Stanford
Center for International Development

Working Paper No. 149

THE BRAZILIAN FEDERATION: FACTS, CHALLENGES AND PERSPECTIVES [*]

by

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May, 2002

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Foreword

Following decades of protectionism and a powerful interventionist state, the Brazilian economy suddenly exposed itself to external competition and went through a fast process of privatization. The institutional reforms implemented in the nineties helped to stabilize the economy and create a friendlier environment for attracting investments and fostering growth. Despite of uncertainties that still loom in the horizon, regarding the prospects for reconciling sustainable development and macroeconomic stability, the overall balance of the results achieved in the past decade is positive.

In the process of moving from a closed, state controlled economy to an open privately run one, the federal regime affected and was affected. Indeed, the greater the degree of sub national governments interests in proposed reforms, the more difficult was to put them into place. In some cases, they had to be lured into accepting changes that reduced state and local autonomy. Even in cases where federal interests were not so evident, the power of state and local governments in the National Parliament give room for bargaining over compensation for less autonomy or financial losses.

Of the reforms that stood high in the agenda for modernizing the Brazilian economy duringthe nineties, three deserve special attention: Privatization, Public Employment & Social Security and Taxation. Given the central role of healthy public finances in the strategy for macroeconomic stability, these reforms were object of an intense debate and much disagreement. Of these, privatization was the only case of success so far. Some advances were made in reducing futur e claims on the national budget, but the Tax Reform remained impervious to a call for alleviating the excessive burden on the competitiveness of the Brazilian economy.

This paper intends to explore the three reforms mentioned above, providing some facts, showing what were accomplished and indicating the main reasons for the failures to implement deeper changes or to succeed in the negotiations. The focus of the analysis is on

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[*] The paper reflects the authors' opinions and not necessarily those of their affiliations. The statistical base was organized by economist Erika Amorim Araujo. The text utilizes information available at the end of December 2001, particularly data available at the site "Banco Federativo": http://www.federativo.bndes.gov.br.

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the challenges the Brazilian federation faces in the wake of institutional reforms that may redress the balanced of power in the federation and reduce state and local government autonomy.

With this in mind, the paper is organized as follows. To set the stage for looking into the future, a brief historical account of the main facts behind the decision to adopt a federal regime in the 1889 Constitution is provided in the first session. The main goal of this historical recompilation is to stress the fact that fierce resistance to a strong central government and some important attempts to secession marked the seven decades that preceded this decision. The reasons behind these movements – loose economic ties among the Brazilian regions and significant external economic relations of Brazilian states – may come back again, mirroring what was a common feature in the past.

Section two intends to summarize the recent developments that shaped the way the Brazilian federation looks nowadays. Two important facts had decisive influence: the transition from authoritarian rule to democracy, following the demise of the military regimen in 1985, and the policies adopted in the nineties to put an end to an era of high inflation, focused on eliminating the public deficit and enforcing fiscal discipline. Whereas the 1988 Constitution pushed for greater decentralization and sub national autonomy, the anti-inflationary drive asked for hard budget constraints that impinged on federal autonomy. These contradictory forces make it difficult to reconcile macroeconomic needs and sub national autonomy.

The issues involved in appraising the measures adopted to adjust the fiscal accounts to meet the targets set in the macroeconomic stabilization plan are the subject of the next session. This session highlights the difficulties faced to implement reforms aimed at cutting public spending and social security benefits, as well as enforcing fiscal discipline at all levels of government in the Brazilian Federation. The so-called " Fiscal Responsibility Law", approved in 2000, shows good prospects for the nearby future, but it is still too early to make a reliable appraisal of its ability to sustain fiscal discipline, given the resistance to alter well-entrenched habits of budgetary profligacy.

Section four describes the privatization program, its successes and some implications. In less than a decade most of the former state owned enterprises were sold in public auctions, generating substantial resources that helped to avoid a fast increase in the public debt and to save tax money, previously used to cover for subsidies, for more important social needs. Besides, the privatization program contributed to increases in productivity that reinforced competitiveness of the Brazilian manufacturing sector in domestic and international markets.

The last of the three reforms dealt with in this paper – Taxation - is the subject of section five. Despite of being recognized as the most important reform of the past decade, it has been impossible, so far, to reach an agreement as to the new model for assigning tax powers in the federation, mainly for reasons related to intergovernmental and regional conflicts. This section stresses the point that these conflicts may increase in the nearby future, due to the possibility of greater regional domestic inequalities following the economic integration of the Americas, in the absence of a new approach to regional development policies.

Whereas macroeconomic pressures for healthy public finances helped to push the privatization program and implement hard budget constraints, pressure groups and intergovernmental conflicts blocked the passage of more ambitious proposals for cutting deep in public spending and moving ahead in implementing a tax reform that is in need to improve competitiveness and bring a better balanced federal regime. Further pressures arising from the calendar of regional economic integration may give new impetus to the institutional reforms that are still in need for a successive integration of the Brazilian federation in the global economy.

1 – History

Contrary to common wisdom, decision to adopt a federal regimen in Brazil was not a merely imitation of the North American model. Since the beginning, the integrity of the Brazilian territory has been threatened by attempts to secession. During colonial times, relationships among the Brazilian provinces were practically nonexistent, not only by reasons of distance and lack of means of communication, but also by absence of economic motives for interchange. Trade of Brazilian raw material was a monopoly of the Portuguese crown, which maintained bilateral relations with the more important Brazilian provinces.

Changes in this situation were prompted by the temporary installation of the Portuguese court in Rio de Janeiro, in the first years of the nineteen-century. Resentments grew in other provinces, setting up the stage for conflicts. The decision to put an end to the Portuguese rule in Brazil gave the opportunity for these conflicts to surface.

Important separatist movements followed the declaration of independence from Portugal. Nourished by the ex-metropolis and supported by the Portuguese military garrisons in their territories, the old provinces of Pernambuco, Bahia and Pará refused to acknowledge the authority of the new Emperor. Loyal troops forced the rebels to surrender, after eleven months of cruel battles to maintain the integrity of the territory conquered during the colonial period. The monarchic project, conceived by José Bonifácio, also helped to keep the national unity.

According to Machado (1980), by the time the Constitution of 1824 came to life, Brazil had eighteen provinces: Cisplatine (nowadays the Republic of Uruguay), Rio Grande do Sul, Santa Catarina, São Paulo, Mato Grosso, Goiás, Minas Gerais, Rio de Janeiro, Espírito Santo, Bahia, Alagoas, Pernambuco, Paraíba, Rio Grande do Norte, Ceará, Piauí, Maranhão and Pará, to which another, Sergipe, followed suit. Being a creature of the will of the Emperor, the Constitution of 1824 aimed to reinforce the power of the center over the provinces, under the argument that it was necessary to keep them united.

During the short period that the first emperor stayed in power, other liberal movements jeopardized the stability of the country, which fed themselves in an open animosity among native Brazilians and fellow Portuguese, to whom the emperor was attached. Having his position undermined by internal disputes, D. Pedro I was forced to renounce. In April 7, 1831, he passed the crown to his son and went back to Portugal. An interim government was put into place to manage the affairs of the country during the infancy of the new emperor.

The emperor's decision to leave the country was not enough to placate the liberals. During the process that led to the dissolution of the Constitutional Assembly and the decision to impose the Constitution of 1824, the main leaders of the liberal movements expressed their discontent with the authoritarianism of the emperor. Being beaten in the first struggle, they did not abandon their aspiration to put in place a constitutional regimen anchored in liberal principles, within which federal ideas had strong support.

A proposal to set up a federal monarchic regimen in 1834, when the Constitution was substantially modified, did not succeed. The main change introduced in 1834 was the creation of legislative bodies at the provincial level, which, contrary to the will of the federalists, increased the centralization of political power by reducing the autonomy that the municipalities enjoyed during the colonial era and the first years of the empire[3].

Revolts continued to challenge the authority of the rulers during the regency. Far to the north, in the Province of Para, a revolt known as "a cabanada" was suppressed only after the imperial troops faced several defeats. The forces loyal to the central governme nt also suffocated new uprisings in Bahia (sabinada) and Maranhão (balaiada), but all these movements contributed to weaken the regimen. The answer of those in power was to enthrone D.Pedro II in 1840 (when he was only 14 years old) and try to further increase control of the center over the provinces.

Of the insurrections of the time, the longer and bloodiest of all occurred in the province of Rio Grande do Sul. Known as the "Farrapos War", it went on for a decade (1835-1845), being defeated only after much effort of the imperial army, which suffered heavy material and human losses. The leaders of this movement proclaimed the creation of the " Estado Rio Grandense", to be an independent and sovereign state and openly admittedly its union, through a federation, to other Brazilian provinces that came to adopt the same ideals and the same regimen[4].

In his struggle to avoid the fragmentation of the Brazilian territory, the imperial rulers did not save efforts. Besides having to deal with insurrections that propped out in different and distant parts of the country[5], Brazil has to engage in external military conflicts with Argentina (1852) and Paraguay (1864-1870) to curb expansionary projects of these countries and sustain national cohesion. Other border conflicts were solved by diplomatic negotiations.

Since independence, conflict among demands for greater province autonomy and pressures for centralization have been in the roots of insurrections against the imperial power. In a time where economic relations among the provinces were almost nonexistent, the eruption of these conflicts could not be seen as a surprise, as there was no coincidence of interests. Furthermore, the drive separatist was fuelled by a spurious correlation among liberalism and decentralization, which attributed to pure conservatism intentions to reinforce power at the central level.

To no surprise, thus, the birth of the republic was seen as a victory of the liberal spirit, whose main manifestation was the rally for the abolition of slavery. The republican Constitution of 1891 wholly enshrined the ideas of decentralization and federal autonomy, initiating a cycle that alternates periods of decentralization and centralization of power which still is a peculiar feature of the Brazilian federation.

The first republican years also witness political turmoil and reactions against the stance of the new regimen. The military, that played a decisive role in the defeat of the empire, sooner walked against liberal interests, giving way to newer insurrections prompted repressed with violence by Marshal Floriano Peixoto, who assumed the Presidency of the Republic after its first president having renounced in 1891.

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[3] According to Pedro Bauducchi, appud Toledo Machado, 1980.

[4] Gonzaga Duque (1998), p. 168.

[5] Besides the ones already mentioned, the regency and the first years under Pedro II witness rebellions in Minas Gerais , Sao Paulo (1842) and Pernambuco (1848).

In a thorough description of the Brazilian revolutions during the first 75 years of the republican era, Carneiro (1965) emphasizes the role played by Floriano in smashing the main movements that threatened the consolidation of the newborn republic: the revolt of the navy and the federalist revolution[6]. The first one did not last, but the latter, which encompassed the three southern states, went on for more than three years, being suppressed after fierce fights, more than ten thousand casualties in the army and heavy material losses.

At the beginning of the nineteen-century, the unity of the country was no more a matter of concern. Other conflicts that emerged in the first republic (1889/1930) were due more to social conditions (Canudos, Revolta dos Marinheiros) or political divergences than to secession intents. From then on, the revolts had more to do with centralization or decentralization, backed by regional interests, which still dominates the debate on the nature of the Brazilian federalism.

In 1932, a revolutionary movement known as the "Revolta dos Tenentes" marked the beginning of this new period. It started the process that led to the ascension of Vargas in 1930 and to a new period of centralization of political power. From then on the history of the Brazilian federation were marked by a regular oscillation of periods of centralization and decentralization, as been stressed in several studies on this subject. To the ousting of Vargas (1945) followed a period of decentralization that lasted till the installation of the military regimen in 1964. A new wave of decentralization formed during the transition to democracy in the beginning of the eighties took a definite form with the new 1988 Constitution. The reproduction over time of what had been observed when the republic was substituted for the monarchy – a spurious association among centralization and authoritarianism and liberalism and decentralization – did not pay due attention to the real causes that made the pendulum moving back and forward, not allowing, thus, to find a solution to this instability (for details see box 1).

The roots of the problem feed themselves on the huge regional inequalities. Not by chance, the turning points of these cycles are associated with changes in the socioeconomic environment that weakened the forces that supported the status quo. The question in point was growing concerns in other regions – mainly the South and the Northeast- over the increasing dominance of the Southeast – mainly São Paulo and Minas Gerais – in economic and political affairs, following the abolition of slavery and reinforced by industrialization. The prosperous region demanded a less role for the central government and more state autonomy. Those who stayed behind saw a strong federal government as the sole way to make their interests prevail in the design of development policies.

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[6] Carneiro (1965, p. 77), explains that the so-called federalist revolt did not have the meaning of a federative movement. Quite opposite, it advocated the preeminence of federal over sate powers. Its main objectives were to install a parliamentary republic (mirroring the one that prevailed in the monarchy), to forbid reelection of state governors and give more autonomy to local governments.

Box 1
The Moving Pendulum – Centralization and Decentralization Cycles in the Brazilian Federation

1891 - 1930: *In the first four republican decades the Brazilian federation was highly decentralized. A weak federal government was accompanied by strong independent states, with power to regulate and tax domestic and foreign trade, besides being responsible for most of the States' responsibilities in the provision of public goods.*

1930 - 1945: *Vargas' dictatorship led to an increasing concentration of powers in federal hands to put into place a more integrated domestic market and set the basis for industrialization. Regulation of domestic and foreign trade moved to federal hands and nationwide taxes were created. Influence of the states' oligarchies on national policies was curtailed, even though state governments kept autonomy to apply own taxes and even to create additional ones.*

1946 - 1964: *Democratization following the end of World War II moved the pendulum back towards decentralization. Sub national autonomy was seen as necessary to support great responsibilities and a stable democracy. However, concentration of manufacturing production in the Southeast aggravated regional disparities and increased political rivalries. Fiscal incentives for investments in the Northeast were granted aiming at reversing the trend towards regional concentration.*

1964 - 1968: *Advent of the military regimen, after the 1964 coup, shifted the pendulum back to centralization. To that end, the Tax Reform of the middle sixties played a key role. Tax powers of the federal government were reinforced, allowing for an increase in overall tax burden to finance infrastructure modernization and accelerate the pace of development. As in the previous centralization round, states were not deprived of their autonomy to tax. Indeed, they were assigned the power to apply a broad basis value added tax in substitution for the existing turnover tax. At the same time, a revenue sharing mechanism was instituted to enhance revenues of those that had a narrow tax basis.*

1968 - 1980: *Democratization led again to a new move towards decentralization. Federal autonomy benefited from a decision to give the states the sole privilege of taxing oil, telecommunication and electric energy, thus enlarging their tax basis. Furthermore, a significant increase in federal revenues shared with states and local governments benefited less developed states and small municipalities. Power of local governments was ratified as municipalities acquired the status of members of the federation.*

1980 - to date: *Opposite forces provoked an unclear outcome. Macroeconomic demands for fiscal adjustment and policy coordination led an increase in federal government's share in total tax collections and great control over sub national debts. On the opposite side, calls for efficiency and accountability in public policies fuelled the decentralization drive in public spending. Pressures from globalization and regional integration make it difficult to find a way to reconcile these two opposite forces.*

Source: Serra & Afonso (1999), Afonso (1994, 1995, 1996); Varsano (1996); Oliveira (1995); Rodriguez (1995); Silva & Costa (1995), Camargo (1993)[7].

Over time, regional and social problems remained intertwined. Decentralization that followed the inauguration of the republic increased the power of local oligarchies and fed growing discontent with living conditions of the population, giving room to the 1922 rebellion and the onset of the authoritarian period installed in 1930. Social reforms promoted during the Vargas

[7] For additional information see Goldsmith (1986) on the Brazilian economic history. Fausto (1995) on Brazilian Hystory. And Camargo (1993), Carvalho(1993) and Love (1993) on the centralization-decentralization issue.

era is a landmark in the Brazilian social policy history, but the duration of Vargas' dictatorship (from 1930 to 1945) gave way to the rebirth of liberal ideas that led to the ousting of Vargas fifteen years after his arrival in the national scene. Social discontent mounted in the two decades that followed feeding leftist groups that menaced the regime, led to the military coup of 1964 and impulse a new round of centralization. Twenty-one years later the democratic government that took power in 1985,aimed to improve social conditions with very modest results, though. Social inequalities remained impervious to changing political conditions, facing nowadays great and newer challenges (Table A.2 provides some figures that show the association between regional and social inequalities).

2 – Recent Developments

The centrifugal forces that led to the present characteristics of the Brazilian federation were in place well before the 1988 Constitution. Back in the middle seventies, the militaryrulers devised a gradual and controlled transition to democracy. An increase in political power of poorer regions and local groups were granted to counteract the dominance of opposition parties in the industrialized areas and more important urban agglomerations. At the same time, an aggressive program of public investments in infrastructure in backward regions followed by an increase in federal transfers to less developed states provided economic substance to fulfill the aim of maintaining federal control over the process of political liberalization.

The political reform enacted in 1977 raised the number of representatives of poorer states in the national parliament, postponed direct elections for governors to 1982, decreed that two out of three state repr esentatives in the senate would be nominated by an electoral college, and reduced to simple majority the quorum for passing constitutional amendments in the National Parliament. Besides, conditions were established to assure control of the military over the Electoral College that would preside over the presidential election to be held in 1985. Control of the central government over national politics was thus reassured[8].

On the economic front, the regional policy contemplated in the national development plan contained investments in infrastructure and social programs oriented towards the less developed North, Northeast and Center-West regions. Together, these programs contemplated investments aimed at improving conditions for economic growth in these regions totaling US$ 2.2 billion for the 1975-1979 period. These investments contributed to bring per capita income of less developed regions close to the national average, thus reducing internal disparities until the middle eighties.

Another important component of the economic measures adopted in this period was a steady increase in the percentage of federal tax revenues transferred to states and municipalities followed by special provisions to benefit the poorest North and Northeast regions[9].

[8] The main goal of the 1977 political reform was to curb the advance of the opposition to the military regimen, since its previous success in municipal elections increased the fears of further advances in the elections for state governors scheduled for 1978.

[9] Ten percent of the amount transferred to the states in 1976 and 1977 and 20% in 1978 were diverted to a special account to be distributed exclusively to Northern and Northeastern states. These same states were also freed from the obligation to allocate part of these funds ininvestments.

During the long transition period to democratic rule, the demands for decentralization led to further increases in the transfer of federal collected tax revenues to states and local governments. The percentage of the two main federal taxes shared with states and municipalities through special funds – the " Fundo de Participação dos Estados" and the "Fundo de Participação dos Municípios" – went up again in l984 and in 1985 before reaching the level attained in the 1988 Constitution. [10]

Political decentralization was also favored by the same Constitution, which gave a new impulse to the unbalance in state's representation in the Lower House. As of 1988, poor and sparsely populated states were entitled to a minimum of eight representatives in the Chamber of Deputies, whereas the bigger ones face a ceiling of 70 representatives. These conditions led to an overrepresentation of the North and an under-representation of the Southeast. The former, who have 8% of the population got 14.5% of the seats whereas the latter, with 43% of the population detains 32.2% of the seats, only. In extreme cases, the number of votes required to elect a representative to the Lower House in the more developed states is sixteen times higher than the same figure for less developed sparsely populated ones.

As common found in other federations, states' representation in the Senate is equal – three seats per state regardless of size or economic importance. In this case, disequilibria result from a great number of states in less developed regions. Having 43.3% of the Brazilian population, the North, Northeast and Center-West regions command 74% of the votes in the Senate. Given the special attributions of the Brazilian Senate (all legal propositions and constitutional amendments approved in the lower house have to be submitted to the Senate, whose approval is required to put them into effect), this disproportional representation in the upper house adds to the unbalance in political representation in the Chamber of Deputies. This led Stepan (1997) to name Brazil as the main example of what he terms " a demo constraining federation"

Unbalances in political representation have its roots in the arrival of the republic, increased after the Second World War and reached its climax with the 1988 Constitution. A crude indication of the disproportionate representation in the Brazilian lower house – the average deviation from the theoretical ideal of one man, one vote – showed a figure of 8.5 in the 1988 elections. It is worth noting, though, that in cases of huge internal regional inequalities, a disproportional representation may be justified on grounds of being functional for putting the regional issue in the national agenda. Souza (1999) makes this point by arguing that in situation like those found in Brazil, a demo constraining condition may be useful from the viewpoint of the need to pay attention to regional disparities.

Over time, changes in revenue sharing mechanisms in the Brazilian federation were closely associated with the political cycle, with centralization of political power being accompanied by an increase in state and local governments share in federal revenues (see box 2 for details).

[10] These funds were created in the 1967 Constitution to share the proceds of federal taxes with states and municipalities. To distinguish them from other transfers of federal resources to subnational governments, they are sometimes refered as Constitutional Funds (see box 2 for details).

Box 2

Revenue Sharing in the Brazilian Federation

Note: *The revenue sharing system has two main components. One is formed by funds set up in the Constitution and assumes the characteristics of a classical revenue sharing mechanism. The other includes distinct arrangements for providing federal resources to finance social policies carried out at the state and local levels. The former is sometimes referred to as Constitutional Funds*

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1964 - 1967: *A Tax Reform enacted by the military regimen established the basis of the present revenue sharing system. Twenty percent of the proceeds of the main federal taxes – on manufacturing production (IPI) and income (IR) – was earmarked in equal parts to a State Participation Fund (FPE) and a Municipal Participation Fund (FPM) and distributed on a formula basis.*

1968: *The percentage of federal taxes shared with states and municipalities were halved, and a Special Fund formed with 2% of same taxes was created to increase federal control over the use of fiscal resources. Fiscal autonomy of sub national governments was reduced to a minimum and remained so until the beginning of the gradual transition to democracy.*

1975 – 1983: *Constitutional amendments enacted in 1975 and 1980 led to a progressive increase in the share of state and local governments in federal collection of income and manufacturing taxes. As a result, states and municipalities recovered the losses infringed in 1968 (the percentage of these two taxes forming the FPE and the FPM reached 10.5% each in 1983).*

1984 - 1988: *Acceleration in transition to democratic rule increased sub national governments' pressure for a larger share in tax revenues. FPE and FPM rose again in 1984 and 1985, reaching 14% and 16% of federal taxes, respectively. At the same time, measures were adopted to curb federal attempts to reduce state and local government's participation in tax receipts.*

1988: *With the New Constitution the percentage of federal taxes forming FPE and FPM rose again for five consecutive years, reaching 21.5% and 22.5%, respectively, in 1993. An additional 10% of the manufacturing tax formed a separate fund to compensate the states for not taxing the exports of manufactured goods. On top of that, 3% of the IR and the IPI was earmarked to a regional development fund to finance investments in the North, Northeast and Center-West regions.*

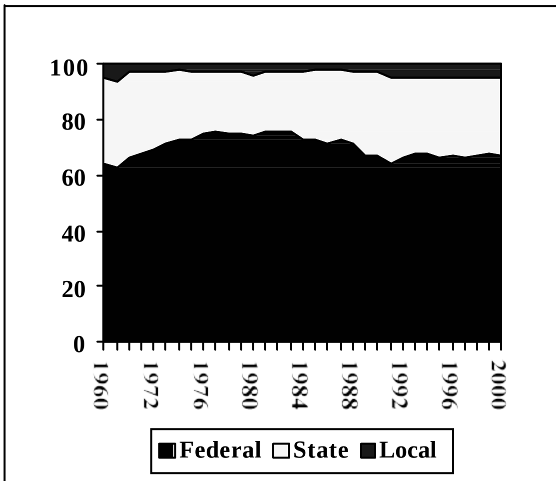
Source: Varsano et allii (1988). See tables A.3 and A.4 for details on the impact of changes in revenue sharing mechanisms on the distribution of tax revenues in the federation.

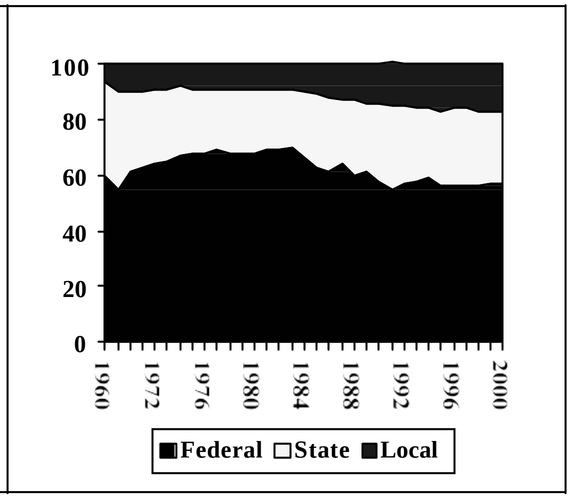
Fiscal decentralization reached its highest in the middle nineties, when the effect of changes introduced by the 1988 Constitution was fully achieved. The share of state and local governments in disposable tax revenues went up to 44% from the 30% observed ten years before. As shown in Chart 1 the municipalities were the main beneficiaries of the decisions adopted in 1988, having increased its share in the fiscal pie to 17% in 2000 (see tables A.3 and A.4).

In spite of its decentralization drive, the 1988 Constitution left the seeds for a quick reversal. Being enacted two years before the fall of the Berlin wall and the subsequent dominance of liberal ideas over former ideals of social justice sponsored by strong governments, it increased the responsibility of the federal government in securing social rights of Brazilian citizens (see box 3 for details) and opened up the room for the creation of earmarked contributions to finance the free universal access to public services.

In practice, the new Constitution installed a dual fiscal regime. The traditional one, which assigned tax powers in the federation and designed mechanisms for revenue sharing, and a new one, specific related to the financing of social policies, to which loose norms apply. Insofar as more than half the revenues collected through the most important federal taxes – income taxes and a value added tax collected at the manufactured level – were to be transferred to states and municipalities, the outcome was easy to predict. Federal tax authorities became to rely more on social contributions to meet their social responsibilities, which not only interrupted the decentralization trend observed since the middle seventies but also led to an undesirable deterioration in the quality of the Brazilian tax system.

Chart 1
Brazil: Tax Collection and Disposable Tax Revenue - 1960, 1965 and 1970/2000e





Source: Tables A.3 e A.4
e/ preliminary

Deterioration of economic conditions following the opening of the Brazilian market to external competition did not allow state and local governments to fully exercise the autonomy supposedly granted by political and fiscal decentralization. On one hand, a low average rate of economic growth did not permit gains from an increase in their competence to tax and in transfers from above to materialize as expected. On the other, growing needs for achieving fiscal discipline to avoid macroeconomic problems meant greater restrictions to spend, meaning that one important instrument for the exercise of political power at state and local level- the budget – was severely affected.

Budget constraints at the state level meant lesser financial ability for them to cope with demands from their constituency regarding provision of urban and social services. Over the nineties, state finances moved along a path that reflected unstable macroeconomic conditions, with a growing share of budgetary revenues being used to cover for personnel expenses, social security benefits and interest on the public debt. Despite of not being able to fully profit from fiscal decentralization, local governments were pressed to raise fiscal effort to meet the demands of their constituency for an increase in social spending given the retreat of federal agencies. Thus, despite of a constitutional call for decentralization of responsibilities in social services provision, a strong movement in this direction was constrained by lack of financial means.

Box 3
Social Security in the 1988 Constitution

In a reaction to the emphasis attributed to economic problems during the military regimen, the 1988 Constitution increased the role of the State in social areas, with special attention to pension systems of private workers and public servants. Main changes introduced in the general regimen were an increase in coverage, a five-year reduction in retirement age for rural workers and a rise in benefits granted to them. The ensuing boom in rural pensions reached its peak in 1994.

All public servants got stability in the job and were granted the right to receive for life a pension equal to the wage of fellow workers that remained in activity. Coupled with provisions for early retirements (after completing 35 years in the service for men and 30 years for women), these rules helped to increase the number of retired public servants in the nineties (fear to lose some of the benefits, included in proposals to reform the social security system, also helped to increase applications for retirement).

Financial impact of these measures was impressive. Resources needed to cover for pension payments rose to 51.4% of federal personnel expenses up from 44% in 1995.
Besides increasing social security benefits, the 1988 Constitution granted every disabled and elderly poor people the right to receive from the federal government, for life, a benefit equal to the minimum wage; established the universal access to the public health system, regardless of previous affiliation to a pension fund; and instituted a social budget to be financed with earmarked contributions.

Resources allocated to social expenditures in 1999 amounted to 16% of the GDP – about US$ 82 billion, of which 60% refer to social security benefits. Other important components of the social expenditures are health, education and unemployment insurance.

Source: Amadeo et allii (2000), Giambiagi and Além (2000); Najberg and Ikeda (1999)

In fact, the constitutional provision for decentralizing public spending in social programs was affected by the centralization of revenues earmarked to that purpose. Social contributions remained the sole competence of the federal government, (contributions to pension systems excepted), who controlled decisions over collection and utilization of these resources. Even though empirical studies show that state and municipalities have increased the amount of money applied in traditional social services activities -, education and health, mainly – the bulk of the financial resources needed to improve the quality of human life, come from social contributions collected by the federal government. Aside from the traditional payroll tax that support pension benefits, the money collected from these contributions rose to 6,5% of the GDP in 2000, up from the modest figure of 1,1% of the GDP in 1988 (see table 1).

Even though a significant portion of social contributions revenues are handed back to sub-national governments through ad hoc negotiations ("convênios") special provisions are attached to its use, meaning that their autonomy is affected. Besides not having autonomy to dispose of these resources, they don't have any guarantee as to their availability over time. They are subjected to annual revisions and to changing political relations that do not provide a solid ground for a sustainable decentralization of state responsibilities in social policies. Between 1996 and 2000 the amount of money transferred to state and municipalities to help finance local provision of social services doubled, reaching US$ 7 billion). About two thirds of this total went to basic health services, whose financing are now facing changes that attempt to reduce instability in the resources available.

Table 1:
National Revenues From Taxes and Social Contributions: 1988 and 2000 e/

	1988	2000
	(% GDP)	
National Tax Burden	**22,4**	**32,7**
Federal Tax Revenues 1/	**15,8**	**22,0**
Social Contributions	**1,1**	**6,6**
Cofins	0,8	3,6
PIS/Pasep	0,3	0,9
CPMF		1,3
CSLL		0,8

Source: Araujo (2001).
e/ preliminary.
1/ Total tax collections. Does not exclude transfers to states and municipalities.
Cofins: Turnover tax earmarked to social programs.
PIS/Pasep: Turnover tax earmarked to unemployment benefits.
CPMF: Tax on financial transactions.
CSLL: Tax on net profits.

Political interference on access to resources that are intended to support municipalization of basic public services may lead to four distinct situations, put out below. The better situation is the one in which the local administration is supported by the same coalition that supports both, state and federal governments. The opposite case occurs when the local government is politically misaligned, at the same time, with the state and federal governments. Of the alternatives in between, the more favorable is the one in which the municipal government goes along with the political line of the federal government, as direct relationships of federal and local governments have gained more attention in the recent past.

Intergovernmental Relations Patterns According to Municipal and State Political Relations With the Federal Government[11]

		STATES	
		Aligned	**Not Aligned**
MUNICIPALITIES	**Aligned**	Very Good	Good
	Not Aligned	Very Bad	Bad

[11] The possible combinations outlined above refer to the political alignment with the federal government, including the coalition that has power in congress over the federal budget.

A special feature of the Brazilian federation that was also a result of the 1988 Constitution is the rise of the municipalities to the status of members of the federation, sharing the same rights and duties of the states. The three-tier federation inscribed in the Constitution reflects the long tradition of municipal autonomy in Brazil and led to less control of the states over its municipalities. Political reasons and efficiency arguments, based on the idea that bypassing the states would speed the process of providing municipalities with the resources needed to better attend the needs of the local community, gave a great impulse in transfers of federal money to local governments to the detriment of the role of member states in the Brazilian federation.

Monetary stabilization achieved as a result of a plan adopted in 1994 to end a long period of adaptation to high rates of inflation brought further difficulties to the management of fiscal and local politics. During the high inflation era, postponing spending and freezing wages of public employees easily adjusted the fiscal accounts, at the same time that revenues were fully indexed to inflation. Efficacy of this practice disappeared with a stable currency putting high pressures on state and local government politicians. All of a sudden, they had to face severe constraints to adjust their budgets, not being able to meet the expectations of their constituencies. The problem assumed an important dimension since the new authorities that took power in 1995, the year following the adoption of the 1994 stabilization plan, inherited problems derived from lass spending policies of their predecessors[12]. As shown table 2, 1999 figures for sub national governments consumption and wage payments were far above the 1988 level.

Table 2
Selected Public Expenditures Items: 1998-1999

	Federal		**Sub National 1/**		**Total**	
	1988	**1999**	**1988**	**1999**	**1988**	**1999**
			% GDP			
Intermediate Consumption	2,6	1,9	2,1	4,1	4,7	6,0
Personnel	3,2	3,0	4,7	6,5	7,9	9,5
Gross Fix Capital Formation	1,1	0,4	2,1	1,6	3,2	2,0
Total	6,9	5,3	8,9	12,2	15,8	17,5
			% Non Financial Expenditures			
Intermediate consumption 2/	55	32	45	68	100	100
Personnel	41	32	59	68	100	100
Gross Fix Capital Formation	34	20	66	80	100	100
Total	44	30	56	70	100	100

Source: IBGE.
1/ States and municipalities.
2/ Purchase of goods and services.

[12] By the end of 1994, state and local governments granted generous wage increases to public employees believing that revenue increases in the first months of the Real Plan would continue and ignoring the disappearance of the inflation tax.

Growing financial difficulties faced in 1995 were met by anticipating future tax revenues through private bank loans carrying high interest rates and delaying consumption and wage payments. This led to renewed pressures to reschedule debts with the federal government, including those already included in previous renegotiations (see box 4 for details).

Deterioration in fiscal accounts of state and local governments in the second half of the nineties was mainly a result of exogenous factors. An important ingredient of monetary stabilization strategy was the maintenance of high interest rates, increasing the burden of interest payments on state and municipal budgets. As high interest rates implied a less dynamic economy, own revenues and federal transfers could not make for the additional commitments of public money, increasing subnational deficit. Therefore, the renegotiation of state debts carried out in 1997 and 1998 cannot be properly considered a classical case of bailing out, as macroeconomic policies were behind the deterioration in state finances.

Box 4
Calendar of State Debts Renegotiations

1989: *After the collapse of the stabilization plan launched in 1986, Law 7976 authorized a federal owned bank (Banco do Brasil) to refinance state debts for twenty years. Being partial - the refinancing was limited to debts with the National Treasury – this operation did little to solve states financial problems that continued to deteriorate under the impact of high interest rates and an accelerating inflation.*

1991: *Law 8388 established new conditions for refinancing debts not included in the 1999 renegotiation. Twenty years for repayment under a 6% interest rate and monthly installments limited to 11% of revenues in the first year and 15% thereafter. As the conditions were not accepted, this proposal did not materialized.*

1993: *Along the lines set by law 8.388/91, law 8.727/93 allowed for the refinancing of outstanding debts with federal financial institutions, including payments overdue since 1991. Limits for repayment were lowered to 9% of revenues in the first year and 11 thereafter. Even though the new conditions allowed for the regularization of debt payments, it did not cover the entire problem, since debts with private banks and bonds were not included.*

1995: *After the 1995 stabilization plan (Plano Real), the federal government changed its approach to the renegotiation of state debts and introduced new measures to control indebtedness. From then on, refinancing was associated with public sector reforms, including privatization and conditions for meeting targets set for adjusting the fiscal accounts. Besides, new agreements would have to be submitted to the state legislatives.*

1996: *New rules were introduced by Provisional Measure 1.560, giving the federal government power to renegotiate all kinds of debts. Negotiations should be carried on an individual basis, depending on measures adopted by the states. The final aim was to bring total states financial liabilities to levels below their net revenues.*

1997/98: *Law 9.496/97 established criteria to be adopted in the renegotiations, setting targets for the total debt, primary surplus, wage costs, tax collections and privatization. Twenty-four, out of twenty-seven states signed agreements with the federal government under the rules of this law.*

Source: Lopreato (2000); Rigolon and Giambiagi (1999).

Whereas the federal government could reshape its fiscal situation by increasing the tax burden through social contributions, state and local officials did not have the possibility to do so. As a result, the primary deficit of sub national governments in the 1995/98 periods could be compensated by a surplus in federal accounts, thus avoiding a negative overall result.

Under rules set out by Law 9.496/97, the federal government signed debt renegotiation agreements with 24 states amounting to US$ 82 billion (equivalent to 10.5% of the GDP), under rather favorable conditions: thirty years for repayment and a fixed interest rate between 6% and 7.5%. Besides, repayment should not surpass 15% of current revenues (this percentage could be as low as 11%). Under these agreements, states cannot issue new bonds until their total liabilities become smaller than yearly revenues. In case of them not performing with their obligations, the federal government have the right to block transfers under the State Participation Fund in federal revenues, with the states also loosing the special benefits of the agreement.

International financial crisis brought further difficulties to the Brazilian economy and the federation. The same medicine applied to counteract the impact of the Asian and Russian crisis – a tight in monetary and fiscal policies – added to the difficulties for states and municipalities to respond to demands from their populations. With the economy going at low speed, tax revenues did not provide enough room to improve public policies. Discontent mounted to the despair of local officials that intended to make use of a constitutional amendment that allowed for reelection at all levels. Fears that reelection at the municipal level would give no opportunity for opponents to win did not materialized. Forty percent of the mayors, only, were reelected in 2000 municipal elections.

To avoid the risk of repeating past experiences of successive renegotiations of states' debts, which could jeopardize the attainment of fiscal targets set in the federal government agreement with the IMF, a tightening in controlling states indebtedness followed the 1997/98 renegotiation. Senates' Resolution 78/98 prohibited new loans of any kind to states that shows a primary deficit in the twelve months period prior to application, reduced indebtedness margins and applied a gradual reduction in the debt/revenues ratio. Contracts signed with the states also prohibited the issue of new debt in case of failure to meet the trajectory set for reducing the debt /revenue ratio, or incur in new debt that may alter that trajectory.

On the supply side, controls created by the National Monetary Council and the Central Bank imposed ceilings on the exposure of financial institutions to loans granted to states, municipalities and institutions under their control.

The tough restrictions on managing fiscal resources at the sub-national level brought important results from a macroeconomic perspective. Consolidated fiscal accounts of state and local governments reached a primary surplus of 1.1% of the GDP in 2001, from a deficit of 0.7% in 1997 (see table A.7). From the viewpoint of the urban public services, though, the price was high.

As shown table 3 sub national governments spending on public safety, transportation, housing and urban services dropped to 3.1% of the GDP in 2000, from an already low 4.1% figure for 1996, even though urbanization kept growing. The same did not occur with spending on social services – education, health and sanitation –, which went up to 7% of the GDP in 2000, from the 5.5% ratio registered in 1996, due to federal money provided for increasing decentralization of social services.

Table 3
State and Local Governments Spending - Selected Functions:1996 and 2000

	States 1/		Municipalities 2/		Total	
	1996	**2000**	**1996**	**2000**	**1996**	**2000**
			% GDP			
Public Safety	1,6	1,1	nd	0,0	1,6	1,1
Housing & Urban Services	0,2	0,2	1,0	0,8	1,1	1,0
Transportation	0,7	0,6	0,7	0,4	1,4	1,0
Health and Sanitation	0,9	1,1	1,1	1,5	2,0	2,6
Education and Culture	2,1	2,6	1,4	1,9	3,5	4,4
Social Security & Aid	2,8	1,9	0,5	0,6	3,3	2,5
Total	**8,3**	**7,4**	**4,6**	**5,3**	**12,8**	**12,7**

1/ Source: IBGE (Despesas Públicas por Funções 1996 – 1998). For 2000, the source is STN.
2/ Source: STN (Finanças do Brasil 1996 e 2000).

The overwhelming priority ascribed to monetary stabilization in a time of economic openness imposed further constraints on government action at the same time that increased conflicts within the federation. On the one hand, macroeconomic policy meant a heavy blow in the autonomy of sub-national governments with important political consequences as mentioned before. On the other hand the opening of the economy to foreign competition and the incapacity of the federal government to deal with regional imbalances led to an increase in conflicts among jurisdictions that did not favor the advance of important institutional reforms. Some of these aspects will be tackled below.

3 – Fiscal Federalism, Economic Crisis and Macroeconomic Stabilization

It should be stressed at the outset that the fiscal adjustment needed to support macroeconomic policies during the second half of the nineties were a result of:

a) an important increase in revenues collected at the federal level through social contributions not shared with states and municipalities, which were responsible for the sharp increase in the tax burden ratio;
b) a curb on public investments, with important negative consequences on the quality of infrastructure and basic public services;
c) more stringent conditions applied to the expansion of public debt at state and local levels, following the renegotiations conducted in 1997/98;
d) implementation of an important privatization program, which freed the government to keep subsidizing inefficient state owned enterprises.

Federal arrangements affected and were affected during the process of achieving stabilization. On one hand, the political difficulties faced to push ahead reforms that were in need to make progress in cutting administrative expenses and social security benefits did not open room for trimming budgetary costs, forcing cuts in investments, which also affected competitiveness of Brazilian exports and its ability to avoid rising deficits in foreign trade [13] (see box 5 for details). As privatization of basic infrastructure went along with a virtual disappearing of savings at the federal level, less developed regions witnessed their capabilities to catch with the regional gap in GDP to vanish, further feeding resentments within the federation.

Box 5
Public Employment and Social Security Reform

Public Employment

Constitutional Amendment 19 *prohibited accumulation of jobs, modified rules for acquiring tenure and suppressed the sole regimen for admission, giving way for applying more flexible norms in hiring new entrants in the public service.*

Law 9.962/2000 *allowed for the adoption of rules applied to private workers in the admission of new public employees.*

Social Security

Constitutional Amendment 20 *changed norms applied to concession of social security benefits, namely:*

- *Eligibility for retiring after 35 years of working life (30 years for women), depend on proof of actual contribution to the social security system;*
- *Possibility for early retirement (five years before the conditions above) was cancelled, thus extending working life of the labor force;*
- *Procedures for calculating value of benefits became a matter of the ordinary law;*
- *End of special advantages granted to university professors and airlines employees, among other professional categories;*
- *Minimum age for retirement in public services set at 60 years for men and 55 years for women;*
- *Exemption from social security contributions granted to philanthropic institutions submitted to more rigorous criteria;*
- *New entrants in public service exempted from privileges granted to old public employees;*
- *Contribution of public entities to supplementary pension plans cannot surpass employees' contribution.*

Law 9.876/99 *changed criteria for establishing pension values upon retirement aiming at achieving actuarial equilibrium in the medium and long run.*

Proposal sent to Congress *submits public servants pensions to same ceilings applied to private workers and creates supplementary funds formed with matched contributions – employer and employees – to provide for additional benefits above the general ceiling.*

Source: Ministério do Planejamento e Najberg e Ikeda (1999).

[13] Despite of constitutional amendments to reduce some privileges of public employees and cut the structural deficit of public pension schemes, state and local governments payroll costs in 2000 remained at the 1996 level.

In opposite direction, federal arrangements interfered in options of the central government with respect to fiscal adjustment. Taking all the conditions attached to utilization of the resources administered by the central government, transfers to sub-national governments included, there is not much room for reallocating expenses in the federal budget. Less than 5% is left to cover for the maintenance of basic services and minor investments. Thus, in spite of a freeze in pubic servant's wages, in place since 1995, and measures taken to reduce the annual rate of increase in pension payments, federal budget investments remained virtually nonexistent, as increase in taxes had to pay for interests on the public debt, that grew in line with a tight monetary policy, and cover the target set for the primary surplus.

One important consequence was a serious blow on competitiveness. Besides suffering from lack of investments in infrastructure, the reintroduction of turnover taxes in the Brazilian tax system is perceived by all to be the worst problem affecting Brazilian producers in the world market. A broad enquiry put out recently by the Brazilian confederation of industrial associations revealed the tax system to be the main villain that constrains businesses' export performance as well as their ability to keep its share in domestic markets. Having been abolished in the 1967 tax reform, these type of taxes – the traditional turnover taxes plus the new tax on financial transactions - now account for one fourth of federal tax collections and may represent an additional burden in the order of 11% of the value added in sectors with a more extended production chain[14].

The revival of turnover taxes in Brazil does not have any parallel in the world. A recent study by a consulting firm shows that Brazil is preeminent among a few countries that still apply this kind of taxes. Of the twenty-eight countries included in this study (ten from the OECD, eight from Asia and nine others from Latin America) turnover taxes were applied in six countries only, with the following rates: Brazil 3,65%; Argentina, Bolivia and The Philippines: 3%; Venezuela: 1.5%; and Colombia: 1%. At the time the study was made only Brazil (0.38% rate) and Colombia (0.2%) applied a tax on financial transactions, to which Argentina now adhered. These data show how far the Brazilian Tax System is from the practices adopted by its main competitors in the world market.

The over reliance of states and local governments on federal transfers also had important implications for the attainment of macroeconomic equilibrium. In spite of a constitutional mandate to revise the formula adopted to distribute federal transfers among its beneficiaries, this revision never occurred. Some attempts to introduce new variables to correct unbalances in the revenue sharing mechanism were soon abandoned since the conflicts of interest came to be seen as impossible to solve.

To circumvent the impossibility of reaching an agreement, a practical solution was adopted in 1992: the share of each state and municipality in federal funds was established through negotiations based on the actual figures of the previous year, remaining fixed since then. As expected, the more developed states and the bigger municipalities lost some position on the process (see box 6 for details).

As the amount transferred increased, the unbalance already in place gained further impetus. Budgets per capita in small municipalities reached levels three times higher than corresponding figures for densely populated urban areas and big metropolitan cities. The same

[14] A recent study (Varsano et allii, 2001) showed that the effective total tax burden ratio from these taxes varies from 0.74% of the value added (non commercial services) to 10.8% (steel production).

applies to the states, albeit in a minor scale: less developed sparsely populated states show per capita budgets 1,5 times higher than those of more developed ones[15].

Box 6
Criteria for Distributing the Municipal Revenue Fund–FPM

Criteria applied to the distribution of federal revenues shared with local governments through a special fund – FPM- establishes the following:

- *10% of the FPM goes to the states' capital cities.*
- *86.4% is distributed to all other municipalities.*
- *3.6% makes for an additional quota for municipalities with more than 156,216 inhabitants.*

The individual quota of states' capital cities is direct related to their population and inversely related to the states' per capita income.

The individual quota of non-capital cities is set by indexes derived from a formula that favor the less populated municipalities. The index varies from 0.6 for those with less than 10,188 inhabitants to 4.0 for municipalities with more than 156,216 inhabitants. In between, 16 population brackets form a distribution of individual indexes that grow at decreasing rates, thus allowing for smaller per capita transfers as population increases.

The overdose of transfers br ought additional distortions to the federation. Among then a financial incentive to political fragmentation at the local level, which supported the creation of 1,465 new municipalities in the past decade – a 30% increase in the number of municipalities in the past sixteen years. As the rules set out in the 1988 Constitution allowed for political separation of former "distritos" based only in a public referendum carried out in the region demanding secession, the outcome was easily predicted since the new founded municipalities profited from partition, leaving the other part of the old municipality impoverished.

Other important negative consequence was the loss of interest of local taxpayers on local politics. As most of their budgets come from transfers, accountability at the local level was severely affected. With the exception of capital state cities and some other important urban areas, own revenues represent less than 20% of the municipal current revenues, meaning that the classical Tiebout's approach to competitiveness at the local level do not have any application to the Brazilian case[16]. We should note a similar argument could be made with

[15] Data for the year 2000 (STN), shows that the smaller Brazilian municipality (Bora, SP) had per capita revenue of US$ 1,390, of which 2/3 came from the FPM. In the same year the municipality of Sao Paulo– more than 10 million people – presented a per capita budget of US$ 407, only, with the FPM representing less than 1% of its revenue. At the state level, Amapa, in the Brazilian Amazon, having less than 500 thousand inhabitants showed per capita revenues of US$ 912- more than 70% of it coming from transfers, whereas the state of Sao Paulo – 37 million inhabitants – presented a US$ 624 per capita budget (less than 0.3% from transfers.

[16] Despite of the disincentive to local fiscal effort built into the revenue sharing system, a significant improvement in tax collections at the municipal level was observed in Brazil recently, with practically all municipalities showing some effort to make use of the local tax basis.

respect to the states, as in twelve out of 27 states own revenues account for less than 50% of their respective budgets[17].

The way fiscal decentralization evolved in the Brazilian federation provoked a growing mismatch among revenues and responsibilities. On the one hand, socioeconomic dynamics led to increasing concentration of modern economic activities and population in medium size cities and large urban centers in more developed industrial areas of the country. On the other, criteria for distributing fiscal and financial resources ran in opposite direction, with money flowing in greater proportion to less dynamic and sparsely populated rural regions. Thus, whereas a high proportion of public money had been diverted to administrative and low priority expenses, demands for urban and basic social services in more needy places could not find the financial means to be properly attended.

As mentioned before, a side mechanism for intergovernmental cooperation in financing decentralization of responsibilities grew in line with the increase in federal government collection of contributions earmarked to public provision of social services. The ensuing increase in dependence of member states and large municipalities on federal money to attend to basic demands of their constituency narrowed the possibilities for people and business to profit from competition among jurisdictions in the allocation of expenses. Federal established rules led to a greater standardization of public spending at the same time that conditions attached to access loans granted by federal owned financial institutions also reduced the autonomy of state and local governments.

The increase in transfers submitted to ad hoc negotiations also brought negative political implications. As the access to resources suffer from volatile political alliances, the quality of services provided may deteriorate by reasons that are beyond administrative capabilities of local administrators. Besides, since there is no possibility of having reliable projections of financial flows in the nearby future, the process of decentralization does not proceed in solid ground, being subjected to setbacks.

Instead of moving in the direction of consolidating the decentralization achieved in 1988, latest developments moved back, with further interference of the federal government in shaping decisions to be implemented at the sub-national level.

The impact of economic openness further contributed to this outcome. Being exposed to external competition after centuries of isolation, the Brazilian manufacturing industry lost ground in domestic markets and could not participate in the more dynamic sectors of the international market. As a result, the national trade accounts deteriorated, going from US$ 15 billion surpluses in the last years of the eighties to a deficit of US$ 7 billion in 1997. Thanks to a sharp decrease in imports, following a slow down in the rate of economic activity, the external deficit turned into a superavit again in the vicinity of US$ 2 billion in 2001[18].

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[17] Eleven of those showing this condition belong to the North and Northeast regions. The other is the Federal District.

[18] The balance in trade accounts remained positive – averaging a 10 billion surplus - during the first half of the nineties, beginning to show growing deficits in 1995, until reaching a high of 7 billion in 1997. Smaller improvements were observed in the last years of the past decade till the reduction in economic activity helped to move to the positive side again in 2001.

External vulnerability turned it more difficulty to face the financial crisis of the nineties, without sacrificing federal autonomy. Tight monetary and fiscal policies were accompanied by stringent norms to govern the actions of state and local governments. Besides the reforms mentioned above, one important component of the measures adopted to adjust states and local government finances was a reform in the financial sector that forced the privatization of state owned banks.

The fragility of the state owned banks came to the fore in the aftermath of monetary stabilization, giving the federal government the opportunity to intervene. A special program was created to force state governors to hand over control of these institutions in exchange for the federal assumption of the responsibility to clear their financial situation before privatization or liquidation. As a result, only seven financial institutions remain in states' government hands, the others having been privatized, in process of being liquidated or transformed into non-banking organizations (table 4 summarizes the present situation).

Table 4
States' Owned Banks – Present Situation

Privatized	09
Under Federal Control	06
Liquidated	10
Non Banking Financial Agencies	16
In States' Hands	07

Source: Planning Minister

More recently, an important new legislation was passed through Congress, setting tough conditions to be observed in managing the government accounts to sustain fiscal responsibility in the federation. The so-called Fiscal Responsibility Law – LRF-, approved in may 2000, intends to enforce fiscal discipline at the federal, state and local governments, establishing objective and clear rules to be observed in administering revenues and expenditure policies, the public debt and government assets. Transparency is emphasized as a condition for social control of the actions of governments to make taxpayers conscious of the use public administrators make of resources extracted from taxation. Among the norms set by the LRF, it is worth noting:

a) limits for personnel spending – remuneration of public employees shall not exceed sixty percent of net current revenues;
b) indebtedness limits– Federal Senate might approve revision of present limits to be proposed by the President of the Republic;
c) yearly fiscal targets- budgetary planning must look ahead, setting fiscal targets for three future consecutive years.
d) provision for recurrent expenditures – public authorities cannot take actions that create future expenses lasting for more than two years without pointing to a source of financing or a compensating cut in other expenses.
e) special provision for electoral years – the law pr ohibits outgoing governors and mayors (last year in office) to anticipate tax revenues through short -term loans, give wage increases and contract new public servants.

Failure to fulfill obligations imposed by the LRF lead to several administrative penalties, to which personal incriminations, included in an additional law (" Lei de Crimes de Responsabilidade") may be added. More serious misbehaviors may be punished with the loss of the mandate, incapability for having a job in the public service, fines and imprisonment. It is worth emphasizing that all levels of government, the federal one included, have to abide to the conditions established in the LRF.

A preliminary appraisal of how states and municipalities' fiscal accounts stand, from the viewpoint of attending to conditions set by the LRF, based on recent data, lead to an optimist scenario, as their net current revenues grew 14% and 17%, respectively, between 1997 and 2000. This increase in revenues allowed for a reduction in the ratio of personnel expenses to revenues in every state, bringing the average ratio down to 51.4% in 2000 from 60.9% in 1997. Whereas in 1997 five states presented ratios above the sixty- percent ceiling, this number was reduced to three in 2000. The same data for the states' capital cities point to an average ratio of 41% in 2000, with none being above the stated ceiling. For the other municipalities as a whole, the ratio of personnel expenses to net revenues was 43% in 2000, with only 6.3% of them being above the 60% ceiling (Nascimento and Debus, 2001).

However, results above do not reflect yet the adaptation of subnational finances to the new norms put in force by the LRF, as this law was put into effect in May 2000. Some indications that growth in revenues will slow down in 2001/2002, coupled with the fact that 2002 will be an electoral year, will make it harder for states and local authorities to sustain the results observed in 2000, providing a good test for the future of the fiscal accounts under the Fiscal Responsibility Law. Nonetheless, the central role played by fiscal discipline in keeping macroeconomic stability and restoring economic growth generates a very distinct scenario for managing the fiscal accounts as compared to those of the past[19]. Besides, Brazilian politicians become to perceive the value of a stable currency for the electorate and the risks associated to fiscal misbehaving.

The economic crisis of the nineties and the measures adopted by the federal government to achieve macroeconomic stabilization under new conditions of exposure to economic openness and free movement of capital, forced important changes that caused a partial reversal in federal autonomy. Even though these measures have been successful in attending to the immediate goal of sustaining monetary stabilization, they brought low levels of GDP growth, lack of investment in basic infrastructure and deterioration in the quality of urban and social services. Even though Brazil could survive the turbulence provoked by the Mexican, Asian and Russian crisis, the price paid, in terms of economic growth and social inequalities, was high.

Up to now, administrative measures and imposition of tight budgetary constraints substituted for political institutions as means to attend to macroeconomic objectives. In the process, the federation was not prepared to face the challenges posed by globalization. Political institutions remained feeble, commanded by clientelism and old habits and several proposals for a thorough political reform did not find any room to prosper.

Nevertheless, to the despair of those that do not believe in the possibility of having budgetary discipline at the sub-national level without a strong federal hand to guide the actions of

[19] In the past, inflation allowed for an easy fiscal adjustment as revenues were fully indexed and espenditures were not. Besides, a closed economy was less vulnerable to external perceptions of risks associated to a high degree of public indebtedness.

mayors and governors, some positive signs can be find in unsuspected cases. Up in the poor Northeast region, two states (Ceará and Bahia), governed by distinct political groups for more than 12 years, have shown very important positive results in managing the public money, meriting the approval of their respective populations.

More recently, the state of São Paulo, which besides being the richest state in the Brazilian federation had been well known for a bad behavior in budgetary policy, also made an important movement in the direction of keeping a sound fiscal situation.

Renegotiations of state debts also helped to improve the situation everywhere. Between 1997 (when renegotiation started) and 2000 total outstanding debt of 26 states- the Brazilian federation has 27 members- dropped by 25% in the average. As a result, the aggregate debt/revenue ratio fell to 1.91 in 2000 from the 2.86 figure reached in 1997.

Aside from the need to sustain a sound macroeconomic environment, the main challenges the Brazilian federation faces nowadays are to resume economic growth and reduce social and regional inequalities. To that end, the present rules governing intergovernmental relations do not make a positive contribution. A more competitive federation is in need.

4 – Privatization, Regionalism and Intergovernmental Conflicts

Beginning early in the nineties, Brazil began to abandon its long-standing tradition of having a strong interventionist government. Shortly after its inauguration, in January 1990, the Collor de Mello Administration launched an ambitious privatization program aimed at achieving fast results. However, despite of some facilities granted to private investors (public sector liabilities that were sold in the market with huge discounts were accepted at face value inpublic auctions), the initial goal of attaining 17 billion dollars in revenues from privatization in the first two years of the program turned out to be very unrealistic. Legal battles and the political crisis that led to the impeachment of Collor de Mello in September 1992 were the main factors behind the slow pace of the program in its infancy

During its first phase – 1990-1994 -, thirty three public enterprises turned to private hands, providing the federal Treasury with resources in the vicinity of US$ 12 billion (8.6 billion from proceedings of sales and 3.4 billion from transfer of debts to the new owners). By the end of 1994, the state had no more interference in steel and fertilizers production and had already alienated most of its participation in petrochemicals. Privatization of state monopolies was not even considered (Pinheiro 1999; Pinheiro and Giambiagi 2000; BNDES 2001).

As expected, it took some time for the pace of privatization to accelerate. Despite of the political scandals that led to the impeachment of Collor de Mello and a more nationalist tone of his successor, Itamar Franco, the first phase of the privatization program showed a strong commitment of Brazilians to privatization ideas, but the state monopolies enshrined in the 1988 Constitution were still in place (see box 7 for details).

Box 7
Privatization Program – First Phase

Background: *The eighties witnessed the first steps towards reducing the degree of state intervention in the economy. Private business that fell into public hands after facing financial troubles returned to private control. All together 38 enterprises were privatized in this period, most of them of small and medium size. Total sales were modest – 780 million dollars – but the main goal of the period was to halt the process of growing state ownership and not to obtain financial gains.*

1990 – 1992: *Privatization became an important component of the economic reforms launched by the Collor de Mello Administration. Sixty-eight public enterprises were included in the National Privatization Program set up in 1990. Efforts were concentrated in sectors that gained strategic status in past development policies, such as steel, petrochemicals and fertilizers. Eighteen enterprises were privatized for US$ 2.3 billion, wholly financed by the so called "privatization money" (public sector liabilities undervalued in the market).*

1993-1994: *The Itamar Franco Administration gave new impetus to the privatization program. Some legal changes was introduced to facilitate the process, such as the abolition of previous discrimination of foreign investors, who gained the right to acquire up to 100% of the capital put to sale. Privatization of steel producers was completed and more cash was required to settle the deals. 15 enterprises were sold in this period for US$ 4.5 billion, plus US$ 1.9 billion of debts being shifted to the new private owners. Despite of an increase in cash payments, "privatization money" still represented two thirds of total proceedings in the period.*

Source: BNDES (2001).

The Cardoso Administration, that took power in 1995, put the abolishing of state monopolies high in his agenda for reforms. A set of constitutional amendments were presented to Congress in the first months following the inauguration of Cardoso's first term in office, with the federal government pushing the passage of these amendments in the Congress to get approval[20]. At the same time, state governments also began to implement their own privatization programs.

At the federal level, privatization was an important component of the monetary stabilization program conducted under the "Plano Real". Political support from the population to end the era of high inflation helped the government to get approval from Congress to pass the constitutional amendments needed to abolish state monopolies in telecom, mining, electricity and gas. At the state level, privatization began to be seen as an important source of resources to finance investments and cancel past debts.

Important institutional changes also helped to impulse privatization. A National Council for Privatization – CND – was created to allow for a better coordination of decisions concerning the sale of state monopolies, which also benefited from a new legislation for the provision of public utilities by private business. The special status the 1988 Brazilian Constitution provided to domestic investors in the field of mining and electricity was also abolished, helping to move faster in privatizing these sectors.

[20] To be approved, a constitutional ammendment has to to be supported by three fifths of the votes in two sucessive rounds, in the Chamber of Deputies and in the Senate. Moreover, it has to return to the form if the Senate modify the text approved by the Deputies.

Between 1995 and 2001 (up to July) 34 federal and 39 state owned enterprises got into private hands, totaling sales of US$ 91.1 billion, including the assumption of debts by private investors. The privatization program proceeded at a high speed. In less than a decade, the state walked out of important activities that were under his absolute control for nearly half a century. Nowadays, private business controls railways and telecom, the most important Brazilian ports, more than half the distribution and a significant part of electricity generation, and a small but growing share in water supply and sanitation (see box 8 for details).

Box 8
Privatization Program – Second Phase

1995 – 1996: *Beginning in 1995, the Cardoso Administration gave great priority to privatization, which become an important component of the structural reforms. The National Council for Privatization was created and sale of state enterprises not protected by monopolies was completed. In this new phase, public utilities were put high in the privatization agenda, and improvement in the quality of services provided by new owners were stated as an important objective for privatizing. The adherence of state governments to the privatization mood was also an important characteristic of this period, as the federal government gave support to the sale of state owned enterprises. Total sales of federal and state owned enterprises added up to US$ 8.1 billion in this period.*

1997: *The sale of a big state controlled mining company – The Vale do Rio Doce Company – for US$ 6.9 billion was the high mark of the year. This was followed by concessions to private business to explore mobile phone services in three important areas of the Brazilian territory, made possible by the approval of a new legislation for telecom, which added more US$ 4.7 billion in revenues. This year also witness the first sale of a federal owned financial institution and important advances at the state level. Privatization of state controlled electricity enterprises amounted to US$ 15.1 billion, whereas state owned financial firms also began to be privati zed.*

1998: *Sales of telecom companies stood up as the more important privatization of the year. Total transactions amounted to US$ 18.9 billion, 64% above the minimum price set for sale. Some advances were also made in the privatization of federally administered ports. State governments also showed good results in the fields of electricity and banks, to which the sale of a state owned Telecom Company was an important addition. In financial terms, 1998 reached a high record: US$ 37.5 billion in proceedings from privatization, of which 10.8 billion referred to state governments.*

1999: *A year of modest results. Performance of the states was much better than the federal one. Total proceedings reached US$ 3.9 billion, of which US$ 554 million only originated from sales of federal assets. Electricity and gas were the leaders.*

2000: *Decision to sell government shares in excess of the amounted required to keep federal government control of the big oil company (Petrobras) helped to push up the results of the year. Proceedings from privatization reached US$ 7.7 billion, not including US$ 3.3 billion generated by the states through the sale of electricity and financial services.*

2001 (up to July): *Further concessions for exploration of mobile phone services was the main achievements, with revenues in the order of US$ 2.6 billion.*

Source: BNDES (2001).

From the viewpoint of more immediate goals, the privatization program was a big success. Public auctions raised a lot of interest both in foreign and domestic investors, with selling prices much higher than the minimum set by consultants hired to appraise the net worth of the state enterprises sold in the second phase of the privatization process. Between 1991 and 2001 (up to July) 136 privatizations took place in Brazil (97 conducted by the federal government and 39 by the states). The importance of the program is revealed in the details given below.

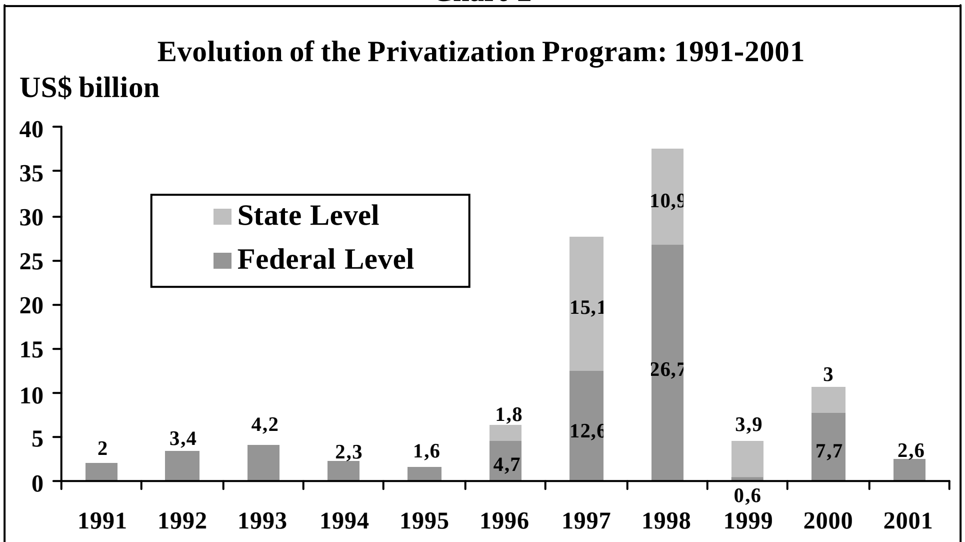
Table 5
Privatization Program: 1991/2001 (up to July)

US$ billion

Sector	Revenues from Sales	Debts Transferred	Total
Steel	5,6	2,6	8,2
Petrochemicals	2,7	1,0	3,7
Mining	3,3	3,6	6,9
Electricity	24,7	7,5	32,2
Sanitation	0,7		0,7
Oil & Gas	6,8	0,1	6,9
Telecommunications	30,5	2,9	33,4
Financial Institutions	6,0		6,0
Transportation	2,3		2,3
Others	2,4	0,3	2,7
Federal Level	57,0	11,3	68,4
State Level	27,9	6,8	34,7
TOTAL	**84,9**	**18,1**	**103,0**

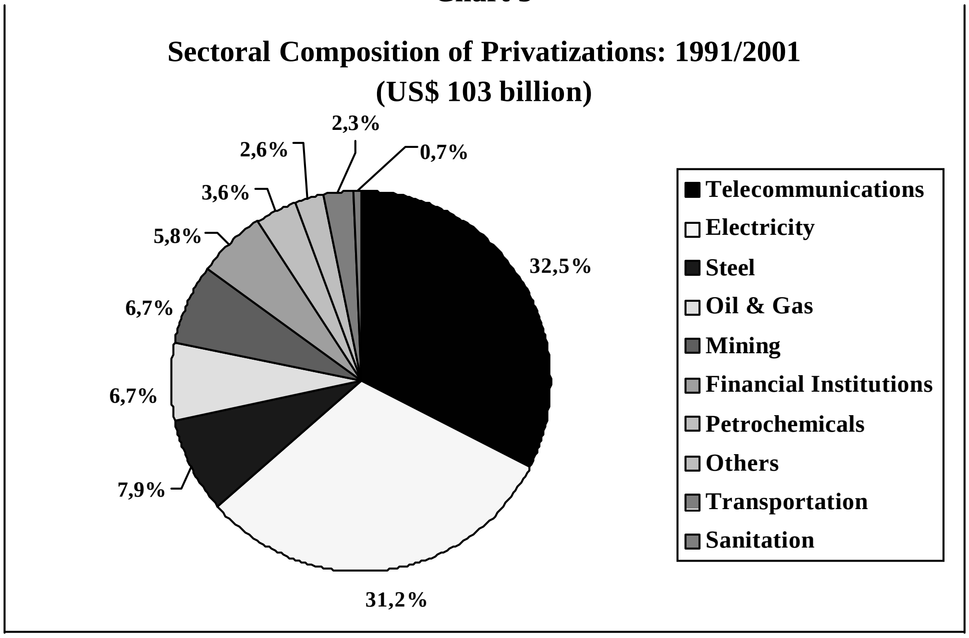
Source: BNDES (2001).

Chart 2



Source: BNDES (2001)

Chart 3



Source: BNDES (2001).

A common measure of the degree of state intervention in the economy – the share of the public sector in total investment – shows the extent of the privatization program in reducing state control. This ratio fell to 7% in 1999 from a high of 24,2% in 1991. Public enterprises wage bill also dropped to less than half the level attained in the early nineties (see table 6 below).

Table 6
Share of State Enterprises in Gross Domestic Capital Formation (GDCF) and in Total Public and Private Wage Bill: 1991 and 1999

Year	Total		Federal Public Enterprises		States Public Enterprises	
	GDCF	Wage Bill	GDCF	Wage Bill	GDCF	Wage Bill
1991	24,2	19,7	16,9	12,4	7,3	7,3
1999	7,0	8,2	3,4	4,9	3,6	3,3

Source: IBGE- Federal Statistics Bureau

Foreign capital played an important role in the privatization process. Foreign investors acquired about half of the shares offered in public auctions. On the whole, foreign capital accounted for 36% of revenues generated under the National Privatization Program, 49% of revenues from privatization of state government enterprises and 60% of the proceedings from telecom. Portuguese, Spaniards and North Americans, in this order, led the group of foreigners involved with the Brazilian Privatization Program.

According to studies made (Ferreira, 2000; Novaes, 2000; Pinheiro, 1999; and Pinheiro and Giambiagi, 2000) privatization carried out during the above mentioned period brought significant benefits for the country, namely:

a) modernization of enterprises helped by foreign investments;
b) more access of the population to services;
c) reduction in need for the government to subsidize deficits of state enterprises
d) financing external debt trough FDI, which also helped to control the expansion of the public debt;
e) a substantial increase in industrial productivity.

As mentioned before, the slowing down of the privatization drive from 1999 on, which coincided with the inauguration of a new term for the Cardoso Administration, reflected a situation in which more difficult negotiations were required. Besides, external shocks provoked by the Asian and Russian crisis also helped to reinforce the views of those that oppose privatization on ideological and equity grounds. The maxi devaluation of the real in 1999 altered perspectives for the Brazilian economy and required a reappraisal of the privatization program. A weakened government, a feeble performance of the GDP and an increase in risk perception brought down asset values, making it difficult to proceed at the same pace as before. The case of state owned banks was an exception since its privatization was a condition for the states to renegotiate their debts with the Union.

Thus, targets set for privatizing the electricity industry were missed by a large margin. Some progress were made in the distribution component of this industry, thanks to the fact that state governments, who owned this part of the business, were pressed to find ways to raise cash to ameliorate their financial troubles. The bulk of the generation, however, is still in public hands. The deterioration of the international scenario, with a low prospect for attracting foreign resources, led to further delays.

Contrasting with the situation in telecommunications, where regulation preceded privatization, thus helping to transfer the control to private hands, a poor regulatory framework contributed to raise public opposition to the advance of the energy privatization program. Regulatory rules are established by federal law and conducted by federal created agencies, but the relations of federal regulatory bodies and their state counterparts are not clearly set. The ensuing energy crisis, caused by a dry 2001 summer season in a context of paralyzation of public investments and unclear definitions regarding guarantees for return on private investments, led to supply shortages and consumption rationing, calling for a time to reappraise the energy privatization program.

At the state level there are different regulatory arrangements. Some states opted for having specific purpose agencies whereas others choosed to create a single agency for overseeing the whole bunch of activities handed to private business in their jurisdiction. The power of states and local governments in areas such as transportation, water supply and sanitation add further difficulties for the advance of privatization in these sectors.

Even though the presence of private investors in transportation is not new, regulation at the state and local level is poor and attempts to create a single independent agency at the federal level to oversee all modes of transportation faced opposition that blocked the idea.. Uniform rules and intergovernmental coordination is in need to improve the situation (Pires and Piccinini, 1999).

Jurisdictional conflicts are more difficult to solve in sanitation. Formal responsibility is in municipal hands but the need for coordinating provision of these services in metropolitan areas and urban agglomerations call for a great role of state governments to avoid inefficiencies. Difficulties to achieve a satisfactory agreement among states and local governments are behind the problems faced in this area.

Judging from the viewpoint of resources invested, modernization of the areas under private administration and access to services, as well as contribution of proceeds from sales of public assets to reduce expansion of the public debt, the privatization program, has been, so far, described as a case of success. Despite of that, the setback provoked by the recent energy crisis cast some dark clouds over it. Contrary to what was done in the case of telecommunication, where state enterprises were allowed to invest before being led to auction to improve asset values, energy firms were nor allowed to do so, as the government expected to move fast towards privatization. Thus, as foreign investors waited for judicial claims to be overruled by courts, the ban on public investment led, in the end, to a shortage in energy supply that will provoke additional delay in the privatization schedule.

One side negative effect of privatizing basic infrastructure was its impact on prospects for development in backward regions. In the past state enterprises played an important role as a vehicle for better exploring the growth potential of backward and frontier regions, by helping to build and modernize the infrastructure required for attracting modern business activities. As decisions to invest goes to private hands, the likelihood of this leading to an increase in regional inequalities cannot be ignored, providing explanation for the more aggressive approach recently adopted by authorities at the state level to attract investments[21].

It should be noted that monetary stabilization achieved in the mid nineties, together with consolidation of democracy and the advance of privatization, led to the resume of large inflows of direct foreign investment, reversing the downward trend observed in the beginning of the decade. In average, FDI in the 1996-2000 period was ten times higher as compared with the level attained in previous years. A significant part of it referred to acquisitions of state owned assets in public auctions, but some important new ventures were also made, mainly in automotive and agribusiness sectors.

For the first time in recent Brazilian history, the inflow of foreign direct investments occurred in a context of a liberalized financial market and aimed not only at the domestic but also the regional market (Mercosur). This new round of foreign investment started a fierce competition among the Brazilian states to attract the best projects.

The so-called “fiscal war” lay, its roots in a vacuum created by the absence of a federal sponsored regional policy to counteract the tendency to concentration of modern economic activities in the already more industrialized state of São Paulo. Without strong actions to promote economic growth of less developed regions, tendency towards a reduction in the

[21] Government control over investments in basic infrastructure – transportation, energy and telecommunications – as well as in basic manugacturing inputs – steel - was an important instrument for promoting regional development as decisions to invest could take into consideration national goals of reducing regional disparities. After privatization, infrastructure investments in backward regions will have to rely on the access to public funds, which are in short supply.

GDP gap among the five main regions, which was well established since the end of the seventies, came to a halt in middle eighties and remained unaltered since then. A still unperceptive movement in the opposite direction threatens to put in march a new wave of increasing regional inequalities, which, if materialized, will bring political instability in its wake.

Box 9
The "FiscalWar"

The so called "fiscal war" spread out in the wake of a virtual abandon of past regional policies by the federal government, given the impact of the macroeconomic crisis on federal finances. Being left alone, state governments opted for making increase use of fiscal benefits to attract private investments and promote industrial development.

The main weapon of this particular war is the mixed origin- destination principle applied to the state value-added tax and the complexity of situations involved. When production occurs in a less developed region and the good is consumed in a more developed one, two thirds of the tax is collected at origin and one third at destination, These proportions are reversed when goods are produced in developed states to be sold in backward ones.

To attract new investments, producer states grant integral rebates of the tax due at origin. Moreover, when production is sold in the main consumption centers, investors can claim credit for the tax supposedly collected at the origin. Thus, the immediate financial burden of these benefits is really supported by the state where the good is consumed.

A new wave of domestic and foreign private investments, formed in the beginning of the nineties, gave impetus to this war, Fears of loosing ground in the dispute for these investments, given better externalities found in the main industrial centers, led to greater advantages being offered by less developed states.

Once started, the "fiscal war" tends to escalate, as investors move around in search of even better concessions as competitors in other states demand equal advantages to sustain a level playing field. Conflicts in the federation mount as threatens to change location tend to equalize conditions everywhere.

In the end, fiscal benefits may backfire. As everybody engages in the war benefits tend to even, thus loosing its efficacy as a tool for attracting investments. At that stage, decisions to invest turn back to basics: good infrastructure and social conditions. As incentives reduce financial ability of less developed states to improve these conditions, they are prone to loose the war. Regional disparities may increase in the absence of a federal sponsored regional policy.

Source: Prado & Cavalcanti (1999 e 2000) and Varsano (1997).

The main tool of the new competition round for investments between the Brazilian states is the granting of tax benefits supported by generous financial concessions. Engaged in what became known in Brazil as a "fiscal war", Brazilian states have been conceding even greater advantages to foreign and local investors to house the location of new manufacturing plants. This process raised severe critics, based mainly on the argument that public money is being diverted to benefit foreign capital to the detriment of actual and future population demands. Besides, escalation of the "fiscal war" is favored by the mixed origin-destination principle applied to the state value added tax, since most of its financial costs are supported by the more industrialized state of São Paulo[22].

It should be noted, though, that other elements also played a role in investors' decisions concerning the better site to locate their industrial plants. Political stability and good governance, for instance, were behind decisions from traditional manufacturing industries established in the southern corner of the country to move up to the Northeast and opt for the states of Bahia and Ceará as their point of destination, in order to benefit from better conditions encountered in these states to carry out their business.

The new wave of investments in the automotive industry witness the location of the new plants in the southern states of Paraná, Rio de Janeiro, Minas Gerais and Rio Grande do Sul, not very far from the main industrial center of São Paulo, choosing cities well known for the quality of their environment and of their labor force. The only case of a car maker deciding to move up North, to the state of Bahia, followed a rejection of the new political rulers of the sate of Rio Grande do Sul to keep the agreement made with its predecessor and a generous federal fiscal and financial support to that end.

Not having enough tools to play with, competition in the federation concentrated in two main directions. One looked at fiscal and financial benefits to attract investments. The other focused on political support to have access to federal sources of financing. In the end, this kind of competition may lead to a negative sum game. In order to attract investments, state and municipalities foregone future budgetary revenues that reduce their capabilities to respond to actual pressing needs and to futures ones that will result from an increase in urbanization. By reducing their own resources in the future, they become more dependent on the access to federal resources, loosing autonomy with respect to policies that create a favorable environment for business. Benefits achieved in the short run may thus be transformed in significant costs in the medium and long run, adding more instability in federal relations.

Competition among member states within a federation is regarded by some as beneficial from the viewpoint of efficiency. On this account, if states and local governments use public resources to create a better economic and social environment for people and business, competition over who receives approval will enhance economic efficiency and social satisfaction. Of course, that implies that authorities at the sub-national level have autonomy with regard do decisions concerning the allocation of their resources, being they composed of own revenues or transfers. As mentioned before this condition is not fully found in the Brazilian federation, meaning that in our case the competition in place provoke economic distortions and social injustice.

[22] Every good produced in other state and sold in São Paulo carries a nominal fiscal credit that reduces tax collections in São Paulo. It shoul be noted that credit is given even though there is a full rebate of the tax collected in the origin.

5 – Regional Integration, Taxation and Antagonisms: Back to the Future?

5.1 – Globalization, Economic Integration and Domestic Regional Disparities

Together with globalization, regional integration projects in America pose further challenges to the Brazilian federation. Being put in place in a time of exacerbating antagonisms and a weak federal government, these projects might fuel these antagonisms in a way that could resemble the early days of the empire and the first republican decades.

Along with globalization of financial and commercial activities, consolidation of regional economic blocs impose growing limits to the autonomy of the nation states, as the role played by the WTO and the experience of the EEC reveal. The latter provides the more important example of submission of national sovereignty to a common project of a powerful Europe. Step by step, the EEC moves towards full harmonization of economic policies. With monetary union, further advances in tax harmonization, in the area of income taxes, will be required. Targets for the fiscal deficit and public indebtedness leave almost no room for fiscal autonomy.

Federal regimes are twice affected in the process of moving towards full regional integration. On the fiscal side, tax harmonization implies loss of autonomy to tax at the state level, whereas macroeconomic constraints mean a tighter control over the budget and access to credit. Thus, the notion of federal autonomy has to be reinterpreted. Greater autonomy to spend, provided that fiscal balance is observed, could compensate for narrow limits to raise resources at the state level. Besides, greater reliance on user charges at the local level may improve autonomy of municipal governments for the benefit of big cities, mainly.

Privatization of infrastructure and urban services also put important decisions out of the hands of mayors and governors as the coverage of private owned public utilities do not have to conform to limits of each jurisdiction. As the State move from direct intervention to regulation, the need for an efficient regulatory apparatus come to the fore, requiring a clear division of responsibilities for regulation in the federation, which Brazil has not yet manage to solve.

One important aspect to be considered is the regional consequences of the global economy. Not without reason the EEC designed from the very beginning a comprehensive regional policy based on funds to be used for enhancing the economic prospects of less developed members of the bloc. Money poured in by the richer member are diverted to the poorer ones (and to poor zones of the not so poor) to improve their economic infrastructure, human resources and technological standards, in order to give them better conditions to participate in the European market as well as in the global economy.

Regional disparities are a matter of great concern in Brazil as well as in other big less developed economies. A recent study carried out by the Economic Commission for Latin America shows that four out of the six sectors that invested more in expanding productive capacity in Brazil in the 1995-97 period - automobiles, electronics, pharmaceutical and food processors - are dominated by multinational enterprises. Greater external control over decisions to invest, based on strategic considerations of access to regional markets, raises doubts about its impact on internal regional disparities. The likelihood of establishing closer ties among the southern Brazilian states and Mercosur countries contribute to renewed worries in less developed Brazilian regions about prospects for the regional distribution of production and income. It is worth noting that the newer automotive plants located in Brazil in the nineties opted for being closer to the southern border.

In the global economy, ability of governments to deal with domestic regional inequalities depends even more on cooperation. Traditional location factors – ill paid labor force, availability of raw material, proximity of consumer markets and low degree of labor organization – loose gravitational force at a time when facilities to move goods and services at long distances, increase in e-commerce and the abandon of antagonism among labor and capital render those factors obsolete. The obsolescence of traditional location factors makes also ineffective the use of fiscal incentives. Not only the degree of freedom to concede fiscal benefits for regional policy purposes is curbed in the process of tax harmonization, as the drive for competitiveness do not permit the maintenance of artificial solutions.

There are solid reasons to argue that integrating in the global economy and in regional economic blocs could lead to greater internal disparities in Brazil, at the same time that create conditions for weakening the degree of national cohesion by allowing for more intense external economic relations and closer ties with foreign neighbors.

The Amazon provides a good example of the case in point. Already, the economy of the Brazilian Amazon is well connected with the exterior. Economic relations of the Amazon with the Northern hemisphere tend to proceed at a faster pace given the potential for exporting products derived from its natural resources – minerals, forestry and grains, not to mention the well known biological richness – to markets eager to consume natural products. Prospects for the output of the Free Zone of Manaus to reach Caribbean an Andean countries markets gets also better as investments in infrastructure facilitate the commerce within the Amazon basin and the Caribbean.

The poor Northeast region also faces new possibilities for cutting dependence from inputs and capital goods originated in the South. A sizable portion of traditional manufacturing industries is already moving to the Northeast to benefit from low production costs and proximity from external markets. In the global economy, industrialization of the Brazilian Northeast is not necessarily dependent on events in the South since it gains access to machinery and other inputs from abroad often better, in terms of quality and prices, than those domestically produced.

In the southern part of the country, Mercosur raises positive expectations whereas others regions see economic integration in the south cone as posing concrete danger for the national goal of a less uneven regional development in Brazil. Already, trade in Mercosur multiplied several times since its inception, to the benefit of southern Brazilian states.

Besides having a significant impact in the flow of goods and services within the area, Mercosur provoked a growing interest in cross investments in the region. Worth mentioning are the positions of Brazilian investors in Argentina, through direct investments, acquisitions and joint ventures as well as Argentinean investors in Brazil. Chile, not a full member of the bloc, also has been active in making investments in both countries, especially in the electricity industry. Some signs of further improvements in cultural ties are reflected by the spread of interest in learning Spanish in Brazil and Portuguese in Argentina.

Simulation of the domestic regional impact of integration, under three distinct scenarios: FTAA; free trade with the EEC; and free trade with all Brazilian commercial partners (IPEA, 2001), shows that all of them might lead to concentration of economic activity in the already more developed areas of the Brazilian territory, providing empirical evidence to support the arguments above.

What is at stake, thus, is the possibility of national disintegration in the process of international integration. To avoid this undesirable outcome it isnecessary to put in place a regional policy focused on reducing the gap among Brazilian regions with respect to infrastructure, human resources and access to modern technologies. On the fiscal side, it is necessary to harmonize the domestic tax system and proceed towards tax harmonization within the continent, replacing old antagonisms for well-established rules of cooperation.

5.2 – Regional Policy and Federal Cohesion

One important consequence of regional economic integration is the call for physical integration. Until very recently, physical connections of Brazil with its Spanish-speaking neighbors were virtually nonexistent. Military worries of the past did not allow Brazilian and Argentinean rail tracks to match, blocking the use of railways to move goods along their borders. Land transportation within Mercosur rely on highway connections whose conditions rise to abnormal levels the cost of moving goods in the region. With the exception of the energy bought from Paraguay as a result of the building of the Hydroelectric of Itaipu, wholly financed by Brazil, there were no interchanges of electricity. Ill functioning communication systems also induced isolation.

Recent investments following privation of the infrastructure in the region began to change the situation, more notably in telecommunication. Pending on the mobilization of financial resources, an ambitious project for improving physical connections in South America will, when implemented, lead to a distinct reality. In 1999 the Brazilian government announced investments of US$ 125 billion aimed to connect the more dynamic areas of the Brazilian territory through national development axes-"Eixos Nacionais de Desenvolvimento". In the meantime some important regional projects as the highway from Manaus to Venezuela and the Bolivia-Brazil gas pipeline have been already implemented. With support of the Inter American Development Bank, studies are under way to move fast towards greater physical regional integration.

Lifting physical barriers to the movement of goods within Mercosur and in the continent as a whole will have important geographical impacts. Even though labor is a perfectly mobile factor in Brazil, significant differences in the quality of the labor force means that attracting people from other regions cannot easily solve shortage of skilled labor in the modern South.In fact, labor mobility usually contributes to worse conditions for global competitiveness by packing ill-prepared population in the outskirts of the more industrialized cities.

As social and cultural barriers also began to fall, a shortage of skilled labor in the South of Brazil might be filled with better-educated workers from neighboring countries, leading to resentment and to claims for the imposition of restrictions to the movement of labor in the continent.

If physical connections advance at a fast pace and labor mobility is not subject to restrictions, a common approach to regional policy might have to be considered. As opportunities for Brazilian regions and their res pective states to profit from increasing economic ties with regions of neighboring countries began to be realized, possibilities to reduce regional differences gain new dimensions. More competition among regions and among states can be a substitute for uniform rules and compensatory policies conducted at the federal level.

The main goal of regional policy should be the support to policies focused on creating a friendly economic environment and not on the concession of subsidies or tax holidays. This mean, as already noted, a joint federal and state effort to create a modern infrastructure, raise the quality of human resources and invest in building capacity to generate and apply scientific knowledge to economic and social aims.

One step towards devolving decision-making power in matters related to labor relations in Brazil was taken with the decision to let the states establish minimum wages above the federal established floor. As the national minimum wage have an important impact on the public accounts, notably in social security debts, it has been kept at very low levels for reasons that are beyond the interests of both workers and employers in modern economic sectors. Since this measure was adopted, some states passed legislation granting an increase in the minimum wage to be observed within their borders.

Despite of the above, proposals to deal with the challenges posed by globalization and regional economic integration in Brazil call for less autonomy of states in fiscal as well as in regulatory matters. Based on arguments that are already unsustainable, most proposals for tax reform call for a federal law to unify rules applied to the value added state tax, at the same time that the tendency for standardization of the criteria used to transfer federal money to cover the financing of social services also mean less autonomy for member states to manage their budgets. The room for states' interference in regulation has also been narrowed. Federal legislation concerning the two more important areas under privatization – telecommunication and electricity – gives the sates only a secondary role in supervising the actions of the newly privatized enterprises, placing in the realm of federal bodies the most important decisions concerning the workings of these enterprises.

Given its importance for the purpose of federal autonomy and the success of regional integration, tax reform has been in the agenda for the past 12 years without finding a way to accommodate the conflicts of interest involved in any attempt to make profound structural changes in the tax system. Whereas private business emphasizes the urgency of a tax reform to establish a level playing field for competition with foreigners, states and municipalities fear that any change in the present regimen will impinge on their autonomy to raise revenues and dispose of the resources collected in their jurisdictions.

5.3 – Tax Reform, Integration and Federal Autonomy

There is a broad consensus on the inadequacy of the Brazilian tax system. It hinders competition in domestic and foreign markets, impinges on economic efficiency, puts additional burden on investments, induces tax evasion and submits taxpayers to a cumbersome legislation. Despite of that, all attempts to reform the tax system in the past fifteen years did not succeed.

One of the points of dispute is an incorrect association between harmonization and unification. State governments correctly oppose renewed attempts from above to give up their competence to institute the value-added tax they administer since 1965. A strong fear to face the need to change the backbone of the fiscal federalism structure put in place 35 years ago is another reason for failure. Without having the courage to redesign the revenue sharing mechanisms enshrined in the Constitution, chances to solve conflicts of interest are very low.

It is not necessary to unify but to harmonize. Harmonization requires a common consumption tax basis but not uniform tax rates. Broadening the basis of taxation and applying uniform basis all over the country is the way to achieve tax harmonization This poses new challenges for assuring fiscal balance in federal regimes with high regional inequalities. The traditional combination of giving power to tax to states and municipalities and designing compensatory transfers to meet the needs of those economically backward cannot be sustained. The need to share a broad basis consumption tax has now to be considered.

To share the tax is not the same of sharing its proceeds. In the latter, the fiscal system is wholly centralized and revenues of the central government tax are divided according to a specific formula. When the tax is shared, both central and state governments are entitled to explore the same tax basis, under a common legislation. Autonomy to set the rules of taxation is jointly put in the hands of the National Parliament, but both partners keep the ability to set rates, collect and dispose of its share.

A common tax basis and a national legislation form a powerful incentive for intergovernmental cooperation in the field of tax administration, bringing benefits for taxpayers and administrators. On the taxpayer's side, a uniform rule for appraising fiscal obligations means lower compliance costs and no need to apply to distinct jurisdictions to solve conflicts. On the side of the tax administrators, unification of tax registers and joint audits improve efficiency, reduce tax evasion and minimize administrative costs.

With a harmonized consumption tax, competition for attracting economic activities through fiscal benefits will impact only the revenues of those that make these concessions removing the main reason for a "fiscal war". Economic development will have to rely more on means to improve basic infrastructure, urban services and social programs, with emphasis in basic education and health. Intergovernmental cooperation in public spending, to implement these policies, is the counterpart of sharing the tax. By sharing a broad base consumption tax, revenue distribution in the federation keeps a close association with income and consumption level in each member of the federation. Compensatory transfers may thus be reduced to levels required to maintain a minimum standard of services everywhere in the country, allowing for a greater role of local governments in the provision of urban and social services.

Stability in the tax system is another important advantage of sharing a tax. When a broad basis tax is shared in a federation frequent changes in legislation are less likely to occur, as proposals will require enough support to overcome reactions of those that may not be in accord with the intended modification. It is worth noting that stability of fiscal rules becomes even more important as globalization and regional integration proceed, given its importance for attracting investments and for decisions to increase productive capacity.

Opportunities for applying the benefit principle of taxation also increase with the possibility of exercising greater autonomy at the local level. Big cities play an important role in the global economy at the same time that face increasing difficulties to match revenue and expenditure needs. Local taxes on property and on retail sales do not create economic distortions and may thus be better used. Charges imposed on the beneficiaries of services public provided at the municipal level could also be important to improve the local public finances.

On the other hand, emphasis on microeconomics put aside considerations of equity in taxation. Progressivity in income taxation is affected by increasing mobility of capital and high paid jobs. Applying selective taxes on consumption is also constrained by competition in domestic and international markets. Equity may thus be better achieved by means of conceding priority to public programs designed to equalize opportunities for social mobility in the use of the public resources.

Overall tax burden is also submitted to international constraints and to macroeconomic standards of a sound fiscal policy. Efficiency in public spending is the only way to maintain an adequate level of public services without surpassing the limits to tax.

In Brazil, and probably in other federations, antagonisms among the states have gained new impetus as the so-called “fiscal war” demonstrates. Antagonisms is also manifested through increasing resentments of taxpayers in richer states over high tax burdens required to sustain generous fiscal incentives and transfers that often benefit the well off living in poorer regions of the country.

Prevalence of antagonisms does not yet favor the installation of a cooperative federalism. On the contrary, the search for individual gains, including by means of improving external economic relations, at the expense of a more intense interchange with other regions of the country, may be seen at first sight more profitable from the viewpoint of each particular state in the federation. The likelihood of a national economic disintegration along with the deepening of the international integration may not thus be overlooked.

6 – Conclusion

Since the beginning of the past decade, Brazil has been engaged in an effort to push institutional reforms to better integrate in the global economy. The agenda for reforms were broad, including: privatization of public enterprises, abolishment of state monopolies, reform of the financial sector, modernization of the public administration, reform of the social security, and modernization of the tax system. Many of them have important implications from the viewpoint of the federal regimen that did not receive consideration. Their utmost priorities were the achievement and sustainability of macroeconomic stabilization.

In the process of emphasizing a stable currency, economic development and federal autonomy were negatively affected. As mentioned above, states were forced to privatize state banks as part of a deal to renegotiate their debts with the federal government. At the same time, tougher conditions were put in place to block the access of states and municipalities to credit, private and multilateral loans included. With their ability to collect taxes undermined by a sluggish rate of growth and the spread of informal activities, they became more dependent on federal money to finance even basic social spending. As the national effort was focused on keeping the targets set for the primary surplus, the public services deteriorated to the detriment of the poor, who rely on these services to meet their basic needs.

The agenda for reforms missed one important aspect for better dealing with federal issues, namely the regional policy. In the context of a closed economy and a strong interventionist state, that prevailed up to the eighties, regional policy relied on federal fiscal benefits for private investments in less developed regions and in heavy public investments financed by the federal budget or conducted by public enterprises, mainly in basic infrastructure. Both disappeared as a result of the fiscal crisis and the privatization program, leaving the regional issue in the hands of the states.

Despite of the need for a new regional policy it has not as yet been raised to a priority in the federal government agenda. Without concerted actions to create favorable conditions for decentralizing production and income, antagonisms in the federation will surely increase, creating political instability and making it harder to move fast towards the full implementation of the agenda for reforms.

High in the agenda for reforms, proposals for changing the tax system failed for not paying due attention to factors that point to further regional unbalance. The emphasis on worldwide competitiveness and the centrifugal forces that develops in the wake of the advance of regional integration calls for the insertion of the domestic regional issue in the process of design of a new tax system, in order to remove the obstacles imposed to the advance of the tax reform.

To achieve the twin goals of competitiveness and regional equilibrium, tax reform must face controversial issues involved in the federal arrangements established in the middle sixties and untouched in 1988. In this revision, a proper balance among competition and cooperation in the federation should be accomplished. Autonomy to set tax rates and freedom to dispose of revenues enable member states to compete for attracting private investments through fiscal prudence and quality of the public services provided. However, a fair competition does not preclude the need for cooperation. To avoid an increase in regional disparities and in antagonisms intergovernmental cooperation to reduce internal gaps in infrastructure, human resources and technological capabilities is in need.

STATISTICAL APPENDIX

TABLE A. 1.
BRAZIL - General Features of the Economy, 2000

GDP	US$ 593,8 billion
Population	169,8 million
Per Capita Income	3,5 thousand
Inflation	9,81% IGP _DI
Exchange Rate	1,83 (average/2000)
Public Sector Net Debt	49,5% of GDP (dec./2000)
Public Deficit 1/	4,50% of GDP
Tax Burden	32,7% of GDP

Source: IBGE, Bacen e Araujo (2001).

1/ Including subnational governments and state enterprises.

TABLE A.2
Brazil: Selected Socioeconomic Indicators, 1999

	Population 1/ % Total	GDP 2/ % Total	Per Capita GDP US$	Infant Mortality Rate 3/	Illiteracy Rate 4/	Satisfactory Housing Conditions 5/ % Total
Brazil	**100,0**	**100,0**	**3.154**	**34,6**	**13,3**	**62,3**
North	**7,6**	**4,4**	**1.857**	**34,1**	**11,6**	**13,6**
Rondônia	0,8	0,5	2.009	31,6	9,6	6,7
Acre	0,3	0,2	1.548	44,2	15,5	22,7
Amazonas	1,6	1,6	3.064	31,8	8,8	27,5
Roraima	0,2	0,1	1.405	38,3	8,6	11,5
Pará	3,6	1,7	1.486	34,6	12,4	11,4
Amapá	0,3	0,2	1.864	31,7	9,5	1,3
Tocantins	0,7	0,2	1.007	33,0	21,0	2,4
Northeast	**28,2**	**13,1**	**1.468**	**53,0**	**26,6**	**32,5**
Maranhão	3,3	0,8	770	54,2	28,8	11,1
Piauí	1,7	0,5	912	45,3	31,6	5,7
Ceará	4,4	2,0	1.446	52,4	27,8	26,3
Rio Grande do Norte	1,6	0,8	1.515	48,7	25,5	31,2
Paraíba	2,0	0,8	1.262	60,3	25,9	40,6
Pernambuco	4,7	2,7	1.802	58,2	24,7	36,5
Alagoas	1,7	0,7	1.250	66,1	32,8	19,3
Sergipe	1,0	0,6	1.679	45,5	23,9	36,5
Bahia	7,7	4,3	1.762	45,4	24,7	44,3
Southeast	**42,6**	**58,3**	**4.309**	**24,4**	**7,8**	**85,5**
Minas Gerais	10,5	9,6	2.879	26,3	12,2	82,4
Espírito Santo	1,8	1,9	3.342	26,0	11,1	71,7
Rio de Janeiro	8,5	11,7	4.366	24,4	6,0	77,3
São Paulo	21,8	34,9	5.060	21,9	6,2	91,1
South	**14,8**	**17,7**	**3.779**	**20,7**	**7,8**	**53,5**
Paraná	5,6	6,3	3.542	24,3	10,2	46,9
Santa Catarina	3,2	3,7	3.668	22,2	6,8	51,8
Rio Grande do Sul	6,0	7,7	4.307	18,4	6,1	60,1
Center West	**6,8**	**6,4**	**2.880**	**24,5**	**10,8**	**40,5**
Mato Grosso do Sul	1,2	1,1	2.887	24,4	10,9	9,8
Mato Grosso	1,5	1,2	2.580	27,5	11,8	24,0
Goiás	2,9	1,8	1.980	25,0	12,5	38,6
Distrito Federal	1,2	2,3	6.008	22,6	5,1	89,9

Source: IBGE (Contas Regionais do Brasil, 1999 e Síntese dos Indicadores Sociais, 2000).
1/ Total Population = 167.909.738 habitants.
2/ GDP = US$ 529, 6 billion.
3/ Per one thousand born alive.
4/ People aged fifteen years or more.
5/ Urban dwellings connected to water and sewage systems (or to a septical tank) and access to garbage collection services.

TABLE A.3
Participation of Each Government Level in Own Tax Collections
1960, 1965, 1970/2000e

	Total Tax Revenues % of GDP	Federal			State	Local
		Total	Taxes 1/	Social Contributions 2/		
1960	**17,4**	64,0	64,0		31,3	4,7
1965	**19,0**	63,6	63,6		30,8	5,6
1970	**26,0**	66,7	66,7		30,6	2,7
1971	**25,3**	68,7	67,9	0,8	28,6	2,7
1972	**26,0**	69,7	67,6	2,1	27,7	2,6
1973	**25,0**	71,1	68,0	3,1	26,3	2,5
1974	**25,1**	72,3	68,5	3,8	25,4	2,3
1975	**25,2**	73,7	69,4	4,3	23,5	2,8
1976	**25,1**	75,4	70,7	4,7	21,6	3,0
1977	**25,6**	76,0	71,1	4,9	21,1	2,9
1978	**25,7**	75,1	70,1	5,0	22,2	2,8
1979	**24,7**	74,8	70,1	4,7	21,8	3,4
1980	**24,5**	74,7	70,5	4,2	21,6	3,7
1981	**25,3**	75,4	71,2	4,2	21,3	3,3
1982	**26,3**	75,9	71,1	4,8	21,4	2,7
1983	**27,0**	76,5	70,7	5,8	20,6	2,8
1984	**24,3**	73,6	68,0	5,7	23,7	2,7
1985	**24,1**	72,7	66,8	5,9	24,9	2,4
1986	**26,2**	70,5	63,8	6,7	27,0	2,5
1987	**23,8**	72,3	66,1	6,2	25,2	2,5
1988	**22,4**	71,7	66,8	4,9	25,6	2,7
1989	**24,1**	67,5	59,3	8,1	29,9	2,7
1990	**28,8**	67,0	55,8	11,2	29,6	3,4
1991	**25,2**	63,4	52,1	11,4	31,2	5,4
1992	**25,0**	66,1	54,9	11,3	29,1	4,8
1993	**25,8**	68,6	55,4	13,2	26,6	4,7
1994	**29,8**	67,9	48,8	19,0	27,1	5,1
1995	**29,4**	66,0	51,5	14,5	28,6	5,4
1996	**29,1**	65,3	51,9	13,5	29,6	5,1
1997	**29,6**	66,2	50,9	15,4	28,8	5,0
1998	**29,6**	67,0	52,4	14,6	27,5	5,5
1999	**31,7**	68,1	50,0	18,1	26,9	5,0
2000	**32,7**	67,3	47,2	20,1	27,7	5,0

Source: Varsano *et allii* (1998) e Araujo(2001).
1/ Tax receipts, social security contributions and unemployment insurance.
2/ Turnover taxes, tax on financial transactions and net profits tax.
e/ preliminary.

TABLE A.4
Participation of Each Government Level In Disposable Tax Revenues: 1960, 1965, 1970/2000e

	Total Tax Revenues % of GDP	Federal			State	Local
		Total	Taxes 1/	Social Contributions 2/		
1960	**17,4**	59,5	59,5		34,1	6,4
1965	**19,0**	54,8	54,8		35,1	10,1
1970	**26,0**	60,8	60,8		29,2	10,0
1971	**25,3**	62,8	62,1	0,8	27,3	9,9
1972	**26,0**	63,8	61,8	2,1	26,9	9,2
1973	**25,0**	64,5	61,4	3,1	26,3	9,2
1974	**25,1**	66,4	62,6	3,8	25,2	8,4
1975	**25,2**	68,0	63,7	4,3	23,3	8,7
1976	**25,1**	68,1	63,5	4,7	23,1	8,8
1977	**25,6**	69,1	64,2	4,9	22,3	8,6
1978	**25,7**	68,1	63,1	5,0	23,3	8,6
1979	**24,7**	68,0	63,3	4,7	22,7	9,3
1980	**24,5**	68,2	64,0	4,2	23,3	8,6
1981	**25,3**	68,4	64,3	4,2	22,3	9,3
1982	**26,3**	69,0	64,1	4,8	22,1	8,9
1983	**27,0**	69,8	64,0	5,8	21,3	8,9
1984	**24,3**	65,8	60,1	5,7	24,1	10,1
1985	**24,1**	62,7	56,7	5,9	26,2	11,1
1986	**26,2**	60,9	54,2	6,7	27,0	12,1
1987	**23,8**	64,1	58,0	6,2	23,3	12,6
1988	**22,4**	60,1	55,2	4,9	26,6	13,3
1989	**24,1**	61,1	52,9	8,1	25,0	13,9
1990	**28,8**	58,9	47,7	11,2	27,6	13,5
1991	**25,2**	54,6	43,2	11,4	29,6	15,7
1992	**25,0**	56,9	45,6	11,3	28,1	14,9
1993	**25,8**	57,8	44,6	13,2	26,4	15,8
1994	**29,8**	59,3	40,3	19,0	25,1	15,6
1995	**29,4**	56,2	41,7	14,5	27,2	16,6
1996	**29,1**	56,0	42,6	13,5	27,6	16,3
1997	**29,6**	56,2	40,9	15,4	27,7	16,1
1998	**29,6**	56,2	41,6	14,6	26,6	17,2
1999	**31,7**	57,0	38,9	18,1	26,0	17,0
2000	**32,7**	56,7	36,7	20,1	26,4	16,9

Source: Varsano *et allii* (1998) e Araujo (2001).
1/ Tax receipts, social security contributions and unemployment insurance.
2/ Turnover taxes, tax on financial transactions and net profits tax.
e/ preliminary.

TABLE A.5
Composition of Tax Receipts - 1980/2000e

(% of Total Tax Burden)

	Total Tax Burden (% of GDP)	**Foreign Trade**	Goods and Services: Total	Goods and Services: Value Added Tax	Goods and Services: Turnover Tax	**Property**	**Income /Profits**	**Payroll**	**Others**
1980	**22,8**	3,1	43,7	31,0	12,7	1,2	13,2	28,2	10,7
1981	**23,3**	2,5	43,9	30,6	13,3	1,4	14,4	29,7	8,0
1982	**24,7**	2,0	42,1	29,5	12,6	1,3	14,0	32,9	7,7
1983	**25,0**	1,8	41,0	28,6	12,4	0,9	17,0	29,7	9,6
1984	**24,1**	1,7	39,9	27,7	12,2	0,9	19,7	27,2	10,6
1985	**24,1**	1,7	41,7	30,2	11,5	0,7	21,3	26,4	8,2
1986	**26,3**	1,8	44,9	32,4	12,5	1,2	19,1	27,2	5,8
1987	**23,8**	1,7	45,6	33,3	12,4	1,0	18,1	26,9	6,7
1988	**22,4**	1,9	44,0	33,6	10,4	0,9	20,9	25,7	6,5
1989	**24,1**	1,8	45,3	35,7	9,6	0,5	21,4	27,1	3,9
1990	**28,8**	1,3	48,9	33,5	15,4	1,0	19,7	25,4	3,7
1991	**25,2**	1,6	49,7	35,3	14,4	2,1	16,5	24,1	5,9
1992	**25,0**	1,6	47,4	34,9	12,4	1,4	19,6	25,2	4,8
1993	**25,8**	1,7	47,5	32,9	14,6	1,0	18,0	26,9	4,8
1994	**29,7**	1,7	51,6	32,1	19,5	1,3	16,1	24,6	4,6
1995	**29,4**	2,6	46,7	31,9	14,8	2,7	19,3	24,4	4,3
1996	**29,1**	1,9	45,4	31,6	13,8	2,9	16,3	27,0	6,5
1997	**29,6**	2,0	45,3	29,5	15,9	3,2	15,5	26,2	7,8
1998	**29,6**	2,4	43,8	28,3	15,5	3,3	17,5	26,9	6,0
1999	**31,7**	2,6	46,8	27,5	19,2	3,0	17,0	25,1	5,5
2000	**32,7**	2,4	48,4	28,1	20,3	3,0	16,0	23,7	6,5

Source: Varsano *et allii* (1998) e Araujo (2001).
e/ preliminary.

TABLE A.6
Selected Items of State and Local Governments Expenditures: 1996 and 2000

	States 1/		Municipalities 2/		Total	
	1996	**2000**	**1996**	**2000**	**1996**	**2000**
			% GDP			
Personnel	**6,8**	**6,2**	**2,4**	**3,0**	**9,2**	**9,2**
Wages	4,2	3,9	2,1	2,4	6,3	6,3
Pensions 3/	1,8	2,0	0,3	0,3	2,1	2,3
Social Charges	0,9	0,2	nd	0,3	0,9	0,5
Fixed Capital Formation	**0,8**	**0,9**	**1,1**	**0,7**	**1,9**	**1,7**
Financial	**2,3**	**1,8**	**0,4**	**0,2**	**2,7**	**2,0**
Interest	0,6	0,7	0,1	0,1	0,8	0,8
Amortizations	1,1	0,6	0,2	0,1	1,3	0,7
Other	0,5	0,5	0,0	0,0	0,6	0,5
Total	**9,8**	**9,0**	**4,0**	**3,9**	**13,8**	**12,9**

1/ Data for 1996 from IBGE, "Despesas Públicas por Funções, 1996-1998". For 2000 the source is the National Treasury Secretariat – STN.

2/ Data for personnel, fixed capital formation and other financial outlays are from STN, "Finanças do Brasil, 1996". Interest and amortization on the public debt came from IBGE "Regionalização das Transações do Setor Público 1991-1998" All data for 2000 are from STN.

3/ 1996 municipal figure for retired personnel are estimates based on actual municipal transfers to individuals. For 2000 this item includes pensions paid to retired public servants and beneficiaries of those deceased.

TABLE A.7
Public Sector Borrowing Requirements: 1995 – 2001

	1995	1996	1997	1998	1999	2000	2001 3/
Nominal (% GDP)	**7,2**	**5,9**	**6,1**	**8,0**	**10,5**	**4,5**	**7,5**
Federal Gov & Central Bank	2,3	2,6	2,6	5,5	7,4	3,1	5,6
States 2/	3,6	2,7	3,0	1,8	2,7	1,8	2,0
Municipalities				0,2	0,5	0,3	0,1
Sate Enterprises	1,3	0,6	0,4	0,5	-0,1	-0,7	-0,1
Primary (% GDP)	**-0,4**	**0,1**	**1,0**	**0,0**	**-3,3**	**-3,5**	**-4,7**
Federal Gov. & Central Bank	-0,6	-0,4	0,3	-0,6	-2,4	-1,9	-2,9
States 2/	0,2	0,6	0,7	0,4	-0,2	-0,4	-0,8
Municipalities				-0,2	-0,1	-0,1	-0,3
State Enterprises	0,1	-0,1	-0,1	0,3	-0,7	-1,1	-0,8
Nominal Interest Rate (% GDP)	**7,6**	**5,8**	**5,1**	**8,0**	**13,8**	**7,9**	**12,2**
Federal Gov & Central Bank	2,9	2,9	2,3	6,0	9,8	5,0	8,4
States 2/	3,4	2,2	2,3	1,4	2,9	2,2	2,7
Municipalities				0,4	0,5	0,4	0,4
State Enterprises	1,3	0,7	0,5	0,2	0,6	0,3	0,6
GDP (US$ billion) 4/	702,4	778,9	806,2	787,7	529,6	593,8	

Source: Bacen (Banco Central do Brasil).
Superavit (negative values); Deficit (positive values). Does not include revenues from privatization.
2/ State and local governments till 1997. Since 1998, state governments only.
3/ Results for January-July.
4/ Average exchange rate used for estimating US$ values.

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