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## **Understanding the new fiscal framework**

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### **ABSTRACT**

The new administration that took over the Federal Government in January 2023 presented important proposals in the first half of that financial year aimed at maintaining fiscal balance and reorganizing the national tax system. The design of a new fiscal framework and tax reform should bring important changes to the public budget at the national level and a new way of managing public finances in Brazil. The sustainable trajectory of the public debt, operationalized based on targets established in the budget guidelines laws, will result in a new budget model, mainly focused on the execution of a responsible fiscal policy.

## SUMMARY

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## 1. INTRODUCTION

The management of public finances in Brazil entered a new phase in January 2023, given the changes that the elected government brought to the budgetary process and national public administration. In the first half of that fiscal year, major projects such as the New Fiscal Framework and Tax Reform were submitted to Parliament for analysis, improvement, and approval.

The motivation for the projects consists mainly of signaling to the market that the new government was making a public commitment to responsible fiscal management. Thus, control of government spending, aimed at keeping public debt on a sustainable path and increasing efficiency in the tax system through the creation of value-added taxes, rationality, and tax simplification, aims to take public accounts to a new level, boosting the country's economic and social development.

The discussion proposed in this article aims to analyze the main characteristics of the New Fiscal Framework, together with the impact that this project is expected to have on the national public budget. The text is divided into six parts, including this introduction, the conclusions of the study, and the theoretical framework.

## 2. GENERAL CHARACTERISTICS OF THE NEW FISCAL FRAMEWORK

Fiscal adjustment and public account balancing programs have been discussed in the country since the 1960s. From that period until the mid-1980s, international financial institutions such as the International Monetary Fund (IMF) and the World Bank (IBRD) granted loans to Brazil, subject to conditions that included, among other requirements, the achievement of primary surpluses in public accounts.

These fiscal rules, imposed by international financial agents, mainly by the IMF, were important in generating payment capacity on the part of borrowing countries, resulting in the need to control public spending, especially in the "above the line" concept.

With the enactment of Federal Law No. 9,496 of 1997 and the publication of Federal **Complementary** Law No. 101 of May 2000—the Fiscal Responsibility Law (LRF)—the rule of fiscal balance was institutionalized in the country at all three levels of government. In this context, some states of the Federation developed local fiscal adjustment program projects (see the LRF of Rio Grande do Sul), and the Federal Government began to promote additional me-

asures to contain the nominal deficit and the growth of public debt.

Constitutional Amendment No. 95/2016 created a fiscal regime that became known as the “Spending Cap Law,” which in practice prevented the real growth of public spending by imposing individualized limits on spending increases in each branch and public agency. It should be noted that the Spending Cap Law had to be adapted and amended during the coronavirus pandemic, when the Federal Government began to adopt expansionary and countercyclical fiscal policies.

The government elected in October 2022, already during the transition process, began to design a new fiscal program, in view of the mandate established in Article 6 of Constitutional Amendment No. 126, of 2022, which determines, *in verbis*:

Art. 6 The President of the Republic shall submit to the National Congress, by August 31, 2023, a complementary bill with the objective of establishing a sustainable fiscal regime to ensure the macroeconomic stability of the country and create the appropriate conditions for socioeconomic growth, including with regard to the rule established in item III of the caput of Article 167 of the Federal Constitution.

The new administration was then presented with two alternatives: renew the Spending Cap proposal or create its own methodology for managing public accounts at the federal level. The decision was made to establish a New Fiscal Framework (NAF), which, after several technical and political discussions with the Ministry of Finance, the Ministry of Planning, and the National Congress, was approved in the form of Complementary Law No. 200 of 2023.

According to a report by the Chamber of Deputies' Finance and Taxation Committee, the New Framework proposal<sup>1</sup>

stands out for its normative content, focused on the integration of current fiscal rules and the replacement of the "spending cap" and improvements to the Fiscal Responsibility Law, in order to require greater fiscal discipline from

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<sup>1</sup> Available at [https://www2.camara.leg.br/orcamento-da-uniao/estudos/2023/NotaTecnica082023\\_PL-P932023REGIMEFISCALSUSTENTAVEL\\_NovoMarcoFiscal.pdf](https://www2.camara.leg.br/orcamento-da-uniao/estudos/2023/NotaTecnica082023_PL-P932023REGIMEFISCALSUSTENTAVEL_NovoMarcoFiscal.pdf). Accessed on September 20, 2023.

the Union, control of primary expenditures, with positive consequences for the balance of federal accounts and the debt trajectory.

The proposal for the New Fiscal Framework, in its theoretical framework, can be associated with the theory of public finance and the role of the State in the economy, especially the classic functions of government, in this case, the stabilizing function, according to Musgrave (1973).

We can also highlight a current trend among authors who, influenced by classical economic theorists such as Adam Smith (1952), postulate that it is not the size of the state that matters, but how much the government can do for national development. From this perspective, there would be no such thing as a minimal or maximal state, but rather a necessary state. Ferreira Júnior (2020) agrees with this thesis in an article published by the Court of Auditors of the State of Santa Catarina:

Although most of the measures to stimulate the economy fall to the federal government, which has monetary authority and the capacity to incur debt, states and municipalities play an important role in this process. In this scenario, there is no question of a minimal or maximal state, but rather a necessary state: lean, inclusive, efficient, and effective.

The Finance and Taxation Committee of the Federal Chamber of Deputies reports in its report (Technical Note No. 08/2023) that it sought inspiration in the work of Eyraud, Debrun, Hodge, Lledó, and Patillo (2018) for inspiration to develop a "sustainable tax regime" whose most important characteristics are simplicity, flexibility, and realistic implementation capacity.

The new tax proposal was designed with the aim of preventing public spending from growing faster than revenues, limiting the growth of public spending, among other measures, to a maximum of 70% of the real growth in revenues collected. The New Framework essentially seeks to assure the productive system that the government intends to help simplify the business environment, presenting itself as an economic agent and partner in market relations.

In fact, the certainty that the government will not spend more than it collects signals to the market that interest rates will remain at a level that will not compete with private sector

investments, a phenomenon known as the *crowding-out* effect.

The New Framework presents as a fundamental proposal for the management of public accounts: maintaining the Central Government Gross Debt (DBGC) "at sustainable levels."

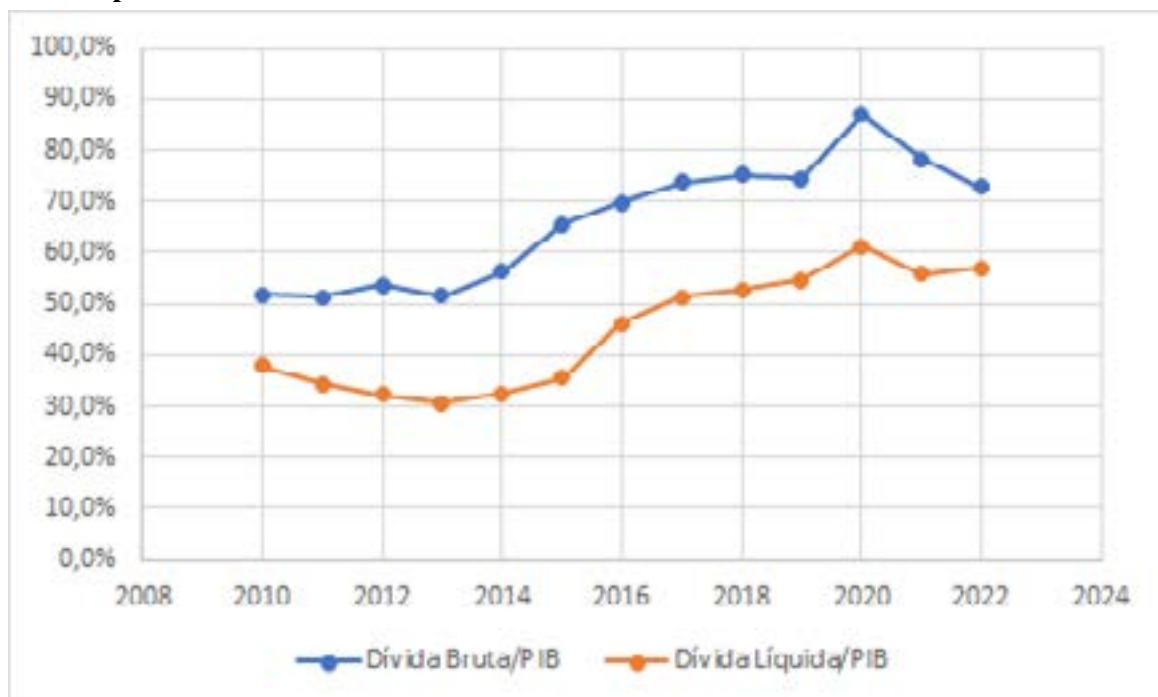
The table and graph below show the trajectory of federal public debt since the 2010 fiscal year. There is a downward trend in debt as a proportion of GDP from 2020 onwards, possibly due to the Spending Cap Law.

**Table 1 – Evolution of Federal Public Debt**

| ANO  | DBGC (MILHÕES)   | DLGC (MILHÕES)   | PIB (MILHÕES)    | DBGC/PIB | DLGC/PIB |
|------|------------------|------------------|------------------|----------|----------|
| 2010 | R\$ 2.011.521,66 | R\$ 1.475.820,18 | R\$ 3.885.847,00 | 51,8%    | 38,0%    |
| 2011 | R\$ 2.243.603,72 | R\$ 1.508.546,91 | R\$ 4.376.382,00 | 51,3%    | 34,5%    |
| 2012 | R\$ 2.583.946,35 | R\$ 1.550.083,08 | R\$ 4.814.760,00 | 53,7%    | 32,2%    |
| 2013 | R\$ 2.747.996,71 | R\$ 1.626.334,87 | R\$ 5.331.619,00 | 51,5%    | 30,5%    |
| 2014 | R\$ 3.252.448,55 | R\$ 1.883.146,99 | R\$ 5.778.953,00 | 56,3%    | 32,6%    |
| 2015 | R\$ 3.927.523,06 | R\$ 2.136.888,01 | R\$ 5.995.787,00 | 65,5%    | 35,6%    |
| 2016 | R\$ 4.378.486,39 | R\$ 2.892.913,45 | R\$ 6.269.328,00 | 69,8%    | 46,1%    |
| 2017 | R\$ 4.854.678,59 | R\$ 3.382.942,21 | R\$ 6.585.479,00 | 73,7%    | 51,4%    |
| 2018 | R\$ 5.271.982,26 | R\$ 3.695.837,32 | R\$ 7.004.141,00 | 75,3%    | 52,8%    |
| 2019 | R\$ 5.500.104,16 | R\$ 4.041.768,78 | R\$ 7.389.131,00 | 74,4%    | 54,7%    |
| 2020 | R\$ 6.615.755,20 | R\$ 4.670.004,31 | R\$ 7.609.597,00 | 86,9%    | 61,4%    |
| 2021 | R\$ 6.966.925,20 | R\$ 4.966.921,42 | R\$ 8.898.727,46 | 78,3%    | 55,8%    |
| 2022 | R\$ 7.224.882,23 | R\$ 5.658.016,87 | R\$ 9.915.316,43 | 72,9%    | 57,1%    |

Source: STN

**Graph 1 – Evolution of Federal Public Debt**



Source: STN

Some versions of the New Framework Bill defined the concept of “sustainable debt level” as a net debt level (not gross, as in the final text) not exceeding 60% of Gross Domestic Product (GDP). The law approved by Parliament (LC 200/2023), on the other hand, links debt sustainability to a trajectory of gross debt in relation to GDP, which should be established based on the fiscal targets set out in the Budget Guidelines Law (LDO), without, however, defining a ceiling for federal public debt.

Thus, sustainability will be presented in the LDO, considering economic conditions (mainly revenue performance) and the government's ability to control the growth of primary expenditures.

The LDO, as stated, will establish a sustainable debt trajectory based on primary results sufficient to pay all interest (in this case, eliminating the nominal deficit) or at least part of the debt charges. The primary surplus, associated with economic performance (reflected in positive GDP growth), will establish, under the New Framework, the sustainable trajectory of federal public debt.

The New Framework also innovates by changing the primary result targets in the LDO's Annex of Targets, as established by the LRF. Under the new fiscal proposal, the primary result target will have a tolerance range equivalent to 0.25 percentage points of GDP, either above or below.

The fiscal target proposals for the coming fiscal years, according to the LDO for 2024, were as follows:

For 2024 - primary result target of R\$ 0.00 (zero result)

For 2025 - primary result target of R\$ 61,610.00 (million)

For 2026 - primary result target of R\$ 130,830.00 (million)

The estimated nominal GDP for the period, as stated in the annexes to the LDO/2024, originally presented the following values:

GDP 2024 – R\$ 11,502,500.00 (million)

GDP 2025 – R\$ 12,322,000,000

GDP 2026 – R\$ 13,083,000,000

In this case, the fiscal target for 2024, considering a zero primary result, could accommo-  
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date a primary deficit of up to R\$ 28 billion (a variation of 0.25 pp of GDP in 2024). The fiscal target for 2025 should be between approximately R\$ 30 billion and R\$ 92 billion, and the fiscal target for 2026, under the new methodology, will be between R\$ 98 billion and R\$ 163 billion. These results are based, as seen, on the variation of 0.25 pp of the nominal GDP projected for the period.

Taking, for example, the fiscal target range for 2025 (between R\$ 30 billion and R\$ 92 billion) and considering the methodology presented by the New Framework, we would then have the following situations:

1. If the primary result verified in 2025 is less than R\$ 30 billion (remembering that the fiscal target is R\$ 61.6 billion), the public spending control measures listed in Complementary Law 200/2023 should be activated, except with regard to hiring personnel and holding public competitions.

2. If the fiscal targets continue to be missed for two financial years, in addition to all spending control measures, competitive examinations and new hires will also be suspended, taking into account the exceptions presented in the legal text.

3. Even in the event of non-compliance with the fiscal target, discretionary expenditures may only grow by a maximum of 50% of the actual revenue growth calculated for the period. Thus, in our assessment, the excess revenue (the other 50%) should be used to offset the primary deficit and to pay the accumulated (unpaid) debt charges for the period.

4. If the primary result remains above the lower range of the target (above R\$ 30 billion), expenditures may have a real increase of up to 70% of the real growth in revenues.

5. If the fiscal result for 2025 exceeds R\$ 92 billion (upper limit of the target range), 70% of the surplus may be used for investment and financial investment expenses.

The examples presented show the rules of the New Framework as a way of adjusting and maintaining the balance of public accounts. Criteria were created to guarantee the payment of debt charges through expenditure control, in addition to the review of tax incentives and revenue waivers. On the other hand, the financial amount in excess of the established fiscal target will be directed, for the most part, to public investment expenditures that generate positive externalities for the entire economic system.

Also according to the proposal, the Annex of Fiscal Targets of the Union's LDO will now contain:

- a medium-term fiscal framework, with projections for the main fiscal aggregates that make up the reference scenarios;
- the expected effect and compatibility, over a ten-year period, of meeting the primary result targets on the convergence trajectory of public debt;
- tolerance intervals for verifying compliance with annual targets for the primary result, converted into current values, of minus 0.25 p.p. (twenty-five hundredths of a percentage point) and plus 0.25 p.p. (twenty-five hundredths of a percentage point) of Gross Domestic Product (GDP);
- budgetary limits and parameters for the branches of government and autonomous agencies compatible with the provisions relating to debt sustainability;
- estimates of the fiscal impact of recommendations resulting from the monitoring and evaluation of public policies provided for in § 16 of Article 37 of the Federal Constitution, considering that public administration bodies and entities, individually or jointly, must evaluate public policies, including disclosure of the object to be evaluated and the results achieved.
- prohibition for the LDO to provide for the exclusion of any primary expenditures from the calculation of the primary result target for the fiscal and social security budget.

In addition to these specific issues, with a view to achieving a balanced fiscal regime and maintaining the debt trajectory at a sustainable level, other rules are included in the text of Complementary Law No. 200/2023 and must be observed. Primary expenditures, in addition to being subject to limitations in the event of non-compliance with primary result targets, may not grow by less than 0.6% or more than 2.5% in real terms.

Mandatory transfers that the Union must make to states, the Federal District, and municipalities, as well as some non-mandatory transfers, such as those transferred for engineering works and services, are excluded from the expenditure control measures. Also, the increases planned for the minimum wage cannot be subject to contingencies, nor can special credits for cases of public calamity. In general terms, the following expenditures may not be subject to contingencies:

- constitutional and legal transfers to states, the Federal District, and municipalities, such as tax distributions (FPE, FPM, ICMS quota, etc.);
- extraordinary credits for urgent expenses, such as public disasters;
- expenses funded by donations, such as those from the Amazon Fund or those obtained

by universities, and by funds obtained as a result of judicial or extrajudicial agreements relating to disasters of any nature;

- expenses paid with own revenues or agreements obtained by Federal Public Universities, federal public companies that manage university hospitals, federal institutions of education, science, and technology linked to the Ministry of Education, federal military establishments, and other scientific, technological, and innovation institutions;

- Federal expenses for engineering works and services funded with resources transferred by states and municipalities, such as works carried out by Army Engineering Battalions on highways administered by local governments;

- payment of court-ordered debt settlements with a discount accepted by the creditor;

- installment payments of court-ordered debt payments obtained by states and municipalities related to transfers from the Fund for the Maintenance and Development of Primary Education and Teacher Training (Fundef); and

- non-recurring expenses of the Electoral Court with the holding of elections.

There are also some flexibilities in the text of the law, when it states, for example, that the LDO may provide for compensation between spending limitation measures (between the other branches and agencies) or when it provides that the President of the Republic may propose to the National Congress measures to ease spending limitations, provided that the sustainable debt trajectory and fiscal targets are not altered. In addition to the Executive Branch, as already stated, the other branches of government, the Public Prosecutor's Office, and the Public Defender's Office must also observe limits on primary expenditures.

Another issue presented in the New Framework refers to budgetary expenditures which, in the execution of the budget law, in any situation, must represent at least 75% of the authorized amounts. Mandatory primary expenditures, on the other hand, may not exceed 95% of total primary expenditures. In addition, in the PLOA, the programming of investment expenditures may not be less than 0.6% of GDP.

In general terms, the new fiscal proposal maintains the rules established in the LRF, with compliance with the Fiscal Responsibility Law being mandatory, together with the provisions of the New Fiscal Framework.

It should be noted that the tolerance range for the fiscal target (primary result) at the state and municipal levels may also be adopted. However, the established parameter must observe the variation in Net Current Revenue (RCL) or Gross Domestic Product (GDP) at the local

level.

These are the most important operational aspects that we can identify in the text of the New Fiscal Framework. There are several rules that must be observed cumulatively: maximum percentage for mandatory expenses; minimum percentage for the execution of expenses defined in the PLOA; minimum investment spending; real growth in expenses as a proportion of revenue growth; minimum and maximum real growth for expenses in the LOA; tolerance range for the primary result, among others.

Measures to control public spending are presented, which will be undertaken when revenues fall short and jeopardize fiscal targets and the sustainable trajectory of public debt.

In this way, the New Framework creates conditions for the resumption of public investments, keeps the debt trajectory under control, and attempts to limit the growth of mandatory expenditures as a proportion of total expenditures.

It will be up to the Federal Government to comply with the established rules, encouraging popular participation through transparency regarding the expected results and objectives to be achieved with the new fiscal program. We will now discuss the text of Complementary Law 200/2023 in more detail, seeking to understand the operationalization of the New Fiscal Framework.

### **3. UNDERSTANDING COMPLEMENTARY LAW No. 200 OF 2023**

The proposal of Complementary Law No. 200 of 2023, as stated, is to establish a sustainable fiscal regime in Brazil to ensure macroeconomic stability in the country and create the right conditions for socioeconomic growth. In general terms, the New Framework is an update of Complementary Law No. 101 of 2000 – the Fiscal Responsibility Law – and is therefore compatible with the fiscal regime presented in the LRF.

According to the legal text, the new rules apply to the collection of primary revenues and the execution of primary expenditures of the federal government's fiscal and social security budgets.

Primary revenues are the "genuine" revenues of a public entity. In the case of the Federal Government, primary revenues include the collection of IPI (Industrial Products Tax), Income Tax, Import and Export Taxes, etc.

At the local level, municipal primary revenues correspond to the collection of property tax (IPTU) and services tax (ISS), in addition to constitutional transfers received from the fede-

ral government (FPM) and the states (ICMS and IPVA quotas). In the states, primary revenues correspond mainly to ICMS and IPVA, in addition to constitutional transfers (FPE). Primary revenues are those that belong to public entities with legal provisions and differ from other revenues originating from activities that are not typical of the public sector. This is the case with revenues from credit operations or revenues from the sale of movable or immovable property, technically referred to as financial revenues or third-party revenues.

Logically, revenue from a loan represents an amount that must be repaid to the lender with interest. The sale of real estate, on the other hand, represents a financial gain for the public coffers, but at the same time a reduction in assets (a permutative fact).

In addition, financial revenues are generally linked to specific expenses (public investments, for example), while primary revenues are freely usable: primary revenues may cover current and capital expenses, while financial revenues should be directed primarily to capital expenses.

Primary expenditures represent all public expenditures not related to the payment of public debt, that is, they are not used to cover interest and amortization. In a simplified way, we can infer that primary expenditures are all public expenditures, minus interest payments, charges, and debt amortization.

In the study of public finances, we can also relate primary revenues and expenditures to the concept of "above the line," while financial (non-primary) revenues and expenditures are associated with the concept of "below the line" (NASCIMENTO, 2021).

The reference made in Article 1 of LC 200/2023 to primary revenues and expenditures reflects the essence of a model that seeks self-sustainability through its own revenues, without relying too heavily on third-party resources (financial revenues). Non-primary revenues are directly related to the trajectory of public debt: the more a nation depends on third-party resources, whether through direct credit operations or the issuance of government bonds, the higher the level of indebtedness, whether measured in gross or net terms.

Thus, a sustainable debt trajectory will necessarily involve an increase in primary revenues, through the control of revenue waivers (incentives, tax breaks, etc.), and the control of primary expenditures, especially those fixed expenditures related to payroll. With efficient management of primary revenues and expenditures, the Federal Government will be able to generate primary surpluses (primary revenues exceeding primary expenditures) sufficient to pay, at least, the public debt charges.

On the other hand, debt should be directed toward covering expenditures that can increase

public assets and improve the performance of the entire economy. The construction of roads and ports, for example, represents expenditures that bring about externalities such as increased production and public revenue collection.

Thus, Article 1 of LC 200/2023 presents us with the main objective of the new fiscal model: to keep public accounts under control by increasing primary revenues and controlling primary expenditures, with a view to managing the trajectory of federal public debt at sustainable levels in relation to Gross Domestic Product. This means going beyond simple debt rollover, as has been the case in Brazil over the years.

### *3.1 Fiscal Targets and Debt Sustainability*

The Fiscal Responsibility Law of 2000 created a culture of fiscal targets for the national public budget. The Budget Guidelines Law (LDO) now includes an annex of targets, in which the public administration commits to generating primary results for a period of three years, sufficient to pay debt charges and amortize the principal.

The savings generated by controlling primary expenditures, combined with an increase in own (primary) revenues, were a prerequisite for generating primary surpluses. These positive results would allow for the maintenance of a constant debt trajectory (if the primary surplus were sufficient to cover interest and charges); a reduction in the volume of debt (surpluses sufficient to pay interest and principal); or even "controlled public debt management" when primary surpluses are not sufficient to fully cover debt charges.

The management of federal public debt over the last 30 years can be associated with the third alternative presented in the previous paragraph. Over the years, the federal government has been unable to generate sufficient primary surpluses to pay off the total public debt charges annually, thereby eliminating the nominal deficit. For example, if the federal government generates a primary surplus of R\$ 100 billion and the debt charges for the period amount to R\$ 110 billion, there is a nominal deficit of R\$ 10 billion. In this case, the public debt will grow to a greater or lesser extent, depending on the magnitude of the nominal deficit, despite the primary surplus of R\$ 100 billion and the fiscal effort undertaken.

The difference presented in the New Fiscal Framework in relation to the original model of fiscal targets provided for in Article 4 of the LRF is the introduction of a tolerance range (band) for the primary result established for a period of three years. In the LRF, the fiscal targets for the primary result are fixed, while in the New Framework they may vary up or down from

the proposed values, within a range of 0.25% of the estimated GDP for the period.

Thus, in the LRF, the primary result target for 2026, under the terms of the LDO, would be equal to R\$ 130 billion, while under the new methodology, the target may range from R\$ 98 billion to R\$ 163 billion, for an estimated GDP of approximately R\$ 13 trillion. It should be noted that, from this perspective, if the fiscal target is a primary result equal to zero (fiscal target for 2024), the budget execution may receive a negative value for the primary result (primary deficit) without this result being considered a breach of the fiscal targets annex. However, it should be noted that the primary deficit is unlikely to bring public debt to a sustainable level.

Compliance with the fiscal targets to be established in the LDO will be directly related to federal budgetary and financial execution, under the command of the Ministry of Finance and the Ministry of Planning. On the other hand, the calculation of the primary result and the sustainable trajectory of public debt will be the responsibility of the Central Bank of Brazil.

### *3.2. Limits on Expenditure Growth*

Primary expenditures will now be subject to individualized limits on the total amount of budget appropriations for all branches and agencies, namely:

1 - Federal Executive Branch;

2 - Federal Supreme Court, Superior Court of Justice, National Council of Justice, Labor Court, Federal Court, Military Court, Electoral Court, and Federal District and Territories Court, within the scope of the Judiciary;

3 - Federal Senate, Chamber of Deputies, and Federal Court of Accounts, within the scope of the Legislative Branch;

4 - Federal Public Prosecutor's Office and National Council of Public Prosecutors; and

5 - Federal Public Defender's Office.

The Budget Guidelines Law (LDO) may provide for a mechanism to compensate for spending limits between branches or agencies. This means that if the Legislative Branch does not use its spending limit, the Judiciary's expenses may be increased without prejudice to the fiscal target.

For the 2024 fiscal year, the primary budget appropriations contained in Law No. 14,535, of January 17, 2023 (a rule that estimates federal revenue and sets federal spending for the



2023 fiscal year) will be adjusted by the cumulative variation of the Broad National Consumer Price Index (IPCA), published by the Brazilian Institute of Geography and Statistics (IBGE), or another index that may replace it. For subsequent fiscal years, spending limits will be based on the previous year's limit, which will also be adjusted by the IPCA and may also receive a real increase, considering the variation in primary revenues.

The calculation of expenses will consider the amounts calculated in the 12-month period ending in June of the fiscal year prior to that referred to in the Annual Budget Law (LOA). In other words, the variation in the IPCA between January and December (calendar year) will not be considered, but rather between July and June of each fiscal year.

However, the positive result of the difference between the IPCA variation rates in the July-June and January-December periods may be used to supplement expenses.

Also according to the New Framework, the actual variation in primary expenditure limits will be cumulative and will be limited, in relation to the actual variation in primary revenue, to the following proportions:

I - 70% (seventy percent), if the primary result target calculated in the fiscal year prior to the preparation of the annual budget law has been met, observing the tolerance intervals.

II - 50% (fifty percent), if the primary result target calculated in the fiscal year prior to the preparation of the annual budget law has not been met, observing the tolerance intervals.

In addition, the real growth of primary expenditure limits may not be less than 0.6% per annum (six tenths of a percent per year) or greater than 2.5% per annum (two and a half percent per year).

It should also be noted that the real variation in primary expenditures (above the IPCA) will observe the real growth in primary revenues, as regulated by the Ministry of Finance (paragraph 2, article 5 of LC 200/2023).

According to the parameters presented, with the fiscal target for 2026 set at R\$ 130 billion, with a range of R\$ 32 billion more or less (for an estimated GDP of R\$ 13 trillion), we would have the following situations:

1. If the primary result for 2026, calculated in 2027, indicated a value of R\$ 125 billion (therefore within the target range), expenditures in the 2027 budget could increase by 70% of the real variation in primary revenues (above the IPCA) calculated in the same period (July –



June).

2. However, if the result calculated in 2026 is R\$ 70 billion (outside the range established in the New Framework), expenditures for 2027 could increase by up to 50% of the actual variation in primary revenues.

3. In addition to these rules, the real growth of primary expenditures cannot be less than 0.6% per year (in the case, for example, of no real growth in primary revenues), nor greater than 2.5% per year, if revenues grow above a normal trajectory.

### *3.3. Fiscal Adjustment Measures*

First, it should be noted that the fiscal adjustment measures presented in LC 200/2023 exceed the previous rules in scope and austerity. For this reason, some market analysts have raised doubts about the Federal Government's ability to comply with such measures <sup>2</sup>.

According to the New Fiscal Framework Law, if the primary result calculated for the previous fiscal year is lower than the lower limit of the target tolerance range, until the next annual calculation, the following are prohibited:

- the creation of positions, jobs, or functions that imply an increase in expenditure;
- changes to the career structure that imply an increase in expenditure;
- the creation or increase of allowances, benefits, bonuses, representation allowances, or benefits of any kind, including those of an indemnity nature, in favor of members of the Judiciary, the Public Prosecutor's Office, or the Public Defender's Office, as well as civil servants, public employees, military personnel, or their dependents, except when derived from a final court ruling or previous legal determination;
  - the creation of mandatory expenses;
  - the adoption of measures that imply an adjustment of mandatory expenditure above the inflation rate, observing the preservation of the purchasing power of the national minimum wage;
  - the creation or expansion of financing programs and lines, as well as debt forgiveness, renegotiation, or refinancing that involves increased spending on subsidies and grants; and
  - the granting or expansion of tax incentives or benefits.

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<sup>2</sup> Available at <https://www12.senado.leg.br/noticias/videos/2023/05/ifi-preve-dificuldade-para-cumprimento-de-metas-do-novo-arcabouco-fiscal>. Accessed on 08/15/2023.

Furthermore, if the primary result is, for the second consecutive year, lower than the lower limit of the target tolerance range, in addition to the previous measures, the Federal Government may not:

- grant, for any reason, advantages, increases, adjustments, or adjustments to the remuneration of members of the government or public agencies, civil servants, public employees, and military personnel, except those derived from a final court ruling or legal determination prior to the implementation of the New Framework measures;
- hire or contract personnel, for any reason, except for replacements of management and executive positions that do not entail an increase in expenses; replacements resulting from vacancies in permanent or lifetime positions; temporary contracts of exceptional public interest; replacements of temporary employees for military service and students of military training institutions; and
- hold public competitions, except for replacements of vacancies in priority areas.

It should therefore be noted that failure to meet the primary fiscal target, as provided for in the LDO, will result in harsh measures by the Central Government, which will not be able to increase personnel expenses, grant tax benefits, increase mandatory expenses, or grant debt financing to states and municipalities if there is an increase in National Treasury expenses (which normally occurs).

The Federal Government thus assumes a firm commitment to adjust public accounts which, if implemented in the form of Complementary Law 200/2023, could keep public debt on a sustainable path, a fundamental proposal of the New Fiscal Framework.

This is a greater fiscal effort than those seen to date in Brazil since the enactment of the Fiscal Responsibility Law in 2000. The measures listed to bring the primary result within the range of the targets set are robust and, if fulfilled, capable of maintaining fiscal balance.

Responsible fiscal management and the fulfillment of fiscal targets are important for a country's economic and social development. The Central Government, through its participation in economic activities (public spending), influences the Gross Domestic Product and market interest rates. A high level of public debt forces the National Treasury to issue securities with attractive rates to investors, competing with other productive activities carried out by the private sector. Income and job creation are compromised when public debt is out of control. In addition, inflation, a consequence of high interest rates, reduces the purchasing power of the

less privileged social classes.

To maintain the functioning of the public sector at a minimum level, in the case of the implementation of measures planned to meet fiscal targets, LC 200/2023 ensures a minimum level of 75% of the expenses authorized in the Annual Budget Law. On the other hand, the adjustment measures listed above must also be implemented if the percentage of mandatory primary expenditures exceeds 95% of total primary expenditures, in which case only the minimum wage update will be preserved.

Thus, there are several rules that must be observed at the same time for the execution of public expenditures and the budgetary and financial management of the Federal Government:

- Real expenditure growth must comply with the primary result targets established in the LDO;
- The real growth in expenditures must observe the real increase in public revenues;
- The Law ensures, in any situation, a minimum execution of 75% of the expenditures established in the Budget Law;
- Mandatory primary expenditures may not exceed 95% of total primary expenditures;
- The annual adjustment of the minimum wage must be preserved.

LC 200/2023 also innovates in that it establishes that the responsibility of fiscal policy managers is not linked to the fulfillment of targets, but to the measures taken to achieve the primary result, within the tolerance ranges. In other words, even if fiscal targets are not met, if the manager takes the measures established in the Complementary Law, there will be no administrative impropriety or violation of the Fiscal Responsibility Law.

However, as the text of the New Framework clearly states the measures that must be taken by those responsible for conducting fiscal policy, it will be easy for fiscal control bodies to oversee budgetary and financial management and the conduct of public officials, who will have no choice but to implement actions aimed at controlling public spending and meeting fiscal targets.

### ***3.4. Fiscal Targets and Public Investments***

LC 200/2023 also establishes that, if there is an annual primary result that exceeds the upper limit of the fiscal target, 70% of this surplus must be used for investment expenses (primarily for ongoing or unfinished works) and financial investments (primarily for expenses re-

lated to housing units).

The amount exceeding the fiscal target, to be used for investments and financial investments, in any situation, may not exceed 0.25 percentage points (twenty-five hundredths of a percentage point) of the previous fiscal year's GDP. In addition, the investment program contained in the Annual Budget Bill and Law shall not be less than the amount equivalent to 0.6% (six tenths of a percent) of the GDP estimated in the respective bill. These measures aim to guarantee a minimum amount of resources allocated to capital expenditures for Gross Fixed Capital Formation (public assets).

### ***3.5. Amendments to the Fiscal Responsibility Law - LRF***

The New Fiscal Framework, as already stated, amends provisions of the LRF, establishing projections and future scenarios for the execution of fiscal targets and their effects on the debt trajectory, measured by Gross Debt as a proportion of GDP. However, the most important change refers to fiscal targets, which will now observe tolerance intervals based on Gross Domestic Product.

The LRF now provides greater detail regarding fiscal policy objectives, translated into the balance and sustainability of public debt. In this sense, it introduces the Medium-Term Fiscal Framework, with projections for the main fiscal aggregates that make up the reference scenarios, distinguishing between primary and financial expenditures and between mandatory and discretionary expenditures.

It should also be noted that, according to the previous methodology, fiscal targets (without a tolerance range) had to be met, regardless of whether adjustments to public accounts were made on the expenditure or revenue side. Certainly, the previous methodology gave greater flexibility to public managers. The new rules are stricter, leaving no room for measures not provided for in the text of Law <sup>3</sup>. For the Chamber of Deputies, however, *the existence of a limit on expenditure growth is desirable, as it creates a paradigm or standard that, for the sake of consistency, tends to serve as a reference for each element of the expenditure set* <sup>4</sup>.

Finally, the states, the Federal District, and the municipalities may adopt, in whole or in part, as applicable, the provisions of LC 200/2023 at the local level, with regard to fiscal targets.

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<sup>3</sup> A debt refinancing program (Refis), for example, could generate an increase in revenues and enable the annual fiscal target to be met.

<sup>4</sup> Technical Note No. 08/2023.

#### 4. A NEW BUDGET MODEL?

The Brazilian budgetary system is dynamic and has been undergoing an evolutionary process, from the use of an accounting budget, unrelated to government planning, to the adoption of government plans with financial targets, aiming at fiscal balance and self-sustainability.

From a theoretical perspective, the public budget can be analyzed in different ways (GIACOMONI, 2012):

- a) as a planning tool (program budget);
- b) as a basic fiscal policy instrument;
- c) as a political control instrument (traditional budget);
- d) as an information system;
- e) as a tool to support government management; and
- f) as a tool for evaluating public spending.

According to Abreu and Câmara (2015), the public budget is a structuring instrument of government action, representing a filter for analyzing the feasibility of implementing public policies, both from an economic and political point of view. According to the authors,

this is due, respectively, to its use in evaluating the availability of resources for the formulation of public policies (static analysis) and also to the possibilities of budget management within the institutional political context of decision-making (dynamic analysis). (ABREU and CÂMARA, 2015)

Despite the technical and conceptual definitions that deal with public budgets, we can affirm that they have a personality (*modus operandi*) that reflects the structure of government democratically installed through voting. Thus, public budgets reflect the public policies that will be implemented for the benefit of society, consolidating a government plan.

During the era of developmentalist state, characteristic of military governments, infrastructure spending consumed a large part of budget appropriations. During the 1980s, public debt servicing expenses (sponsor of the "economic miracle") began to consume a significant portion of the federal public budget.

In addition, especially since 2000, the national public budget has included fiscal and financial targets that must be observed by all leaders in the three spheres of government, under penalty of personal liability for government officials. Concepts such as Primary Result, Net Current Revenue, and Continuing Expenditures were incorporated into the budget in an effort to balance public accounts, based on a theoretical managerial perspective and so-called "result-based management."

We can also say that we are currently facing a new budgetary methodology, where the expected results of public management have repercussions on the expectations of an entire economic system, directly affecting companies and citizens. Since the public budget in Brazil ceased to be a "black box," especially due to the principle of transparency, social control has begun to influence decisions regarding the allocation of budgetary resources.

Thus, transparency and market monitoring began to compel public managers to analyze the demands of budget units, together with the effects of public spending on the economy. Before the Federal Constitution of 1988 and the Fiscal Responsibility Law, this concern apparently did not exist. Until then, the correlation between public spending and domestic product was merely an identity function accepted by all, but not fully understood.

According to macroeconomic postulates (UN, 1953), Gross Domestic Product (Y) is based on an equation that adds private investment (I), household consumption (C), the trade balance (X-M), and government spending (G). Thus:  $Y = C+I+G+(X-M)$ <sup>5</sup>.

With the advent of the Fiscal Responsibility Law (LRF), studies involving public finances in Brazil began to emphasize the G element in the formation of GDP, highlighting the importance of government budget management. Considering that when the public budget is in deficit, the immediate consequence is an increase in interest rates in the economy (with its effects on inflation and consumption), government plans began to adopt proposals aimed at fiscal balance.

This balance is translated into targets that counterbalance the level of indebtedness with other current and capital expenditures included in the budget. In other words, fiscal results have become the main focus of the budget, as opposed to projects in areas most demanded by the population, such as health, education, and public safety. First, the fiscal target will be established in the LDO, which precedes the LOA. After defining the fiscal (primary) result target, governments will verify the space for other current and capital expenditures. Thus, the execution of the budget itself should be directed toward meeting the fiscal targets established in the LDO.

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<sup>5</sup> Model created by English economist Richard Stone, inspired by 18th-century marginalism and adopted by the UN since 1953.

Salary increases, research spending, infrastructure investments, and hiring of civil servants must comply with the fiscal space determined after the primary and nominal result targets are set, together with the expected trajectory of public debt. Only mandatory expenditures will be preserved. However, it should be noted that mandatory expenditures currently account for about 90% of total primary expenditures.

From this perspective, budget management is no longer what it was twenty years ago, when the program budget represented the ideal model to be followed in all levels of government in Brazil.

We are now faced with budget management based on results, more specifically, fiscal results. In technical terms, the "below-the-line" accounts now define the rules for "above-the-line" expenditures and revenues. To achieve this condition, some theoretical paradigms are being broken.

The idea that increased public spending creates a virtuous circle in the economy, generating income, employment, and taxes, is no longer accepted and defended with the same enthusiasm as in the past. Even public managers who advocate for a welfare state are bowing to the demands of a productive sector that refuses to accept high interest rates. Capital flight from the country is directly correlated with fiscal imbalance.

In short, a new paradigm of budget management shows that the public budget in Brazil (which corresponds to about 40% of GDP), in its preparation, monitoring, and execution, has been adapting to an economic market reality, where the government is involved, not as a supporting actor, but as an agent that participates in the country's economic and social development.

It is from this perspective that the Federal Government, still during the transition, began to develop a New Fiscal Framework, signaling to the market and society that public spending would remain under control based on pre-established fiscal targets, with a view to keeping public debt on a sustainable path. In other words, the objectives of the public budget will be directed mainly toward fiscal balance.

A new school of public policy makers believes that good management of government accounts, translated into control of public spending, efficient tax policy, and control of debt, can bring the country the best results in the social field (GOMES, 2009).

Furthermore, the current context, which arose with the establishment of the New Fiscal Framework, provides an opportunity to improve and enhance the mechanisms of cooperation between the Powers and Agencies with a view to achieving better economic, fiscal, and social results for Brazilian society. In fact, the branches of government—Legislative, Executive, and

Judicial—and the Public Prosecutor's Office, as well as strategic management, research, statistics, and control agencies, such as the National Treasury Secretariat (STN), the Federal Revenue Service (RFB), the Central Bank of Brazil (BACEN), the Federal Budget Secretariat (SOF), the Institute of Applied Economic Research (IPEA), the Brazilian Institute of Geography and Statistics (IBGE), the Office of the Comptroller General (GCU), and the Federal Court of Accounts (TCU), among others, now have modern and transparent mechanisms for performing their duties and functions.

## 5. FINAL CONSIDERATIONS

The purpose of this article is to provide some clarification regarding the operation of the New Fiscal Framework. The text of the new fiscal program could represent, if implemented, an advance over the projects developed to date at the national level. While creating stricter rules, it offers public managers a margin of tolerance for meeting fiscal targets. It also establishes objective issues and effective measures for managing the public deficit, in particular limiting personnel expenses, while maintaining control over tax incentives and revenue waivers.

In fact, the maximum limit for real expenditure growth of 2.5% per year will control the trend of continuous and substantial increases in spending, which between 1998 and 2022 grew by an average of 4.5% per year<sup>6</sup>. The new rule restricts spending growth to less than half the historical average and ensures that federal spending will increase at a rate consistent with revenue growth.

However, the success of LC 200/2023 will depend on federal management as a whole, based on an agreement to be established between all branches and agencies in the pursuit of a sustainable fiscal regime. From this perspective, expenditure managers from all ministries and dependent public companies, branches of government, and agencies must participate in this effort so that the New Fiscal Framework can be implemented and its results can achieve the objectives of long-term economic and social development.

The purpose of public administration is to meet social demands that can be met by the government sector. Governments play an important role in generating income and employment, based on the expenditures allocated in each year's budgets. But we must not forget that the State is at the service of its citizens and that people are not numbers. The fulfillment of social

<sup>6</sup> Federal Chamber Technical Note No. 08/2023. Available at [https://www2.camara.leg.br/orcamento-da-uniao/estudos/2023/NotaTecnica082023\\_PLP932023REGIMEFISCALSUSTENTAVEL\\_NovoMarcoFiscal.pdf](https://www2.camara.leg.br/orcamento-da-uniao/estudos/2023/NotaTecnica082023_PLP932023REGIMEFISCALSUSTENTAVEL_NovoMarcoFiscal.pdf). Accessed on 09/20/2023.



demands cannot be measured solely by the achievement of fiscal targets. On the other hand, it is certain and indisputable that balanced public accounts have positive effects for the entire community, for businesses, and for the economy as a whole, especially when they keep debt and inflation under control.

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