

# ***The Politics of Decentralized Federalism, National Diversification, and Regionalism in Brazil***

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If the federation does not shrink to fit within the GNP, there is no reform that will save Brazil.

—*Ives Gandra da Silva Martins*  
*Brazilian tax law scholar, 1997*

Federalism has increasingly shaped Brazilian politics in the 1990s. Because the military regime of 1964 to 1985 heavily centralized government in Brasília, civilian political forces since 1985, in reaction, have expanded decentralization in the name of representation and participation. Institutional reforms, free-market (“neoliberal”) policies, and privatizations since 1990 have moved the country away from the legacy of statist authoritarian rule. The executive has lost power to the legislative and judicial branches, the union to states and municipalities, and the state to society, private enterprise, and market forces. The Constitution of 1988 recognized the local government units called *municípios* (loosely, municipalities) as component parts of the federation and shifted considerable political power and tax resources from the federal government to the states and municipalities (Selcher 1989).

By the mid-1990s, however, defects and deadlocks in the functioning of the federal system, including its regional aspects, raised issues of representativeness, accountability, governance, distribution of resources, and fiscal soundness that began to stifle progress toward modernization, greater democratization, and solution of social problems. Brazil has become a federal state that is increasingly difficult to manage. A fragmentation of localized interests characterizes its political process, seriously hindering the building of broader coalitions necessary for a national perspective or sense of national interest in the political class and for a truly national politics.

The purpose of this article is to identify and analyze some of these problematical features, tendencies, and issues in Brazilian federalism today, and to trace the essence of the national debate on its future.

Brazil is a very large and complex country that, in the 1990s, has been dealing simultaneously with several powerful centrifugal forces of change. Brusque and rapid trade liberalization, free-market reforms, economic

integration into Mercosul, and the challenges of globalization generally are redefining the role of the state and making a varying impact on the diverse regions of the country.

In the mid-1990s, Brazil was nearly 80 percent urban and had 11 cities with a population of more than one million, according to the national census (IBGE 1994, 1-36). So metropolitan urban governance is an increasing challenge. There is also an upsurge in the number of medium-sized cities, about 180, in the interior regions. These smaller cities have enough quality infrastructure to become increasingly attractive places to live, and their population is rising above the national average. Municipalism—the drive for experimentation, greater popular participation, and accountability at the local level—has combined with the activity of proliferating nongovernmental organizations to produce some of the most creative and exciting experiments in democracy and empowerment in the country today. There is so much social, economic, and political heterogeneity in Brazil, however, that generalizations about the effects of decentralization are difficult to substantiate at the national level, as Souza has well established (1997).

The significance of federalism, decentralization, and local government as elements of governance, governability, and democratization in Brazil has only recently begun to gain attention from scholars of Brazil in the United States and, to a lesser extent, in Europe. Most foreign scholarship on Brazil continues to emphasize the national government *per se* and national policy issues of First World academic or “politically correct” interest. In Brazil, however, a rich and insightful literature on the effects of federal arrangements on political dynamics has developed in academic circles and research institutes. The focus has shifted from earlier analyses largely of financial flows or legal issues toward the impact of federalism on politics and public policy.<sup>1</sup>

Fernando Henrique Cardoso, of the Brazilian Social Democratic Party (PSDB), was elected president in 1994 by a wide margin, largely because of his former role as finance minister in implementing the successful 1994 Real Plan to counteract inflation. President Cardoso’s program from 1995 to early 1998 was most concerned with issues of modernization, economic restructuring and stabilization, civil service reform, social security reform, balance of payments, and Brazil’s engagement in international markets. Federal system reform, and tax reform as related to federalism, were just too controversial to tackle head-on right away. Cardoso was able to gain a presidential reelection amendment to the Constitution but had to include in it a provision for the reelection of governors and mayors, which will deepen state and local power bases and political stakes. During 1997 and 1998, federalism as an issue was forced to the fore by huge state and local fiscal deficits and federal efforts, in response, to impose fiscal discipline.

In the coming years, federalism-related issues are likely to figure more explicitly in national discussions, and not only because of the varying impact of globalization. Successful experiences in state and local administration and citizen relations are being publicized as never before, in an incipient horizontal federalism that was lacking until recently. Yet the degree of state experimentation is restricted (in contrast to the United States and Canada) because state constitutions, laws, and practices must align closely with federal ones, according to Supreme Federal Tribunal constitutional interpretations. In addition, federal law overrides state law, and the national government can intervene in the states under certain circumstances (specified in Article 34 of the Constitution of 1988). Brazilian state assemblies, moreover, have no strong or innovative legislative tradition, being heavily subservient to the governors.

In the mid-1990s, the National Congress, particularly the Senate, produced more new approaches to federalism issues, especially regional ones, than did the president. Perhaps this is because more than one-third of the senators during that period were former state governors (DIAP 1994), and others were aspiring governors. These are some of the factors that fuel the continuing debate.

## **THE CHALLENGES OF REGIONALISM**

Brazil ranks fifth in the world in territorial size, fifth in population (just over 160 million), and seventh in gross national product. After India and the United States, Brazil is the third most populous democracy. It is one of the several "big emerging market" countries, yet it also has the world's most unequal distribution of income, according to the World Bank (1997, 222–23). As table 1 shows, major socioeconomic and political disparities characterize its five principal regions, set out geographically in map 1.

In the view of some specialists on Brazilian federalism and of many politicians from the three less-developed regions, overcoming these regional inequalities is one of the most serious challenges to federalism and democracy in the country today. The task is to establish at least a minimum national standard for the quality of life (Lavinias 1997). Current federal development programs designed to compensate for regional disadvantages are of questionable efficacy, however, and still depend heavily on developmental paradigms of the 1950s and 1960s. They have been subject to widespread misuse for clientelistic purposes, personal or group enrichment, and tax write-offs. Furthermore, customary incentive-based regional advantages run against World Trade Organization principles, and in 1996 and 1997 caused major unfair trade complaints from Brazil's top two trading partners, Argentina and the United States.

Skepticism about the effectiveness of regional development bodies and funding has grown in the 1990s. As it has, two of the programs have

Table 1. Socioeconomic and Fiscal Characteristics of Brazil's Five Major Regions

	South	Southeast	Center-West	Northeast	North
1. Percentage national territory	6.8	10.9	18.9	18.2	45.2
2. Percentage national population, 1991	15.1	42.7	6.4	29.0	6.8
3. Percentage contribution to GNP, 1995	15.7	62.6	5.9	12.6	3.2
4. Average per capita income (US\$, 1991)	\$3,002.0	\$4,019.0	\$3,032.00	\$1,426.00	\$2,088.00
5. Average per capita income as percentage of national average, 1991	102.8	137.6	103.8	48.8	71.5
6. Percentage of poor persons in region, 1990	20.0	23.0	25.0	46.0	43.0 <sup>a</sup>
7. Percentage of poor in region as percentage of total poor in Brazil, 1990	10.4	33.4	5.9	45.1	5.3 <sup>a</sup>
8. UNDP Human Development Index score, 1991	0.844	0.838	0.826	0.548	0.706
9. Percentage of population in urban areas, 1991	74.1	88.0	81.3	60.7	57.8
10. Percentage of total taxes collected by federal government, 1993					
11. Share of national collection of ICMS, 1995 <sup>b</sup>	11.1	74.6	7.1	6.0	1.2
12. Average ratio of federal transfers to net state revenue, 1991-94 <sup>c</sup>	16.2	60.5	6.4	12.6	4.2
	0.17	0.12	0.38	0.46	0.57

<sup>a</sup>Includes urban areas only.<sup>b</sup>Value-added tax, the principal source of state revenues.<sup>c</sup>Net revenue figures consist of total tax and nontax revenue minus transfers (current and capital) and credit operations" (de Mello 1998). Sources: *Anuário estatístico* 1994 (items 1, 2, 10); IPEA/UNDP 1996 (items 4, 5, 6, 7, 8, 9); CNI 1996 (items 3, 11); de Mello 1998, 20 (item 12).

been dismantled: SUDESUL for the South and SUDECO for the Center-West. Funding for the most active and famous one, SUDENE, for the Northeast, and also for SUDAM, for the Amazon, has been reduced, weakening them to the point of little relevance beyond production of economic analyses. President Cardoso eliminated the Ministry of Regional Integration, leaving a vestige of its functions with a Special Secretariat of Regional Policies in the not fully sympathetic Ministry of Planning and Budget, in an attempt to force the regional question into the context of national integration macropolicy. The retraction of the state's role since 1990 and ongoing federal administrative reform in the midst of large federal deficits have definitely lessened Brasília's ability to alleviate regional inequalities.

The traditional classification of the five major regions is now seen as insufficiently accurate or precise to be of best policy utility, but no new pattern has yet gained general acceptance. Inequalities and public policy issues do not coincide only within these current boundaries; now they also appear in rural-urban splits, differences among metropolitan regions, and disparities among and within states in the same region. Regional development policy must be rethought in a more disaggregated way, within newer paradigms of development and shifting economic opportunities, including integration with neighboring countries and major foreign or domestic private investment flows.

One approach to this reconceptualization, proposed by the federal government's Institute for Applied Economic Research (IPEA), is to apply the United Nations Development Program's Human Development Index to the national situation, regardless of current regional conventionalities, as shown in map 2 (IPEA/UNDP 1996). The most effective new approach would uncover the potentials of each region, so as to promote locally based growth and to bring about a transformation of capacity, rather than focusing on perpetual interregional income transfers and incentives just to compensate for disparities. Restructuring of regional definitions in more policy-relevant terms, however, is hindered by the vested interests of the state and regional actors now dominating the National Congress, and must await a general reform of the federal system.

Brazil today has no regional ethnicities, political parties, social movements, or separatist pressures of practical consequence, but the nation is well aware of regional differences. In political discourse, explicitly regional appeals are more typical of politicians from the three poorer regions, the North, Northeast, and Center-West. Occasionally, politicians from the southern state of Rio Grande do Sul have capitalized on a longstanding regionalist feeling and a sense of local superiority to whip up state pride and "secessionist" sentiments, as they did in the early 1990s, but only at a rhetorical level.

Map 1. The Five Major Regions of Brazil

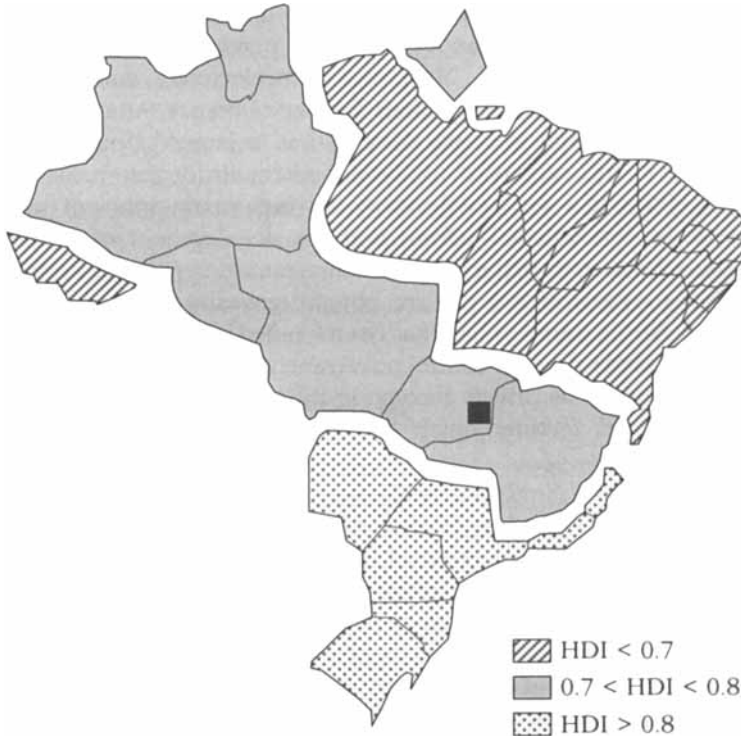


Source: IBGE.

In contrast, politicians from the Southeast, the most developed region and the effective center of national life, very rarely use the regional designation in their rhetoric. The interests of the considerably more pluralistic Southeast and South are segmented by party and by economic sector, and do not converge as clearly around a few key points or benefits as do those of the other three regions—which also have less-complicated leadership structures and less politically mobilized populations. One indication of this difference is that competition for seats in the Chamber of Deputies among the South and Southeastern legislative delegations is more intense than among the Northeastern and (especially) Northern groups (Abranches 1995, 30).

Patronage is a major source of jobs in the three less-developed regions. Public employment, for example, is much more important as a percentage of the total registered workforce—and therefore as a political issue—in the North (39 percent), the Northeast (34 percent), and the Center-West (30 percent) than in the South (20 percent) and the Southeast (18 percent). In the poorest state, Piauí in the Northeast, 52 percent of the

Map 2. The Three Major Regions of Brazil, as Measured by the UNDP Human Development Index



Source: IPEA/UNDP 1996, 13. Used by permission.

registered workforce is in the public sector, higher than Brasília's 48 percent (MARE 1997b).

Party strengths around the country vary through electoral cycles. As a general rule, progressive and reformist parties have a stronghold in the more developed South and Southeast, while conservative parties tend to be more established in the other three regions. Beyond a gradual shift toward a more nationally competitive party system, the regional blocs within each party show local variations in program and style. Congressional voting studies, such as those of Ames or Mainwaring, show region or constituency location to be a stronger influence on deputies' voting records than party affiliation, which changes with considerable frequency (Ames 1995a and 1995b; Mainwaring 1992–93, 1995). Political parties in Brazil are weak as electoral vehicles or as coherent programmatic entities at the national level, commonly losing out in significance to the personal appeal of candidates or to an "ins versus outs" distinction. Many candidates for Congress make little note of their party affiliation in campaigns, and

voters tend to vote for the individual rather than the party. Politicians who switch parties usually are able to carry their voter base with them.

In the debate over North-South regional issues, the impoverished Northeast has long been the classic underdog to the South and Southeast. The Northeast comprises nine states with 18 percent of Brazil's territory, 30 percent of its population, 27 percent of its electorate, and 13 percent of its GNP in an area about 3.4 times the size of France. Among all other Latin American countries, only Mexico has a larger population. The persistence in this region of traditional, clientelistic, paternalistic, and corrupt politics, in a weak civil society in which many principal political figures resist fundamental reform and the development of pluralism, confounds the success of the national democratization process. Popular or grassroots movements are present but are growing more slowly than elsewhere. Northeastern politics has been typified by "rent seeking," in the sense of the elite's drive to control government in order to acquire public funds and benefits as private income in the absence of a strong private sector or a civic culture, much like precapitalist and predemocratic societies.

The traditional Northeastern elites developed, decades ago, what Iná Elias de Castro, an analyst from another region, terms the "myth of neediness" as part of their regional identity and political discourse and strategy, portraying the region (often emotionally) as a peripheral area of the country within the dependency paradigm of development. Through this mythology, argues Elias de Castro, the conservative Northeastern regional elites have bargained successfully for redistributionist concessions from the national government (and therefore from the South and Southeast) while avoiding authentic regional reforms that would benefit the poor, restructure power, and therefore threaten their own privileged status (Elias de Castro 1992). As a result, even when the macroeconomic indicators for the Northeast improve, as they did in the mid-1990s, the social indicators lag behind because of the high concentration of wealth and political power.

Meanwhile, the federal government's reduced role in development and redistribution is curtailing the income transfers the Northeast has come to depend on. Some more modern Northeastern leaders are advocating programs to develop the human and physical infrastructure to promote economic growth that would alleviate the regional concentration of income. To promote cohesion and articulation of regional interests, Northeastern governors hold regional meetings more frequently than do the chief executives of the other regions. Northeastern national deputies and senators are strategically positioned on the key congressional committees, especially those dealing with fiscal and tax matters and infrastructural concerns, and on the joint budget committee of the two houses. They are also well represented among the most influential members of Congress.



The alliance of their largely Northeastern-based Liberal Front Party (PFL) with Cardoso's Social Democratic government has given a more modern and change-oriented ("neoliberal" rather than rightist) image to the PFL. This image enables the party to get much of its program passed, and has eased its metamorphosis in recent years toward the status of a national party.

The PFL delegation became the largest party in both houses of Congress in 1997–98, and is clearly a consistent supporter of Cardoso's programs. Cardoso's own Brazilian Social Democratic Party (PSDB) was only the third-largest delegation in the Senate and the second-largest in the Chamber of Deputies in that period. In spite of this alliance, however, voices in the three poorer regions regularly accuse President Cardoso of disproportionately favoring the Southeast and South in government actions and investments.

## **AN ASYMMETRICAL FEDERALISM**

The unusually great variance in its territorial, economic, and demographic conditions marks Brazil as an example of seriously asymmetrical federalism, a problem analyzed by Ramos (1998). Among and within its 26 states, furthermore, independent of region, per capita income varies considerably. Institutional aberrations overlaying such variations have produced major distortions in representation across the federation, which have become particularly relevant in national politics with the increased power of the National Congress.

The richest and most populous state, São Paulo, accounted for 37.5 percent of the gross national product and 22.2 percent of the national population in 1995. Its per capita income in 1994 was nearly 7.4 times higher than that of the poorest state, Piauí (CNI 1996, 31, 9, 33). The state of São Paulo accounts for more than one-third of the telephone lines in Brazil, more than half of the scientific research, about half of the industrial GDP, and 60 percent of the ISO 9000 Quality Certificates issued in Brazil in 1995 (Nakano 1996). In 1994, 50.7 percent of all federal revenue was raised in the state of São Paulo (Fundação Sistema Estadual de Análise de Dados 1997). The state also has the most sophisticated administrative structure and educational system in the nation and holds the lion's share of foreign investment stocks in Brazil. The state's capital city, São Paulo, is the second- or third-largest urban agglomeration in the world, with world-class problems of governance.

To prevent domination of the federation by a single state (namely, São Paulo), Article 45 of the Constitution of 1988 sets a minimum of 8 and a maximum of 70 federal deputies per state in the national Chamber of Deputies. The Chamber has 513 members serving four-year terms, a comparatively high number per capita and the maximum allowed by the

1988 Constitution. Nine of the 26 states and Brasília, the Federal District, currently have the minimum 8 federal deputies each. Because the constitutional provision in question was not implemented by the necessary "complementary acts" of the Supreme Electoral Tribunal until later, the state of São Paulo until 1995 had only 60 federal deputies, not the ceiling of 70 constitutionally allowed it.

In December 1997, the Supreme Electoral Tribunal voted unanimously not to apply a 1993 "complementary law" that required reapportionment of the Chamber in accord with population shifts, and therefore not to adjust the then-current size of the other state delegations, based on the latest census statistics. The tribunal, in maintaining a temporary constitutional provision meant for the 1986–90 period, argued that the Congress itself would have to pass enabling legislation to allow reapportionment. This did not happen, however, and it remains a very unlikely prospect because of the resistance of those favored by the present imbalance.

Each state elects three senators for eight-year terms, which raises the relative representation of the smaller, more rural, and usually more traditional or conservative states. An imbalance in favor of smaller states goes back at least to the Constitution of 1946. The tilt intensified in the 1970s, when the military regime shifted electoral rules to favor the more conservative and less economically developed states of the Northeast, North, and Center-West (where its ARENA party held greater support) over the more urban and developed states of the South and Southeast, where the opposition was strongest. Because the Congress elected under these rules was also the Constituent Assembly for the 1988 Constitution, the favored states banded together successfully to avoid a shift in the electoral formula.

The creation of three new states (Tocantins in the Center-West and Amapá and Roraima in the northern Amazon) under the 1988 Constitution further tilted the balance by adding 16 new deputies and 9 new senators from these two poorer regions. Mainwaring and Samuels contend that "what distinguishes Brazil is that both the upper and lower chambers are among the most malapportioned among the world's democracies," adding, "among the fifteen (including Spain) federal democracies in the Stepan/Swenden Federal Databank, Brazil has the second most malapportioned upper chamber after Argentina" (1997, 20).

In 1996, São Paulo had 157 times the number of registered voters of the least populated state, Roraima in the Amazon, but only 8.75 times its number of votes in the Chamber of Deputies. According to the calculations of Nicolau, as of 1991, if the state of São Paulo had been granted the proper number of federal deputies, based on its true proportion of the electorate in 1989, it would have had a total of 114 deputies instead of 60 (or 70, after 1995) (Nicolau 1991, 24). Beyond the more dramatic case of São Paulo, the

five states of the developed South and Southeast were underrepresented by from 1 to 5 deputies. Nineteen of the mostly small, thinly populated states of the other three major regions and the Federal District were overrepresented by a factor of 2 to 8 deputies each. Only one state, Rio Grande do Norte, fell at the proper proportional level under the scheme as of 1991 (Ligiero 1991; Teixeira 1995).

For 1995, however, after São Paulo state's representation was raised from 60 to 70 deputies, Santos and Schmitt estimated that the total population-representation balance by state in the Chamber was skewed by about 9 percent of the seats (47 of the 513). This imbalance was attributable mainly to São Paulo's having 21 percent of the national population but only 14 percent of the seats, compared to the overrepresentation caused by the five low-population states of the North, which had the eight-deputy minimum allotment. All other states were not significantly misrepresented (Santos and Schmitt 1995, 51).

As of the mid-1990s, about 58.3 percent of Brazilian voters, by state, were thus penalized in the six most developed states (South and Southeast), which produce 79.7 percent of the national economy but hold only 48 percent of the votes in the Chamber of Deputies. This is also a major comparative disadvantage at the national level for those parties with electoral strength heavily centered in those states, as Kinzo notes (1997, 24). As Nicolau shows, distortions in state representation in the Chamber are considerable—varying, and always present in Brazil's history since 1872, at an average of about 10 percent of the seats. Yet despite their impact on relative party positions and competitiveness, such distortions have not been the subject of much serious electoral scholarship. For example, Nicolau found the PT and the PSDB to have been particularly disadvantaged in the elections of 1994 by malapportionment in the Chamber (1997, 458).

Table 2 shows the degree of representational distortion in the Chamber of Deputies by region rather than by state. The Northeast and South balance out evenly, the Southeast is notably underrepresented, and the North and Center-West show the greatest overrepresentation because of the number of states—six and five (including the Federal District), respectively—that are sparsely populated but have the constitutional minimum of eight deputies each.

The poorer regions that are overrepresented in the Chamber of Deputies tend proportionately to elect deputies from more conservative parties, thus magnifying conservative forces in Congress (Nunes et al. 1995). The broader political consequences of this hybrid federal bargain of over- and underrepresentation are a frequent alliance of conservative and regional interest-oriented senators and deputies from the North, Center-West, and Northeast (plus the Southeast border state of Espírito Santo) voting together on regional interests with a North-South (poor-rich)

Table 2. Distorted Regional Representation in  
the Chamber of Deputies, 1997

	Percent of national population	Percent of seats in Chamber of Deputies
Southeast	42.7	34.9
Northeast	29.0	29.4
South	15.1	15.0
North	6.8	11.1
Center-West <sup>a</sup>	6.4	9.6

<sup>a</sup>Includes Federal District

axis. These three overrepresented regions consistently hold a strong majority on the crucial, budget-oriented, bicameral Joint Committee for Planning, Public Budgets, and Oversight (Samuels 1998, 11–14). They can also form a majority on some key committees and in both houses to block constitutional amendments, which take a three-fifths majority in both houses on two separate votes.

The Departamento Intersindical de Assessoria Parlamentar (DIAP), a labor-oriented research and lobbying group in Brasília, comes to a somewhat different conclusion. Its 1997 annual study of the one hundred most influential members of Congress shows a distribution of formal and informal leadership in both houses quite close to the proportion of the national population represented by each region: Southeast (43 percent), Northeast (30 percent), South (16 percent), Center-West (5 percent), and North (6 percent). Thus, DIAP concludes, the distorted electoral representation in favor of poorer regions is regularly counterbalanced by a de facto legislative leadership structure favoring the underrepresented richer, urbanized, and industrialized regions and the richer states of the poorer regions (DIAP 1997, 18).

It is also noteworthy that the state capitals (in each case the most populous city in the state) total 23 percent of the national electorate. They are also underrepresented in the Chamber of Deputies by a deficit of 7 percent of the total number of deputies, or about 36 deputies out of the 513. This bias in favor of the rural areas, according to Carvalho, clearly tends to disadvantage candidates from more modern ideological or programmatic parties (left or right) that characteristically draw more votes in the urban centers (Carvalho 1996, 41–47, esp. table 2).

## DECENTRALIZATION, GOVERNANCE, AND PUBLIC DEBT

Decentralization of government has been one of the most important and widespread concomitants of democratization in Latin America in the 1990s (Willis et al. forthcoming). As elsewhere, in Brazil the process was launched with the purpose of encouraging state and local initiatives and greater democratic representativeness, based on the concept that those closer to the problems could diagnose and attend to them most effectively.

The size of the consolidated public sector in Brazil in the period 1990–95 was above average for the developing world, and one of the largest in Latin America, at 31.2 percent of GDP (IDB 1997). Measured by total subnational government spending as a percentage of all government spending, in Latin America in 1995, only Argentina was more fiscally decentralized (at 49.3 percent) than Brazil (at 45.6 percent) (IDB 1997).

Under the Constitution of 1988 and its redistribution of tax resources, Brazil has become one of the most politically and fiscally decentralized federal systems in the developing world, such that the federal government's ability to pursue effective macroeconomic and currency stabilization policies has been severely weakened, albeit arguably more democratized (Bonfim and Shah 1994, 535, 540). At the same time, too few forces have been working in favor of fiscal responsibility at any of the three levels of government.

From the perspective of effective and democratic governance, Brazil may well be "overdecentralized," at least in terms of the current overlapping competencies and the unclearly defined responsibilities at the three levels of government—federal, state, and municipal. The president has increasingly needed to arrange particularistic deals, make large concessions, and conciliate local, state, regional, and national interests on legislative issues. Cardoso nevertheless has successfully gained state governors' support in ad hoc coalitions to pass important bills or Constitutional reforms in a more assertive Congress heavily attentive to local interests and power configurations.

Party strength is very much based in the state and local constituencies rather than in the national party offices. From his studies of key roll-call votes, Ames concludes that, more than the directives of the national party leaderships, what matters in determining member voting in Congress is "ideological position, constituency characteristics, electoral weakness, and pork barrel" (Ames 1998). One high-level observer of the national policy process asserted, "there is no decision that does not pass through the sieve of regional interests" (IPEA 1996).

Governors are more powerful and less controlled within their own states than is the president nationally, a position that, alluding to the Empire of 1822–89, Abrucio astutely calls "the barons of the federation" and, in modern terms, "state ultrapresidentialism" (Abrucio 1996a, 1996b).

The governors, particularly in the most populous states, have managed to influence and coordinate their congressional delegations to enhance their own role on the national scene. The possibility of reelection of governors, introduced by constitutional amendment in 1997 and starting with the elections of late 1998, will tend to strengthen their hand. As Samuels and Abrucio argue, the powerful governors' low accountability to the state assemblies and the public creates dilemmas for decentralization as a democratic strategy. It would require enforced accountability and responsiveness at the state level to prevent a new concentration of power there (Samuels and Abrucio forthcoming, 31).

The individual local interests of the 5,506 municipalities (as of early 1998) are diffuse, a situation that inhibits their clear or forceful articulation as a class, despite national associations of municipalities and the excellent decades-long work of the Brazilian Institute of Municipal Administration (IBAM). Municipal interests are usually expressed individually to or through the intermediation of the governors and the national deputies, rather than autonomously or in a proactive "horizontal federalism."

Samuels has demonstrated that Brazilian national legislative politics is characterized by short congressional terms; a typical deputy's career includes a strong component of time spent in local and especially state positions. Many federal deputies serve only a single four-year term, or possibly two, during which they build up influence to return to municipal or state politics at a higher level, bringing particularistic benefits from Brasília to their constituencies (Samuels 1998, 3). In the 1996 elections, for example, 116 of the 513 federal deputies (22.6 percent) stood for election for mayor; they would have had to resign their congressional seats only if elected.

Municipalities have always been a principal focus of Brazilian loyalties, beyond what is generally acknowledged in foreign political studies of the country. According to an Ibope public opinion poll of March 1998, 55 percent of a nationwide sample of voters considered the municipalities to be the most important level of the government for dealing with daily issues, while only 17 percent cited the states and 16 percent the federal government. Fifty-one percent felt that the local level should have the most financial resources of the three; only 20 percent favored the states and 14 percent the federal government. Popular support for decentralization was evidenced when 40 percent said that the municipalities should provide most public services, while 25 percent favored the federal government and 21 percent the state governments (*Estado de São Paulo* 1998a).

As antiquated local power structures persist or subnational political groups gain predominance, the resolution of major national issues, such as constitutional reforms, is delayed. Former planning minister and federal deputy Antonio Kandir referred to this dispersion of interests as a

spreading "hyperlocalism" propagated by interests that worked, among other things, to continue the current tax structure, which hindered Brazil's international economic competitiveness (Kandir 1998).

To get around the difficulties of dissensus in the lack of a reliable governing majority in the multiparty Congress, President Cardoso adopted the expedient of issuing numerous "provisional measures" (*medidas provisórias*), temporary executive decrees that must be renewed periodically but need congressional approval only to become permanent law. This repeated practice creates many *faits accomplis* for the Congress and gives an air of "imperial presidency" to his leadership style. By early 1997, Congress had taken steps to limit somewhat his provisional measure authority, to force more issues into the congressional negotiation arena.

The fiscal decentralization mandated by the Constitution of 1988 proceeded apace, shifting tax bases, revenues, and block transfers to the states and, especially, the municipalities. The process had a haphazard quality, however, because no concomitant strategy was followed to develop and coordinate either the responsibilities or the capabilities to meet them. Nor were overlapping, concurrent, or exclusive competencies adequately defined in law or ironed out through intergovernmental consultations or planning (Souza 1994, 1996). At least 80 percent of the federal government's receipts are now marked for rigidly blocked entitlements, including mandated transfers to the two lower levels. Yet in actual practice, Brasília kept many of its previous functions, even as it gave up some of its share of the tax revenues and its flexibility in their use.

The states and municipalities, with their new largesse, began to expand their payrolls, fund a surge in retirement pensions, and instigate costly public works. Public works spending to impress voters in election years became standard practice. In the years of high inflation, states became accustomed to borrowing against inflation and allowing monetary correction (the inflation compensation index) to devour the interest payments. When the Real Plan practically ended inflation in July 1994, states continued the same borrowing habits but suddenly confronted real interest payments and payrolls no longer reduced by inflation. As of January 1997, 22 of the 27 larger federal units (the 26 states plus the Federal District) had debts equal to at least one year's revenues (*Folha de São Paulo* 1998).

Brazilian states may borrow from the Inter-American Development Bank and the World Bank, as well as from private banks, but only with the approval of the Senate and the Brazilian Central Bank. State governments, furthermore, borrowed so much from their own state banks—usually under legally questionable circumstances and sometimes to fund public projects around election time—that most of the state banks underwent federal intervention for bankruptcy during the early 1990s. The state with the worst situation in volume of sheer indebtedness was São Paulo, which

owed 29 billion reais (about US\$25.6 billion) to its state bank, Banespa. This became a notorious case of gross mismanagement; the bank is now slated to be privatized.

In November 1997, the federal government gave the governors a choice of three alternatives to restructure the insolvent state banks: privatization, liquidation, or transformation into regional development agencies. Of the 33 state banks extant at the start of the process, about a dozen, once made solvent, will remain in state control as commercial banks, most likely with the participation of private capital. Debates in the state governments over which alternative to pursue and the size of the total capital involved, relative to both the federal and the private sector roles in the transition, will stretch out settlement of the issue. In January 1998, the Central Bank director in charge of restructuring the state banks estimated that the total future bill to the National Treasury to complete the changeover would be the concession of R\$50 billion (US\$43.9 billion) in loans of 30 years' maturity at 6 percent real interest. Of the total, 74 percent will go to the state of São Paulo (Cristino 1998).

In December 1996, an average 74 percent of states' liquid receipts were going to payrolls (and increasingly to retirement benefits and pensions), varying from a high of 92 percent for Espírito Santo to a low of 61 percent for Paraíba (MARE 1997a). By late 1997, this national average was reduced to 67 percent (MARE 1998, 54). A survey by *Folha de São Paulo* in January 1998 found that states spent an average 30 percent of their payroll on inactive and retired workers and surviving spouses, partly (and ironically) because of a wave of early retirements offered in the mid-1990s to trim public payrolls (Bressan and Osman 1998).

Most state governments followed the financially questionable practice of paying retirements out of current income, which was a continuing personnel expense. The states of Bahia, Pernambuco, Ceará, and Espírito Santo creatively eliminated this burden by using funds from privatizations to create capitalized pension funds, a practice more states are adopting to follow national administrative and retirement fund patterns being set in Brasília.

Downsizing of public payrolls continues, because under the 1995 Camata Law, beginning in January 1999, states that spend more than 60 percent of their net receipts on payroll risk suspension of federal funds. As of May 1998, 17 of the 27 larger federal units were still above the 60 percent limit. Some officials in the national executive branch advocated extending the effective date, however, because it is illegal for states or municipalities to fire personnel in the three months before an election and before the elected officials take office.

States (and some municipalities) compete sharply to attract domestic and foreign investment by offering investors generous long-term tax breaks, credit concessions, and donations of land. The Tax on Circulation



of Merchandise and Services (ICMS), a value-added tax, is the major source of state revenue, one of the principal taxes in Brazil, and a chief source of state transfers to municipalities. Waivers of this tax are the most common state incentive offered to investors. The competition to lure investors by waiving this tax has been termed a "fiscal war," a vicious cycle of bidding in which states reduce their own tax revenues (and consequently those of their municipalities) and assume broad commitments in exchange for dubious economic benefits. The contest was especially fierce over the location or relocation of automobile assembly plants controlled by multinational corporations. The effort to lure these investors was part of Brazil's larger competition with Argentina in Mercosul to lure international investment.

The overall drama got a clear regional twist when President Cardoso decreed Provisional Measure 1532, in March 1997, which allowed several federal tax breaks for automotive assembly plants installed in the North, Northeast, and Center-West. These deals, ironically, occurred under a national automotive investment policy promoting incentives in exchange for exports at a time of major overcapacity in the world automotive industry, throwing into further question the reality of the assumed benefits. The federal government condemns but has not yet limited the practice of granting incentives, and actually encourages it by not establishing a coordinated national industrial policy.

Under the Constitution of 1988, creation of new municipalities is a prerogative of the states. Anticipating the greater flow of resources mandated to the municipalities, many states created new ones by subdividing others, just to receive more federal transfers. The total number of municipalities jumped 31.4 percent in ten years, from 4,189 in 1988 to 5,507 in early 1998. More than 4,000 of them in 1998 had fewer than 20,000 inhabitants and depended on intergovernmental transfers for at least 80 percent of their revenues. By nature, the urban property taxes attributed to the municipalities provide a significant income only in those with more than 50,000 inhabitants; smaller-population municipalities tend to be heavily rural, which is a federal tax base (Lopes Filho 1998). The creation of new municipalities was slowed by Constitutional Amendment No. 15, of September 12, 1996, which requires a municipal viability study followed by a general plebiscite in the affected municipalities before resizing into new units can occur.

The current constitutional practice of attributing the same social service responsibilities to all municipalities nationwide, despite their wide range of social and economic characteristics and functional capabilities, just does not work. The mayors' offices in many municipal capitals suffer serious staff and budget inadequacies, and are unable or unwilling to provide services to their own rural areas. Rural municipalities in the three poorer regions are falling behind badly in quality of services, and many are

in total abandon, as the Northeast drought of 1997–98 vividly demonstrated. For municipalities that depend heavily on federal and state transfers and borrowing, the quality of their political relationships with the state government and Brasília is vital for administrative success.

The federal Fundo de Participação dos Municípios (Municipal Participation Fund) is an indispensable source of income for most municipalities. But many of those that have a tax base do not even bother to utilize it fully (perhaps to avoid local political confrontations), preferring to depend more heavily on federal and state transfers than they would have to if they resorted to the fund. A survey by Federal Deputy Alexandre Cardoso of Rio de Janeiro concluded that as of 1995, 54 percent of the municipalities of Brazil did not raise enough revenue within their own borders to cover even the administrative expenses of the mayor's office and the municipal council. In 1,965 of the poorest municipalities, 36 percent of the total at that time, no federal taxes were collected at all (*Folha de São Paulo* 1997).

The federal government is ultimately responsible for coordinating the overall system. Brasília must serve as creditor of last resort and disciplinarian for curbing cost overruns and excessive indebtedness, in order to pursue its goal of controlling the money supply and keeping inflation down under the Real Plan. By 1996, however, fiscal imbalance and public sector debt were so severely out of control that they threatened the stability of the anti-inflation plan and came under IMF and World Bank criticism in that regard. The states' financial weight thus is heavy enough to cause considerable difficulty for the federal government. (Ironically, those states with the worst bank debt were precisely those most important in Cardoso's governing coalition—São Paulo, Rio de Janeiro, Minas Gerais, and Rio Grande do Sul.)

The Cardoso administration kept the Real Plan working by maintaining unusually high real interest rates to attract foreign capital for a more favorable balance of payments and by sustaining an overvalued real. These measures also affect the federal system by suppressing the economy, lowering tax income, and increasing the interest owed by all three levels of government. Additionally, as a way to ward off foreign capital flight (related to the Asian financial crisis that began in October 1997), the Central Bank's basic annual interest rate was raised in November 1997 from 20.7 percent to a world-class 43 percent. The rate dropped to 34.5 percent in February 1998 and to 28 percent in March, but climbed to 50 percent in September 1998 in response to the Russian fiscal crisis. Interest rates on government debts usually average below this basic level, but were forced sharply upward as well.

In February 1994, the Congress passed the Fiscal Stabilization Fund (FEF) measure, which eventually became the Social Emergency Fund (FSE). The Cardoso government has used this fund to impound or divert

funds destined for the states and municipalities—even constitutionally mandated transfers—for the sake of “emergency” fiscal stabilization. This strategy has made the two lower levels of the federation leery of any federal scheme that allows Brasília discretion over when and how to release money due them.

In September 1996, the federal government considerably reduced state revenues (and the funds they transferred to the local level) when it exempted from payment of the ICMS all primary and semimanufactured products headed for export, as well as capital goods that companies used to upgrade their operations. The purpose was to promote exports and increase national competitiveness, so Brasília promised payment of a partial compensation to states and municipalities for the losses suffered from this so-called Kandir Law. Delay in reimbursement, however, added one more dimension to the struggles in the federal system.

The main tool Brasília has used to impose some financial discipline and accountability is to set stringent contractual conditions when renegotiating state and municipal debts. Such demands have included privatization of the notoriously deficit-prone state enterprises (especially electric, water, and sewage companies and banks), restrictions on or prohibition of certain types of new loans, payment of principal on existing loans, and reduction of personnel. Yet the pressure to relax rules and roll over debts is heightened by the need for political support from governors and key legislators to pass administrative reforms in the Congress. Thus policy has vacillated, but has tended toward repeated and routine redefinition of the rules and leniency in debt rollovers in return for promises of austerity and fiscal discipline from the state governors.

The overall situation became even more controversial when a 1996–97 congressional investigation uncovered multibillion-dollar diversionary schemes for public funds in the city of São Paulo, in five smaller cities, and in the states of São Paulo, Alagoas, Pernambuco, and Santa Catarina. Using real and supposed court orders to pay debts they owed, these federal entities gained legal power to issue bonds. The bonds then were not used to pay debts but were fraudulently shifted to payroll, public works, and falsification and speculation for private gain, as the bonds were overvalued and resold for high profits.

In November 1997, the Senate, the constitutional regulator of procedures regarding debts in the federal system, approved a resolution requiring states to use in debt repayment 50 percent of the revenues gained through privatization of state enterprises or forfeit Senate support for loans. About one-third of the value of state assets to be made available on the market as of January 1997 were privatized during that year, with most of the remaining two-thirds to be sold during 1998, largely in the state of São Paulo. In December 1997, however, the Supreme Court unanimously ruled in favor of a petition from 14 governors and suspended the Senate's

measure until its legal validity could be judged. With federal resistance to previous forms of deficit financing, privatization is the only remaining politically easy resource for cash-strapped state governments; and a tempting one in 1998, an election year in which the great majority of governors ran for reelection for the first time.

The financial reports for 1997 in the federal system confirmed that public debt was accelerating rapidly. Yet tax receipts hit a record level, over 31 percent of the GDP, a high level for a developing country, largely because of more rigorous income collection and spending-based (in contrast to production-based) taxes. At year's start, the federal government anticipated a public sector primary surplus of 1.5 percent of the GDP among all three levels of government. Not considering the income from privatizations, the year actually closed with a primary deficit of 0.94 percent of GDP and a nominal deficit (including interest and inflation) of 6.12 percent of the GDP, or 4.3 percent as the operational deficit, if inflation is factored out, according to the Central Bank (*Estado de São Paulo* 1998b). The three levels of the federation blamed each other. Indeed, not all states had public finances in deplorable shape, and some used expenditures during 1997 to pay various types of old debts (some of which the Central Bank does not account for).

Total public debt stood at 35.3 percent of the GDP at the end of January 1998, not a high level by international standards. It nevertheless provoked concern for the rapid rate of growth in the public deficit during late 1997 and early 1998, the effects of ongoing high interest rates, and indications of further financial indiscipline at all levels of the federation.

During 1998, the federal government concluded a three-year process of renegotiating practically all state debt, thereby refinancing R\$84.9 billion (US\$74.5 billion) of state debt, according to the then acting treasury minister (Otta 1998). (Previous rounds of renegotiation occurred in 1989 and 1993.) The federal government vows to promote state fiscal soundness by enforcing the contract terms strictly and levying penalties on violators. States are bound to stringency programs of reduced expenditures and are to repay the National Treasury over a 30-year period at the concessionary rate of 6 percent yearly interest above the rate of inflation. States under contract are not allowed to issue bonds to cover deficit financing until their debt total is down to the equivalent of 1 year's receipts. For the major states, this period was expected to last for at least 10 years.

The states as a group have thus lost much fiscal autonomy to Brasília, as a consequence of their earlier excesses. In June 1998 the National Monetary Council prohibited the states and *municípios* from contracting new foreign debts. Shortly thereafter, the Senate severely restricted the ability of states in financial difficulties to contract any new debts except those related to a financial restructuring program. Meanwhile, during 1998,

pressure grew from the local level for a major federal renegotiation of the municipal debt, demanding treatment more like that afforded to the states.

## CONCLUSIONS AND PROSPECTS

In a metaphorical sense, Brazil stands between municipalism and globalization, and so must deal simultaneously with a varied set of contradictory challenges at all levels of the federation. Beyond the three constitutional levels, federal, state, and municipal, Brazilian politics disperses in the five major regions, the "three Brazils" revealed by the UNDP Human Development Index, the largest national rich-poor gap in the world, major rural-urban disparities, and the challenges of economic integration into Mercosul.

Issues in a complicated configuration of regionalism and federalism are holding up decision making at the national level. As they receive serious attention, more substantive public policy issues will be easier to resolve and governability will be facilitated. Although some modest progress has been made toward fiscal accountability and effective budget oversight, on the whole, Brazil's federal system is still poorly equipped for the challenges it faces.

The financial size of the federation must be brought within the realistic limits of a sound economy. Yet crucial general tax reform will open up the problematic chief issue of revision of revenue allocations among the levels of the federation. This is a controversy so sensitive that President Cardoso was reluctant to push the topic during the major election year of 1998. The federal government's general intention in its initial proposals clearly was to modify the types of taxes, both to rationalize and consolidate the overly complicated system and to increase the degree of its own control over the national tax revenue base. One specific motivation was to curtail states' abilities to alter their tax bases or rates, both to end the "fiscal war" and to reduce their spending.

Brasília also wants to reopen the question of the distribution of responsibilities, in the belief that the Constitution of 1988 gave to the states and municipalities more funds than tasks, while the federal government suffered the reverse. States and municipalities, of course, strongly resist any weakening of their tax base, attributions, or autonomy, and suspect federal intentions in any "compensatory fund" for state losses on replaced or modified taxes. Such concerns about change are especially strong among legislators from the three poorer regions, which are overrepresented in Congress and more heavily dependent on revenue transfers from Brasília.

The South and Southeast, or the São Paulo–Rio de Janeiro axis, can no longer dominate the country as these regions once did. They must acknowledge a more cooperative national perspective, considering the changing geoeconomic and political roles of the other three regions. New cities in the interior, metropolitan regions, and development poles are

emerging, with or without explicit recognition, such as in the Vale do Paraíba between Rio and São Paulo. States, regions, larger cities, and nongovernmental organizations are beginning to conduct their own foreign relations regarding trade, loans, investment, personnel training, and tourism, which is creating a "multilayered diplomacy" for Brazil.

These new definitions of regions arise as Brazil pursues the integration of its regions both nationally and into the continental and global economies. Soon, for example, Mercosul's regional goals will require more compatibility among the members' tax systems, particularly on movement of goods, which will affect Brazil's federal arrangements and regional development schemes. This explains Brasília's interest in federalizing the ICMS, now administered by the states; Brazil is quite unusual in attributing to the states, rather than to the central government, collection of and revenues from a value-added tax (Martins 1998).

Mercosul trading already pulls the Center-West toward Bolivia and Paraguay and the South and Southeast toward Argentina and Uruguay. Other regions are striving to be included in this activity. The North is discussing a waterway to link it to the Rio de la Plata region (much of the North's political leadership revolves around the Manaus Free Trade Zone). Yet there is a danger that the dominant, wealthier areas of Mercosul's member countries will interact with each other transnationally, boosted by official investments, and leave the poorer regions out of the picture.

On the positive side, participation, creativity, fiscal responsibility, and change of political style have proven to be more effective solutions than the old systems of regional claims, entitlements, patrimonialism, or clientelism. For example, the city of Curitiba and the state of Ceará have attracted international acclaim for their success in innovative practices for more democratic and effective public administration. Ceará has made quite notable efforts to professionalize and motivate public officials and to assure accountability in policy making and public service delivery (Tendler 1997). The municipal model of participatory budgeting, most thoroughly developed in Porto Alegre, is spreading around the country as a way to give citizens a voice in the local budgetary process (Larangeira 1996).

Respect for citizens, efficiency, transparency, and accountability are cutting across party lines at the local level generally, but the Workers' Party (PT) in particular has promoted this approach to social problems. Local government is the focus of greatest citizen awareness and can be a seedbed for civil society, citizenship, and the building of a democratic political culture. Public-private partnerships attuned to popular movements can benefit from the participation of nongovernmental organizations like Pólis in São Paulo. In a nation that is now nearly 80 percent urban, cities of various sizes will assume greater weight as political actors, particularly if what are the beginnings of an effective horizontal federalism can be further developed beyond mere joint stances vis-à-vis Brasília. The municipal

elections of late 1996 clearly showed, above all, that voters throughout Brazil responded favorably not to the entreaties of former kingpin governors but to local governments that had achieved concrete accomplishments in the delivery of services and that had won local citizens' respect. If these positive tendencies could generalize and spread upward throughout the federal system, they would revolutionize democracy and federalism in Brazil.

## NOTES

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1. An outstanding example of this literature is the ongoing series of volumes on federalism, *Federalismo no Brasil*, published by the Fundação do Desenvolvimento Administrativo of the State of São Paulo (FUNDAP) and Editora UNESP, under the general editorship of Rui de Britto Alvares Affonso and Pedro Luiz Barros Silva: *Desigualdades regionais e desenvolvimento* (1995); *Reforma tributária e federação* (1995); *A federação em perspectiva* (1995); *Empresas estatais e federação* (1996); *Descentralização e políticas sociais* (1996).

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