

12 September, 2007

B R A S Í L I A



Brazilian Federal Public Debt



Brazilian Federal Public Debt

Macroeconomic Overview

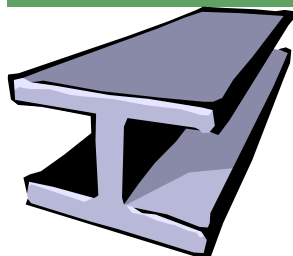
Fiscal Outlook

Public Debt Management

On the path to sustainable growth

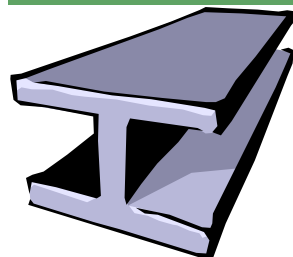
The Economic Policy Mix Provides a Buffer Against External Shocks

Prudent Fiscal Policy



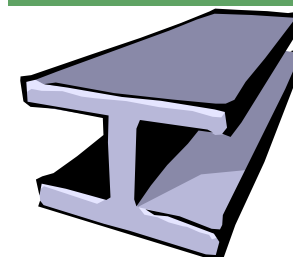
the main pillar of the economic policy

Cautious Monetary Policy



macro stability at the core of economic policies

External Adjustment



robust export growth and strong external accounts

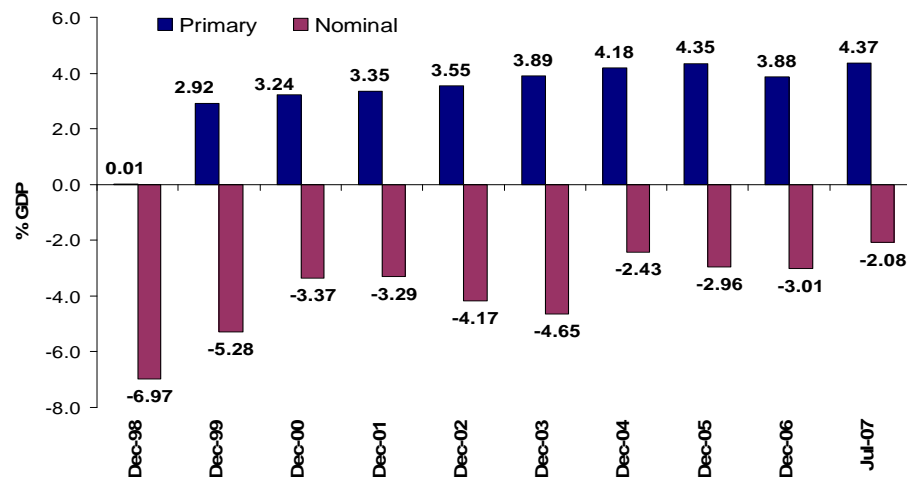
Lead to...

- ✓ Stable inflationary expectations
- ✓ Lower long-term interest rates
- ✓ Improved debt dynamics
- ✓ Greater fiscal flexibility
- ✓ More credit → more jobs

Sustainable Economic Growth & Improving Social Conditions

Macroeconomic Overview - Fiscal Commitment

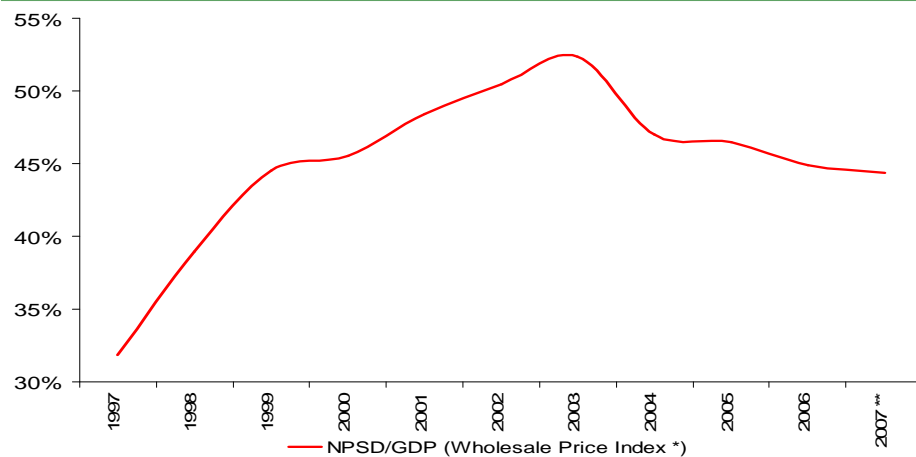
Public Sector Balance (in 12 months)



Source: Central Bank

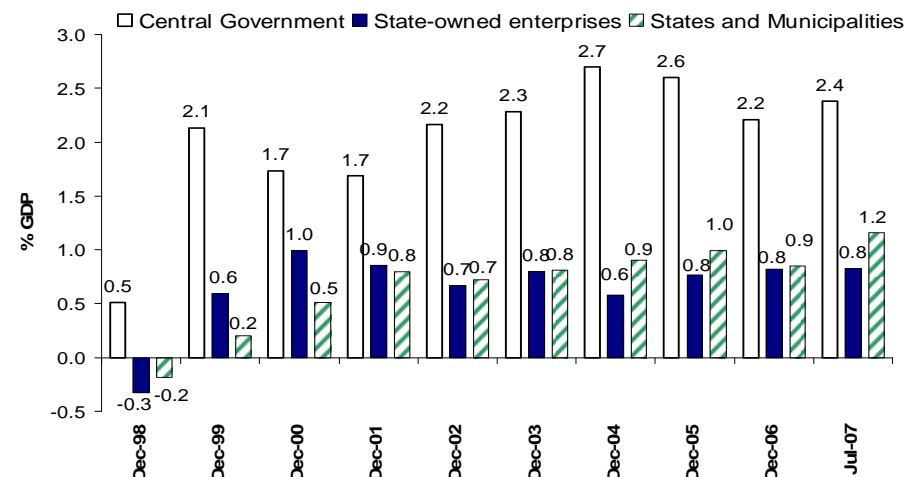
Net Public Sector Debt / GDP

MACROECONOMIC OVERVIEW



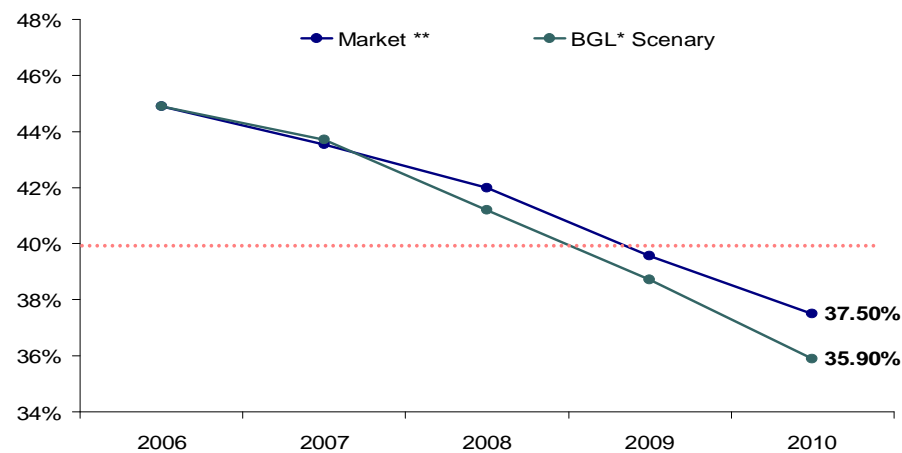
* Central Bank Data - IGP-DI (wholesale price index) 'modified' ** July

Primary Balance by Government Level (in 12 months)



Source: Central Bank

Net Debt / GDP scenarios based on market expectations**



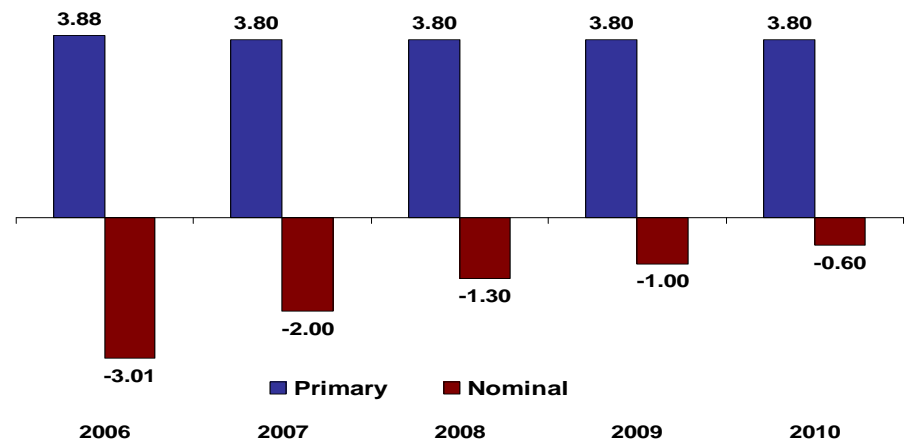
Source: National Treasury * Budget Guidelines Law'08 ** Central Bank/FOCUS 09/06/2007 3



Keeping the Primary Balance for the next years

- **Budgetary Guidelines Law** - Already sent to the Legislative
- **3.8% of GDP for the Primary Balance** - This is not fiscal easing as it corresponds to the same fiscal effort that has been delivered prior to the GDP series revision.
- **0.45% of GDP regarding the PPI** - This is a cap to PPI, but still under rigorous criteria as for project selection.
- This is consistent to the downward trend shown below in the NPSD/GDP ratio.
 - Under the BGL, a 3.8% of GDP primary balance would result in a NPSD/GDP of 35.9% in 2010.
- Nominal Balance should be near equilibrium also in 2010.
- With these efforts, Brazil is about 4 years ahead in its path to steadily reduce the NPSD/GDP ratio
 - This is particularly important considering an environment where reforms are forthcoming.
 - Such measures should speed up this drop in that key ratio.

Primary* and Nominal** Balances (%GDP)

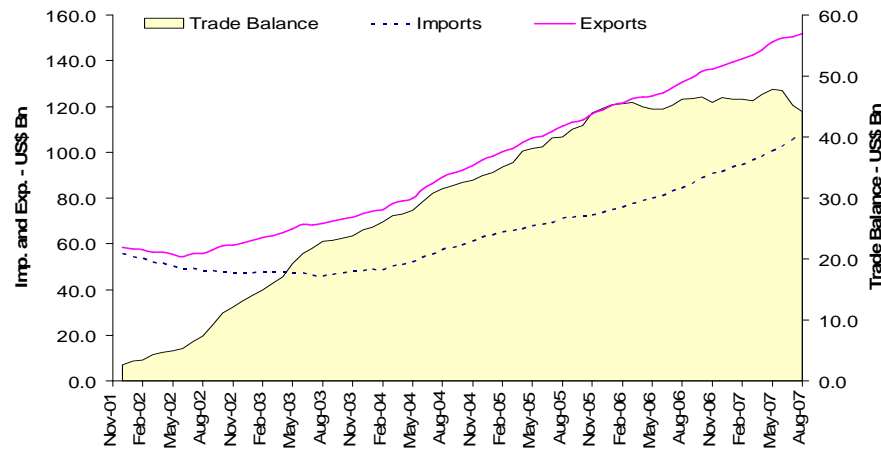


Source: * Ministry of Finance and ** Market expectations



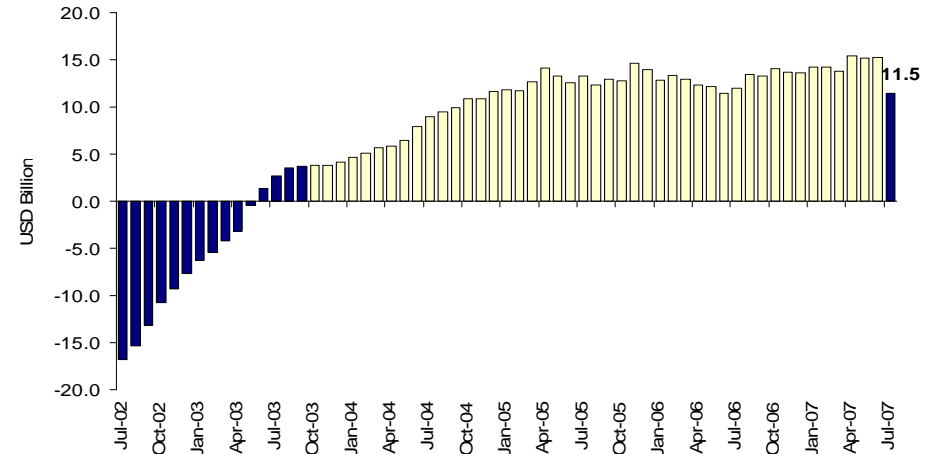
Macroeconomic Overview - Reduction in the External Vulnerability

Trade Balance



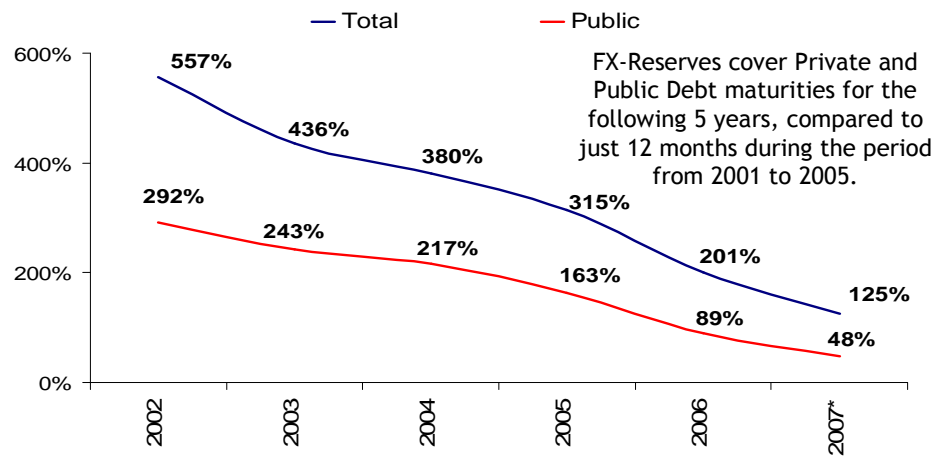
Source: Reuters

Current account (12 months accumulated - US\$ bn)



Source: Reuters

External Debt / FX-Reserves (%)



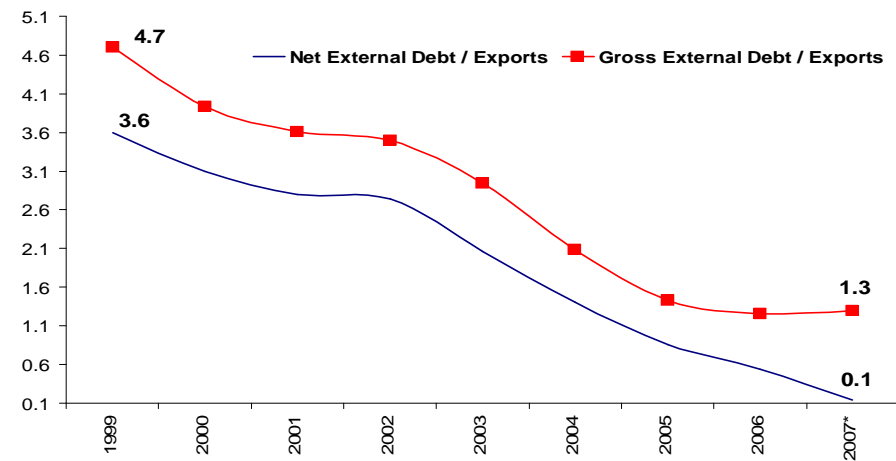
FX-Reserves cover Private and Public Debt maturities for the following 5 years, compared to just 12 months during the period from 2001 to 2005.

* Until July-07

Public: Non-financial Public Sector

Source: Reuters and Central Bank

Net External Debt / Exports accumulated in 12 months**

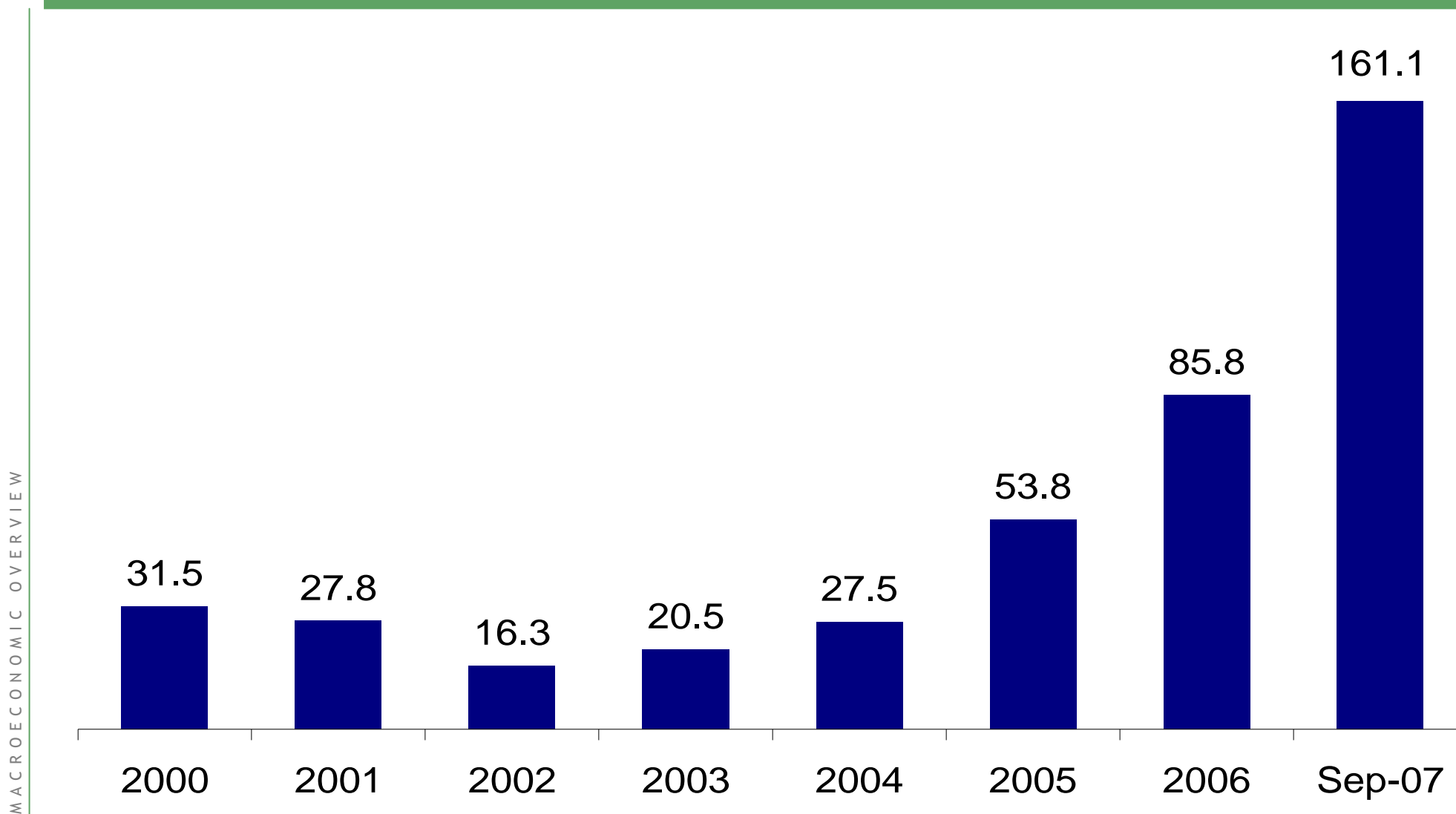


Source: Central Bank. * Until Jul-07 **Public Debt and Private Debt as a share of export accumulated in 12 months



Building an insurance against external volatilities

Internacional Reserves - USD bn

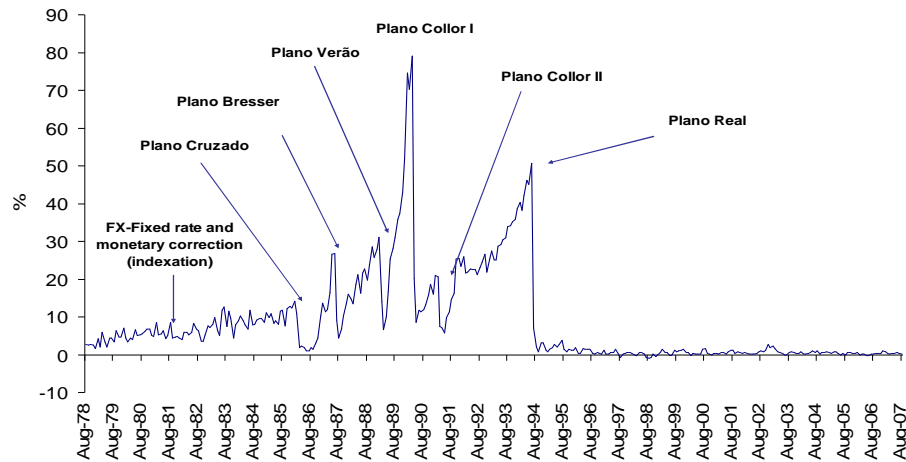


Source: Central Bank



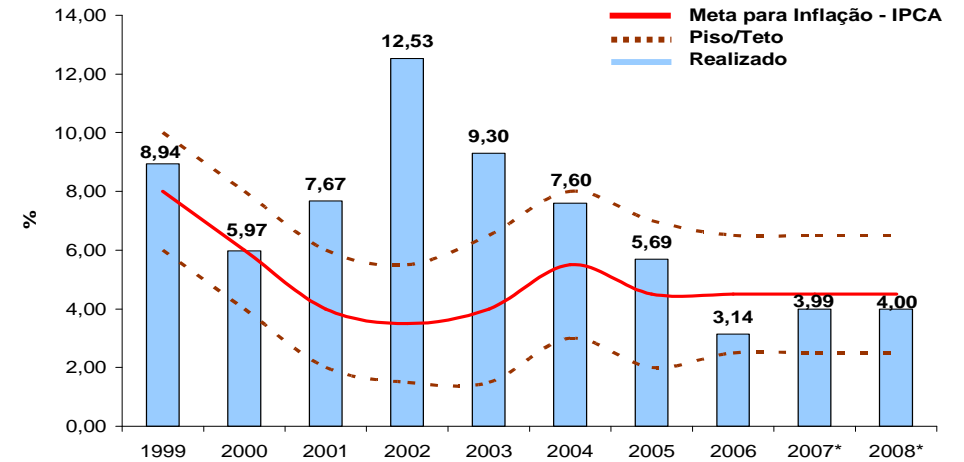
Macroeconomic Overview - Inflation under control and the economy stability

Inflation 1978/2007 - CPI* - Monthly (%)



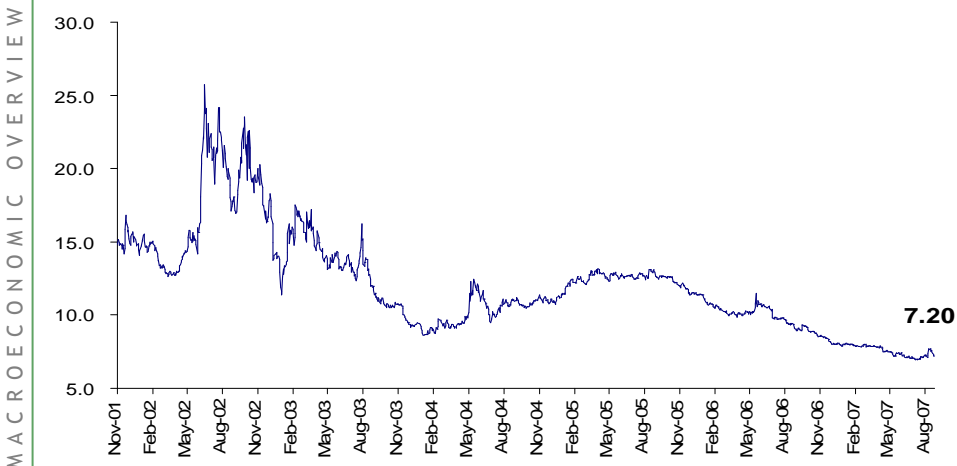
Source: IPEADATA. * Consumer Price Index - IPC (FIPE)

Annual Inflation - Target and Performed



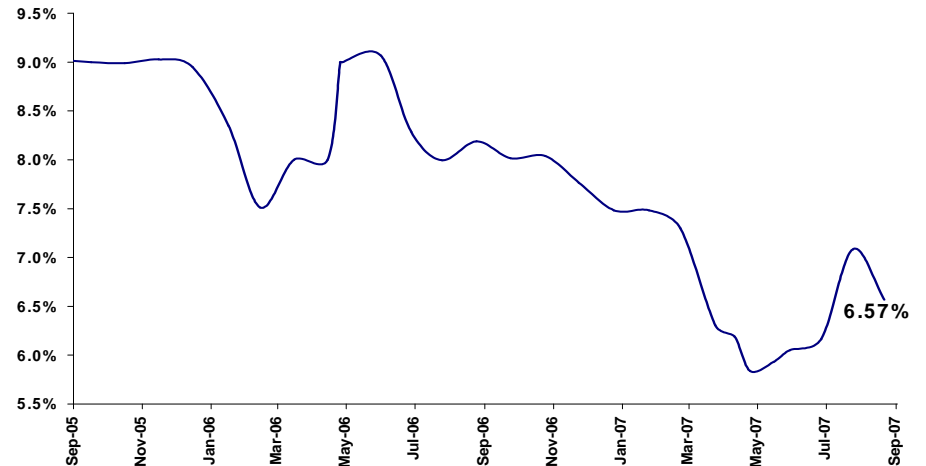
Source: Central Bank * Market Expectation - Central Bank/FOCUS - 09/06/07

Real Interest Rate (Swap 360 vs 12-month CPI forecast)



Source: Central Bank and Bloomberg

Medium and Long Term Real Interest Rate on inflation linked bonds* - Average rate of auctions



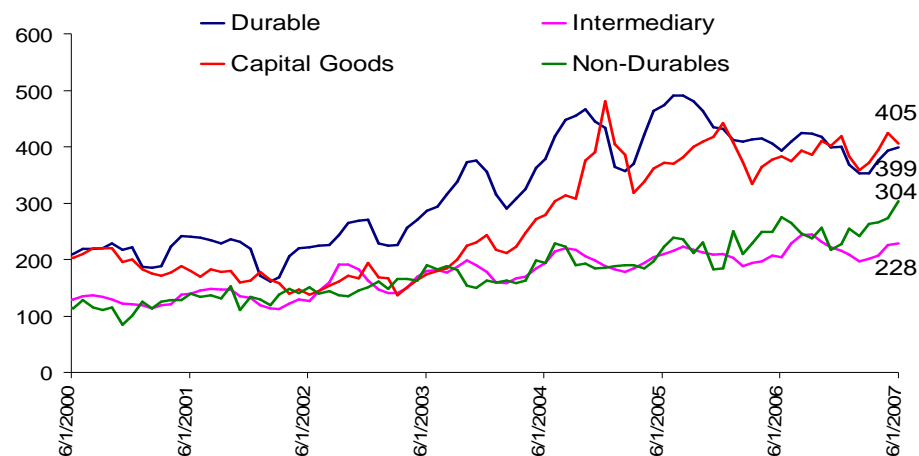
Source: National Treasury

* NTN-B: CPI indexed bonds, maturing in 2024, 2035 and 2045.



Beyond the 3 Pillars - Exports diversified by products and countries

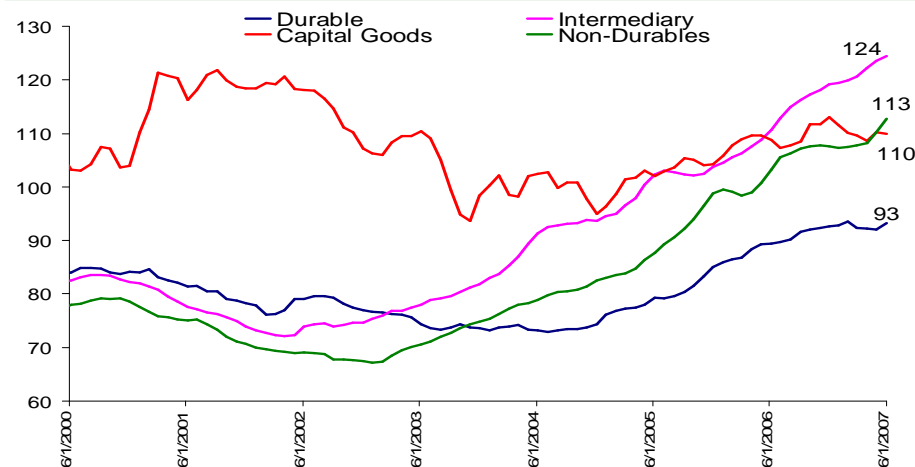
Exports - *quantum* evolution (moving average)



Source: Ipeadata

Note: Index in USD-av. '96=100

Exports - *price* evolution (moving average)



Source: Ipeadata

Note: Index in USD-av. '96=100

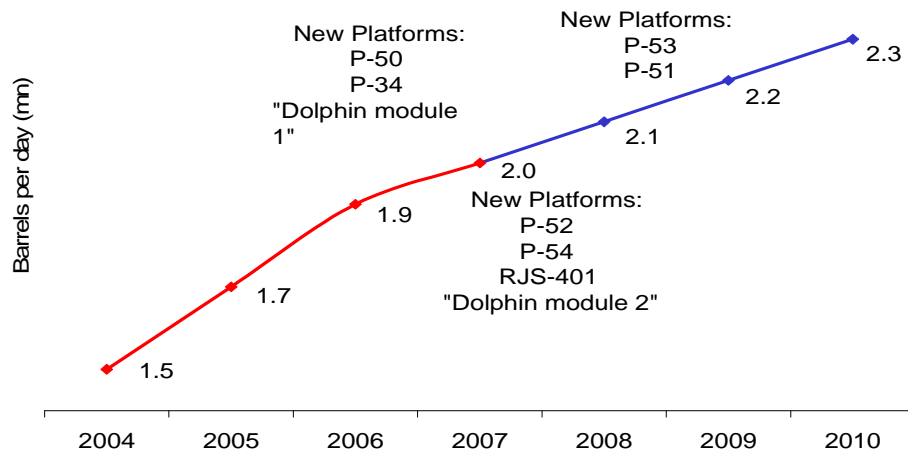
MACROECONOMIC OVERVIEW

	2000			2006		
	US\$ bn	%	Accum. %	US\$ bn	%	Accum. %
European Union	14.8	26.8	27	30.5	22.2	22
USA	13.4	24.3	51	24.4	17.8	40
Argentina	6.2	11.3	62	11.7	8.6	48
China	1.1	1.1	64	8.4	6.1	55
Mexico	1.7	3.1	68	4.4	3.2	58
Chile	1.2	2.3	70	3.9	2.8	61
Japan	2.5	4.5	74	3.9	2.8	63
Venezuela	0.8	1.4	75	3.6	2.6	66
Others	13.4	25	100	46.7	34	100
Total	55.1			137.5		



Beyond the 3 Pillars - The energy sector mitigates risks...

Brazilian Oil Production

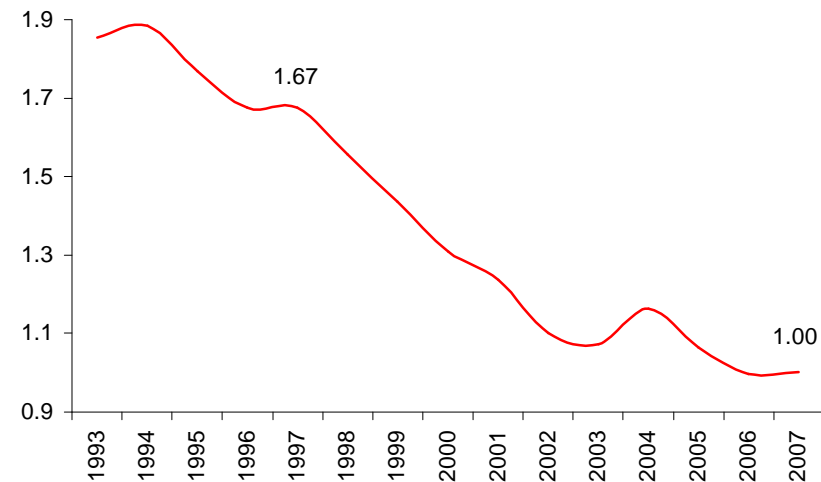


Source: MME - 2006* preliminary data

- Brazil is self-sustainable in oil since 2006.
- Petrobras is a leading company in exploiting oil sources in the sea.
- High-technology solutions in fuel production.
- Top productivity in ethanol fuel.

- There are indeed forecasts for new oil platforms for the next years, increasing the potential production.

Oil Consumption / Production

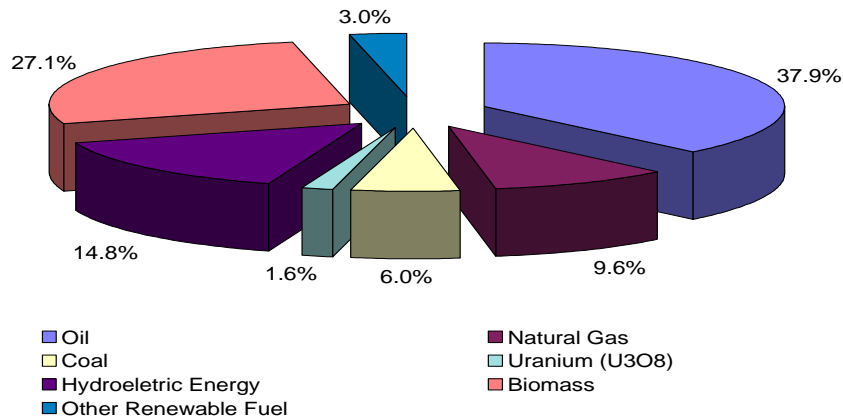


Source: ANP



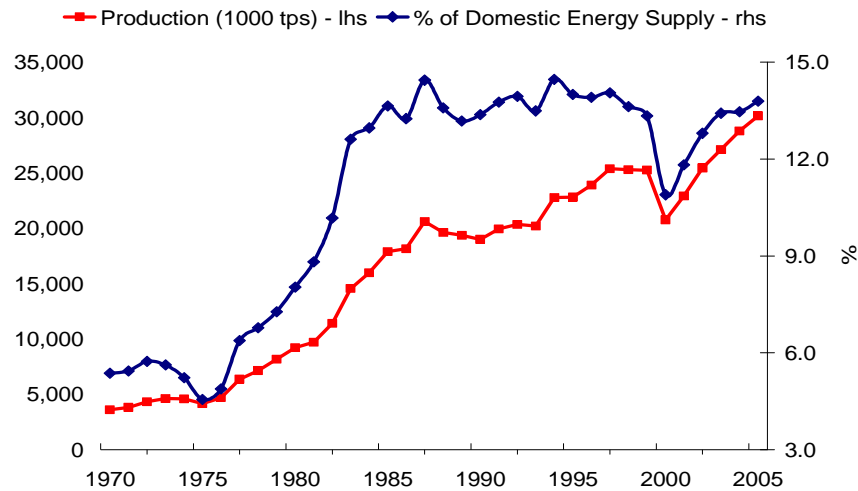
Beyond the 3 Pillars - ... and becomes international reference

Brazilian Energy Domestic Structure - 2006



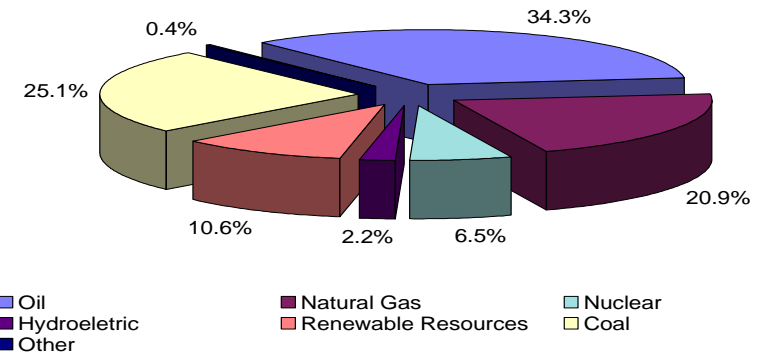
Source: MME - 2006* preliminary data

Brazilian Ethanol (sugar cane) production and share in total energy supply



Source: MME

World Energy Domestic Structure - 2004



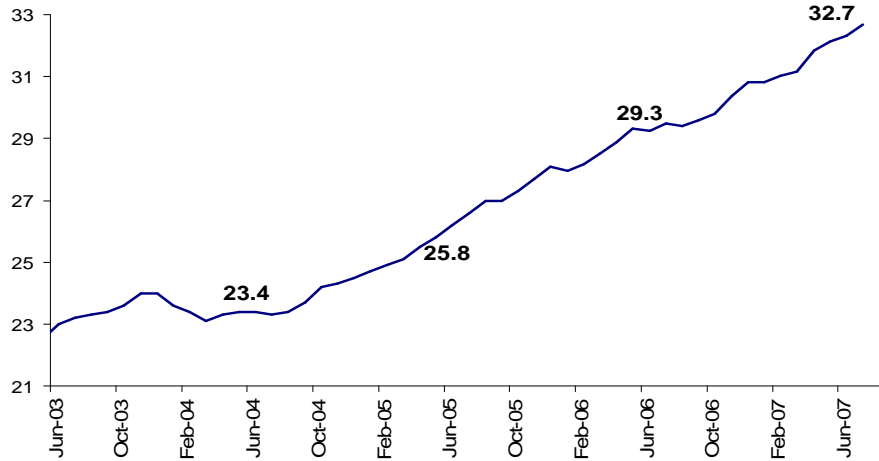
Source: MME

- In 2006, roughly 45% of Brazilian domestic energy supply came from renewable sources
- Gradual substitution of vegetal coal for sugar cane ethanol.



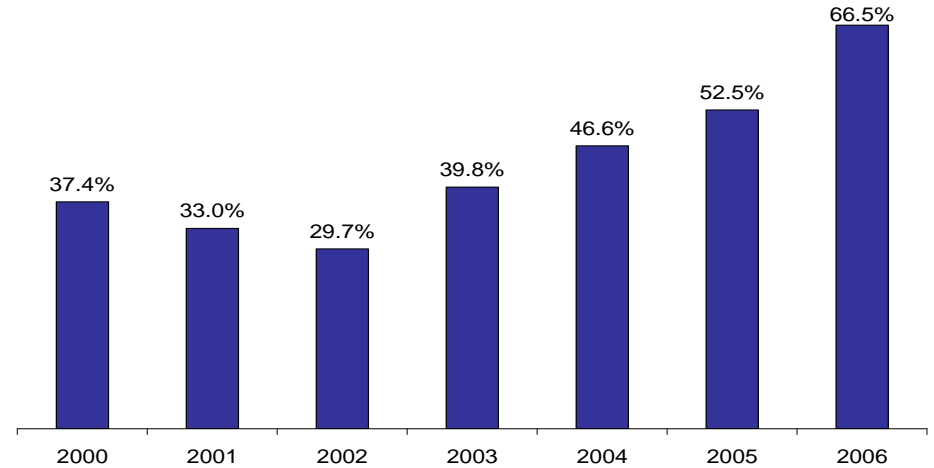
Beyond the 3 Pillars - Capital Market booming

Credit (% GDP)



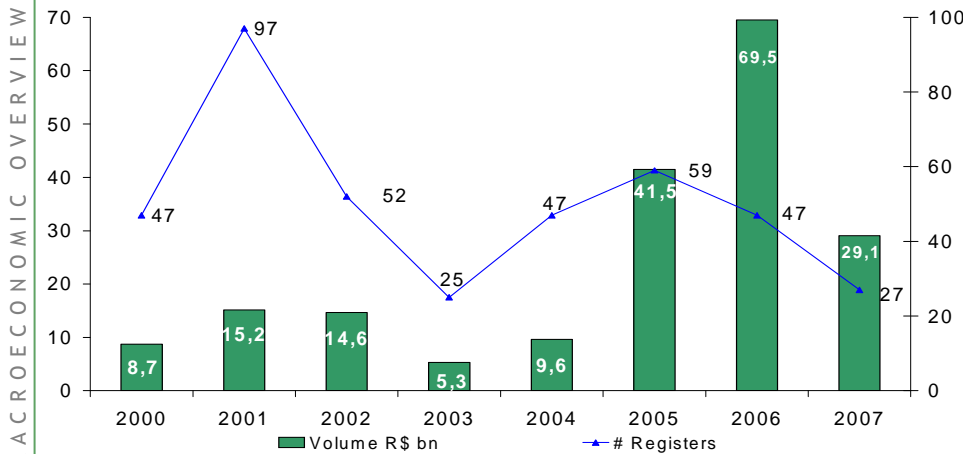
Source: Central Bank

Stock Market Value (% GDP) - Bovespa



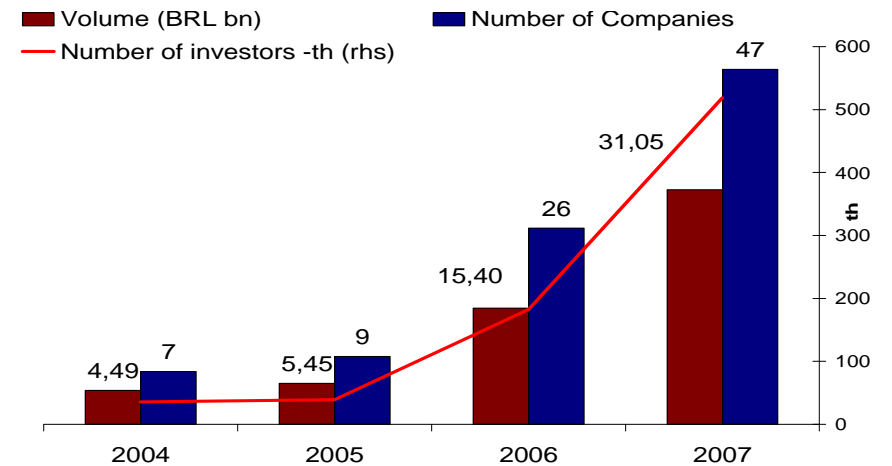
Source: Bovespa and IBGE

Debentures: Volume and # of registers



Source: CVM

IPOs in Brazil

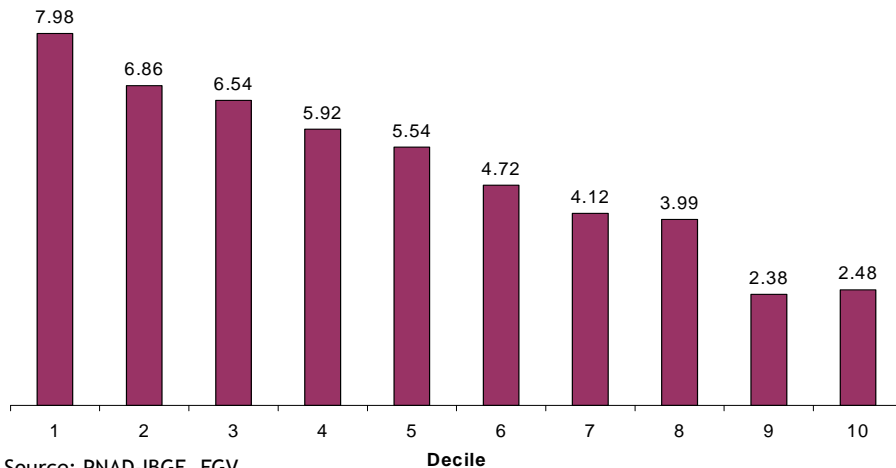


Source: Bovespa



Beyond 3 Pillars - Improving Social Equality

Increase in Household Income (%) 2001-2005



■ From 2001 to 2005 the distance between the richest (highest) income deciles and the poorest (lowest) deciles has reduced **1.2% p.y.**. This places Brazil among the top countries in reducing inequality.

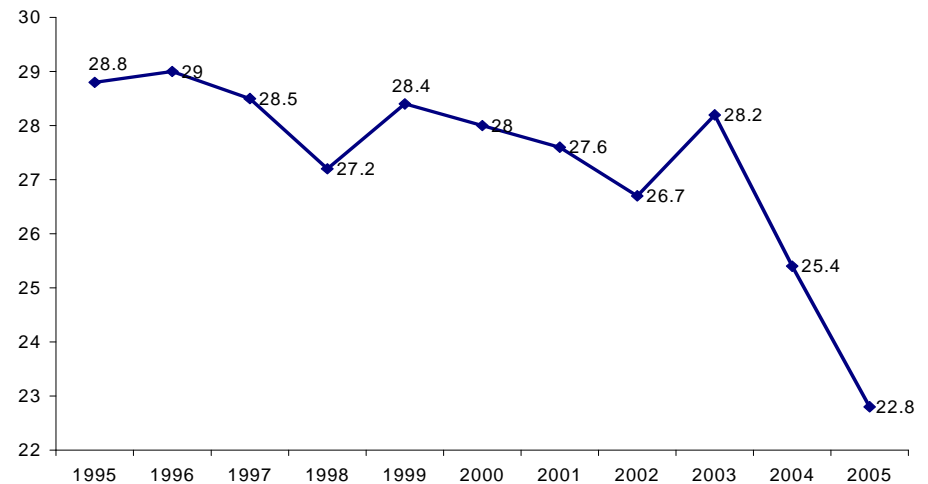
■ The main reasons were the “Bolsa Família” program, the minimum wage recovery and, mainly, **the economic activity spillover effect.***

■ If this performance could be reproduced every 4 years, extreme poverty may be eradicated in 12 years*.

*Barros, R.Paes de - IPEA's economist

- Considering the huge social needs, Gov't has promoted efforts aiming at reducing poverty level under a **fiscal sustainable framework.**
- Inequality has dropped since 2001 and has reached its lowest historical level.

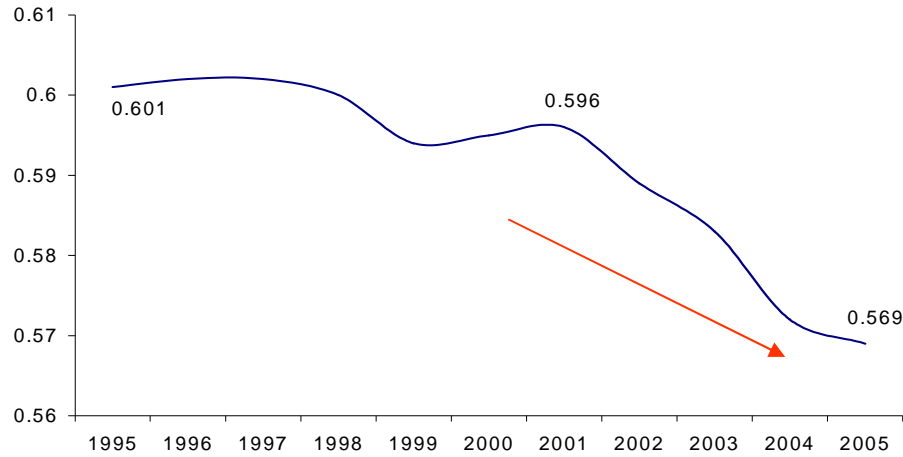
Population under the Poverty line (%)



Source: PNAD-IBGE, FGV

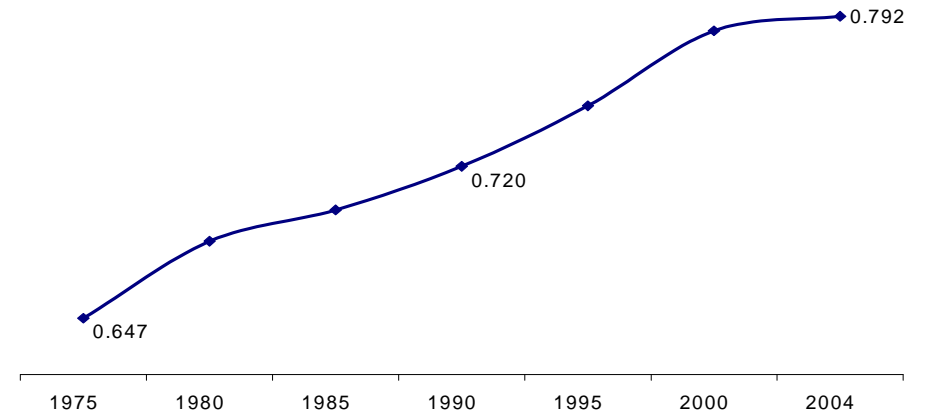
Beyond 3 Pillars - Improving Social Equality

Improving Equality - Brazilian GINI coef.: 1995-2005



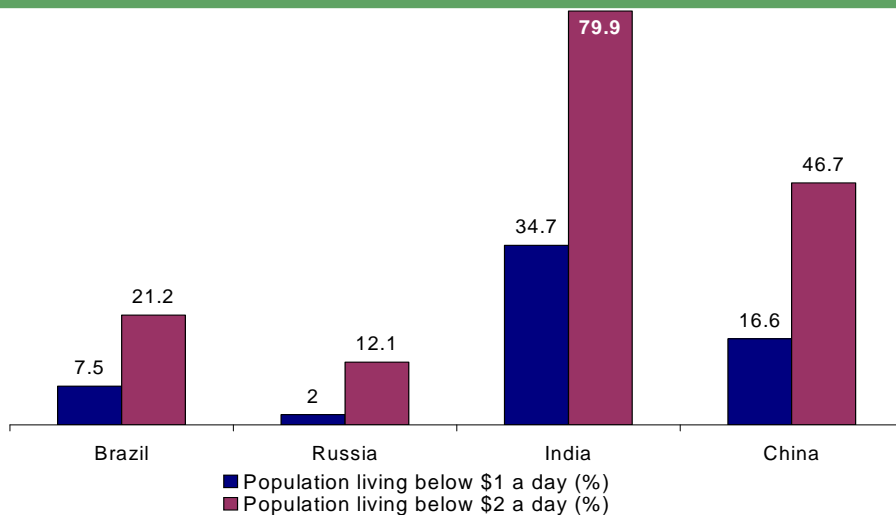
Source: PNAD-IBGE, FGV

Brazilian HDI- Human Development Index



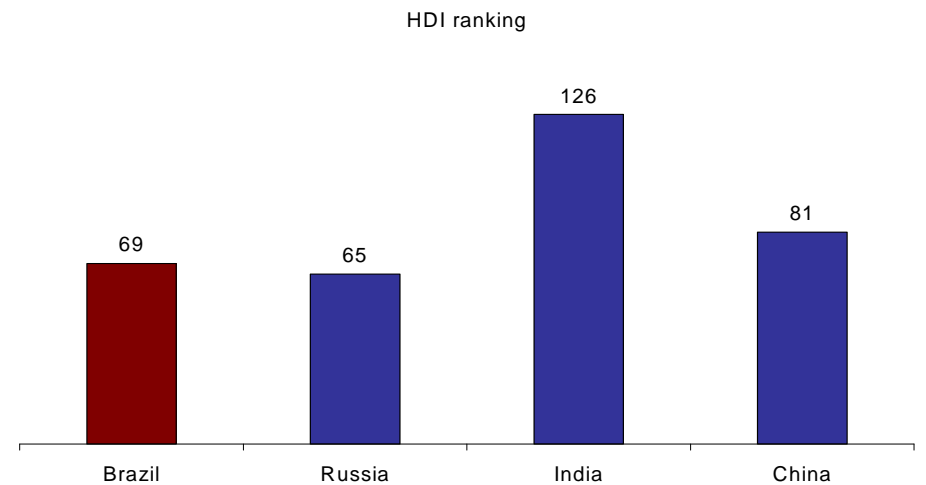
Source: PNAD-IBGE, FGV

Population living in extreme poverty (%) - 2004



Source: World Bank-UNDP

HDI- Human Development Index- 2004



Source: World Bank-UNDP



Brazilian Federal Public Debt

Macroeconomic Overview

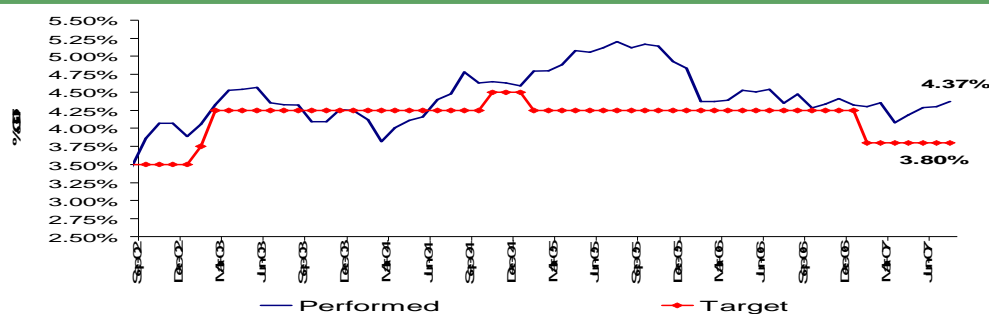
Fiscal Outlook

Public Debt Management

Key reasons why we've always achieved fiscal target

- 1997 - 25 states (out of 27) had its outstanding obligations assumed by the federal gov't renegotiated with a 30-y horizon . They were complied to establish a downward trend in the Financial Debt/Net Real Revenue ratio, which forced them to make adjustments in order to generate primary surpluses;
 - By that contract, the federal gov't can access high-quality guarantees, represented by the constitutional transfers and by tax revenue (ICMS). The states had to present a fiscal plan, on an annual basis, that would track the main sub-national account indicators
 - This framework, allied to state's reduction in financial bank activities¹, has assured the good fiscal performance in local gov'ts, which came from a 0.29% of GDP deficit in 1998 to results higher than 1.10% of GDP in the past few years;
- 2000 - The Fiscal Responsibility Law (LRF) set the conditions to a responsible fiscal management:
 - It limits indebtedness and specific expenditures;
 - Set rules for reaching the primary balance defined in the Budget Guideline Law (BGL);
 - Considered the cornerstone of the Brazilian fiscal adjustment, this law is completing 7 years of existence without any modification, which is particularly important in a democratic environment as found in Brazil.
- 2001 - 180 municipalities (the most indebted ones) also renegotiated its liabilities, under conditions similar to those previously set for states;
- In line with this framework, there is a close follow-up in all levels financing programming, aiming at assuring the primary balance set in the BGL. In case a gov't level doesn't meet its fiscal target, another gov't level must compensate it such that the whole Public Sector is not compromised.

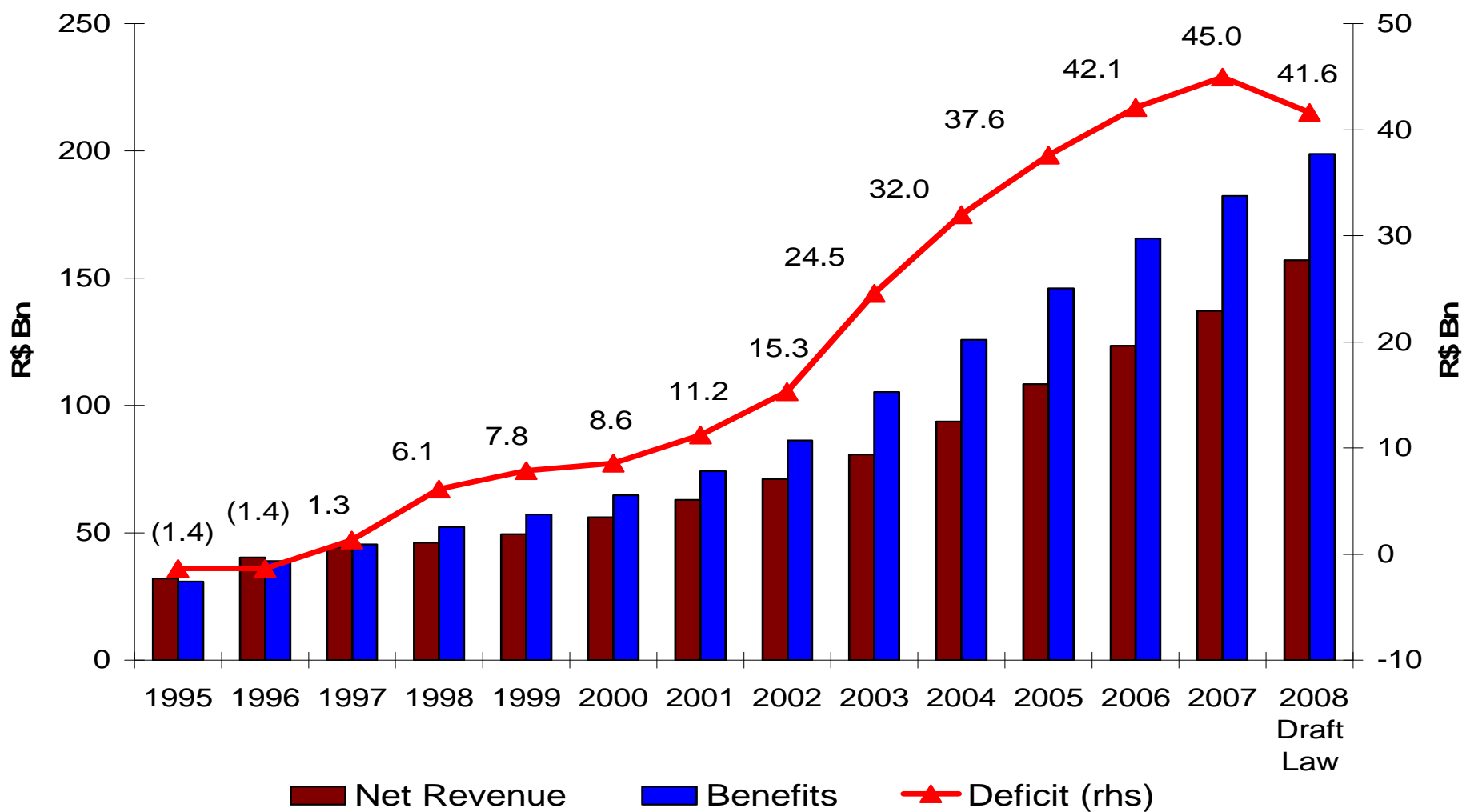
Public Sector Primary Surplus



Source: Ministry of Finance ¹ Eliminated an important source of indebtedness used by local state banks at that time.

Government is aware of its challenges: Social Security deficit should drop in 2008...

Social Security Deficit - 2008 Budgetary Draft Law



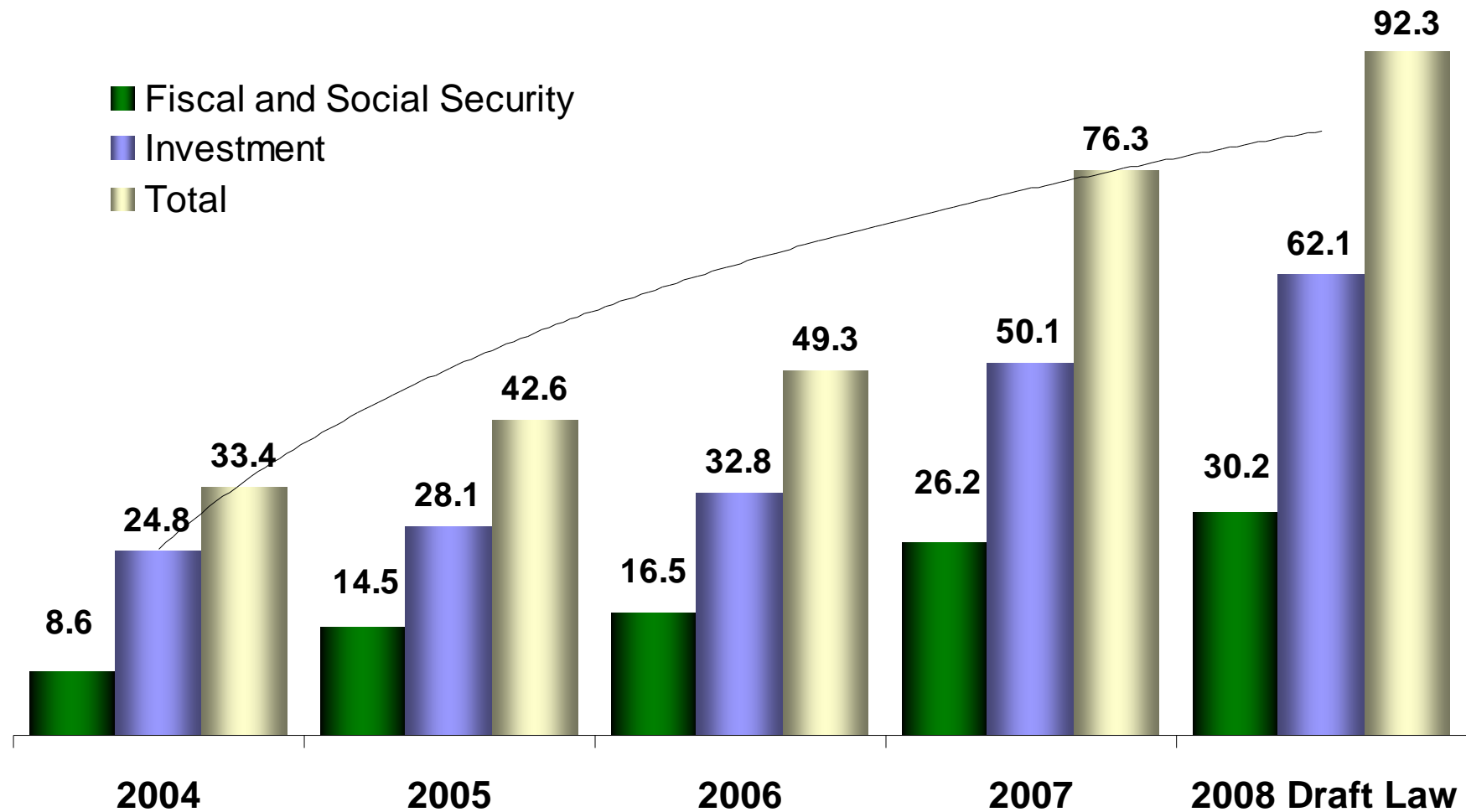
FISCAL OUTLOOK

Source: Ministry of Planning



..and Investments are contemplated in 2008 's budget

Investments - Budget & Social Security - 2008 Draft Law - R\$ Bn



FISCAL OUTLOOK



Brazilian Federal Public Debt

Macroeconomic Overview

Fiscal Outlook

Public Debt Management

- Annual Borrowing Plan

- Recent Events



Annual Borrowing Plan 2007

2007 Guidelines

- Lengthen the DPF average maturity, primarily by increasing the average term of the securities issued in auctions;
- Reduce the share of debt due in 12 months, thus reducing refinancing risk;
- Gradually replace Selic-linked and FX-linked bonds by fixed rate and price index ones, thus reducing the market risk;
- Issue foreign currency bonds based on qualitative aspects, observing market conditions;
- Stimulate the development of the yield curves for federal public securities on domestic and external markets; and
- Broaden the investor base.

Annual Borrowing Plan 2007

Federal Domestic Debt Indicators

Indicators	2003	2004	2005	2006	Jul-07	2007	
						Minimum	Maximum
Stock of DPMFi held by the public (R\$ billion)	731.4	810.3	979.7	1,093.5	1,171.1	1,230.0	1,300.0
Average Maturity of DPMFi (months)	31.3	28.1	27.4	31.1	35.6	32.0	36.0
% Maturing in 12 months	35.3	46.1	41.6	35.7	33.7	29.0	33.0
Share of DPMFi (%)							
Fixed rate	12.5	20.1	27.9	36.1	36.3	37.0	43.0
Inflation Linked	13.6	14.9	15.5	22.5	24.9	23.0	27.0
Floating rate	61.4	57.1	51.8	37.8	35.4	29.0	36.0
Exchange rate	10.8	5.2	2.7	1.3	1.1	1.0	2.0
Others	1.8	2.7	2.1	2.2	2.4	2.0	4.0

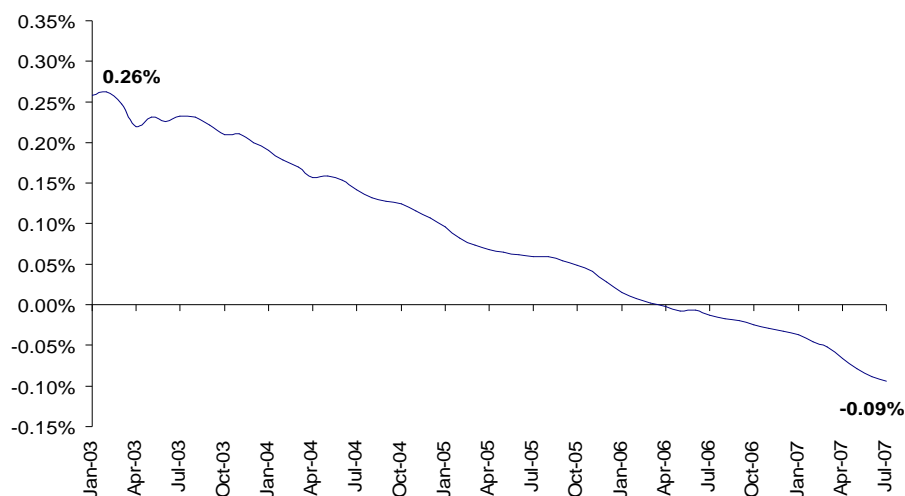
Federal Debt Indicators*

Indicators	2003	2004	2005	2006	Jun-07	2007	
						Minimum	Maximum
Stock of DPF* held by the public (R\$ billion)	965.8	1,013.9	1,157.1	1,237.0	1,289.4	1,370.0	1,450.0
Average maturity - Federal Outstanding Debt (months)	39.0	35.3	32.9	35.5	38.9	37.0	42.0
% Maturing in 12 months	30.7	39.3	38.2	32.4	31.3	27.0	31.0
Share of DPF (%)							
Fixed rate	9.5	16.1	23.6	31.9	33.8	33.0	39.0
Inflation Linked	10.3	11.9	13.1	19.9	22.6	20.0	24.0
Floating rate	46.5	45.7	43.9	33.4	32.1	26.0	32.0
Exchange rate	32.4	24.2	17.6	12.7	9.3	10.0	12.0
Others	1.4	2.2	1.8	2.0	2.2	1.0	3.0

* It includes the external debt under the responsibility of National Treasury

The improvement on the Public Debt composition has reduced the exchange rate and floating rate risks

Impact of 1% FX devaluation on Net PS Debt/GDP

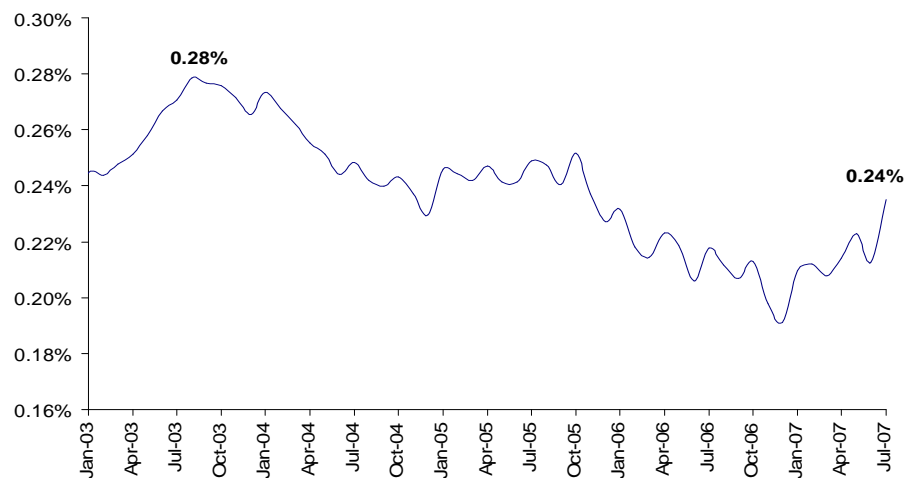


Source: National Treasury

■ The risk of NPSD/GDP not only was reduced in 17.8% of GDP in four years, but the protection created by the fact that we have more FX assets than liabilities has compensated the interest rate risk. This shielded the NPSD against market risks.

■ Considering the reduction on the sensibility of the NPSD to the variations on the currency and on the SELIC rate, in a stress scenario that generates an overshooting of **56.6%** on currency and a following increase of **7.8 bps** on the SELIC rate (three standard deviations), **NPSD/GDP** in December of 2002 **would increase 16.5%** in one year. On march of 2007, this same scenario would represent **a decrease of 1.3%** in the **NPSD/GDP** being the increase of 1.56% on interest rates compensated by the reduction of 2.83% caused by the currency.

Impact of 1% SELIC change on Net PS Debt/GDP*



Source: National Treasury

*In 12 months



Brazilian Federal Public Debt

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Fiscal Outlook

Public Debt Management

- Annual Borrowing Plan

- Recent Events

How did Brazil do during the crisis?

Highlights

- Meanwhile the turmoil, on 23rd August, Brazil received an upgrade from Moody's, reaching the same ratings given by the agencies Standard & Poor's and Fitch Ratings.
- During August 2007, National Treasury placed net issuances of R\$ 7.6 bn* on the domestic market.
- Brazilian indicators show a better performance when compared to other emerging countries.
- FX net outflow wasn't observed during July and August.

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	
Brazil	Moody's	B1	B2	B2	B1	B1	B2	B2	B1	Ba3	Ba2	Ba1
	S & P	BB-	BB-	B+	B+	BB-	B+	B+	BB-	BB-	BB	BB+
	FITCH	B+	B+	B	BB-	BB-	B	B+	BB-	BB-	BB	BB+

* R\$ 4.3 bn including early redemptions and exchanges



How did Brazil do during the crisis?

Foreigners' share in Domestic Debt - Status on own portfolio

- According to the National Treasury (NT) preliminary analysis, confirmed by main custodians, the pace of non resident investments has decreased, although selling off public bonds are quite rare. Most common movements are reinvestments when portfolios come to maturity.
- In fact, during the crises (from June to August), the NT estimates that non resident investors portfolio raised 18% (11% from June to July and 6% from July to August), showing increased confidence as money flowed to a range of country's assets.



The confidence remains...

NTN-F 2017 Yield



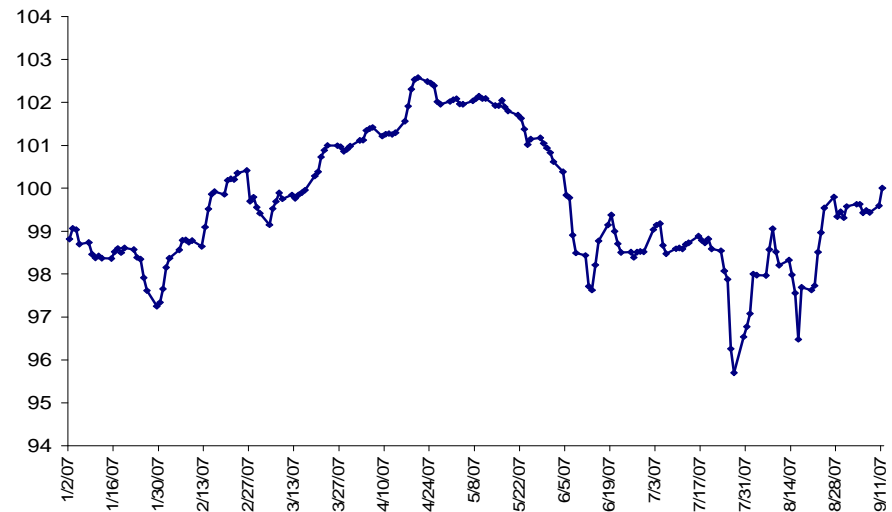
- Financial volatility has been well managed and absorbed by Brazilian markets, since the economy maintains strong economic fundamentals, which reduces Brazil’s vulnerability to external shocks.

José Coutino (Sr. Economist for Latin America at Moody’s Economy.com).

- Brazil’s economic fundamentals have never been as strong as they are at present. Even if there is a global recession, the impact on Brazil will be much smaller than it would have been in years past given Brazil’s improved public debt profile, large international reserve level and current account surplus.

Ricardo Amorim (Head of Latin America Research at WestLB).

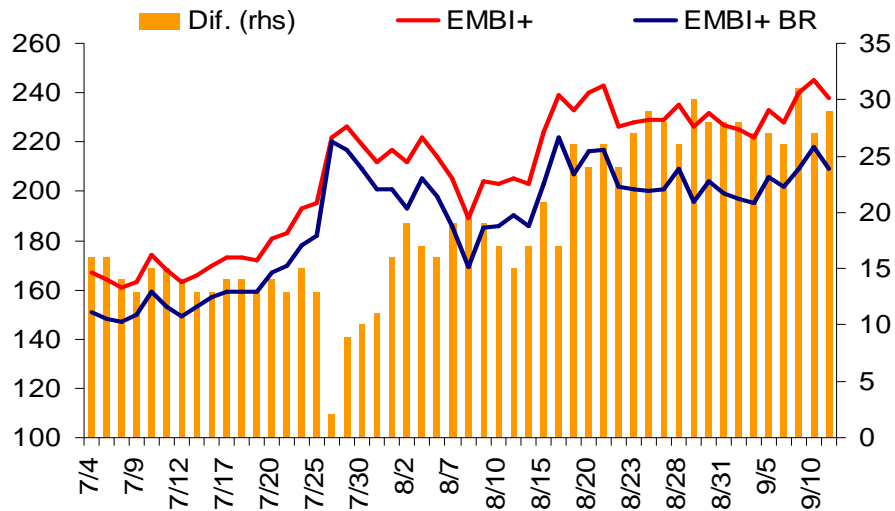
Global 2037 Price





... and the recovery takes place.

Embi



Source: Bloomberg

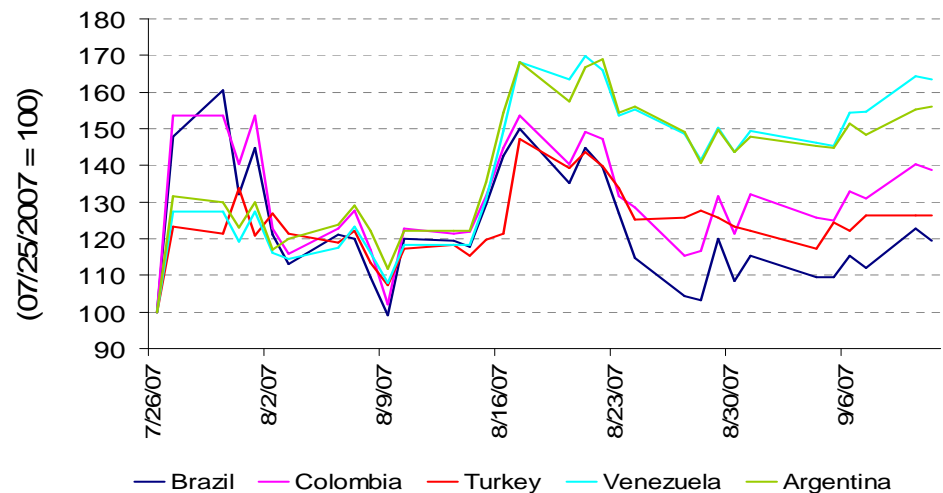
- The Brazilian economy is better to weather turbulence through the capital account as well. Proactive debt management by the public and private sectors has markedly reduced Brazil's external indebtedness and vulnerabilities. As a result, the potential for capital outflows should be less than in the past.

Lisa M. Schineller (Director - Standard & Poor's).

- Brazil is in a strong position to withstand the immediate impact of the crisis, both from financial and trade flows viewpoints ... the degree of Brazil's dependence on securitized instruments and leveraged credit is small relative to that of the industrialized countries.

Alexei Remizov (Senior VP for Global Capital Markets, Latin America at HSBC Economy.com).

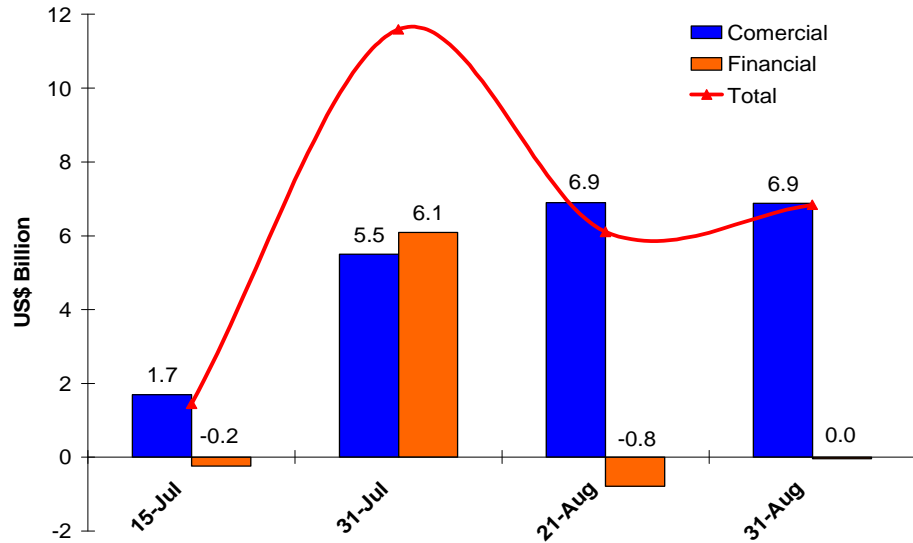
Brazil and Emergent Countries (CDS 5 years)



Source: Bloomberg

How did Brazil perform during the crisis?

FX Flow (operations with clients in Brazil)

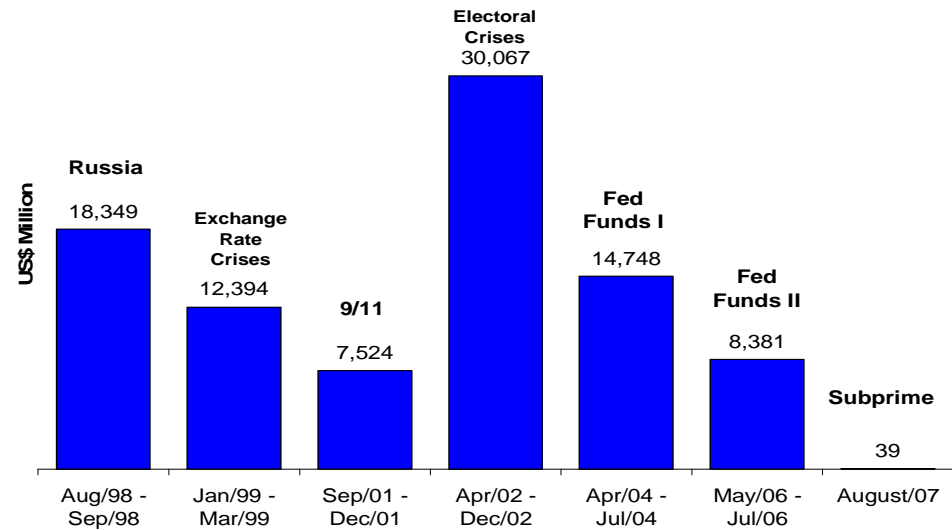


Source: Central Bank

- Compared with past recent turmoil, subprime credit crisis has had little impact on FX flow, which demonstrates a better risk perception on Brazilian economic fundamentals.

- Through July to August, a positive FX inflow has been observed.

Net FX outflow in the financial sector (US\$ mn)



Source: Central Bank



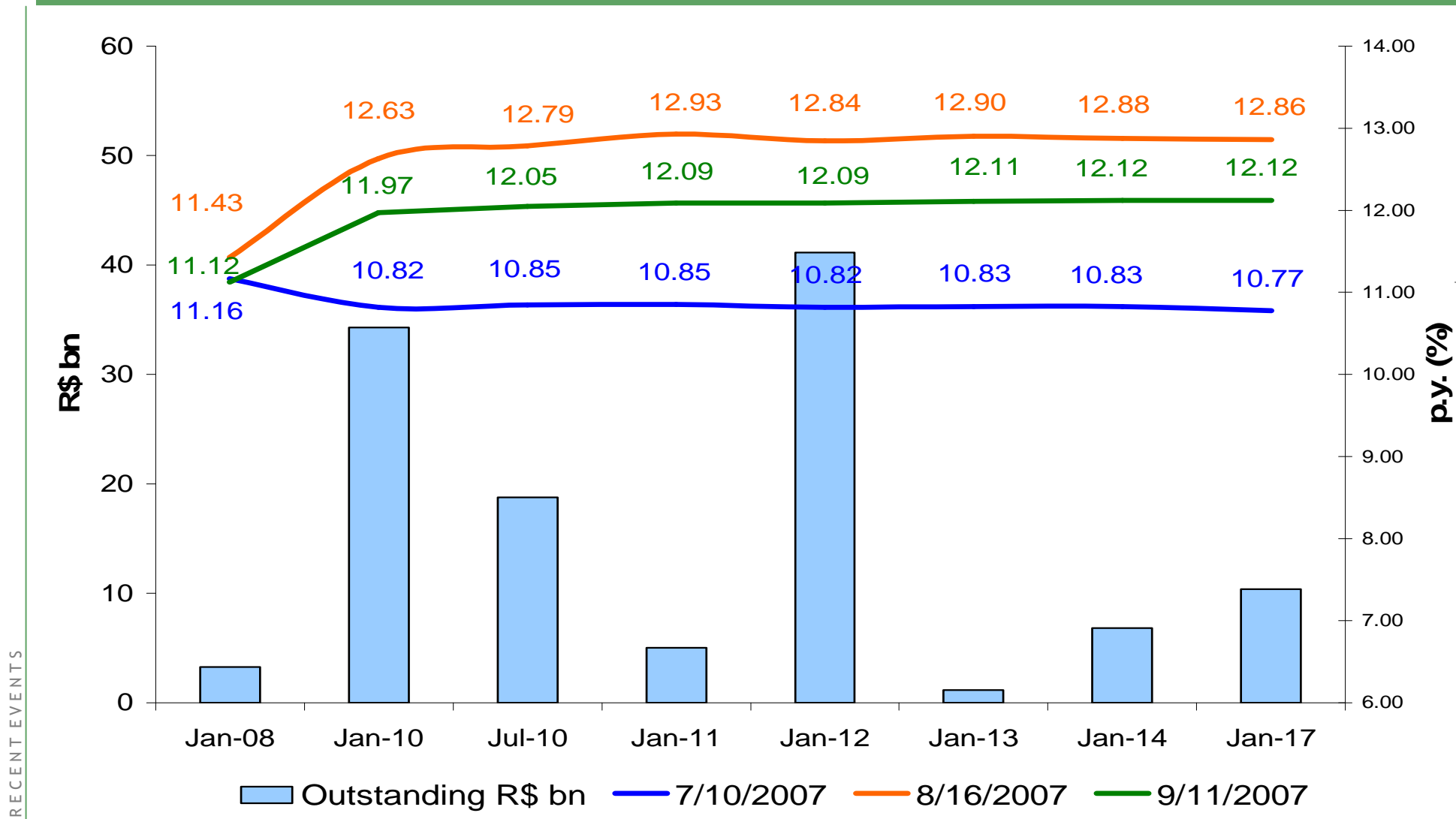
How did Brazil perform during the crisis?

NTN-B (inflation linked) Auctions

- On Aug- 7th and 8th, traditional NTN-B (2009, 2012 and 2017) auctions were performed. In that occasion, 1.5 mn bond was offered: 0.5 mn bond in the first round and 1.0 mn bond in the second round (exchange). All bonds were sold in the first round **totaling BRL 2.3 bn** by the end of the day.
- On Aug-22th, 800 mn bonds units were offered in NTN-B 1st round auction, from which 300 mn bonds were in short maturity bonds and 500 mn bonds were in longer maturities. Once again, all offered bonds were sold (**BRL 2.7 bn**).
- On Aug-23th, the National Treasury performed NTN-B (2024, 2035 and 2045) buyback auctions, to provide reference parameters to the market. There was no significant offers from market participants, showing a high level of confidence in these securities.
- On Sep-11th, there were sold **BRL 3.2 bn** with maturities ranging from 2009 to 2045.

National Treasury Performance - *Big opportunities merge in the domestic market*

Domestic medium term fixed rated bonds (NTN-F) - Outstanding and yields

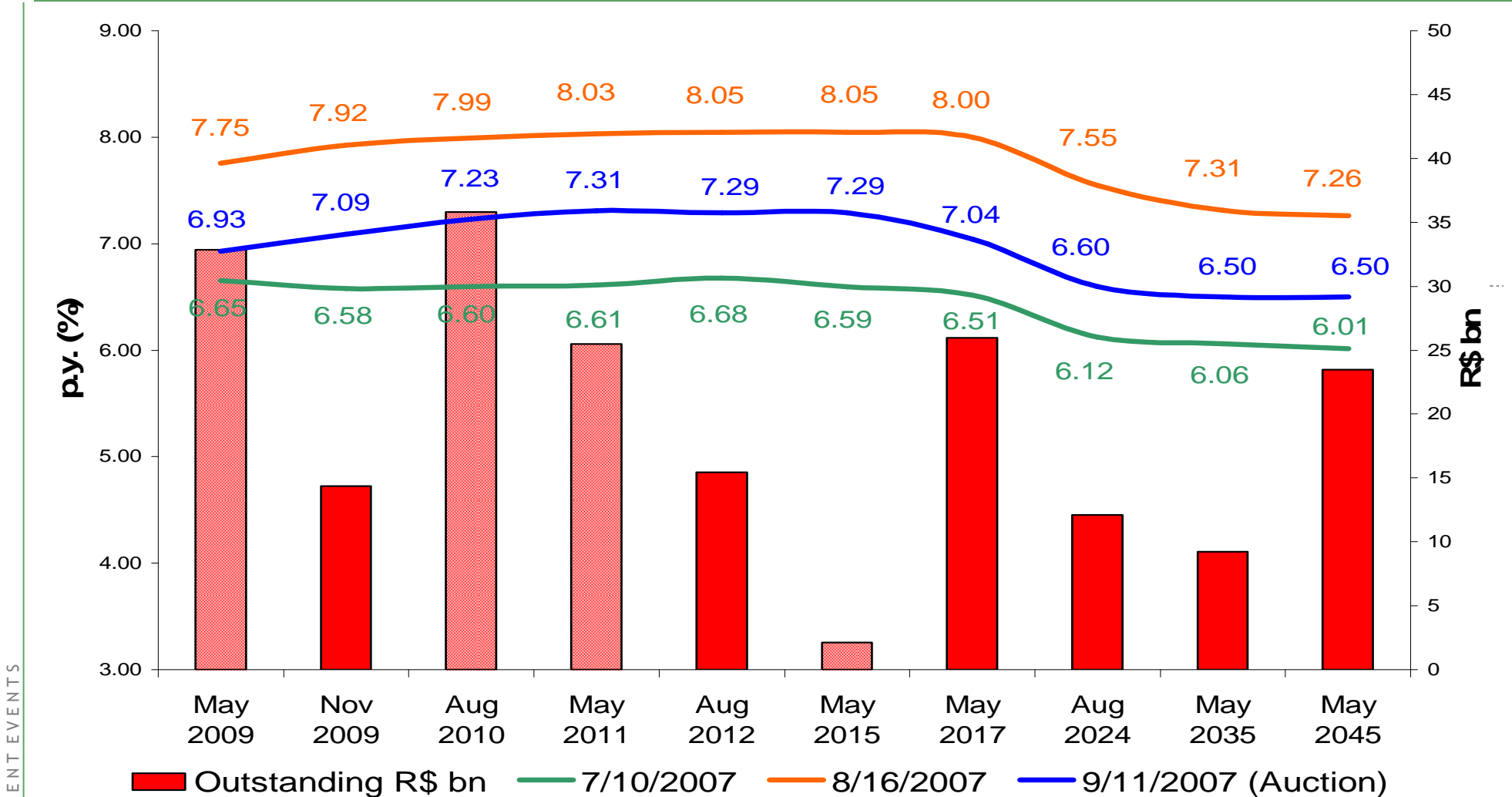


Source: ANDIMA



National Treasury Performance - *Big opportunities merge in the domestic market*

Inflation linked bonds (NTN-B) - Outstanding and yields



Source: ANDIMA

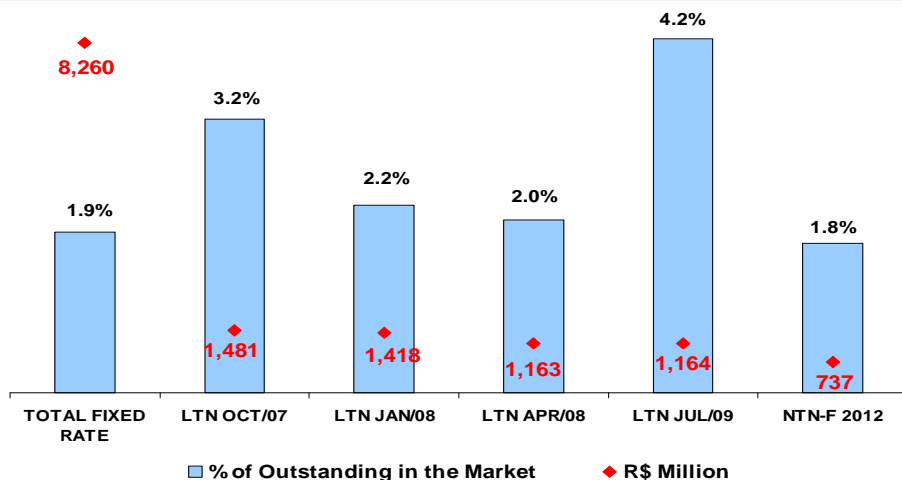
Note 1: The August 2010 NTN-B is not issued anymore.

Note 2: There are NTN-Bs with other maturities.

RECENT EVENTS

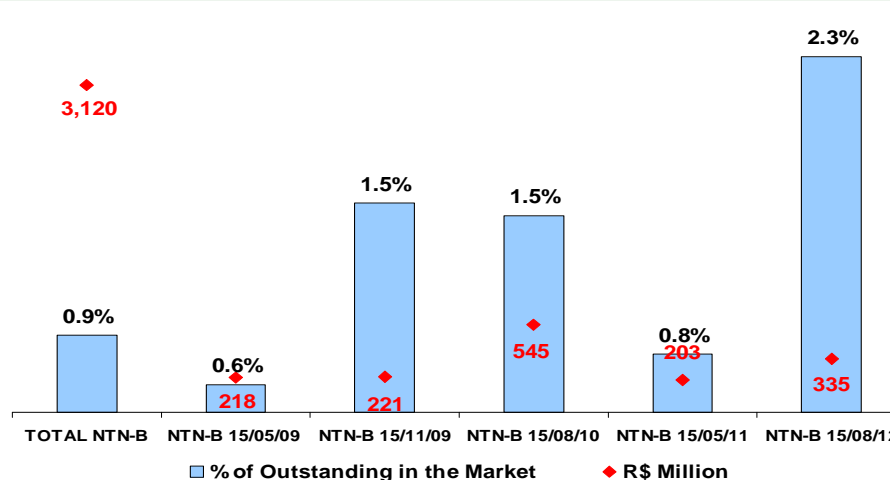
Performance in Domestic Market - Liquidity Indicators

Daily Turnover* - Fixed Rate Bonds



Source: National Treasury * as of July-07

Daily Turnover* - Inflation linked



Source: National Treasury * as of July-07

YIELD x Spread* 8/30/07

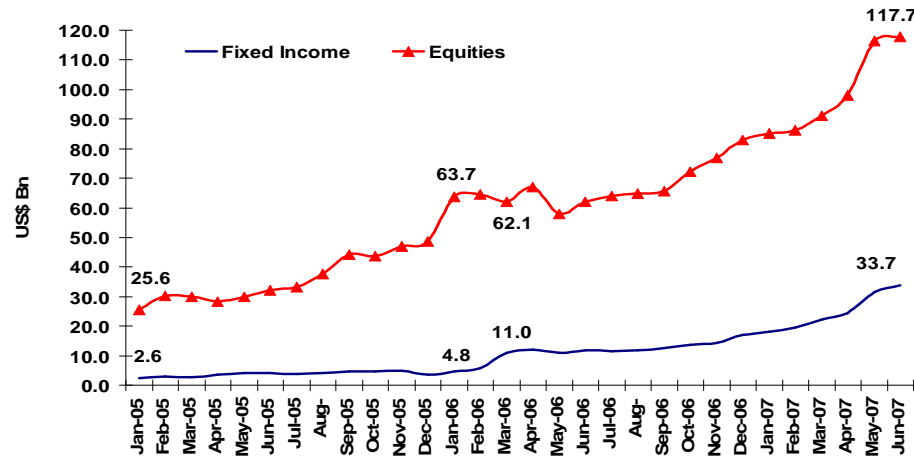
	NTN-B 15/5/09	NTN-B 15/8/10	NTN-B 15/8/12
Yield	7.02	7.23	7.29
Spread (bps)	5	6	7

	LTN 1/10/08	LTN 1/10/09	NTN-F 1/1/13
Yield	11.51	11.96	12.08
Spread (bps)	2	2	2

* The difference between Maximum and Minimum Rate from ANDIMA

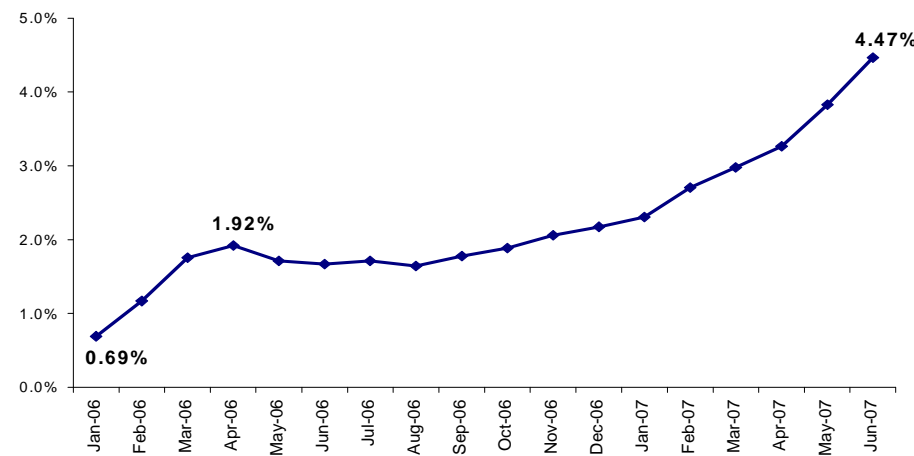
The new frontier: increasing foreign access to the fixed income market

Foreigner's Investors: Portfolio level (US\$ bn)



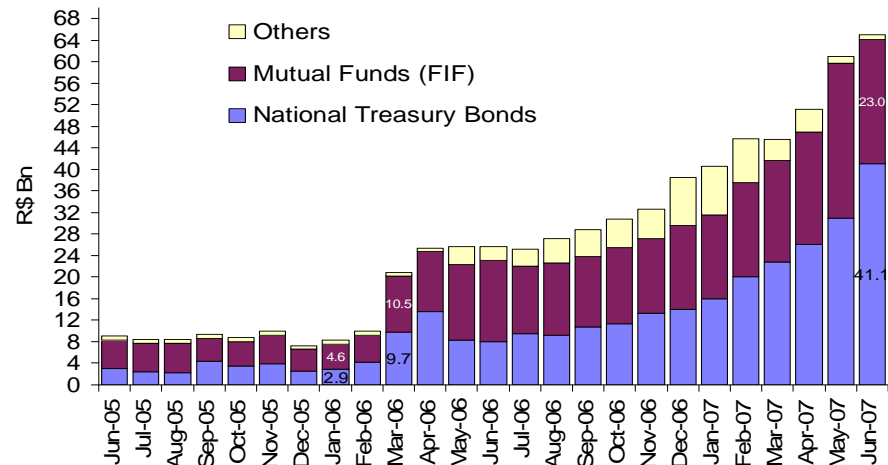
Source: CVM

Foreigner's Investors: Domestic Debt Participation*



Source: SELIC

Foreigner's Investors: Distribution among Fixed Income instruments (R\$ bn)

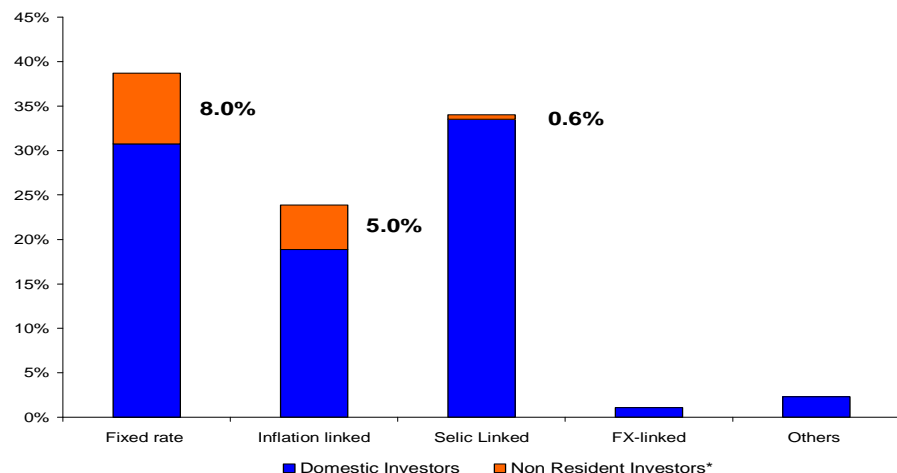


Source: CVM

The good fundamentals of the Brazilian economy are attracting foreign investors to the domestic debt, but there is still much space to grow.

The new frontier: increasing foreign access to the fixed income market

Domestic Public Debt Profile

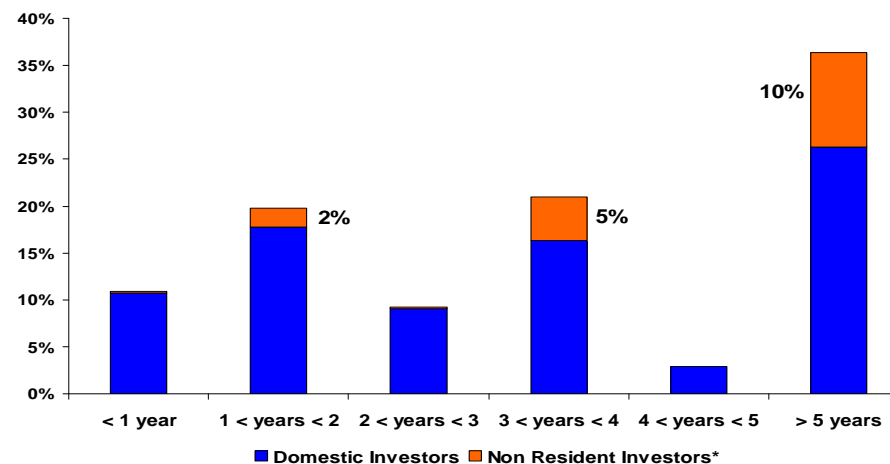


* Estimated Source: National Treasury jun - 07

Considering the guidelines stated in the Annual Borrowing Plan for 2007, in particular the development of the secondary market, the lengthening of the fixed rate and inflation linked bonds and the broaden of the investor base ...

... we believe the foreign investors have an important role to help us in reaching these targets as they usually have a higher participation on fixed rate and inflation linked long term bonds.

Maturity Distribution of Inflation Linked Bonds



* Estimated Source: National Treasury Jun - 07



A steady level of public external debt with improved profile

Impact of the “Cleaning Up” on the Federal Government External Debt from 2005 to 2007

(US\$ bn)	
Operations	Face Value ¹
External Public Debt in Bonds	18.3
C-Bond call (Oct-05)	1.1
Early Redemption Program ²	9.4
Brady Bonds call (Apr-06)	6.5
Tender Offer (Jun-06)	1.3
Contractual Debt	22.1
IMF early payment I (Jul-05)	4.9
IMF early payment II (Dec-05)	15.5
Paris Club early payment (Jan-06 ³)	1.7
Total	40.4

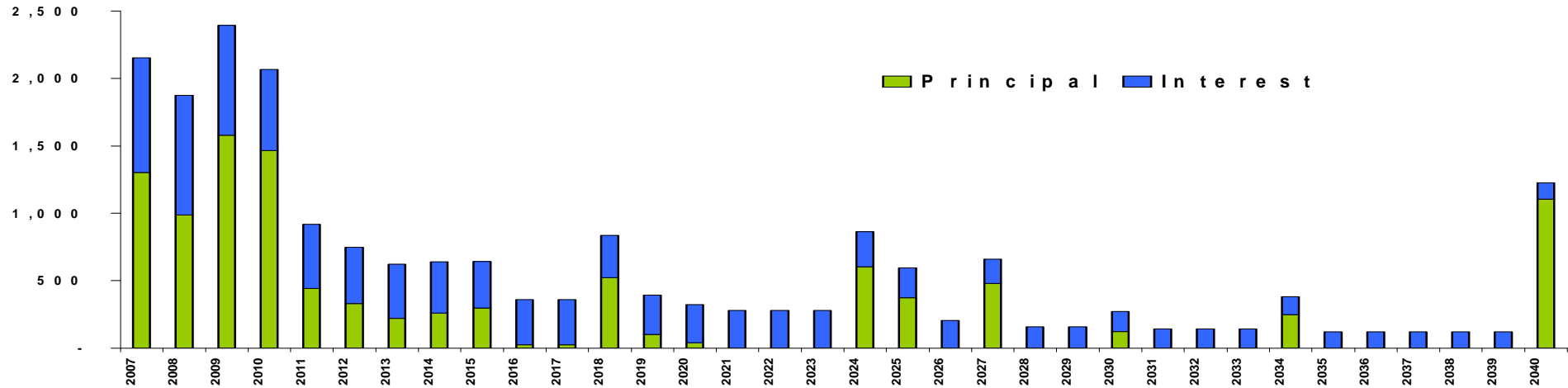
¹ It captures the impact of the operations on the outstanding public debt

² The program started in Jan/06. The value of US\$ 9.4 bn refers to the bonds repurchased up to 06/30/07. Being US\$ 6.1 Bn repurchased in 2006 and US\$ 3.3 Bn in 2007.

³ Announcement

External Public Debt - Indicators

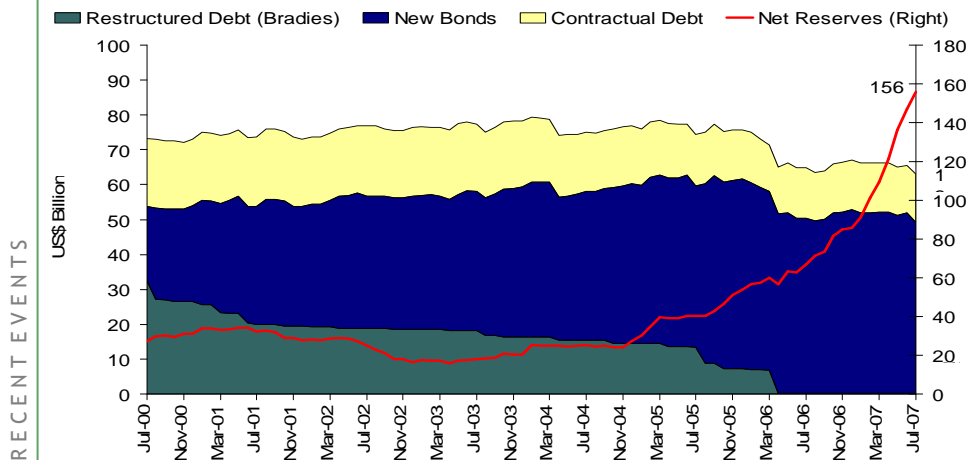
Buyback Program - Reduction on External Debt's Payment Flow (US\$ million)*



Source: National Treasury

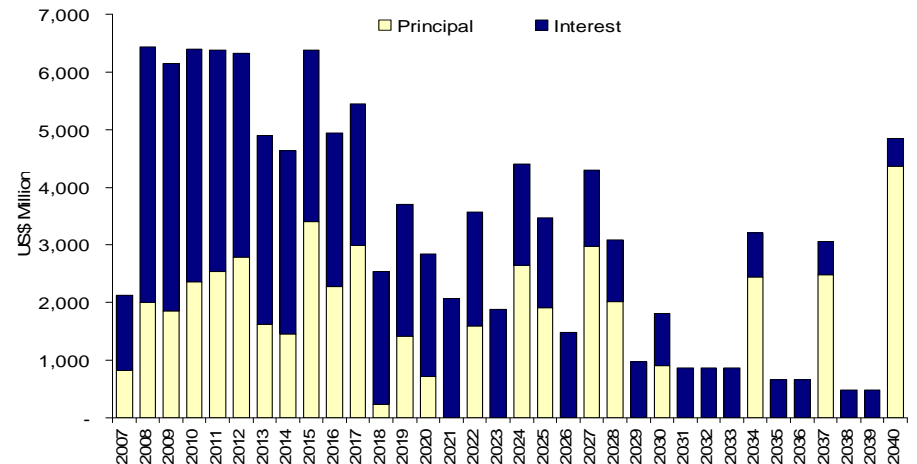
* Since Jan/06 until Jun/07

External Debt - National Treasury



Source: National Treasury

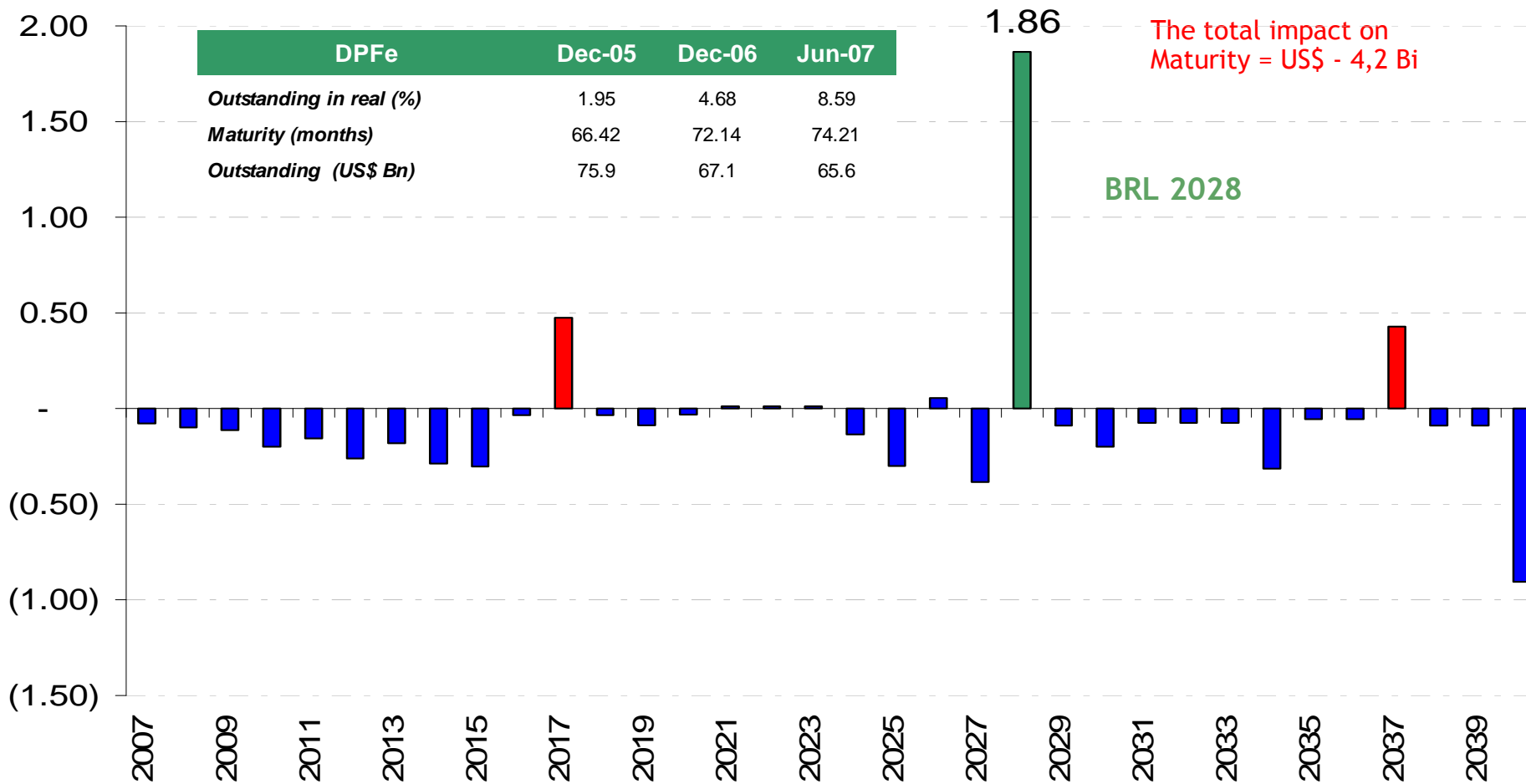
External Public Debt Profile - New Bonds and Bradies



Source: National Treasury.
2007 - From August to December

PAF Strategy Impacts on Maturity

Buyback Program - Reduction on External Debt's Payment Flow (US\$ million)*



RECENT EVENTS

Source: Nacional Treasury

*From January up to July 2007



**For additional information access
Brazilian National Treasury site:**

www.tesouro.fazenda.gov.br

Or contact Institutional Relations area:

brazildebt@fazenda.gov.br

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Tax Reform

September - 2007



Tax System and Development

- ↖ The Brazilian tax system's complexity and lack of neutrality has represented a bottleneck to economic growth
- ↖ The Brazilian tax system's main distortions are related to indirect tributes on goods and services, which are the objects of the reform



Main Distortions

↩ Complexity

← Multiplicity of taxes

- Federal: PIS, Cofins, IPI, CIDE
- State: ICMS
- Municipal: ISS

← Multiplicity of tax rates and regimes

↩ Lack of neutrality

← Cumulative incidence

← Flaws in the international trade tax incidence

← Fiscal war



Federal Taxes Main Distortions

- ↖ Multiplicity of taxes and tax regimes on goods and services (PIS/Cofins, IPI, CIDE)
- ↖ PIS/Cofins – the overlapping of cumulative and non-cumulative regimes compromises the neutrality and the efficiency of resources allocation
- ↖
- ↖ CIDE – It does not grant credit to production adversely affecting the neutrality of the tax system



State Tax (ICMS) Main Distortions

- ↖ Main Problem: Taxation in the state of origin in interstate operations (origin principle)
 - ← Fiscal war
 - ← International trade taxation distortions
- ↖ Fiscal war – low or zero cost to states that grant tax benefits and high to the ones that do not grant them
- ↖ At cost of about R\$ 25 billions/year
- ↖ Fiscal war reactions
 - ← Judicial measure (ADIN) that would be filed on the Federal Supreme Court (STF)
 - ← Credit disallowance by state governments



ICMS – Interstate Taxation

(Considering the following tax rates: 18% internal S-VAT, 0% interstate and 10% F-VAT)

INTERNAL OPERATION

Producer (State A)		Retailer (State A)		
Internal Sale - 100	Internal Purchase - 100	Internal Sale - 150		Tax Collection
Debit	Credit	Debit		
18	18	27		9D

INTERSTATE OPERATION

Producer (State A)		Retailer (State B)		
Interstate Sale - 100	Interstate Purchase - 100	Interstate Sale - 150		Tax Collection
Debit	Credit	Debit		
12	12	27		15
7	7	27		20



ICMS Main Distortions

↩ International trade taxation distortions :

← Favoring imports

- Due to the fact that the ICMS revenue belongs to the addressee State regarding importation, such States have granted a number of fiscal benefits for such commercial activity

← Difficulties to exempt exports due to the credit accumulation.

- Part of the ICMS credits from exports inputs are related to taxes collected from other States. The one where the exporter is located battles to recognize the accumulated credits.



Municipal Tax (ISS) Main Related Problems

- ↖ Productive chain cumulativeness (no-neutrality issue)
- ↖ Conflict regarding the due competence for ICMS revenue collection
- ↖ Intermunicipal conflicts (fiscal war)



Consequences of tax distortions on goods and services

- ↖ Judicial uncertainty discouraging investments
- ↖ Inefficient Productive Factor Allocation
- ↖ Lack of international trade neutrality, harming domestic production
- ↖ High cost on tax compliance
- ↖ Higher level of tax evasion



Tax Reform Main Objectives

- ↖ Set a simple and neutral system of indirect taxes, rationalizing the tax system and enhancing the economic efficiency
 - ↖ Enhance productive investments
 - ↖ Eliminate international trade distortions that harm domestic production, exempting exports and granting equal treatment to imports
 - ↖ Simplify the tax system reducing compliance costs

- ↖ Extend taxpayer's base, reducing informality



Reform Proposal

- ↖ Replace the actual taxes by a dual VAT comprising a state VAT (S-VAT) and a federal VAT (F-VAT)
 - ← The S-VAT would observe the destination principle
 - ← End of fiscal war
 - ← Debate with municipalities about the inclusion of ISS in the VAT's framework

- ↖ Formulation of a regional development policy as an effective and transparent alternative to the fiscal war



Main characteristics of the new VATs

↖ National Uniformity

← Complementary Law

← National Regulation defined by a committee formed by Union and State representatives.

↖ Tax Rates

← F-VAT – federal law

← S-VAT – state law

- States would have autonomy to define tax rates within established national parameters



Main characteristics of the new VATs

- ↖ Non-cumulative
 - ← Debit and credit system
 - ← Credit for capital goods
- ↖ Supervision – specialized according to taxation competence and integrated (with common database and records which could be shared by means of agreement or law)
- ↖ In the interstate operations the origin principle will be obeyed (reducing the tax evasion risk *vis-à-vis* the use of the destination principle)



Example of Interstate Operation Taxation

(Considering the following tax rates: 18% internal S-VAT, 0% interstate and 10% F-VAT)

INTERNAL OPERATION

Producer (State A)		Internal Purchase - 100		Retailer (State A)		Internal Sale - 150		Tax Collection	
	Debit		Credit		Debit				
S-VAT	18	S-VAT	18	S-VAT	27	S-VAT		9D	
F-VAT	10	F-VAT	10	F-VAT	15	F-VAT		5D	
Total	28	Total	28	Total	42	Total			

INTERSTATE OPERATION

Producer (State A)		Interstate Purchase - 100		Retailer (State B)		Interstate Sale - 150		Tax Collection	
	Debit		Credit		Debit				
S-VAT	0	S-VAT	0	S-VAT	27	S-VAT		27	
F-VAT	28	F-VAT	28	F-VAT	15	F-VAT		13D	
Total	28	Total	28	Total	42	Total			



Advantages with respect to the Previous Reform

- ↖ Integration of Tax Administrations: electronic invoice (SPED)
 - ↖ The new database from electronic invoice will allow an appropriate calibration of the new tax rates and a precise estimation of the impacts on each federative unit
- ↖ Reduction of tax evasion and increase of tax revenues due to the use of SPED
- ↖ Intensification of acts to close tax evasion gaps and end of fiscal war will allow for a better rationale for the tax system and tax rates reduction



Transition Phase

- ↖ The ICMS would be maintained for a transition period (about 5 years) and soon substituted by S-VAT
- ↖ The S-VAT interstate tax rates would be slowly reduced, alongside the use of the destination principle
- ↖ The F-VAT's setup will start in 2 to 3 years
- ↖ Specific fiscal war benefits already granted in the ICMS framework would be accepted on the S-VAT framework by means of negotiation between State and beneficiaries and upon CONFAZ's approval.



The ISS Issue

- ↖ Important points regarding the ISS inclusion in S-VAT's framework
 - ← It would solve the main problems related to the ISS
 - ← It would allow the S-VAT to have a complete harmonization with the F-VAT (uniform legislation)
 - ← There would be a possibility to reach a not much explored tax base by municipalities
 - ← Municipalities would lose a share in the taxation competence (specially for median and large cities)
 - ← It would demand a resetting mechanism for municipality tax revenues
- ↖ The transition phase would also take some time



Agenda for the Future: Improving Federalism

↩ The tax reform debate allows an opportunity to revise the “federative pact”, establishing a more fair and rational criteria on revenue sharing

← Current System

- Complex and deficient share criteria
- Earmarking and high level of non-flexible expenditures

← Desirable System

- Greater efficiency in the reduction of regional inequalities
- Share system more suitable to the federative entities' competences



Conclusion

- ↖ A broad tax reform is a positive sum game where everyone wins:
 - ← Economic Efficiency
 - ← Enhancement of investments
 - ← Higher growth

- ↖ It represents an opportunity for tax revenue growth without burdening the society
 - ← Reduction of tax evasion
 - ← End of the fiscal war
 - ← Opportunity for reducing tax rates

- ↖ It is possible to devise a compensation system between losses and gains where there would be no losers

