



ECONOMIC FACT

1



National Confederation of Industry
Brazil
CNI. THE STRENGTH OF THE BRAZILIAN INDUSTRY

Fiscal policy choices

Spending on social security and public servants hinders investments and expenditures on health and education

► THE MATTER

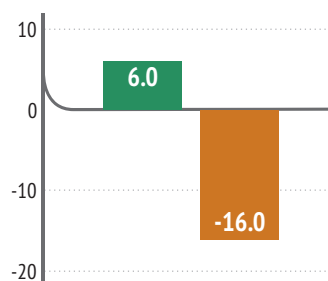
Brazil's fiscal results in recent years make it essential to rein in public-sector expenditures. This fact has been recognized and executed by the current government. However, the composition of the fiscal adjustment under way, particularly in 2017, is a cause for concern.

Given the need to adjust public accounts, the option to increase wages, retirement pensions, and pensions of federal civil servants and the continued pressure exerted by social security expenses (INSS) lead to a decline in investments – which undermines economic growth – and in the availability of health and education funds for health and education. Under this scenario, it is essential to approve the social security reform and pay close attention to the increase in personnel expenses.

Graph 1 – Public spending

Real change

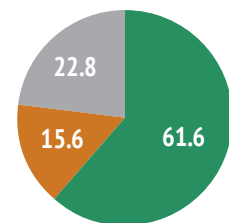
Percentage (%) - Jan-May/17 - Jan-May/16



■ Social Security + Personnel (excluding court-ordered payments)
■ Other expenditures (mandatory and non-mandatory)

Composition

Percentage (%) - In 2016



■ Social security + Personnel
■ Other mandatory expenditures
■ Non-mandatory expenditures

Source: CNI based on data from the National Treasury Secretariat (SNT) and the Ministry of Finance.

► THE FACTS

1. FEDERAL EXPENDITURES ARE DOWN IN THE FIRST FIVE MONTHS OF 2017

Federal spending fell by 1.1% in real terms from January to May 2017 as compared to the corresponding period a year ago. This reflects the government's commitment to keep public accounts under control.

2. PERSONNEL EXPENDITURE GROWS

One of the main components of the federal Government's primary expenditure, accounting for 21% of total spending, personnel expenses (federal public servants) posted a real growth of 7.6% – excluding court-ordered payments – in the first five months of 2017 over the same period in 2016. This behavior is mainly explained by salary increases granted to federal civil servants in the second half of 2016.

3. SOCIAL SECURITY EXPENSES PUSH FEDERAL SPENDING UP

Social security expenditures, which account for 41% of total federal spending, grew by 5.1% – excluding court-ordered payments – in real terms from January to May 2017 from the corresponding period the year before. Given the continued increase in social security spending and the population aging, if the social security system is not reformed, social security spending will increasingly eat away at funds available for other areas and will make it difficult for Brazil to get out of the fiscal crisis. As a result, achieving macroeconomic stability and stepping up the country's sustained growth rate would become more difficult.

4. TAX RULES BRING NON-MANDATORY SPENDING DOWN

On account of the spending growth cap imposed by Constitutional Amendment No. 95 and the need to meet the fiscal target, an increase in personnel and social security expenses inevitably leads to a decline in non-compulsory spending, including investment.

5. FALLING INVESTMENTS HINDER RECOVERY

Investment expenditures – capital spending minus subsidies granted under the *Minha Casa Minha Vida* (My House My Life) program – decreased by 46% in the first five months of 2017 on a year-over-year inflation-adjusted basis.

This decline moves the country further away from the investment rate required to boost growth. According to IBGE data, this rate – Gross Fixed Capital Formation as a percentage of Gross Domestic Product – stood at 15.6% in the first quarter of 2017, while other developing countries, like Brazil, have recorded rates above 20% in recent years.

6. DECLINE IN NON-MANDATORY EXPENDITURE ON HEALTH AND EDUCATION

Non-compulsory spending by the Ministries of Education and Health dropped respectively by 22.3% and 2.5% in the first five months of 2017 from the same period in 2016. It is worth stressing that this decline does not affect the minimum expenditure level required by the Constitution, but if no efficiency gains are made, it may hinder the delivery and/or quality of the services provided to the population.

► THE IMPLICATIONS

The composition of the fiscal adjustment is as important as its intensity, as an increase in some expenses means leads to a reduction in others. Thus, defining the adjustment level in each spending category is one of the great challenges facing the government amid the need to boost economic growth and meet other demands of society. This scenario is made even more complex by the fact that a significant share of expenditures is mandatory, such as social security spending and civil servant expenses.

The data for the first five months of 2017 make it clear that the increase in personnel and social security expenses has led to a decline in the availability of funds earmarked for investments, health and education. This composition is far from ideal for the Brazilian economy to get back on a growth path.

Apart from playing a key role in defining the economy's growth potential, investments are also an important piece in this moment of recovery. At the same time, the population believes that health and education are always among the most important services. This is to say that reducing these expenses will certainly have a negative impact on the country. To avoid this, it is necessary to reform the social security system and resist the constant pressure to increase civil servant salaries, otherwise we will have a hard time solving the fiscal crisis and increasing Brazil's economic growth capacity and we will suffer from a decline in the availability and quality of essential public services.