

# Strengthening the Fiscal Ecosystem in Brazil

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## EXECUTIVE SUMMARY

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### Introduction

Brazil, the largest economy in South America and among the top ten worldwide, has long wrestled with the paradox of great economic size paired with persistent inequality. While its GDP surpasses US\$2.2 trillion, GDP per capita remains significantly lower than its regional peers, and the richest 10 percent of Brazilians capture over half of the nation's income and nearly 60 percent of its wealth. These stark disparities are rooted in and perpetuated by distortions in taxation and public spending, entrenched in the institutional fabric of the Brazilian fiscal ecosystem.

This case study examines how Brazil's fiscal institutions have evolved since the adoption of the 1988 Constitution, tracing reforms, crises, and power struggles that shaped accountability and equity. Three interlocking tensions define this trajectory: (a) the balance between fiscal discipline and universal public policies; (b) the shifting power dynamics between the Executive and the Legislature; and (c) the contradictions of a federal system that oscillates between decentralization and recentralization.

Brazil's fiscal governance currently faces a paralysis, marked by executive/legislative conflicts over parliamentary amendments (*emendas parlamentares*), judicial interventions, constrained fiscal space limiting vital social investments, and citizen dissatisfaction over transparency and participation. Nevertheless, ongoing debates, potential legal reforms, increased media coverage, and subnational innovations offer glimmers of reform potential, albeit within a politically polarized environment facing upcoming 2026 elections.

### The 1988 Constitution and the Origins of the Fiscal Ecosystem

The return to democracy in 1988 brought with it a new constitutional order that enshrined social rights, decentralized responsibilities, and reshaped fiscal governance. Citizens gained guarantees to education, health, and social assistance, while local governments were empowered with fiscal transfers like the Municipal Participation Fund.

Budgetary governance was also formalized through a triad of instruments:

- The **Multi-Year Plan (PPA)**, a strategic document with a four-year horizon, set in the first year of each presidential term, delineating development goals and sector objectives.

- The **Budgetary Guidelines Law (LDO)**, an annual framework presented by April 15, setting fiscal parameters and priority directives for the following year's budget.
- The **Annual Budget Law (LOA)**, detailing revenues and expenditures for the forthcoming year and enacted by year-end, aligning with the PPA and LDO guidelines.

This gave Congress significant authority in budget deliberations, including the uncommon power to approve the LDO before budget elaboration. The Constitution also gives Congress a broad ability to amend executive budget proposals, including spending additions and changing macroeconomic assumptions, conditioned on revenue offsets. Despite these checks, the LOA remains fundamentally an authorizing document, not mandating precise expenditure execution. The executive retains discretion to adjust spending during the fiscal year, notably through “*contingenciamento*”—the power to limit budget execution to maintain fiscal targets.

Oversight institutions like the Federal Audit Court (TCU), formally tasked with auditing and supporting legislative oversight, the Public Prosecutor’s Office (MPU), and later the Comptroller General (CGU) were tasked with additional accountability safeguards, while sectoral policy councils institutionalized citizen participation.

Despite these advances, Brazil’s tax system remained regressive. Heavy reliance on indirect consumption taxes placed disproportionate burdens on the poor, while income and wealth taxation lagged. Exemptions for dividends and profits shielded the wealthiest, undermining equity goals. Thus, while the Constitution universalized social rights, fiscal distortions meant distributive conflicts persisted, often managed rather than resolved.

### **The First Wave of Reforms: Fiscal Control in the 1990s**

Brazil’s transition to democracy coincided with a macroeconomic crisis marked by hyperinflation, fueled by chronic fiscal deficits monetized by the central bank and by external imbalances. Stabilization plans failed repeatedly, with inflation reaching over 2,000% annually by 1993. This environment forced governments at national and subnational levels to adopt indexation of revenues and expenditures, leveraging inflation to manage civil servant salaries and service contract payments, enabling control over “real” spending despite nominal volatility. Executive budget control strengthened amid this low transparency environment, limiting legislative influence. At the same time, rising public dissatisfaction fueled demands for fiscal accountability reforms.

To stabilize public finances, Brazil embraced a series of fiscal reforms culminating in the 2000 Fiscal Responsibility Law (*Lei de Responsabilidade Fiscal*, LRF). The LRF set limits on personnel spending, restricted subnational borrowing, and institutionalized transparency through new reporting requirements. It also strengthened the National Treasury and expanded the oversight role of the TCU. While the LRF enhanced accountability and stabilized macroeconomic conditions, critics argued it privileged fiscal discipline over social responsibilities. Efforts to link planning, budgeting, and performance in the 2000–2003 PPA led to the introduction of program-based budgeting, but entrenched fiscal rigidity and

political dynamics prevented its full adoption. Ultimately, financial targets overshadowed policy goals, institutionalizing tensions between fiscal guardians and sectoral spenders.

### **The Second Wave of Reforms: From Executive Dominance to Legislative Power**

Between 2000 and 2013, Brazil experienced macroeconomic stability—with economic growth averaging 4% annually—maintained primary surpluses, and achieved significant reductions in poverty and inequality facilitated by social programs like *Bolsa Familia*. The Workers' Party (PT) government built on prior macroeconomic policies, sustaining fiscal discipline while deepening social spending. Transparency also expanded through innovations such as the Transparency Portal (2004) and the 2009 Transparency Law, which mandated real-time disclosure of fiscal data. Participatory processes during PPA formulation further opened spaces for civil society. However, taxation reform faltered amid vested interests. The regressive tax structure persisted, with wealth redistribution financed mainly by middle-class taxes rather than the rich.

Despite these advances, executive dominance over budget execution persisted, particularly through discretionary control of parliamentary amendments (*emendas parlamentares*). Presidents used the release of funds for legislators' projects as leverage to secure congressional support. This arrangement unraveled after 2014. Amid recession, falling commodity prices, and fiscal deficits, Congress asserted its authority through Constitutional Amendment 86/2015, which mandated execution of individual amendments. The impeachment of President Dilma Rousseff, triggered partly by fiscal irregularities, ushered in a new era of legislative dominance.

Temer's government cemented fiscal austerity through a fiscal rule called "*Teto de gastos*" (spending ceiling), freezing primary spending for 20 years. While designed to restore fiscal confidence, the rule eroded investments in social programs and proved unsustainable, and was repeatedly breached until its repeal in 2023. A new fiscal framework under Lula now allows expenditure growth in line with revenue increases, but tightens debt control. Meanwhile, congressional control of amendments ballooned, reaching nearly half of discretionary spending by 2024. This has weakened strategic planning, fostered clientelism, and prompted judicial interventions by the Supreme Federal Court (STF) to impose transparency.

### **The Contemporary Fiscal Ecosystem: Advances and Contradictions**

Brazil's fiscal governance today embodies a series of contradictions. On one hand, accountability mechanisms have proliferated: real-time budget information portals, expanded fiscal reporting, investigative journalism, and watchdog groups have all contributed to strengthening oversight. Landmark cases—such as *Contas Abertas* uncovering irregularities that led to Dilma's impeachment—have demonstrated civil society's potential to hold power to account.

On the other hand, abundant disclosure has also created fragmentation and opacity, leaving ordinary citizens and even policymakers overwhelmed. Transparency has not always translated into accountability, as enforcement capacity remains weak. Oversight institutions like the TCU have increased their technical capacity and profile, but remain constrained by political appointments and limited enforcement powers, often favoring persuasion over sanctions. The IFI's influence has been muted by institutional proximity to Congress.

Equity has also stagnated. Planning instruments like the PPA have lost relevance, overshadowed by annual fiscal targets and political bargaining. Although Lula's government has introduced cross-cutting agendas for equity—focusing on women, racial justice, early childhood, and indigenous peoples—these remain vulnerable to congressional amendments and mid-year blockages.

Tax reform offers some promise: in 2023, a long-awaited overhaul of indirect taxation was approved, simplifying complex levies and aiming for greater efficiency. Yet the more politically sensitive reforms on income and wealth taxation remain elusive. The persistence of regressive tax structures continues to undermine redistributive efforts.

One exception lies in education. The evolution of the main funding mechanism for basic education (FUNDEB) has culminated in a permanent, equity-oriented financing system. By incorporating socioeconomic and fiscal capacity criteria, FUNDEB redistributes resources across states and municipalities and embeds gender and racial equity considerations. It represents a rare case of distributive reform successfully institutionalized.

### Revisiting the Three Tensions

The Brazilian case illustrates how fiscal ecosystems are shaped by enduring tensions:

1. **Fiscal discipline versus universal rights.** The 1988 Constitution expanded social guarantees, but fiscal crises ushered in austerity regimes. While stability underpinned social gains between 2000 and 2014, subsequent ceilings curtailed rights realization. Even under the new fiscal framework, redistributive ambitions remain constrained by fiscal orthodoxy and powerful vested interests.
2. **Executive versus Legislature.** What began as executive dominance through discretionary spending has morphed into legislative ascendancy via mandatory amendments. This has fragmented policy coherence and distorted accountability. Instead of balancing powers, the dynamic now risks undermining both branches' capacity to govern effectively.
3. **Federalism and decentralization.** Brazil's federative pact oscillates between empowering states and municipalities and reasserting federal control during crises. FUNDEB represents progress in balancing equity across territories, but parliamentary amendments have reintroduced fragmentation, privileging localized over national priorities.

### Mapping the Actors of Today's Fiscal Ecosystem

Beyond the core set of actors originally empowered by the 1988 Constitution, the fiscal ecosystem now includes a wider cast.

- 1) The **executive** branch remains constitutionally dominant in budget formulation but has ceded substantial discretionary spending control due to mandatory amendments and rigid budget rules, weakening its ability to prioritize effective development investments and equity.
- 2) The **legislature** has grown more assertive, with expanded powers over budget execution but a narrow focus on amendment implementation at the expense of strategic budgeting and oversight roles. This evolution compromises accountability and equity goals.
- 3) The **TCU** provides critical auditing functions but is limited by political appointments and lacks sanctioning teeth, functioning more as an advisor than enforcer.
- 4) The **judiciary** is increasingly involved informally, mediating budgetary conflicts and promoting transparency, a novel but impactful role given its lack of formal budgetary authority.
- 5) **Civil society** participates but remains limited in budgetary influence, with formal mechanisms insufficient to overcome governmental opacity and complex fiscal governance. Conservative religious and political forces exert growing influence impacting equity agendas.
- 6) The **private sector**, engaged heavily in lobbying, often opposes redistributive reforms, sustaining regressive tax expenditures amounting to nearly 7% of GDP, though it occasionally supports simplification reforms.
- 7) **Media** concentration coexists with a robust tradition of investigative journalism, essential for exposing fiscal abuses and stimulating public discourse.

This complex interplay reveals a system where distributive conflicts dominate, but where accountability and equity can still be advanced through coalition-building and institutional innovation.

### Future Pathways and Opportunities

Despite pervasive challenges, four areas hold potential for reform:

- **Judicial interventions.** The STF's role in demanding transparency in parliamentary amendments could catalyze more accountable budget governance.
- **Legal reform.** Momentum is building to replace the outdated 1964 budget law, with initiatives across ministries, states, and independent think tanks.
- **Public debate.** Growing media coverage and citizen awareness of fiscal issues may pressure political actors toward reform.
- **Subnational innovations.** States and municipalities, as frontline service providers, are experimenting with fiscal management reforms that could scale nationally.

History suggests that crises often drive reform in Brazil—from hyperinflation to the adoption of the LRF. The current deadlock between executive and legislature, coupled with fiscal rigidity and inequality, may yet generate the conditions for another transformative wave.