IV

Public Finance

Fiscal and tax policy

In the fiscal and tax policy framework, the measures approved by the National Congress in 2004 were generally aimed at stimulating new investments in strategic areas, in order to sustain the momentum of growth in economic activity. These measures can be classified into four large groups:

1. Measures aimed at reducing taxes on investments and stimulating long-term savings:

a) authorization granted to financial institutions to open current accounts for purposes of investment deposits. This new bank account modality makes it possible for investors to rechannel their funds without having to pay the CPMF, thus optimizing returns on their investments;
b) reduction of the Financial Operations Tax (IOF) from 7% to 4% on life insurance policies and definition of a programmed schedule of reductions designed to diminish this rate to zero in September 2006;
c) broadening of the existent tax exemption on Mortgage Bonds, as well as its extension to Real Estate Credit Bills and Certificates of Real Estate Receivables, when they are held by individual persons, and application of differentiated tax treatment to both fixed income and variable income financial investments; and
d) with regard to Social Security-type benefit plans instituted as of January 1, 2005 and structured into defined or variable contribution modalities, permission for pension fund entities and insurance companies to opt for a tax system in which the amounts paid to participants or to those assisted by such entities in the form of benefits or redemptions of cumulative amounts are subject to the income withholding tax at declining rates that vary from 35%, for resources with periods of accumulation of two years or less, to 10%, for resources with accumulation periods of more than ten years.

2. Measures aimed at reducing the acquisition costs of capital and investment goods in general:

a) institution of the Port Structure Modernization and Expansion Incentive Tax System (Reporto);

b) lengthening of the period for payment of the Industrialized Products Tax (IPI), to be levied monthly instead of every fifteen days, effective as of October 2004;
c) reduction of the IPI rate on capital goods from 5% to 2% and expansion of the list of machines and equipment entitled to tax reductions with inclusion of an additional 29 product lines;
d) institution of the "Invest Now Program", which consists of a reduction in the period for deducting Contribution to Social Security Financing (Cofins) and Social Integration Plan/Program of Civil Service Asset Formation (PIS/Pasep) in the form of tax credits when such are levied on acquisitions of machines and equipment in the period from 10.1.2004 to 12.31.2005, from four to two years, as well as permission for depreciation of such equipment in four years, instead of the previous period of ten years; and
e) creation of the National Industrial Structure Modernization Program (Modermaq), which encompasses financing for acquisitions of machines and equipment and other capital goods, with the objective of generating jobs, increasing productivity and technological development of the national industrial structure.

3. Measure designed to reduce taxation on specific sectors of economic activity, so as to diminish the tax load on foodstuffs and farm products in general:

reduction of the Cofins and PIS/Pasep rates on internal market imports and marketing of agricultural fertilizers and elimination of the levying of these contributions on revenues generated by sales of beans, rice, manioc flour, farm production inputs, vaccines for veterinary use and other products.

4. Measure designed to implement rules applicable to the construction industry market, including new credit and securitization instruments:

institution of an optional and irrevocable special system of taxation applicable to real estate incorporation transactions, during such time as the credit rights or obligations of the incorporating entity with the parties acquiring the real estate included in the incorporation transaction remain in effect.

Aside from these measures, mention should also be made of issue of Provisional Measure 222, dated 10.4.2004, which authorized the executive branch to create the Social Security Revenue Secretariat (SRP) within the structure of the Ministry of Social Security. The major objective of this measure is to achieve greater agility and efficiency in the collection of Social Security revenues. With creation of the Secretariat, the National Social Security Institute (INSS) will henceforward be able to dedicate itself with greater intensity to the activities involved in rendering services to Social Security beneficiaries, concentrating its efforts on improving both the services provided to society and the systems used in granting, maintaining and paying benefits.

At the same time, based on a decision taken by the Federal Supreme Court (STF), regulations were issued on the provisions of Constitutional Amendment 41, dated 12.19.2003, involving the charging of contributions to be paid by civil service retirees and pensioners belonging to any branch of government. As a result, inactive civil servants were obligated to pay 11% of the value of their retirement and pension benefits which exceeds the ceiling imposed on the benefits paid by the INSS to private sector workers.

Law 10,887, dated 6.18.2004, determined that active civil servants will be obligated to contribute 11% of their base pay to their specific civil service social security system. Base pay is understood as the earnings attributed to a position plus any permanent financial advantages granted by law, additional amounts of an individual character or any other advantages, excluding any amounts paid on a nonregular basis. For purposes of calculating retirement benefits, civil servants occupying effective government positions may opt to incorporate the amount received as a consequence of holding a commissioned position or position of trust into the contribution base, duly respecting the ceiling defined at R$2,400.00.

On 6.30.2004, the National Congress approved Constitutional Amendment 44, dated 6.30.2004, which raised the participation of the states and municipalities in the collection of the Contribution on Intervention in the Economic Domain (Cide) from 25% to 29%. It is important to note that state and municipal participation in Cide was authorized by Constitutional Amendment 42, dated 12.19.2003, which went into effect in January 2004.

Law 11,079, dated 12.30.2004, was approved by the National Congress following thirteen months of deliberation. This Law introduced a series of general rules on the tendering and contracting of Public-Private Partnerships (PPP) within the public administration (federal, state and municipal governments, plus the Federal District). The Law defined two modalities of concession contracts formalized within the PPP framework:

a) sponsored concession: consists of the concession of a public service or public works project as defined in Law 8987/1995, when such a system also involves amounts to be paid by the public partner to the private partner, aside from rates charged to users; and
b) administrative concession: consists of a service contract in which the public administration is the direct or indirect user, even though it may involve execution of specific works or the supply and installation of goods.

With the partnership mechanism, the government hopes to attract private investments in order to finance public works projects considered to be of vital importance to driving and ensuring the country’s economic growth. Between 23 and 25 projects are expected to be executed through this type of contract over a period of three years, with estimated investments of R$13 billion. Among the priorities, mention should be made of construction of railway segments and recovery of the nation’s highway network in different regions of the country, together with investments in the port system.

Institution of two other programs of a social character deserves mention:

a) the University for All Program (Prouni), which is designed to grant scholarships for undergraduate courses and continuation of specific training courses at profit-seeking and nonprofit private higher education institutions. Those institutions that adhere to the program will be exempted from payment of the income tax, Social Contribution on Net Profits, PIS/Pasep and Cofins; and
b) National Targeted Productive Microcredit Program (PNMPO), which has the objective of facilitating and expanding access to productive credit on the part of microentrepreneurs. Targeted productive microcredit is defined as credit granted on the basis of a direct relationship between the credit agent and the microentrepreneur at the site of the latter's activity, through:
   i) services provided by persons trained to offer guidance on business management and credit needs, aimed at achieving sustainable development;
   ii) personal contact, among other aspects, during the entire credit period; and
   iii) definition of the value of the credit and the conditions underlying the operation, following evaluation of the activity and of the borrower's debt capacity.

Public sector borrowing requirements

The nonfinancial public sector registered a primary surplus of R$81.1 billion, 4.6% of GDP in 2004, as against R$66.2 billion, 4.3% of GDP in 2003. The increase of 0.3 p.p. of GDP in the 2004 primary surplus reflected growth of 0.49 p.p. in the central government result and 0.11 p.p. in the result for regional governments, together with a reduction of 0.24 p.p. for state-owned companies.

In 2004, the central government registered a surplus of R$52.4 billion, based on a federal government surplus of R$84.7 billion and deficits of R$32 billion in INSS accounts and R$336 million in BCB operations.

The federal government result was a consequence of revenue growth equivalent to 0.87 p.p. of GDP, generated basically by upward movement in the pace of economic activity. It should be stressed that revenue growth was also driven by changes in PIS and Cofins legislation introduced by Law 10,865/2004. This legislation extended this tax to all imported goods and services, effective as of the start of May 2004, with the overall objective of harmonizing internal and external market operations with respect to the levying of these contributions.

Annual growth in 2004 spending was equivalent to 0.47 p.p. of GDP. Transfers to states and municipalities and outlays on personnel and social charges registered declines of 0.03 p.p. of GDP. Moving in the opposite direction, spending on other current and capital outlays increased 0.52 p.p. of GDP. Among other factors, this heading also includes

Table 4.1 – Public sector borrowing requirements

Itemization	2001		2002	
	R$ million	% of GDP[1/]	R$ million	% of GDP[1/]
Total nominal	42 789	3.6	61 614	4.6
Central government[2/]	25 273	2.1	10 029	0.7
States	23 080	1.9	43 797	3.3
Local governments	1 178	0.1	7 696	0.6
State enterprises	-6 742	- 0.6	92	0.0
Total primary	-43 655	- 3.6	-52 390	- 3.9
Central government[2/]	-21 980	- 1.8	-31 919	- 2.4
States	-7 211	- 0.6	-8 560	- 0.6
Local governments	-3 260	- 0.3	-2 073	- 0.2
State enterprises	-11 204	- 0.9	-9 838	- 0.7
Nominal interest	86 443	7.2	114 004	8.5
Central government[2/]	47 253	3.9	41 948	3.1
States	30 291	2.5	52 356	3.9
Local governments	4 437	0.4	9 770	0.7
State enterprises	4 463	0.4	9 929	0.7

(continues)

Table 4.1 – Public sector borrowing requirements (concluded)

Itemization	2003		2004	
	R$ million	% of GDP[1/]	R$ million	% of GDP[1/]
Total nominal	79 030	5.1	47 142	2.7
Central government[2/]	62 150	4.0	27 031	1.5
States	22 936	1.5	27 497	1.6
Local governments	4 067	0.3	6 485	0.4
State enterprises	-10 124	- 0.7	-13 872	- 0.8
Total primary	-66 173	- 4.3	-81 112	- 4.6
Central government[2/]	-38 744	- 2.5	-52 385	- 3.0
States	-11 916	- 0.8	-16 060	- 0.9
Local governments	-1 906	- 0.1	-1 422	- 0.1
State enterprises	-13 608	- 0.9	-11 245	- 0.6
Nominal interest	145 203	9.3	128 253	7.3
Central government[2/]	100 894	6.5	79 417	4.5
States	34 851	2.2	43 557	2.5
Local governments	5 973	0.4	7 906	0.4
State enterprises	3 484	0.2	-2 627	- 0.1

1/ Current prices.
2/ Federal Government, Central Bank and National Social Security Institute.

spending on assistance benefits, particularly those carried out under the terms of the Social Assistance Law (Loas), which increased from R$4.4 billion to R$7.5 billion, and outlays on public investments, which expanded from R$5.1 billion to R$9.2 billion, in 2004. Furthermore, it is important to mention that spending related to other current and capital outlays was pressured by education and health spending. These two headings have their own specific dynamics and are not subject to conditioning factors. Thus, annual outlays on education may not be less than 18% of the overall tax inflow, after deduction of 20% in Nonearmarked Federal Government Resources and constitutional transfers, while disbursements on health activities and services are expected to close at last year's level, plus nominal growth in GDP.

Table 4.2 – Central government primary result

R$ million

Itemization	2002	2003	2004	Change %	
	(a)	(b)	(c)	(b)/(a)	(c)/(b)
Total revenues	321 842	357 891	422 450	11.2	18.0
Treasury revenues	250 815	277 159	328 685	10.5	18.6
Administered revenues[1/]	224 860	246 244	287 924	9.5	16.9
Non administered revenues	25 955	30 915	40 761	19.1	31.8
Social security revenues	71 027	80 732	93 765	13.7	16.1
Total expenditures	289 383	318 407	372 730	10.0	17.1
Treasury expenditures	201 354	211 272	246 978	4.9	16.9
Transfers to states and municipalities	56 138	60 226	67 559	7.3	12.2
Personnel and social charges	73 304	78 068	87 730	6.5	12.4
Other current and capital expenditures	71 912	72 978	91 689	1.5	25.6
Social security benefits	88 029	107 135	125 751	21.7	17.4
Federal government result	32 459	39 484	49 721	21.6	25.9
National Treasury	49 461	65 887	81 707	33.2	24.0
Social security	-17 002	-26 403	-31 986	55.3	21.1
Central Bank result	- 777	- 195	- 336	-74.9	72.5
Primary result (above the line)[2/]	31 682	39 289	49 384	24.0	25.7
Primary result/GDP – %	2.4	2.5	2.8	-	-

Source: Ministério da Fazenda/STN

1/ Deducted from returns and fiscal incentives.
2/ (+) = surplus (-) = deficit.

INSS revenues increased from 5.18% of GDP in 2003 to 5.32% in 2004. The major determinants of this performance were employment growth in the formal market sector and a higher contribution ceiling. Outlays on benefit payments also expanded, moving from 6.88% of GDP to 7.15%, primarily as a consequence of increases of 11.1% in the average value of the benefits paid, reflecting the minimum wage increase, coupled with a rise of 4.08% in the average monthly volume of benefits paid. At the same time, it should be stressed that the heading of "judicially determined payments" also increased; due primarily to payments of suits involving adjustments in retirement benefits.

The result for regional governments remained positive over the entire year of 2004, particularly as a result of the inflow response of the Tax on the Circulation of

Merchandise and Services (ICMS) to the upturn in the pace of economic activity. Deflated by the IGP-DI, growth in these revenues closed the year at 52.7%. As far as spending is concerned, observance of debt limits and restrictions on administrative outlays were determining factors in the continuity of the fiscal performance of this sector.

State-owned companies turned in a primary surplus that was below the 2003 level. This decline reflected the deficit for the first half of the year, when outlays were concentrated in investments and dividend distributions. This tendency reversed course in the second half of the year, as state-owned companies accumulated a surplus of approximately 0.6% of GDP in 2004, compared to 0.9% in the previous year.

Nominal interest appropriated in 2004 totaled R$128.3 billion or 2 p.p. of GDP below the previous year's result. This is a clear indication of a reduction in the Selic rate target accumulated in 2004, as well as a downturn in the debt/GDP ratio observed over the course of the year. It is important to stress that, in 2004, gains obtained in exchange swap operations carried out by BCB closed at R$6 billion, as against R$15.6 billion in 2003.

The strong increase in the nonfinancial public sector primary surplus, coupled with a sharp reduction in interest appropriations, resulted in significant contraction of the

Table 4.3 – Uses and sources – Consolidated public sector

Itemization	2003		2004	
	R$ million	% of GDP	R$ million	% of GDP
Uses	79 030	5.1	47 142	2.7
Primary	- 66 173	- 4.3	- 81 112	- 4.6
Internal interest	126 043	8.1	111 196	6.3
Real interest	91 267	5.9	39 226	2.2
Monetary updating	34 776	2.2	71 969	4.1
External interest	19 160	1.2	17 058	1.0
Sources	79 031	5.1	47 144	2.7
Internal borrowing	94 486	6.1	88 950	5.0
Securities debt	122 438	7.9	68 553	3.9
Banking debt	- 31 361	- 2.0	9 449	0.5
Renegotiation	-	-	-	-
State government	-	-	-	-
Local government	-	-	-	-
State enterprises	-	-	-	-
Others	3 409	0.2	10 949	0.6
Relationship TN/Bacen	-	-	-	-
External borrowing	- 15 456	- 1.0	- 41 806	- 2.4
GDP flows in 12 months[1/]	1 556 182		1 762 499	

1/ GDP at current prices.

nominal nonfinancial public sector deficit to the level of R$47.1 billion, 2.7% of GDP, in 2004. This result is equivalent to 60% and 76% of the cumulative deficits registered in 2003 and 2002, respectively. As a ratio of GDP, the nominal 2004 deficit stands as the best result obtained since the series was first created in 1991.

The cumulative 2004 nominal deficit was financed through issues of security debt totaling R$68.6 billion; monetary base in the amount of R$10.9 billion; and R$9.4 billion expansion in the banking debt. In the opposite direction, there was a reduction of R$41.8 billion in the net external sector debt in the year.

Federal tax and contribution inflow

In 2004, the inflow of federal taxes and contributions totaled R$322.6 billion, compared to R$273.4 billion in the previous fiscal year, corresponding to a real increase of 10.6% using the IPCA as deflator. Revenues administered by the Federal Revenue Secretariat came to R$300.6 billion, while those collected by other public entities, excluding social security contributions on labor earnings which are the responsibility of the INSS, totaled R$22 billion. It is important to emphasize that the sharp inflow gains in 2004 were a consequence of alterations introduced into the legislation covering Cofins and the income tax in the year under analysis.

The Income Tax (IR) inflow climbed to R$102.8 billion or 31.9% of the total, corresponding to real growth of 3.6% compared to the previous year. This result reflected a 7.8% real increase in Corporate Income Tax (IRPJ) revenues, which totaled R$40.3 billion.

Income tax withholdings registered 0.1% real growth in 2004, closing at R$59.7 billion. Inflows on labor earnings and other segments increased 11.7% and 7.4%, respectively, while those levied on capital earnings and remittances abroad decreased 15% and 6.8% in the year. Withholdings on labor earnings reflected the upturn in employment levels as well as court decisions determining that the income tax should be withheld from earnings paid by the party effecting payment. On the other hand, the inflow of taxes on capital earnings and remittances abroad was impacted by reductions in fixed income investments, in the first case, and by exchange stability and it's repercussions on swap operations, in the latter case.

In 2003, the Cofins inflow reached R$76.9 billion, as against R$59.6 billion in the previous year, corresponding to real growth of 20.6%. The major factors underlying this performance were:

a) extension of this tax to imports of goods and services, effective as of 5.1.2004;

b) increase in the rate levied on the revenues of financial institutions from 3% to 4%, effective as of 6.1.2003;
c) withholding of taxes on payments made by public sector entities and companies to corporate entities, resulting in a revenue gain consequent upon the enhanced control exercised by the Secretaria da Receita Federal (SRF).

Table 4.4 – Gross federal revenues

R$ million

Itemization	2002	2003	2004	Change %	
	(a)	(b)	(c)	(b)/(a)	(c)/(b)
Income Tax (IR)	85 803	93 016	102 820	8.4	10.5
Industrialized Products Tax (IPI)	19 799	19 674	22 830	-0.6	16.0
Import Tax (II)	7 972	8 143	9 200	2.1	13.0
Financial Operations Tax (IOF)	4 022	4 450	5 253	10.6	18.0
Contribution to the Financing of the Social Security (Cofins)	52 267	59 565	76 890	14.0	29.1
Social Contrib. on the Profits of Legal Entities (CSLL)	13 364	16 750	19 647	25.3	17.3
Contribution to PIS/Pasep	12 872	17 337	19 454	34.7	12.2
Provisional Contribution on Financial Transactions (CPMF)	20 369	23 046	26 432	13.1	14.7
Contribution on Intervention in the Economic Domain (Cide)	7 243	7 496	7 669	3.5	2.3
Other taxes	19 295	23 881	32 361	23.8	35.5
Total	243 006	273 358	322 556	12.5	18.0

Source: Secretaria da Receita Federal

The IPI inflow totaled R$22.8 billion, for real growth of 8.7% in the year. This result mirrored the significant expansion registered by the industrial sector in 2004, together with volume increases in internal market sales of automobiles and upward movement in tobacco-derived products.

The Social Contribution on Net Profits (CSLL) registered an inflow of R$19.6 billion, for real growth of 9.7% compared to 2004. This figure not only reflected improved business results, was also generated by two other factors:

a) increase in the calculation base from 12% to 32% of gross revenues, effective as of 6.1.2003, applicable to service companies that effect payment of their contributions based on presumed profits; and
b) expansion of the universe of businesses subject to the withholding tax as of 2.1.2004, when the service in question is rendered to public sector entities and companies.

Inflows administered by other public sector entities that are not included in the "Federal Revenue System" totaled R$22 billion and registered real growth of 12.7% in 2004. The

Table 4.5 – Income Tax and Industrialized Products Tax

R$ million

Itemization	2002	2003	2004	Change %	
	(a)	(b)	(c)	(b)/(a)	(c)/(b)
Income Tax (IR)	85 803	93 016	102 820	8.4	10.5
Individuals	4 462	5 103	6 136	14.4	20.2
Corporate entities	33 893	33 833	38 894	-0.2	15.0
Financial institutions	4 589	5 871	6 195	27.9	5.5
Other companies	29 304	27 962	32 699	-4.6	16.9
Withholdings	47 450	54 079	57 790	14.0	6.9
Labor earnings	22 480	26 456	31 523	17.7	19.2
Capital earnings	16 362	19 056	17 281	16.5	-9.3
Remittances abroad	5 371	5 596	5 575	4.2	-0.4
Other earnings	3 237	2 971	3 411	-8.2	14.8
Industrialized Products Tax (IPI)	19 799	19 673	22 830	-0.6	16.0
Tobaco	1 924	1 993	2 305	3.6	15.7
Beverages	1 796	1 899	2 005	5.7	5.6
Automotive vehicles	2 664	2 312	2 965	-13.2	28.2
Other taxes	8 528	8 905	10 378	4.4	16.5
Linked imports	4 887	4 564	5 177	-6.6	13.4

Source: Secretaria da Receita Federal

factor that made the major contribution to this inflow was growth in the inflow of the contribution to the Civil Service Social Security Plan (CPSS). In more specific terms, this involved an increase in the employer contribution from 11% to 22%, coupled with the Federal Supreme Court decision as to the constitutionality of the contribution required from civil service retirees and pensioners.

Federal securities debt

Evaluated in terms of the portfolio position, the federal securities debt outside BCB came to R$810.3 billion, 43.8% of GDP, in December 2004, compared to R$731.9 billion, 45.8% of GDP, at the end of the previous year. The reduction of 2 p.p. of GDP reflected overall net redemptions of R$36.8 billion in 2004, based on net issues of R$49.6 billion in LTN; R$4.7 billion in NTN-B; R$2.1 billion in NTN-F; and R$1.1 billion in NTN-C; together with net redemptions of R$53.2 billion in LFT; R$19.7 billion in National Treasury Note – Series D (NTN-D); R$18.9 billion in Central Bank of Brazil Notes – Special Series (NBCE); and R$1.6 billion in LFT – Series B (LFT-B).

In December 2004, National Treasury securities totaled R$1099.5 billion, of which R$302.9 billion were held by BCB and R$796.7 billion were held outside the monetary authority. BCB securities added up to R$13.6 billion, 1.6% of the total securities debt on the market, as compared to R$30.7 billion in the previous year, when it accounted for 4.2% of the debt. The decline in this participation reflected net redemptions of NBCE and 8.1% appreciation of the real against the dollar in 2004.

Table 4.6 – Federal securities – Portfolio position

Balances in R$ million

Itemization	2000	2001	2002	2003	2004
National Treasury liabilities	555 908	687 329	838 796	978 104	1 099 543
Central Bank portfolio	130 897	189 442	282 730	276 905	302 863
LTN	37 243	27 970	45 775	101 376	126 184
LFT	90 595	114 986	145 614	99 646	117 405
NTN	1 812	44 943	89 664	74 026	57 275
Securitized credits	1 246	1 543	1 678	1 857	1 999
Outside the Central Bank	425 011	497 887	556 066	701 199	796 680
LTN	75 399	48 791	13 596	91 055	159 960
LFT	262 301	322 153	372 584	443 180	457 757
BTN	64	67	100	74	62
NTN	46 233	87 488	127 399	126 721	133 700
CTN/CFT-A/CFT-B/CFT-C/CFT-D/CFT-E	14 280	19 366	19 214	18 236	17 343
Securitized credits	21 119	16 044	15 406	15 001	21 103
Agrarian debt	3 108	1 689	5 761	4 879	4 345
TDA	2 495	2 276	2 005	2 052	2 411
CDP	14	11	1	1	0
Central Bank liabilities	85 686	126 198	67 125	30 659	13 584
LBC	-	-	-	-	-
BBC/BBCA	-	-	-	-	-
NBCE	83 745	124 707	67 125	30 659	13 584
NBCF	1 942	1 490	-	-	-
NBCA	-	-	-	-	-
Outside the Central Bank – Total	510 698	624 084	623 191	731 858	810 264
In % of GDP	44.2	49.7	39.3	45.8	43.8

With regard to the distribution of securities by indexing factor, the participation of preset papers in the total securities debt rose from 12.5% of the total in December 2003 to 20.1% in December 2004, due primarily to net issues of LTN and NTN-F. The participation of Selic-indexed securities dropped from 61.4% to 57.1%, reflecting net LFT redemptions. The share of exchange-indexed papers dropped from 10.8% to 5.2%, reflecting redemptions of NBCE and NTN-D, as well as appreciation of the real against the dollar. Parallel to this, the participation of securities indexed to the Reference Rate (TR) moved from 1.8% to 2.7%, while the participation of price-indexed securities rose from 13.5% to 14.9%.

The amortization schedule of the federal securities debt on the market was distributed as follows in December 2004: R$359.8 billion, 44.4% of the total, to mature in 2005; R$218.1 billion, 26.9%, in 2006; and, R$232.4 billion, 28.7%, as of January, 2007.

Table 4.7 – Federal public securities

Percentage share by indexator – Portfolio position

Index numbers	2000	2001	2002	2003	2004
Total – R$ million	510 698	624 084	623 191	731 858	810 264
Foreign exchange	22.3	28.6	22.4	10.8	5.2
Reference Rate (TR)	4.7	3.8	2.1	1.8	2.7
IGP-M	1.6	4.0	7.9	8.7	9.9
Over/Selic	52.2	52.8	60.8	61.4	57.1
Preset	14.8	7.8	2.2	12.5	20.1
Long-term Interest Rate (TJLP)	0.0	0.0	0.0	0.0	0.0
IGP-DI	4.4	3.0	3.1	2.4	1.8
INPC	0.0	0.0	0.0	0.0	0.0
IPCA	-	-	1.5	2.4	3.1
Others	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0

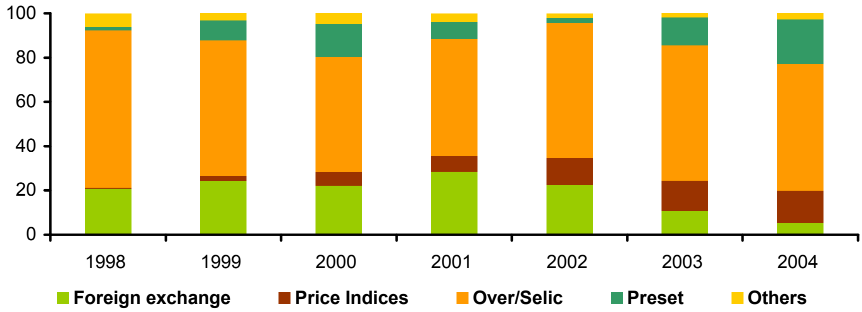
The average duration of federal public securities issued by BCB and the National Treasury in public offers closed at 11.31 months in December 2004, compared to 10.85 months in December 2003. When separated by issuing entity, the average duration of BCB papers closed at 15.77 months, while that of National Treasury securities came to 11.22 months.

Total exposure in exchange swap operations carried out up to December 2004 came to R$38.3 billion, compared to R$82.3 billion in December 2003. Viewed in terms of the accrual criterion, the cumulative results of these operations in the year, encompassing the difference between DI profitability and exchange variation plus coupons, closed at a positive figure of R$7.6 billion for the BCB. Viewed according to the cash criterion, the cumulative positive result in the year was R$6 billion.

Graph 4.1

Federal public securities

Participation by indexing factor



Net Public Sector Debt (DLSP)

At the end of 2004, DLSP totaled R$957 billion, 51.8% of GDP, compared to R$913.1 billion, 57.2% of GDP, at the end of 2003.

The sharp reduction of 5.4 p.p. of GDP in the DLSP/GDP ratio interrupted the steady upward trend registered by this indicator since 1994. This performance was generated by a combination of positive factors, including continued fiscal equilibrium in all segments, economic growth, lesser interest appropriations and exchange rate stability.

It is important to stress that the public sector fiscal effort was targeted specifically to amortization of the internal securities debt and the external debt, since these segments are particularly important in terms of cost. In the case of the internal securities debt, the highlight was the volume of net redemptions of exchange-indexed securities. To understand the importance of this it is enough to state that the participation of these papers in the total securities debt dropped from 20.5% in December 2003 to 9.3% at the end of 2004, already considering exchange swap operations. These alterations reflect the public debt management strategy adopted with the aim of sharply reducing the level of vulnerability to market risk.

The gross general government debt, which includes the federal government (INSS, state governments and municipal governments), totaled R$1331.8 billion, 72.1% of GDP, at the end of 2004, as against R$1228.6 billion, 76.9% of GDP, at the end of the preceding year. The decline of 4.8 p.p. in relation to GDP was caused, above all, by a drop of 3 p.p. in the federal government external debt.

Table 4.8 – Public sector net debt growth

Itemization	2001		2002	
	R$ million	% of GDP	R$ million	% of GDP
Total net debt – Balance	660 867	52.6	881 108	55.5
Net debt – Growth accumulated in the year	97 704	3.5	220 241	2.9
Conditioning factors (flows accumulated in the year):[1/]	97 704	7.8	220 241	13.9
Public sector borrowing requirements	42 789	3.4	61 614	3.9
Primary	- 43 655	-3.5	- 52 390	-3.3
Nominal interest	86 443	6.9	114 004	7.2
Exchange adjustment[2/]	37 814	3.0	147 225	9.3
Domestic securities debt indexed to exchange rate[3/]	19 182	1.5	76 662	4.8
External debt	18 633	1.5	70 564	4.4
External debt adjustment – Others	- 383	0.0	753	0.0
Acknowledgement of debt	18 465	1.5	14 286	0.9
Privatizations	- 980	-0.1	- 3 637	-0.2
GDP Growfh effect – Debt[4/]		-4.2		-11.0
GDP accumulated in 12 months – Valued[5/]	1 255 658		1 587 584	

(continues)

Table 4.8 – Public sector net debt growth (concluded)

Itemization	2003		2004	
	R$ million	% of GDP	R$ million	% of GDP
Total net debt – Balance	913 145	57.2	956 994	51.8
Net debt – Growth accumulated in the year	32 037	1.7	43 848	-5.4
Conditioning factors (flows accumulated in the year):1/	32 037	2.0	43 848	2.4
Public sector borrowing requirements	79 030	4.9	47 142	2.6
Primary	- 66 173	-4.1	- 81 112	-4.4
Nominal interest	145 203	9.1	128 253	6.9
Exchange adjustment2/	- 64 309	-4.0	- 16 194	-0.9
Domestic securities debt indexed to exchange rate3/	- 22 715	-1.4	- 3 336	-0.2
External debt	- 41 594	-2.6	- 12 858	-0.7
External debt adjustment – Others	16 712	1.0	7 137	0.4
Acknowledgement of debt	604	0.0	6 516	0.4
Privatizations	0	0.0	- 753	0.0
GDP Growth effect – Debt4/		-0.3		-7.8
GDP in R$ million5/	1 596 846		1 847 872	

1/ Net accumulated debt growth as percentage of GDP when considering all factors taken together GDP, divided by the current GDP accumulated in the last 12 month period valuated, calculated by the formula: (∑CondictioningFactors/GDPAccumulatedIn12Months)*100. Not reflecting debt growth as percentage of GDP.

2/ Indicates the sum of the monthly impacts up to the reference month.

3/ Includes adjustment of rate between the basket of currencies composing international reserves and the external debt as well as other adjustments in the external area.

4/ It takes into account the change in the ratio debt/GDP due to growth observed in GDP, calculated by the formula: Dt-1/(PIB present month/PIB base month)-Dt-1.

5/ Annual GDP at December prices deflated by the centered IGP-DI based on a series published by the IBGE**.**

Table 4.9 – Net debt of the public sector

Itemization	2003		2004	
	R$ million	% of GDP	R$ million	% of GDP
Fiscal net debt (F=D-E)	652 560	40.9	699 702	37.9
Internal debt adjustment (E)	129 361	8.1	126 025	6.8
Fiscal net debt with exchange devaluation (E=A-B-C-D)	781 921	49.0	825 727	44.7
External debt adjustment (D)	101 708	6.4	95 988	5.2
Inventory adjustment (C)	93 245	5.8	99 760	5.4
Privatization adjustment (B)	- 63 729	-4.0	- 64 482	-3.5
Total net debt (A)	913 145	57.2	956 994	51.8
Federal government	584 544	36.6	610 075	33.0
Banco Central do Brasil	- 5 796	-0.4	- 8 600	-0.5
States	278 016	17.4	305 961	16.6
Local governments	38 703	2.4	45 098	2.4
State enterprises	17 678	1.1	4 460	0.2
Domestic debt	726 688	45.5	818 062	44.3
Federal government	365 776	22.9	411 878	22.3
Banco Central do Brasil	52 694	3.3	64 480	3.5
States	261 587	16.4	289 981	15.7
Local governments	36 098	2.3	42 447	2.3
State enterprises	10 533	0.7	9 277	0.5
External debt	186 458	11.7	138 931	7.5
Federal government	218 767	13.7	198 197	10.7
Banco Central do Brasil	- 58 490	-3.7	- 73 080	-4.0
States	16 429	1.0	15 980	0.9
Local governments	2 605	0.2	2 651	0.1
State enterprises	7 146	0.4	- 4 817	-0.3
GDP in R$ million[1/]	1 596 846		1 847 872	

1/ Annual GDP at December prices deflated by the centered IGP-DI based on a series published by the IBGE.

Social Security

In the year under analysis, the General Social Security System (RGPS) registered a nominal deficit of R$32 billion, 21% more than in the previous year. Excluding transfers to third parties, net inflow came to R$93.8 billion, with outlays of R$125.8 billion on Social Security benefits. As a proportion of GDP, the annual deficit closed 0.12 p.p. higher than in 2003, with 1.82% of GDP.

The net 2004 inflow was the largest in history, reflecting growth of 16.2% compared to 2003. The major determinants of this growth were:

Table 4.10 – Gross and net government debt[1/]

Itemization	2003		2004	
	R$ million	% of GDP	R$ million	% of GDP
Net public debt	913 145	57.2	956 994	51.8
Net general government debt	901 263	56.4	961 133	52.0
Gross general government debt	1 228 569	76.9	1 331 758	72.1
Internal gross debt	987 116	61.8	1 111 246	60.1
Foreign gross debt	241 453	15.1	220 512	11.9
Federal government	222 418	13.9	201 881	10.9
State government	16 429	1.0	15 980	0.9
Local government	2 605	0.2	2 651	0.1
Assets of general government	- 327 306	- 20.5	- 370 625	- 20.1
Internal assets	- 323 655	- 20.3	- 366 941	- 19.9
Available assets of general government	- 136 461	- 8.5	- 175 855	- 9.5
Investment of social security system	- 860	- 0.1	- 289	0.0
Tax collected (not transferred)	- 1 587	- 0.1	- 745	0.0
Demand deposits	- 4 371	- 0.3	- 3 965	- 0.2
Available assets of fed. govern. in Banco Central	- 120 190	- 7.5	- 158 232	- 8.6
Investment in the banking system (states)	- 9 454	- 0.6	- 12 624	- 0.7
Investment in funds and financial programs	- 58 132	- 3.6	- 53 298	- 2.9
Credits with public enterprises	- 29 215	- 1.8	- 24 970	- 1.4
Other federal government's credits	- 25 624	- 1.6	- 25 800	- 1.4
Laborer assistance fund (FAT)	- 74 223	- 4.6	- 87 018	- 4.7
Foreign credits	- 3 651	- 0.2	- 3 683	- 0.2
Federal government	- 3 651	- 0.2	- 3 683	- 0.2
State government	-	-	-	-
Local government	-	-	-	-
Banco Central net debt	- 5 796	- 0.4	- 8 600	- 0.5
Public enterprises net debt	17 678	1.1	4 460	0.2
GDP in R$ million[2/]	1 596 846		1 847 872	

1/ Includes federal, state and local government debt, with other economic agents, including the Banco Central.
2/ GDP of the last twelve months, at prices of month indicated. Centered IGP-DI deflator (geometirc mean of IGP-DI variation in the month and in the following month.

a) positive growth in formal market employment in 2004, aiding in improving overall wages and, consequently, generating increased current Social Security revenues, which expanded 9.5% in the year;
b) annual growth of 14.8% in the recovery of Social Security credits from debtors of the system; and
c) increase in the RGPS ceiling from R$1,869.34 to R$2400, effective as of January 2004, thus expanding the contribution base and raising current revenues.

Table 4.11 – Social Security – Cash flow

R$ million

Itemization	2002	2003	2004	Change %	
	(a)	(b)	(c)	(b)/(a)	(c)/(b)
Revenues	105 032	122 227	160 000	16.4	30.9
Banking inflow	76 080	86 588	101 126	13.8	16.8
Other revenues	361	602	2 610	66.8	333.4
Revenue anticipation	2 939	- 3 238	6 885	-	-
Federal government transfers	25 652	38 275	49 380	49.2	29.0
Expenditures	102 145	123 359	151 742	20.8	23.0
Social security benefits	88 029	107 135	125 751	21.7	17.4
Non-social security benefits	4 083	5 062	8 168	24.0	61.3
Other expenditures	4 980	5 304	10 463	6.5	97.3
Transfers to third parties	5 053	5 857	7 360	15.9	25.6
Cash result	2 887	- 1 131	8 259	...	...
Social Security balance	- 17 002	- 26 405	- 31 985	...	...

Source: Ministério da Previdência e Assistência Social

It is also important to note that revenues generated by business contributions accounted for 77.6% of the overall net inflow in 2004.

The primary causes of growth in outlays on Social Security benefits were as follows:

a) the impact of the real minimum wage increase, resulting in upward movement in the real value of the Social Security benefit floor. The average value of the benefits paid by the Social Security system rose 8.5% above inflation, moving from R$459.74 in 2003 to R$498.68 in 2004;
b) natural growth in the stock of benefits; and
c) increase of 185% in outlays on judicially determined payments, compared to 2003.

In 2004, the Social Security system paid 23.1 million benefits to those insured by the system, 5.9% more than in the previous year. Of this total, 19.7 million corresponded to Social Security benefits (retirements, pensions by reason of the death of the insured party, maternity assistance, among others), 757 thousand accident benefits and 2.6 million assistance benefits granted to the elderly, the handicapped, and others.

A comparison of 2004 averages with those of the previous year points to growth of 428.3 thousand retirements, 296.9 thousand illness assistance benefits and 267.4 thousand benefits granted under the terms of Loas, reflecting respective rates of growth equivalent to 3.6%, 31.8% and 16.4% in the period under analysis.

In the Loas framework, additional benefit grants to the elderly came to 193.6 thousand benefits, for annual growth of 30.8%. This expansion reflected the cutback in the minimum age defined in the Law on the Elderly from 67 to 65 in order to qualify for this benefit.

Illness assistance benefits continued on the growth curve that has marked the last four years. From 2000 to 2004, annual outlays under this heading jumped from R$2 billion to R$9 billion, raising the participation of these outlays in overall benefits paid by the system from 7.2% to 7.5%.

In 2004, inflows generated in urban and rural areas came to R$92.8 billion and R$3.2 billion, respectively, while outlays on benefits totaled R$104.9 billion and R$23.9 billion, in the same order. The ratio between inflows and benefit payments was 88.5% in urban areas as against 13.4% in rural areas.

State and municipal finance

Federal government transfers to the states and municipalities added up to R$67.6 billion in 2004, 12.2% more than in the preceding year. The major factors underlying this growth were inflows of the income tax and the IPI, which are used as the basis for calculating constitutionally determined transfers, coupled with state participation of 25% in the Cide inflow as of January 2004.

Table 4.12 – Federal government onlendings to states and municipalities

R$ million

Itemization	2002	2003	2004	Change %	
	(a)	(b)	(c)	(b)/(a)	(c)/(b)
Constitutional onlendings (IPI, IR and others)	44 596	46 243	51 138	3.7	10.6
Export Compensation Fund	3 953	3 900	4 295	-1.3	10.1
Cide transfers	-	-	1 109	-	-
Others[1/]	7 591	10 083	11 015	32.8	9.2
Total	56 140	60 226	67 557	7.3	12.2

Source: Ministério da Fazenda/Secretaria do Tesouro Nacional

1/ Contribution of education benefit, Fund for the Support and Development of Primary Education and Enhancement of the Teaching Career (Fundef), petrol royalties and other onlendings.

With regard to the sources of funding, transfers are grouped into four segments:

a) constitutional transfers (IPI, income tax and others): R$51.2 billion;
b) Export Compensation Fund (L.C. 87/1996): R$4.3 billion;

c) Cide transfers (E.C. 42/2003): R$1.1 billion; and
d) others: R$11 billion.

The heading of constitutional transfers refers to State and Municipal Revenue Sharing Funds (FPE/FPM), North, Northeast and Central West Constitutional Financing Funds (FNO, FNE and FCO) and the Industrialized Product Export Compensation Fund (FPEX). The Export Compensation Fund refers to reimbursement of ICMS inflow losses caused by reductions in taxation on exports of semimanufactured and primary products. "Other transfers" encompass payments of royalties for the working of oil deposits, federal government contributions to the Fund for the Support and Development of Primary Education and Enhancement of the Teaching Career (Fundef), as well as the share corresponding to the Education Wage Contribution.

In 2004, the ICMS inflow totaled R$138.2 billion, reflecting real growth of 5.7% in the year, using the IGP-DI as deflator. In São Paulo, the total inflow came to R$45.9 billion, 33.3% of the overall inflow of this tax and real growth of 4.1% compared to the previous year. The other four states that turned in significant levels of tax inflows were Rio de Janeiro and Minas Gerais, both of which closed with figures in the range of R$13.1 billion; Rio Grande do Sul, R$9.6 billion; and Paraná, with R$7.8 billion. The sum total ICMS revenues obtained by these five states accounted for 64.9% of the total national inflow.

Table 4.13 – Payment of the Tax on the Circulation of Merchandise and Services (ICMS)

R$ million

Itemization	2002	2003	2004	Change %	
	(a)	(b)	(c)	(b)/(a)	(c)/(b)
São Paulo	37 254	40 289	45 922	8.1	14.0
Rio de Janeiro	10 409	11 181	13 052	7.4	16.7
Minas Gerais	9 544	11 026	13 222	15.5	19.9
Rio Grande do Sul	7 441	8 989	9 638	20.8	7.2
Paraná	5 787	6 710	7 824	15.9	16.6
Bahia	5 154	5 871	7 133	13.9	21.5
Santa Catarina	3 858	4 663	5 258	20.9	12.8
Goiás	3 020	3 699	3 978	22.5	7.6
Pernambuco	2 865	3 178	3 667	10.9	15.4
Espírito Santo	2 382	2 935	3 732	23.2	27.2
Other states	17 270	20 787	24 815	20.4	19.4
Total	104 984	119 328	138 241	13.7	15.9

Source: Ministério da Fazenda/Confaz