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Unpaid commitments and loss of budgetary credibility

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This article discusses the use of unpaid commitments and its impacts on the credibility and transparency of public finances. Based on a typification of the four types of existing carry-over in current Brazilian regulation, the article shows evidence of the emergence of a "parallel budget" in the three levels of government with regulation and external control issues. The development of the balances and enrollment of the unpaid commitments was proxied by the sum of these accounts in the Federal Government balance sheet, as well as in 26 States and the Federal District, and for 4,100 cities. Additionally, the interpretation given by the Courts of Auditors for unpaid commitments usage by governments without financial ballast was observed as well as the level of transparency given by those governments with the larger amounts of unpaid commitments. The results indicate that, besides the growing debt, the weak regulation of unverified unpaid commitments is seriously reducing the credibility and transparency of the budget at all levels of government.

Keywords: unpaid commitments; public budget; *carry-over*; indebtedness; transparency.

Restos a pagar e a perda da credibilidade orçamentária

O artigo discute o uso da inscrição em restos a pagar e seus impactos na credibilidade e na transparência do orçamento público. A partir de uma tipificação dos quatro tipos de *carry-over* existentes na regulação brasileira, articularam-se evidências do surgimento de um "orçamento paralelo" nos três níveis de governo com aspectos de regulamentação e controle externo. A evolução dos saldos e da inscrição de restos a pagar foi captada pelos saldos dessas contas no governo federal, nos governos de 26 estados e Distrito Federal, e em cerca de 4.100 municípios. Adicionalmente, observaram-se a interpretação dada pelos Tribunais de Contas para a inscrição em restos a pagar sem lastro financeiro, assim como o nível de transparência dada pelos governos com maiores saldos de restos a pagar. Os resultados indicam que, além do crescente endividamento, a fraca regulação sobretudo dos restos a pagar não processados está reduzindo seriamente a credibilidade e a transparência do orçamento em todos níveis de governo.

Palavras-chave: restos a pagar; orçamento público; *carry-over*; endividamento, transparência.

Compromisos pendientes y la credibilidad del presupuesto público

El artículo debate el uso de la inscripción en restante a pagar y sus impactos en la credibilidad y en la transparencia del presupuesto público. A partir de una tipificación de los cuatro tipos de *carry-over* existentes en la reglamentación brasileña, se articularon evidencias del surgimiento de un "presupuesto paralelo" en los tres niveles del gobierno con aspectos de reglamentación y control externo. La evolución de los saldos y de la inscripción en restante a pagar fue captada de los saldos de tales cuentas en el gobierno federal, en los gobiernos de 26 estados y el Distrito Federal, y cerca de 4.100 municipios. Además, se observó la interpretación dada por los Tribunales de Cuentas para la inscripción en restante a pagar sin lastre financiero, así como el nivel de transparencia dada por los gobiernos con mayores saldos de restante a pagar. Los resultados indican que, además del creciente endeudamiento, la débil reglamentación, sobre todo de los restantes a pagar no-tramitados, está reduciendo seriamente la credibilidad y la transparencia del presupuesto en todos los niveles de gobierno.

Palabras clave: compromiso pendiente; presupuesto público; *carry-over*; endeudamiento; responsabilidad.

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1. INTRODUCTION

Balanced budget has been a frequent object of analysis in Brazil. Sixteen years after the Fiscal Responsibility Law (FRL) came into force in the country, the nation is facing serious threat to the fiscal sustainability of governments. A balanced budget — for the average person — means not spending more than what it is made in a year (or total expenses equal to or less than total revenues). However, the use of the accounting mechanism of 'carry-over' or 'deficit carry-over' when registering values in budget exercises, makes management of the balance and obtaining a clear notion of the fiscal result in government difficult.

The amount of unpaid commitments (in Portuguese "*restos a pagar*") is critical in several countries, and the recurrent use of this practice may indicate a weakness in regulation in one of the phases of the financial cycle (Flynn and Pessoa, 2014:8-10). Thus, the consequences of increasing the register of unpaid commitments as financial liabilities go beyond the mere indebtedness of a government. Adjusting the following year's budget with the credits or deficits carried over from the current year leads to less transparency and loss of credibility of the budget.

In the last decade, there has been a continuous increase in unpaid commitments in federal, state and municipal governments (Santos et al., 2012), which is seen as one of the "great problems of the Brazilian budget and financial execution" (Alves, 2011:8), suggesting that the controls over the rules regarding fiscal discipline have not had the expected effect. The total federal government's unpaid commitments increased by 277% in inflation-adjusted amounts from 2003 to 2014, from R$ 33 to R$ 227 billion (or 577% in nominal values). In 2013 and 2014, technical personnel from the National Treasury Secretariat (STN) warned the Presidency of the Republic that the surplus obtained came partially due to the use of unpaid commitments, but "at some point the skeletons in the closet will come to light"[1]. Currently, more than half of the execution of public investments by the federal government has been made via unpaid commitments, through credits authorized in previous budgets (Almeida, 2013:129). In the states and municipalities, the use of unpaid commitments from 2003 to 2014 increased by 161% and 242%, respectively.

The origin of such growth, as observed in international experiences (Flynn and Pessoa, 2014), may be a combined result of a) opportunistic actions by governments facing budgetary pressures; b) gaps in the regulation of fiscal discipline; and c) low coercion from the Courts of Accounts (Melo et al., 2014). The FRL does not expressly limit[2] the use of unpaid commitments by the government; thus, public managers could mitigate external pressures in the budget without harming the government's short-term fiscal and financial performance, as well as postponing payments (Almeida, 2014:167).

In Brazil, "unpaid commitment" is, in general, an issue discussed in nationwide research as a measure of indebtedness. It is also associated with accounting or fiscal maneuvers (Augustinho et al., 2013) and classified as a form of 'creative accounting' (Almeida, 2011; Melo et al., 2014) in order to bypass the regime of fiscal discipline in force. As far as these authors are aware, the issue has not been associated with the issue of regulating the mechanism of budget deficit or credit carry-over. Internationally, unpaid commitments are considered a response to crisis (Flynn and Pessoa, 2014), as observed in central and local governments in Italy in the late 1990s (Reviglio, 2001). It is also considered a way to obtain better budgetary results (Dietrichson and Ellegård, 2015) and as evidence of weakness in the financial cycle (Lienert and Sarraf, 2001; Flynn and Pessoa, 2014).

The purpose of this article is to classify the regulation of unpaid commitments in Brazil as a type of 'carry-over' and discuss the impacts to the credibility and transparency of the budget. Starting from the classification of the mechanism in Brazil, the article connects the use of "verified unpaid

[1] Note no. 5/Gecap/Copec/Supof/STN/MF-DF; Technical Note 1/2014/Gecap/Copec/Supof/STN/MF-DF.
[2] Article 31 of the bill of the Fiscal Responsibility Law (FRL) portrayed the limits of unpaid commitments. However, the article was absent in the version of the law that passed.

commitment" (VUC) and "unverified unpaid commitment" (Uvuc) with the emergence of a "parallel budget" given the gaps in regulation and the position of the Courts of Accounts. The study captured the evolution of the use of VUC and Uvuc by the balances and registers of these accounts in the federal government (2000-14), the governments of 26 states and the Federal District (2000-14) and about 4,100 municipalities (1998-2014). The interpretation of the Courts of Accounts for the register of unpaid commitments without financial support was observed analyzing previous opinions for government accounts issued by the Courts of Accounts themselves. The study observed the transparency practices adopted by the governments who have greater commitments to pay in order to assess the transparency given to the execution of the expenses made through unpaid commitments.

The article presents a literature review on budget credits and deficits carry-over. Subsequently, it presents the institutional context of four forms of ongoing carry-over in Brazil, including "unpaid commitments". The article also presents the emergence of a "parallel budget" with the continuous growth of the use of unpaid commitments in the federal, state and municipal governments, as well as the current position of the Courts of Accounts regarding this issue. Finally, it discusses the impacts on the budget's credibility and transparency, referring to the new Finance Law that is in debate in the National Congress of Brazil.

2. LITERATURE ON BUDGET CARRY-OVER

The literature on balanced budget requirements proposes the combined use of several mechanisms for achieving financial sustainability of governments at all levels (national, state and local governments). The main issue is how constitutional rules for fiscal discipline are effective (Smith and Hou, 2013; Azzimonti et al., 2016), and whether to adopt more or less rigid budgetary rules. Some studies point out that a no deficit carry-over rule (Bohn and Iman, 1996:8) is a more effective rule in comparison to others, when it comes to containing expenses and achieving a balanced budget (Smith and Hou, 2013). However, harsh budget-balancing rules may lead policymakers to take other unregulated actions to deal with fiscal crises, such as asset sales or accounting manipulation, as observed by Costello et al. (2017) in state governments in the United States.

The carry-over issue deals with reducing the rigidity of the annual budget, where the year's revenues should strictly support the expenses of the same fiscal year (Caiden, 1982). The complete rigidity in the association of expenses and revenues in the year has side effects. The cancellation of rights to make use of resources unused in the previous fiscal year, which is expressed in the saying "use it or lose it" by Liebman and Mahoney (2013), leads to inefficient use of resources (Alves, 2011; Liebman and Mahoney, 2013). In addition, this rule encourages solutions to extend the use of the resources beyond the fiscal year (Douglas and Franklin, 2006). The situation of unused resources at the end of a fiscal year may occur either because of mismanagement or because of intentional postponement, such as a "buffer" to the uncertainties of the year. The pressure for the application of resources at the end of the fiscal year can be enhanced by the questioning of the legislative branch whether the resource was allocated properly (Freixas, Guesnerie and Tirole, 1985).

As a way of relaxing the rigidity of the budget, mechanisms for transposing deficits and credits between periods emerged, mainly from 1980 (Olson, 1998). The carry-over of balances or budget credits between the fiscal years would allow for accommodating the estimation and allocation errors in the different periods (Lienert and Ljungman, 2009). This would be possible by reducing the discontinuity between budget periods: (i) by carrying-over or carrying-forward available budget balances, extending their validity beyond the time originally considered; and (ii) by carrying-over deficits for subsequent periods (Lienert and Ljungman, 2009). However, in order to maintain financial sustainability, the mechanism should require that part of the revenues and availabilities of the following year be reserved to accommodate the credits and deficits carried-over from previous fiscal year(s).

The empirical literature on this issue advises about the adequate implementation of carry-overs. The literature points out that their positive effect is associated to a good regulation of the mechanism. The use of deficit carry-over and how it is considered in the measurement of goals related to fiscal discipline vary with the country and the level of government (federal, state or municipal). Sutherland, Price, and Joumard (2005:146) present the differences between subnational governments in Germany, Netherlands, and Denmark — in which the guarantee of a balanced budget showing fiscal discipline is based on data from the executed budget and do not allow deficit carry-over — and local governments in Spain — in which it is possible to carry-over deficit for the following three years.

Other studies point to the benefits of proper regulation of the mechanism. Comparing states in the US. Mahdavi and Westerlund (2011) and Smith and Hou (2013) conclude that the adoption of carry-over, together with controls over supplementary appropriations is particularly effective in balancing the budget. The reason for this is that governments, when proposing the budget to the appreciation of the legislative branch, as they are preventing from compensating deficit of a fiscal year in the following years, results in reducing spending. Finally, Dietrichson and Ellegård (2015), analyzing Swedish municipalities, find that the fiscal surplus is higher in municipalities where carry-over is well regulated. In this case, local committees are allowed to carry-over financial surpluses but are forced to carry-over deficits between fiscal years.

3. METHODOLOGY

In order to analyze the impact of the use of verified and unverified unpaid commitments in the credibility and transparency of the budget as a case of carry-over, it is important to go beyond simple indebtedness by the observation of financial liabilities. Given the warnings made regarding the impact of the design of fiscal rules on the response of the agents (Azzimonti et al., 2016; Smith and Hou, 2013; Flynn and Pessoa, 2014), the study first identified the relevant dimensions – classification – of the carry-over regulation as it is adopted in Brazil.

Analysis of documents related to Brazilian budget legislation was conducted, and four forms of carry-over were identified, two of which were "unpaid commitments". Such regulation, associated with the opinions issued by the Courts of Accounts – adopting an inductive approach – led to six dimensions of regulation and one of external control, thus discriminating the attributes of the four forms of carry-over identified. The preliminary proposition suggests that verified unpaid commitments (VUC) and unverified unpaid commitments (Uvuc) are in an institutional context that is unfavorable to the regime of fiscal discipline, given the regulatory gaps and the lower external control in place.

From this preliminary proposition, the reality of the use of VUC and Uvuc was analyzed for the national and subnational governments (states and municipalities) in Brazil, articulating with evidence of the emergence of the "parallel budget", the regulatory gaps and the positions of the Courts of Accounts.

The study employed three sources of evidence. First, the annual data of the federal government balance and unpaid commitments (2000–2014), the same data for the 26 state and Federal District governments (2000–2014), as well as for more than 4,100 municipalities (1998-2014). Data were obtained in the systems of the National Treasury Secretariat (Siconfi and SISTN), and complemented by formal requests made through the Access to Information Act. Second, the study analyzed the practices of disclosure of budget execution via unpaid commitments by states and municipalities, among the cases with the highest Uvuc in the year 2014.

Finally, the third source of evidence was the analysis of the content of previous opinions on governments' accounts, issued by Courts of Accounts at federal, state and municipal levels, seeking to understand how the Courts have interpreted the use of unpaid commitments by governments. The study analyzed opinions of the last three fiscal years (2010-13) for the Presidency of the Republic, and four state and five municipal governments that had the highest relation between VUC and financial availability for the year 2014.

It should be noted that the analysis in the case of the states and Federal District, as well as the municipalities is aggregated by the means of VUC, Uvuc and revenues (per inhabitant, inflation-adjusted (IPCA)). The intention was not to explain the greater or lesser use of unpaid commitments at the individual level of governments. Thus, aggregate analysis is sufficient to understand the carry-over behavior at national and subnational governments.

4. BALANCED BUDGET AND CARRY-OVER IN BRAZIL

Over time, the budget regulation in Brazil in its various rules and norms, together with the understanding of professionals, lawyers and academics, ended up establishing "budgetary principles". These principles somehow guide the understanding of control bodies, legislators and governments, and coupled with constitutional and legal definitions, they represent the country's fiscal regulation. Two of these principles are especially important for the analysis on credit and deficit carry-over: principle of equilibrium and principle of annuality.

According to the principle of equilibrium, which is the most important rule in the literature on requirements for balanced budgets, governments must use resources as there are revenues to support expenses. Brazilian law Nº 4,320/1964 does not present the principle as a rule, which appeared expressly in the Federal Constitution of 1967 (Article 66). However, the principle was suppressed in the Federal Constitution of 1988, which specified only the balance between credit operations and capital expenditures. More than 10 years later, the FRL brought contingency measures to recover the fiscal balance (Article 9), as well as ways to measure it. On the other hand, the FRL left to the government the responsibility to determine how this would be done (Article 4), and even the level of deficit that would be considered a loss in the balance.

Since 1964, by Law Nº. 4,320, the rigidity in the principle of annuality was reduced by mechanisms of credit and deficit carry-over. By this principle, resources allocated for public policy and other administrative functions in a budget exercise should be spent over a defined period of time, usually a fiscal year (Di Francesco and Alford, 2016). In Brazil, the exercise of the 12–months of the calendar year, although the credits authorized for the year belong exclusively to that year,[3] they can be taken to the following year in four forms of carry-over (chart 1). Each of the forms has specific characteristics regarding disclosure obligation, automatic adjustments in the following fiscal year affected by the occurrence of the expense, whether or not it is computed within the limits of the FRL, whether there is understanding and action form external control.

The first two forms of carry-over are (i) the reopening budgetary appropriation (*créditos especiais* in Portuguese) in the next budgetary exercise. These are expenditures authorized in the current fiscal year that can be reopened the following year, without the need for a new authorizing law; and (ii) the financial surplus registered on the balance sheet, which can be used to open budgetary credits in the following year. The other two forms of carry-over are the unpaid commitments: (iii) verified unpaid commitments (VUC), which are committed expenses that fulfilled requirements and were verified by the government, who accepts fully or partially the service rendered or goods delivered, recognizing the bill as a liability. These expenses accomplished the budgetary phase of expenditure verification, named settled (*liquidadas* in Portuguese) as the liability is registered in the accrual-accounting regime. These debts, therefore, compromise revenues from future fiscal years. Finally, (iv) the traditional end-year-flexibility, known in Brazil as "*restos a pagar não processados*" or unverified unpaid commitments (Uvuc). Those unpaid commitments refer to committed expenses that are not verified (not settled) by the government as they did not go through the verification stage. Therefore, they are not accepted as a liability, allowing the carry-over of balances of the current fiscal year not yet executed (not settled) for the following year.

[3] Except the reopening budgetary appropriation approved in the last four months.

CHART 1 FORMS OF CARRY-OVER IN BRAZIL

Forms of *carry-over* in Brazil	Item carried-over	Regulation						External control
		Disclosure of an updated version of the budget	Adjustments are needed in the next fiscal year in order to accommodate the carry-over	Spending occurs via regular budget	It is accounting liability vs. financial liability	Accounted at the limit of spending on personnel stated at the FRL	Influences budgetary results of FRL[10]	
(i) Reopening budgetary appropriation[6]	Credit	No[3]	No	Yes	No; No	Not applicable	Yes	It is not subject to control because it is allowed. It can cause damages if re-opened without financial support
(ii) Financial surplus to next fiscal year[7]	Surplus	No[4]	Yes[9]	Yes	Active	Not applicable	Not applicable	Surplus is not a problem, even though some courts can understand that recurrent financial surplus can be considered bad management of public policies
(iii) VUC — Financial liability	Deficit	**No[2]**	**No[8]**	Yes	Yes; Yes	Yes	Yes	There are no limits to the balance of VUC. The government fiscal goal, in agreement with the legislative branch, is reduced by the balance of VUC
(iv) Uvuc	Credit	**No**	**No[1]**	**No**	No; Yes	**No**	**No**	Some Courts of Accounts understand the disclosure as a limit to registering Uvuc (Article 55), but they do not reject governments' accounts that violate the limit [5]

(1) The FRL limits the balance of Uvuc in relation to the availability of resources and imposes evidence (article 55.III, b 3 and 4th), which is reinforced by the model suggested in the STN manual (Ministry of the Economy — MDF). (2) The FRL does not expressly limit the registering of VUC, but the 9th article determines limitation on commitments, which would then limit VUC. (3) Federal Constitution 1988, article 167, §2. (4) Article 43, §1, I, 4,320/1964. does not request disclosure of updated version of the budget. (5) Article 55 of the FRL was associated to Article 41, which was vetoed. (6) Budgetary appropriation during the last 4 months of the fiscal year can be reopened, even though they do not have financial support in the actual budget. (7) Net value of VUC and Uvuc. (8) It will consume cash, without guarantee of revenues or associated resources available. (9) Carry-over increases cash. (10) Net income.

Source: Elaborated by the authors.

In order to preserve fiscal discipline, which is a major goal of the FRL, the use of carry-over necessarily requires (i) a limit on the use of unpaid commitments, or (ii) that unpaid commitments affect the budget result for the year to be analyzed by the control agencies. In these two cases, effectiveness would depend on regulation and monitoring of the disclosure of budget balances and results. A third solution would be (iii) to determine that the unpaid commitments balance reduces (the total balance or a part of it) the budget of subsequent years. Such procedures would lead governments to be impacted by their own choices. In the case of the third solution, the legislative branch would be automatically informed of the volume of unpaid commitments, which would deduct the volume of resources to be allocated in public policies in the following year.

The best regulated forms are the first two, since they occur within the regular budget, being subject to legislative control and informed in the budget execution reports. The first type deals with the authorization to reopen budgetary appropriation (expenses authorized in the previous budget) that were created by law in the last four months of the previous year, which still have resources available to commit. Although it is within budget and authorized by law, it can overcharge the next budget if there are no financial resources to support it. The second type allows new credits to be opened in the next fiscal year because of financial surplus, which does not pose challenges for fiscal discipline. However, when the result of the year is negative, the financial deficit does not deduct the budget in the next year. In practice, what happens is that when the result is positive, it is used. Being negative, when despised it ends up as a deficit carry-over, even if it is not formally forecasted in regulation.

The last two forms (iii and iv) are the most problematic forms when it comes to fiscal discipline. The registration of VUC would come from expenses already settled that have not been paid within the year, either by processing time or by the due date of the title. However, Uvuc registration would come from the need to maintain commitments for future execution that have been delayed by unforeseen events in non-recurring services that will be finalized only after the end of the fiscal year. In such cases, a portion of the budget is left open for future implementation.

Law No. 4,320/1964 does not impose penalties or limit the use of unpaid commitments. It only establishes that the balance of unpaid commitments is attached to the Appropriation Bill (in Brazil, LOA) and it has prevented municipalities from spending more than one-twelfth of the budget's estimated expenditure during the last month of the mandate. There is no association between credit and deficit carry-over with credit reduction in the following fiscal year. In addition, the fiscal law does not expressly prevent the existence of a financial deficit, except that this deficit increases in the last eight months of the mandate (article 42 of the FRL). In the case of Uvuc, the regulation determines that this should be registered up to the limit of cash availability, but this determination has been ignored, perhaps because it is on a topic of law related to the fiscal report (article 55). Moreover, the Courts either have no legal command to support the control of the dysfunctional use of unpaid commitments, or do not fully use the command they have. In case of verification of Uvucs, transforming them in verified unpaid commitment, they do not add to the budget result as verified expense to be paid (*liquidado*). Such a scenario constitutes an institutional context unfavorable to the regime of fiscal discipline (loopholes in regulation and less external control).

5. THE PARALLEL BUDGET OF UNPAID COMMITMENTS IN THE FEDERAL GOVERNMENT, STATES AND MUNICIPALITIES

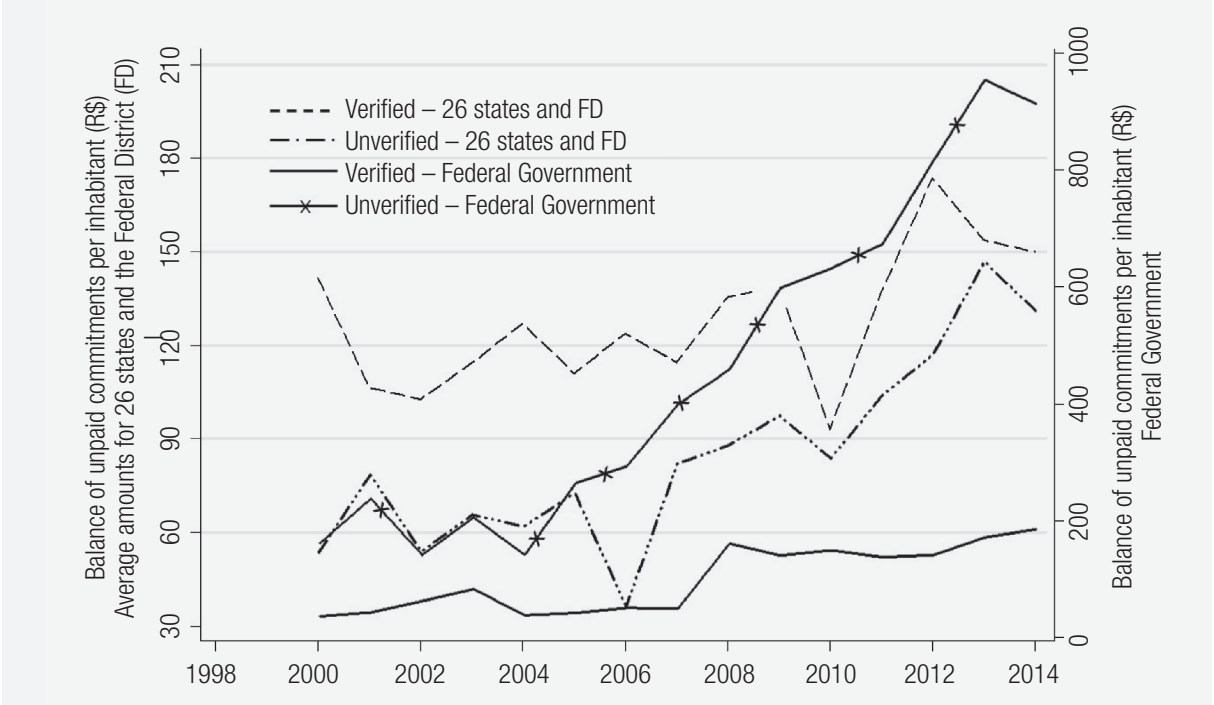
The two forms of "unpaid commitments" challenge the fiscal regime. However, the Uvuc form is particularly problematic because it does not circulate in the regular budget. What should be an exception has become a rule, establishing what has been called the "budget of unpaid commitments" (Castro,

2011), or "parallel budget", as it is called by the opinion of the Federal Court of Account (TCU) (TCU, 2006:237). The "parallel budget of unpaid commitments" is the execution of expenses incurred outside the regular budget, expenses that are of total discretion of the executive branch and, in general, escape to the legislative process and to the realm of external control. This budget is composed of the amount spent with the verified Uvucs with the recognition of the bills by the government.

5.1 FEDERAL GOVERNMENT AND COURT OF ACCOUNTS

Graph 1 shows the growth trend of the balance of VUC and of Uvuc per capita for the federal government and compares them with the average of the 26 states and the Federal District. The nominal growth of the federal government unpaid commitments between 2010 and 2014 was pointed out in a previous TCU report in 2015 of 76%, being: 51% for VUC and 83% for Uvuc. In the same year, the volume of expenditures paid via federal government unpaid commitments was 65% of the total investment and financial investment expenditures executed in the fiscal year (Almeida, 2013:133). This intense use of unpaid commitments, especially Uvuc (five times greater than the VUC in 2014, about 48% of tax revenues in the year), is a strong evidence of a parallel budget in the federal government.

GRAPH 1 BALANCE OF UNPAID COMMITMENTS IN COMPARISON TO THE MUNICIPALITIES POPULATION FROM 1998 TO 2014 (AMOUNTS ARE INFLATION-ADJUSTED — IPCA)



Note: Average population of the states: 7,5 million inhabitants. Total amount of VUC (2014): R$ 38,4 billion; Uvuc: R$ 21,1 billion. In federal government, for 205,6 million inhabitants in 2014, the balance of VUC was R$ 38,5 billion and the Uvuc was R$ 189,5 billion. States with larger VUC per inhabitant: Roraima (866); Amapá (542); São Paulo (516) and larger Uvuc per inhabitant: Distrito Federal (775); Roraima (418); Rondônia (245). States with lower Uvuc per inhabitant: Ceará (1); Rio Grande do Sul (29); and Pará (30), and lower Uvuc per inhabitant: Ceará (11); Piauí (17) and Santa Catarina (175).
Source: Elaborated by the authors.

Besides the balance, another point to be highlighted is how old these credits are. The duration of the unpaid commitments in the various budget exercises is more than 10 years. At the end of fiscal year 2014, the federal government had VUC referring to commitments made in 2012, and Uvuc issued in 2007. This means that the federal government is executing expenditures authorized by the National Congress for more than seven years (Carvalho, 2014). Alves (2015) makes an interesting analysis of the Ministries of Transport, National Integration, Cities, Science and Technology, and Mines and Energy from 2009 to 2013, and shows the growth rate of such a parallel budget for those ministries.

The Federal Court of Accounts (TCU) has demonstrated and evidenced concerns about the deliberate and repeated use of Uvucs, culminating in the issuance of decision Nº 1,039/2006, which requires the STN to establish a system of verification of unpaid commitments to map "due or not-due unpaid commitments". Only in 2013, the STN recognized the problem and warned the Presidency of the Republic for the growth of the "parallel budget". Finally, although the TCU report on the 2014 accounts considers that the STN complied with the requirement (it segregated the Uvucs into "to be verified" and "under verification"), the balance continued to grow.

In the series of graph 1, while the VUC balance remains stable from 2008 to 2014, the Uvuc rapidly increases, probably as a response to fiscal pressure as pointed out in Costello et. al. (2017). According to TCU, the strategy used by the Federal Government to leave expenses on unpaid commitments and not computing expenditures on the fiscal goals is a form of fiscal "makeup" (Augustinho, Oliveira and Lima, 2013). This is because the goal for the primary balance established in the Budgetary Guidelines Law (in Brazil LDO) would be artificially achieved only by the growth of these balances. Although both the Federal Court of Accounts and the Federal Comptroller's Office (CGU) have denounced the abusive use of Uvuc, its volume in the federal government is already similar to the budget itself (Conorf, 2015). The Presidency of the Republic does not seem to be sensitive either to the warnings given by the TCU or to the technical staff of the National Treasury Secretariat. What is observed in the case of the federal government is the low effectiveness of external control in deterring the intense growth of VUC and Uvuc with the existing regulation.

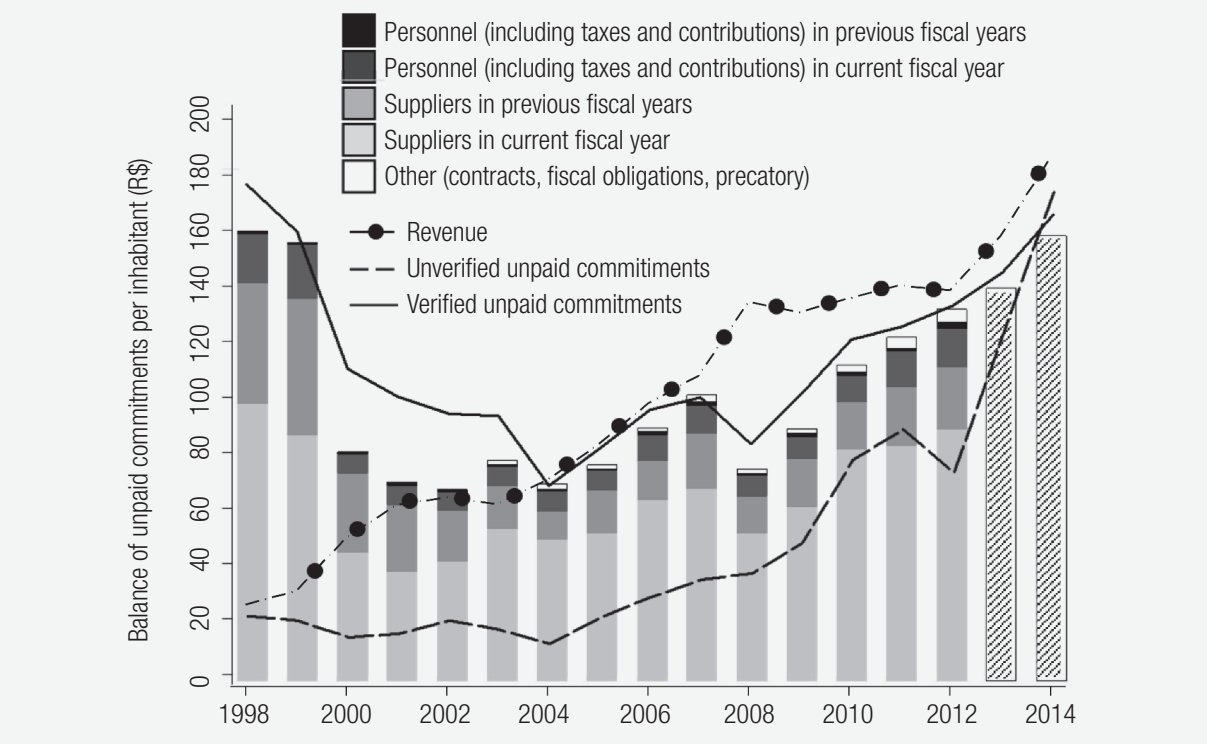
5.2 GOVERNMENTS AND COURTS IN STATES AND MUNICIPALITIES

It is important to note that growth of the balance of "unpaid commitments" means an increase in indebtedness, because the registration is higher than the payments or credit cancellations. The increase in indebtedness is shown in graph 1 for both the federal government and the states and Federal District (since the average is observed). The average for states and Federal District grows with a drop in some of the years analyzed. The growing volume of Uvuc may include credits that are increasingly old, which is the case of the government of Minas Gerais. The State Court of Accounts issued a report for the year 2014 showing the existence of unpaid commitments from 1997. In comparison with the federal government, the states and the Federal District used VUC more often. However, from 2006 it was possible to observe in the states an increasing use of Uvuc. This inversion of proportion shows the emergence of the parallel budget also in regional governments. The 26 states and Federal District have a parallel budget of 3.3% of their revenue (taxes + current transfers) in Uvuc for the year 2014 (standard deviation of 3.2%, maximum of 13.9% for the Federal District). It should be noted that there have been cases of states that ended the year with 60% of their revenues committed to Uvuc (Paraná, in 2000).

As shown in graph 2, the same growth in the use of unpaid commitments and the consequent indebtedness are observed in municipalities. Before 2004, the average VUC was reducing due to

the FRL that was coming into force, and Uvuc was stable and not very representative. After the first transition in mayor's mandate post-FRL (in 2004), it was possible to observe a steady growth of the two forms of unpaid commitments. Graph 2 shows the composition of VUCs over the years. In 2012, most VUCs in municipalities were used to finance suppliers (60%), followed by "various expenses" (23%), personnel from the previous fiscal year (10.6%) and other expenses (4%). Stand out the balances registered regarding expenses with personnel expenses from previous years (1.5%), which would not be expected, since the expenses with personnel registered in VUC should be paid in the immediately following year. In VUC, the average grows mainly in suppliers, which can mean payment delays with services, such as garbage collection. It is interesting to note that the increasing curve of average current income contradicts the argument constantly used by municipal managers. For them, the increase in unpaid commitments is a response to the fall of revenues; however, it seems to be more a response to mismanagement and rising expenditure in an unsustainable way.

GRAPH 2 BALANCE OF UNPAID COMMITMENTS IN COMPARISON TO THE MUNICIPALITIES POPULATION FROM 1998 TO 2014 (AMOUNTS ARE INFLATION-ADJUSTED — IPCA)

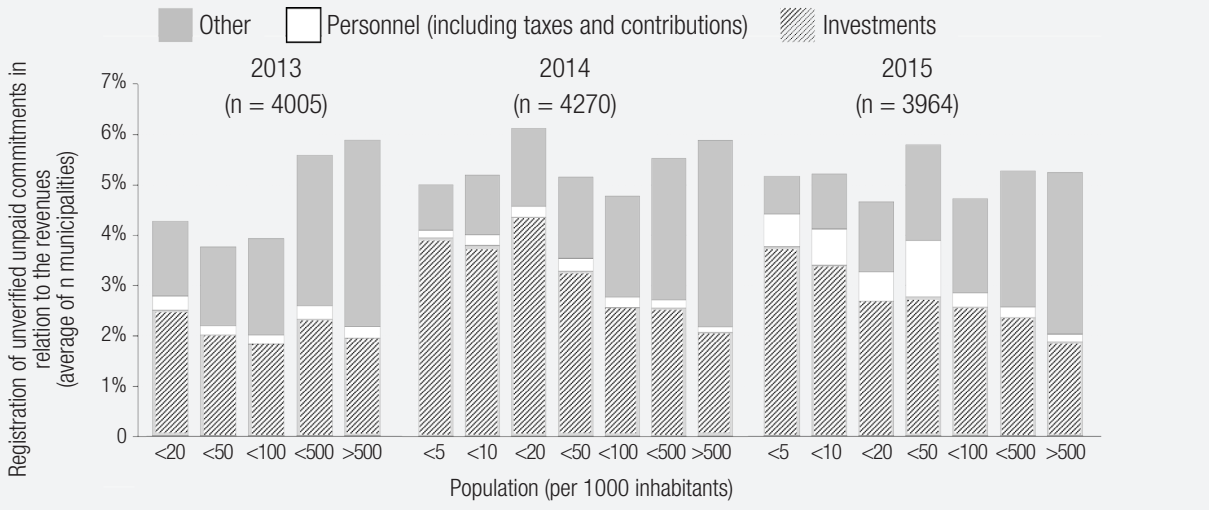


Note: (1) The height of the bars is the total of average VUC for Brazilian municipalities, considering data from 1998 to 2012 obtained in SISTN and those of 2013 and 2014 in Siconfi (marked bars with no details on their nature because the system does not disclose this information, reducing transparency on the management of unpaid commitments). (2) For all years, when the total amount show by the bars do not follow the continuous line (which represents the average total of municipalities VUC), it indicates that around 200 to 300 municipalities cannot be analyzed regarding the type of VUC, because the municipalities did not provide details on the nature of their balance of VUC when feeding SISTN with information. (3) The number of municipalities in the analysis from 1998 to 2014 is: average of 5,103 for VUC (min.= 3,570 in 1999 and max.= 5.451 in 2001); and average of 5.046 for Uvuc (min.= 4.581 in 2012 and max.= 5,425 in 2001). Included the municipalities that sent data to STN in that year, and that had balance of VUC in that year.
Source: Elaborated by the authors.

In the case of municipalities, the issue of Uvuc is even more serious. The average is 6.9% of the revenue (standard deviation of 11.7%, maximum of 369% in 2014 for the municipality of Cerro Branco/RS). Following a vertiginous growth of Uvuc from 2012, the average Uvuc exceeded that of VUC, and assumed a similar pattern to the one presented by the federal government.

The use of Uvuc would be justified in cases such as infrastructure work in progress or delayed by unforeseen events. It would not be justified for current and predictable expenditures, such as garbage collection, personnel and charges or debt repayment. However, it is observed for municipalities from 2013 to 2015, the use of Uvuc outside the nature of the expenditure item "investment" (graph 3). Graph 3 shows the average of registered Uvuc per revenue, separating cities according to their population (horizontal axis, in thousands) and the classification of the expenses (proportion of bars). The expenses registered as unpaid commitment and allocated in the category "other current expenses", are operating expenses other than personnel and associated charges. These "other current expenses" are higher than the expenses of investments for the municipalities from 100 thousand inhabitants (<500 and > 500). It is also observed the increase in registering Uvuc of personnel expenses and charges in 2015 in all classes of municipalities with less than 50 thousand inhabitants. Personnel expenses and charges, because they are continued, should not be registered in Uvuc; Thus, either mayors are "reserving budget" through Uvuc, or they have identified that such personnel values, when launched through Uvuc, do not escape the limits of personnel expenses.

GRAPH 3 **REGISTRATION OF UVUC OF MUNICIPALITIES IN COMPARISON TO THEIR REVENUES — 2013 TO 2015 (AMOUNTS ARE INFLATION-ADJUSTED (IPCA). REVENUES ARE COMPOSED BY TAXES + REGULAR TRANSFERS)**



Note: (1) Municipalities listed in each year are those that sent data to STN in that year and registered at the Uvuc. Data from 2015 was collected from Siconfi in February 2017.
Source: Elaborated by the authors.

As observed in the federal government, the growth in using unpaid commitments is connected to the obstacles faced to exercise external control. The Courts of Accounts in states and municipalities have

pointed out, in the accounts presented by mayors and governors, cases of registration of unpaid commitments when the government exceeds the financial availability. However, previous opinions end up approving the accounts or only pointing out reservations, even when financial insufficiency is observed. An emblematic citation in one of the court reports says that "the financial deficit, corresponding to one month and five days of municipal tax collection, does not have the strength to compromise the budget of the subsequent exercise", thus justifying the approval of the mayor's accounts. It is common to find technical recommendations for disapproval of accounts, and reversal of such recommendation in the courts' opinion after processing by the group of judges. In only one case among all those analyzed, the court maintained the reprobation of the accounts due to the financial insufficiency generated by the use of unpaid commitments. There were also cases in which the high financial deficit on the balance was not even mentioned in the final report of the Court of Auditors. On the other hand, it was found in some cases recommendations for adjustments in subsequent periods in the same government.

Specifically regarding article 42 of the FRL, some Courts of Accounts operate with a soft interpretation of the rule. In these cases, the courts consider that criterion mentioned in the article is determined by comparing the financial deficits of April 30 and December 31 in the last year of the government mandate. Such a practice encourages governments to artificially and intentionally worsen the one-month result in April to have more room for meager results at the end of the period. In addition, the lower attention of the Courts of Accounts can also be observed from the absence of this theme in manuals, training and normative positions in general. It is curious, considering that the issue is directly related to fiscal discipline, that the control problems brought about by the use of Uvuc (and characterizing the "parallel budget") are not openly discussed.

Of course, external control depends on the legislative branch's act in approving the accounts of the president, governors and mayors. Even if the Courts of Account decide to disapprove the accounts of a government, it is still up to the legislative to accept the recommendation and reprove the government accounts, which would depend on the political dynamics of the coalition at that time (Melo, Pereira and Figueiredo, 2009).

6. THREATS TO CREDIBILITY AND TRANSPARENCY

The current regulation and the low control on carry-over via unpaid commitments produce side effects such as increase of indebtedness, loss of the principle of annuality and the reduction of budget credibility and transparency. As shown in Chart 1, both Uvucs and VUCs operate in a context of fragile regulation that imposes no limits on the use unpaid commitments, there is no demand for adjustment in the following year's budget, and no obligation to disclose settled expenditures of Uvuc.

Both the implementation of part of the expenditure by a parallel budget and the loss of the principle of annuality lead to a *decrease in budget credibility*. Low predictability of the budget as a "plan to be executed" leads to the discrediting of the budget as a tool for managing and directing public spending, becoming a mere document for compliance (Rezende and Cunha, 2013). Given that the registration of expenses through the settlement of Uvuc became an "accepted" mechanism at all levels of government in Brazil, managers know that the approved budget is a "myth" (Rezende and Cunha, 2013:60), it will not be executed in practice (and there is no way to do so, since part of the revenue is compromised). An additional effect is the reduction of the discretion of the executive branch in paying expenses for the current period (a mayor that just took office will open their mandate paying

expenses made by the previous mayor in government), as well as a cascade effect delaying payment to suppliers. The obligation of payments in chronological order – according to the due date – where payment of unpaid commitments have priority over the expenses executed during the year (Law 8.666/1993, article 5) causes the expenses of the current year to be "pushed" to the next budget. The solution would be the use of contingency of the expenses (Conorf, 2015), but the growth of the balance shows that this is not a practice commonly adopted.

In addition to the above, the parallel budget of Uvuc *seriously reduces transparency*. The current regulation (article 48 of the FRL) is not enough to control the expenses executed by the "parallel budget". The 10 municipalities with the highest registration of Uvuc in 2014, which includes the capitals of São Paulo (R$ 1.7 billion), Rio de Janeiro (R$ 742 million) and Belo Horizonte (R$ 499 million), as well as three other capitals, do not have information on the settlement of Uvucs in their portals. The same happens with the federal government and the three state governments with the highest amount of Uvuc in 2014, analyzed in this study. As for external control, the Courts of Accounts do not demand such disclosure, and the Office of the Comptroller General (CGU) ignores the issue of unpaid commitments when releasing the ranking of transparency based on the online information provided by state and municipal governments to the public.[4] At the federal level, it was not possible to find information on execution of expenditures via Uvuc in the transparency portal maintained by the CGU,[5] and in the recently launched transparency portal of the STN.[6] A further reduction in the transparency of Uvuc came with the adoption of the new national chart of accounts (PCASP), in a new accounting framework converging with the International Public Sector Accounting Standards (IPSAS) (a movement called in Brazil as "*Nova Contabilidade Pública*", or New Public Accounting). In the new national chart of accounts, Uvucs are no longer considered accounting liabilities and they are not to be evidenced in the balance sheet. Finally, the Whole of Public-Sector Accounting (*Balanço do Setor Público Nacional* — BSPN) of 2014 does not include the total unpaid commitments of the federal, states and municipal government, which are evidenced only in the budget execution reports (*Relatório Resumido da Execução Orçamentária* — RREO and *Relatório de Gestão Fiscal* — RGF).

Because Uvuc are operated outside the regular budget and with low transparency, it is hard to exercise legislative control over them. Despite the authorization by previous legislation and not being canceled by the executive branch, the Uvuc serve as a space for the executive to exercise its discretion, because city counselors, deputies and senators do not receive the information about the resources registered as Uvuc. When expenditures are executed "outside" budgets, such expenditures will remain outside the radar of legislative control and will be used to manage fiscal limits, such as the aforementioned personnel expenses settled by Uvuc.

Finally, the way VUC and Uvuc are regulated leads to a distortion of the budget result, also reducing transparency regarding the real fiscal performance of the government. Between the two methodologies for calculating the budget result (by Law 4,320/1964 and by the FRL), the courts adopt the method indicated by the FRL, in which the result is obtained from deducting from the revenues the total expenses settled in the regular budget. However, when an expense is settled via Uvuc, it is not computed in the budget result, which generates an incentive to the increasing use of the parallel

[4] Available at: <rankingdatransparencia.mpf.mp.br>.
[5] Available at: <transparencia.gov.br>.
[6] Available at: <tesourotransparente.gov.br>.

budget. Thus, while both forms of carry-over are a financial liability, they do not affect the FRL budget result ascertained by public entities.

7. CONCLUSIONS AND IMPLICATIONS

The use of "unpaid commitments" in Brazil as a mechanism to bring flexibility to the annuality of the budget is opening space for governments' indebtedness without transparency. The budget is losing its value as a tool for planning, and no longer governs the legislative negotiation regarding the allocation of resources through democratic representation and fiscal control. Even with the CGU and the TCU pointing in recent years to the abusive increase of the unpaid commitments and the use of them as a mechanism to manage the primary result in the federal government, the eventual reduction in its general use does not solve the problem. The same behavior has been observed in regional and local governments, also with the low effectiveness of external control bodies in containing the growth of Uvuc use, which indicates a lack of sustainability.

Brazil's good position in the Public Expenditure and Financial Accountability (PEFA) assessment and in the Open Budget Initiative (OBI) should be viewed with caution. It is a fact that Brazil got the highest grade in Pefa's evaluation (federal government) when it comes to disclosing VUC, and the FRL was praised for regulating the issue in a broad way (Flynn and Pessoa, 2014:14). However, it is important to remember that evaluation takes into in consideration the VUCs and nothing is said about the Uvucs, which have skyrocketed in the last decade (perhaps because they have not been the subject of any regulation). Even if Pefa deals with the balance of the VUC in relation to the total annual budget, the indexes do not encompass the intricacies of carry-over regulation and the transposition of budget periods and their impacts.

The weak regulation identified could be improved at the present moment, given the political convergence in the National Congress that discusses the new Finance Law (PLS 229/2009, PLP 295/2016). However, the bill, while trying to impose limits on the use of VUCs, does not adjust the next budget in the event of a carry-over deficit. In addition, it does not adjust when reopened budgetary appropriation are transferred to the next year without support from revenues or cash and cash equivalents. The bill does not address the issue of transparency and the inclusion of the settlements of Uvuc in the budget information of the year, which will favor the continuity of its use as a parallel budget. Thus, if the bill is approved in this way, the control bodies, such as the Comptroller General and the Courts of Accounts, will continue with the difficult task of inhibiting such practice without a legal apparatus to do so.

Considering the contributions exposed in this article, future research could analyze the individualized behavior of the balance of Uvuc of governments as a response to fiscal pressure. In addition, research can be conducted in the association of such a balance with the political cycles, observing whether the expectation of reelection changes the propensity for registering unpaid commitments, and whether the degree of activism of the Courts of Accounts would reduce such a balance. These clarifications would bring relevant contribution to the regulation and control of these carry-over mechanisms in Brazil and certainly would contribute to the improvement of fiscal discipline.

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