The Week in Review

On the Economic Front

Accounting Irregularities

On Wednesday Brazil's Federal Audit Court (*Tribunal de Contas da União* - TCU) decided to delay a vote on its report on government accounting improprieties. The report concluded that the Rousseff Administration had inappropriately postponed routine financial transfers that were to have been made from the National Treasury to the public banks (*Banco do Brasil, Caixa Econômica*, and *Banco Nacional de Desenvolvimento Econômico e Social*). The executive branch allegedly withheld these payments in order to record reduced government spending so as to increase the public account balances and thereby demonstrate a better chance of meeting the government's primary surplus target.

The TCU gave President Dilma Rousseff 30 days to respond to the report's charges of accounting irregularities. This is the first time a Brazilian president has had to provide a written clarification to the TCU on government spending and the first time the TCU has indicated that it would delay final action on the report until after the president's response. (See Pulse Below)

Provisional Measures Signed into Law

This week, President Rousseff signed into law two Provisional Measures (*Medidas Provisórias* - MP) as part of the ongoing fiscal adjustment:

» **MP 665 (LAW Nº 13.134 FROM JUNE 16, 2015)** reduces employee benefits in order to cut public spending. The proposal was approved in a tight vote, 39 to 32. The text reduces unemployment insurance and salary bonuses. The MP was originally expected to reduce spending by BRL$ 16 billion, but during its movement through Congress, it faced strong resistance from labor supporters. To avoid its possible rejection, the government agreed to renegotiate salary bonuses, which reduced expected savings to between BRL$7 and BRL$10 billion for 2015.

» **MP 664 (LAW Nº 13.135 FROM JUNE 17, 2015)** would further restrict who can apply for death pension and sick leave benefits. The MP requires two years of marriage or stable union before a surviving spouse is entitled to death benefits, with at least 24 months earned towards a prior contribution period. The MP also established new standards limiting the time that a survivor is eligible to receive a pension, with younger survivors receiving less time for pension eligibility. The MP stated that for disability and sickness payments, the employer would have to pay for up to 30 days leave, instead of 15 days as is the case today. The government's original proposal would have reduced government expenditures by approximately BRL$2 billion. Subsequent changes to the text reduced that amount in half to BRL$1 billion.

Petrobras CPI

Last week, the Petrobras Parliamentary Inquiry Comission (*Comissão Parlamentar de Inquérito* – CPI) approved the hearing of the president of *Instituto Lula*, Paulo Okamotto, to provide information about BRL$3 million in donations made between 2011 and 2013 by contractor Camargo Correa to former President Luiz Inacio Lula da Silva's foundation. Camargo Correa is one of the companies suspected of organizing the corruption scheme within Petrobras. In addition to the BRL$3 million, members of Congress want Okamotto to explain the transfer of BRL$1.5 million to another Lula company, L.I.L.S. Palestras e Eventos. The *Instituto Lula* claimed that all donations to the foundations are for maintenance of their activities and that all donations were declared to the IRS.

On the Political Front

New Supreme Court Minister

On Tuesday, Luiz Fachin took office as Minister of the Supreme Court (*Supremo Tribunal Federal* - STF). The new minister will occupy the seat left vacant in August 2014 with the retirement of Minister Joaquim Barbosa. The Supreme Court has all 11 positions filled.

Task Forces

Tax & Investment

Brazil-U.S. Bilateral Agreements: The full House approved the constitutional urgency request to vote on three international agreements that were signed by the Brazilian and U.S. governments:

» Legislative Decree 88/15 (PDC): Defense Cooperation Agreement;

» Legislative Decree 106/15 (PDC): To improve international tax compliance and implementation of U.S. law against tax evasion, and;

» Presidential Message 211/15: Security measures for the protection of classified military information.

New Retirement Formula: President Dilma Rousseff vetoed an increase in pension benefits approved by Congress and instead offered a new approach to limit expenditures for social security in coming years. Provisional measure 676/15, introduced on Thursday June 18th in the Official Gazette, creates an alternative to the so-called 85/95 formula in which women can receive full pension benefits when the sum of their age and years of pension payments reaches 85 and men when the sum reaches 95. The MP has a new formula starting with a calculation of 85/95 by taking into account the population's increasing life expectancy and gradually raising that sum over time to limit the flexibility of the minimum retirement age.

Innovation

National Digital Governance Strategy: On Tuesday, the Ministry of Planning and Budget (MPOG) held a Seminar on National Digital Governance Strategy to promote discussions on whether to subsidize the federal initiative. This is the first time the government has proposed a unified IT strategy, moving beyond the current Information and Communication Technology (ICT) strategy. The government's objective is to review the digital governance strategy every four years, aligning the timing with the Multiyear Plan (PPA), which sets the guidelines, goals, and objectives of the federal government. The strategy, which will be presented by the government, will be valid for the 2016-2019 period.

The ministry is working on a draft presidential decree for the new strategy. Despite the implementation of e-government policies in 2000, the ICT management of the various federal agencies remains decentralized. The government expects to complete the decree draft in August to allow the federal government's bodies to use the second half of the year to become familiar with the principles, which will begin to be implemented in 2016. The government's objective is to launch a unified strategy based on three pillars:

» ICT as a support tool for accessing information;

» ICT enabling services, and;

» ICT as a platform for social participation.

Oil & Gas

Petrobras Sharing Scheme: On Tuesday, the full Senate approved a constitutional urgency request to vote on Bill 131/15 (PLS), which would remove from the sharing scheme law (12,351/10) the article that makes Petrobras the single operator of all blocks contracted under the production sharing scheme, with minimum participation in consortiums. The bill goes next to the Senate floor. All four reports from the committees that were analyzing the bill must now be sent to the Senate floor to be discussed and voted on.

Healthcare

Genetic Patrimony Law Comment Period: The Ministry of Environment (*Ministério do Meio Ambiente - MMA*) opened a comment period for contributions to subsidize the creation of a standard that will regulate the Genetic Patrimony Law (Law 13,123/2015). All suggestions and comments can be sent here by July 31st. Contributions received in this first step will be compiled into a priority list, and then a second comment period will take place in mid-September that will specifically address the most relevant issues that should be regulated. The ministry's goal is to include civil society, businesses, and researchers in the process so that the regulation meets the needs of the broader population.

The Pulse

Adjusting the Fiscal Adjustment

The Rousseff Administration has begun to admit, at least informally, that the fiscal adjustment announced at the beginning of this year may not see its 2015 goals achieved until 2016 or beyond. It has become increasingly clear to market analysts and other observers that Finance Minister Levy's goal of reaching a primary surplus of 1.2% of GDP by the end of the year is unlikely to be realized. There may be many reasons for this outcome, not the least of which is encountering a fiscal account balance far worse than originally anticipated.

In addition to the unexpected magnitude of the adjustment, the "quality" might be judged as poor given that the majority of new revenue will come from higher taxes paid by individual taxpayers and companies and the decline of government spending will come at the expense of much-needed public capital investment rather than reductions in wasteful and redundant programs and payments. Reduced investment sacrifices the country's future growth and efficiency, perhaps placing an additional burden on public finances in the future.

It is widely believed that Minister Levy will be able to achieve a primary surplus equal to 0.7% of GDP this year, and perhaps reach the 1.2% target in 2016. Several economists from President Rousseff's Workers Party (PT) have argued that the fiscal adjustment plan should be extended through 2017 or 2018. President Rousseff's fiscal credibility, however, is coming under pressure again with recent actions by the Federal Audit Court (*Tribunal de Contas da União* - TCU), which acts as the watchdog arm of the Brazilian Congress. As part of a recently released report criticizing her accounting methods, the TCU gave President Rousseff 30 days to explain irregularities found in her 2014 federal government financial statements.

This is an unprecedented maneuver for the TCU, which may be compared to the U.S. Government Accountability Office (GAO). Should the TCU reject President Rousseff's 2014 financial statements, it could constitute legal basis for an impeachment process against her. It is difficult to predict whether the TCU will take such a drastic decision, but as an arm of the legislative branch, it is subject to greater political considerations than a purely judicial agency.

In any case, TCU's request for a formal explanation from President Rousseff is a significant political development and reflects a growing government consensus that fiscal responsibility should to be taken with the utmost seriousness by government and society.