for balanced budgets in the Brazilian legal system.

The system adopted by this regulation provides that it shall be annually established by another regulation, the LDO - Budget Guidelines Law (regulation conveyed by each federal entity) the annual targets for inflation, revenues, expenses, primary and nominal results and public debt amount for the fiscal year to which they relate and for the next two.

The Federal Senate also plays an active role in this sector, since it must allow the domestic and foreign credit operations of the federal entities, as well as set limits to their debt.

21. The legal reading of a balanced budget does not correspond to an accounting and mathematical equation with the aim to eliminate, without a certain criterion, public deficit. The possibility of acting in a deficit is an expression of economic policy that presents results destined

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[38] LRF, article 59, §1.

to overcome moments of crisis or reach certain goals set by society – such as, in Brazil, the eradication of illiteracy.

The *balanced budget* is subordinate to the concept of *financial sustainability* and should be considered in a framework that corresponds to the state role in the medium and long term, beyond the period of twelve months equivalent to the effectiveness of the budget rule and using all the financial elements available, such as revenues, expenses, credit (grace period, form of payment, interest).

There are economic and political sanctions that have to be applied in case of noncompliance with the established targets as provided by the Constitution and the Brazilian Fiscal Responsibility Law.

22. Law as a whole is influenced by globalization; among such influences is the Financial Law, which results from financial relations among public entities and private agents.

These relations do not owe allegiance only to the present generations but also to the future ones, since the financial instruments applied at the present almost always have an effect on future generations, such as high debt, long-term fiscal renounces or public spending on rigid expenses such as personnel (at least in Brazil, due to the irreducibility of wages).

It follows from this observation that the rules pertaining to the relations between Government and Parliament should no longer be subordinate *only* to the policy of the present time, but also have their eyes turned to this financial sustainability, which has an intergenerational logic.

Local *autonomy* of subnational entities should not be understood as *sovereignty* and their financial dynamics should also be subordinated to the interests of the Nation State. In Brazil, we do not have the supranational dimension existing in the European Union.

Finally, the concept of a *balanced budget* cannot be understood as a straitjacket requiring public entities to have the same amount of revenue and expenditure, closing these numbers with full identity. This concept must be understood as one of the many instruments of financial sustainability, so that a potential annual budget imbalance can be a tool for achieving social goals established democratically, sustainable in the medium and long term.