

Public governance

IMPROVING THE EFFECTIVENESS OF PUBLIC SPENDING

- ▶ Brazil's fiscal outlook has become more challenging, including in the longer term when population ageing will add fiscal pressure. The authorities are rightly committed to consolidating the public finances.
- ▶ The current situation also provides an opportunity to spend public resources better on social benefits, education, health, and industrial support. Spending should focus on the most effective instruments in these areas.
- ▶ Public spending could be made more efficient by reducing rigidities in the budgeting process and narrowing the scope of extensive earmarking and mandatory spending floors.

What's the issue?

Brazil has made significant progress in building a reputation for sound fiscal policy since it passed the Fiscal Responsibility Law in 2000. In recent years, however, the fiscal situation has become more difficult as public spending and gross debt have risen (see Figure). Owing to its high interest rates, Brazil currently spends significantly more on debt service than other countries in the region. This fiscal outlook is likely to become still more challenging in the longer run, as Brazil's population is set to age more rapidly than in most other countries.

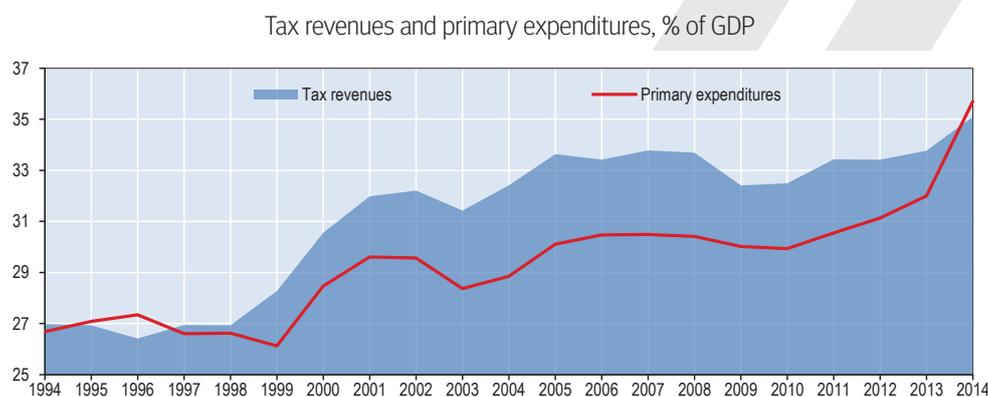
Brazil's authorities have recognised these challenges and are showing a strong commitment to adjusting public finances by improving fiscal results in the short term, and by

implementing structural measures to enhance the efficiency of the public expenditures needed to achieve medium-term policy objectives.

Why is this important for Brazil?

Successful adjustment would reinforce the credibility of fiscal policy, even though it is difficult to implement in the current environment of weak growth. Preserving and building on credibility will reduce borrowing costs, attract more domestic and foreign investment, and achieve higher living standards for Brazilians. The current situation provides a unique opportunity to undertake a broad review of public

» The primary surplus has turned into a deficit



Note: Figures refer to the consolidated public sector.
 Source: National treasury of Brazil.

spending in Brazil, focusing on what policymakers want to achieve and how these objectives can best be reached.

Beyond individual policies, Brazil's budget process needs to be rethought. It is now characterised by large shares of earmarked revenues and mandatory spending shares for certain policy areas. These rigidities make it difficult to adapt public expenditure to changing realities and priorities.

Social expenditures are a key instrument for reducing inequalities and they currently account for over 10% of GDP. Partly as a result of progress made over the years, some of the policy instruments that had a strong impact in the past now no longer reach Brazil's poorest. This includes old-age pensions and other benefits whose floor is determined by the federal minimum wage, which currently corresponds to the 56th percentile of the income distribution. Going forward, the effectiveness of social benefits would be enhanced if they were rebalanced towards programmes such as the highly successful conditional cash transfer programme Bolsa Familia, which currently costs only around 1% of GDP. Indeed, Brazil could have achieved 63% more in inequality reduction during 2012 and 2013 if the real increases in pension benefits had instead been used for conditional cash transfers to poor households.

Education spending currently accounts for almost 6% of GDP, and has been instrumental for the remarkable improvements in skills and opportunities. Education spending would be still more effective, if directed more towards priority areas such as pre-school and basic education. Moreover, some Brazilian states have illustrated how good governance and well-designed policies can result in rapid educational progress. The state of Ceará, for example, ties the distribution of tax revenues across municipalities to educational outcomes, thus creating a healthy competition between municipalities for improving their schools. Incentive mechanisms, which can also include performance-based pay for teachers and principals, often perform much better than traditional governance mechanisms and can deliver better quality education without raising expenditures. The government should evaluate and harness the lessons from such experiments.

Public health expenditures, which amount to almost 5% of GDP, finance an impressive public health system that has led to substantial improvements in health outcomes. Nonetheless, the potential for efficiency gains is substantial in comparison with many other countries. Improving the collection of performance indicators is instrumental in identifying areas where the potential for efficiency gains is the largest and can strengthen the accountability of local governments. Enhancing the role of regional networks and fostering coordination between healthcare providers could bring economies of scale. This would also be a way to avoid duplication of healthcare services and unnecessary hospital stays, which are more expensive than outpatient care.

Policies to foster industrial development include support to individual firms engaged in innovation or exports, lending by public banks, and tax benefits to certain sectors or production locations (for example, information technology

What should policy makers do?

- ▶ Implement the fiscal adjustment in line with medium-term objectives, including stabilising gross public debt.
- ▶ Review expenditure programmes in areas such as social benefits, education, health, industrial support and public payroll, and focus on the most effective ones.
- ▶ Strengthen the effectiveness of social benefits through better targeting on low-income households, including by rebalancing transfers towards the Bolsa Familia programme.
- ▶ Review the earmarking of public revenues and mandatory spending floors with a view towards making public spending more responsive and flexible to new needs and policy priorities.

or the Manaus Free Trade Zone). While some policies have made a difference, applying careful cost-benefit analyses to all of these programmes would identify which has delivered results. Policy analysis also needs to take into account interactions among policies: for example, support for innovation may not be effective when competition is weak, because firms then have weak incentives to innovate.



Further reading

OECD (2015), *OECD Economic Surveys: Brazil*, OECD Publishing, forthcoming.

OECD (2015), *Recommendation of the Council on Budgetary Governance*. <http://www.oecd.org/gov/budgeting/Recommendation-of-the-Council-on-Budgetary-Governance.pdf>

OECD (2015), *Fiscal Sustainability of Health Systems: Bridging Health and Finance Perspectives*, OECD Publishing. <http://www.oecd.org/publications/fiscal-sustainability-of-health-systems-9789264233386-en.htm>