

# INTERGOVERNMENTAL RELATIONS IN BRAZIL: RECENT DEVELOPMENTS AND OUTLOOK\*

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## INTRODUCTION

**B**razil is one of the largest countries in the world. It is also one of the largest federal states, behind only India and the United States in terms of population, and smaller than only the Soviet Union and Canada in terms of territory. It is also the country where federalism is least studied and understood.

Although it is a fairly homogeneous federation from the linguistic, ethnic and cultural standpoints, Brazil is marked by great disparity in the distribution of land and population among its 27 states. The main problem Brazilian federalism faces is the enormous economic and fiscal disparity among the states and the unequal distribution of income among the inhabitants of the states.

The result is a complex stratification of the states in terms of economic and demographic importance. São Paulo, Minas Gerais, Rio Grande do Sul, Paraná and Rio de Janeiro are in the top group. Bahia, stands alone as the only large, populous and poor state. There is a rising group of states with large territories, mid-size populations and growing economic weight, located in the west-central region. There is another group of states with large territories, small populations and little economic weight, located in the north. The final group of states is the northeastern states, with relatively small territories which are more densely populated than the preceding two groups, but which are also extremely poor. This heterogeneity is reflected in the political strength of the states within the federation, and is one of the reasons for the low degree of institutionalization of intergovernmental relations in Brazil

The dynamics of intergovernmental relations in Brazil can be better understood against the background of some historical peculiarities of Brazilian federalism. First, Brazil is a relatively old federation (1889), contemporaneous with Canada (1867) and Australia (1901), and, like these two countries, a former monarchy. But the Brazilian federalist movement only gained a degree of political importance because it became associated with the peculiar republicanism of the provincial elites that formed the basis of what could be called “oligarchic federalism,” which replaced the constitutional monarchy.

The chief characteristic of that first phase of Brazilian federalism was the great political and fiscal autonomy of the states, dominated by land-owning elites supported by the export of agri-

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\* Translated from Portuguese.



cultural products. The political balance of the federation depended on a complex play of coalitions between the most powerful states, such as São Paulo, Minas Gerais and Rio Grande do Sul, which contended for control of the federal government, and the intermediate states, such as Rio de Janeiro, Bahia and Pernambuco. This latter group depended on these strategic alliances in order to have any political influence.

Throughout the 20th century, Brazilian federalism and its intergovernmental relations were marked by the oscillation between centralizing, authoritarian regimes, and liberal, decentralizing regimes. This pendulum swing can be understood as the result of two concurrent processes. The first is the marked political and fiscal strength of the Union (federal government) in relation to the governments of the more powerful states, although these continue being central players in national politics. The second is the broadening of national political competition, which was not accompanied by institutionalization of intergovernmental relations that would clearly define the rules of the federal game. Thus, the political strength of each state has always depended on the ability of its political elites to form alliances with other state forces and national players in the federal sphere.

The most important result of this process is that the democratization that has transformed the country in the past twenty years has not had as great an impact on intergovernmental relations, which have remained a game of state political elites that are with or against the federal government. Moreover, this political dynamic continues to be strongly centralized in the hands of the President of the Republic, who is still the most important political figure in the federation, and the state governors. The strength of the state governors depends as much on their state's economic power as on the weight of their parliamentary representation at the federal level.

During times of political and economic strengthening of the federal government, there was a process of political, fiscal and administrative centralization (1930-1945 and 1964-1985). In periods of weakened central power, the states initiated a process of political and fiscal, but not necessarily administrative, decentralization. The process of decentralization was accompanied by a grab for the Union's tax revenues that can be described as "predatory" (1902-1926; 1985-1993).

The great change began in the first term of office of President Fernando Henrique Cardoso (1994-1998), with the breaking, at least in part, of the pattern of intergovernmental relations. In fact, the strengthening of the Union has not reversed but rather intensified the process of political, administrative and fiscal decentralization. At the same time, however, it has led to the concentration of tax revenues in the Union's coffers due to the strong fiscal adjustment that Fernando Henrique Cardoso initiated in 1994, while Minister of Finance under President Itamar Franco.

However, the current scene of intergovernmental relations in Brazil has become more complex and uncertain, due to the magnitude of the economic and politico-institutional changes of the 1990s. In this text I will describe the constitutional (Part 1) and political (Part 2) bases of federalism in Brazil; and, lastly (Part 3), I will describe the dominant patterns in intergovernmental relations and their impact on public policies.

## **PART I: CONSTITUTIONAL PRINCIPLES OF BRAZILIAN FEDERALISM AND THEIR IMPACT ON INTERGOVERNMENTAL RELATIONS IN THE 1990S**

To understand the intense political and administrative decentralization that Brazil has gone through in the past twenty years, we must bear in mind the set of economic and political processes that led to the crisis in the military dictatorship (1964-1985), resulting in the Constituent Assembly (1987-1988), which led to the 1988 Constitution. The main features of the current Constitutional Charter are its strong emphasis on civil, political and social rights, and a major restructuring of the tax system that has resulted in significant fiscal decentralization.

The crisis in the military regime, combined with the government's fiscal crisis, greatly strengthened the state governors, who were elected democratically in 1982 and 1986, whereas the President of the Republic, who was chosen by an Electoral College in 1985, had difficulty legitimizing his mandate. The agenda of constitutional reform, however, was controlled in large part by regional political forces.

Despite their political strength, the states have shown no interest in redefining the spheres of jurisdiction of the different levels of government. Their main concern has been to guarantee tax autonomy, especially as regards the main tax, the ICMS (a state VAT), and to expand and consolidate the system of tax transfers from the federal government to the states and municipalities.

Thus, while the definition of spheres of politico-administrative jurisdiction has continued to be fairly generic and flexible, so that Brazilian federalism can be characterized, at least according to its constitutional principles, as cooperative (see articles 20 to 25, especially 23), the large-scale redistribution of tax revenue has made Brazil one of the most decentralized federations in the world (see Title VI, especially articles 153 to 159).

Some figures on spending by level of government will serve to illustrate this major feature of Brazilian federalism. Expenditures by the subnational governments, after constitutional tax transfers, account for 62% of total spending on the civil service, 71% of current expenditures (except staff payroll) and 78% of fixed investments. The federal government, on the other hand, accounts for 80% of spending on social welfare and other transfers to individuals, and for 90% of interest payment on the national debt.

From the standpoint of intergovernmental relations, the new constitutional structure of federalism has yielded ambivalent results. It has guaranteed the richer states a fairly high degree of autonomy, while the poorer states are still very dependent on voluntary revenue transfers from the Union. At the same time it has left in the background two central issues for building a balanced federal system: flexible and effective mechanisms for fiscal equalization; and legal constraints and incentives for vertical and horizontal cooperation between the levels of government (federal, state and municipal). Let us take a look at how this constitutional system operates in practice, that is, how it interacts with the Brazilian political and party system, as it emerged in the 1980s.

## **PART 2: POLITICAL STRUCTURES AND PROCESSES AFFECTING THE EFFECTIVE OPERATION OF FEDERALISM IN BRAZIL**

The Federative Republic of Brazil is composed of the federal government (“the Union”), 27 states, the Federal District and more than 5,500 municipalities, which are also considered federated entities with jurisdictional powers defined by the Constitution. The Brazilian political system has two major features:

- 1) a presidential system, in which a president, elected in two rounds of voting, with a direct mandate from the people, needs to seek support from a bicameral Congress with symmetrical powers for the Chamber of Deputies and the Senate, with a multiparty and state system, and a strong, independent Supreme Court; and
- 2) a federal system that reflects the presidential system at both the state and municipal levels (but without bicameralism and with no municipal judiciary) and that grants a fair amount of constitutional autonomy to the federated entities.

The combination of a coalition-style presidentialism – in which an elected president depends heavily on majority congressional support in order to govern effectively – and a rather heterogeneous, dynamic federal system results in a fairly complex political system. The ability of the federal government to fulfil its role as coordinator of intergovernmental relations depends on a number of economic and political factors.

The first and most important factor is the political strength of the President for putting together his governing coalition in the Congress. Complex political maneuvering is called for, depending on the distribution of thousands of executive posts (currently nearly 19,000 in the direct administration alone) filled at the President’s discretion and, by delegation from him, by the ministers of state.

In order to form a coalition, the President must satisfy two imperatives that are not always mutually compatible. Firstly, the dominant groups in the major parties of the coalition must be represented. Secondly, a certain balance of strength must be maintained in the federal sphere. The trick is to balance party and state interests, without producing a politico-administrative patchwork quilt.

One of the President’s most important political resources in putting together a governing coalition is the power to appoint parliamentarians to government posts without their having to give up their political office. The effectiveness of this appointment power is dependent on the fiscal capacity of the federal government. In the first ten years of the current democratic regime (1985-1994), the three presidents have not had sufficient resources to distribute owing to the government’s fiscal crisis. Thus, they became virtual hostages of the political forces of the states. These, led by their governors, have managed to shift the cost of the fiscal adjustment to the Union, thereby causing a steep rise in the federal public debt.

This predatory intergovernmental dynamic was only reversed with the success of the so-called Real Plan, which broke the inflationary inertia that was blocking any lasting fiscal adjustment. The impact of monetary stabilization on the states’ finances was one of the main reasons for the weakening of the states vis-a-vis the federal government. To this point the governors had been

using the inflationary mechanism to devalue their expenditures, mainly the payroll of civil servants, whereas their tax revenues were indexed. As of 1995, when it became clear that inflation would not be making a resurgence in the near future, the state administrations fell victim to their own stratagem. This was one of the main reasons for the political success of the government of Fernando Henrique Cardoso.

Another important feature of the political system that affects intergovernmental relations is the overrepresentation of the less populous states in the Chamber of Deputies, combined with equal representation in the Senate (three senators per state). Since the Constitution, despite guaranteeing proportional representation in the Chamber, sets a minimum of 8 and a maximum of 70 deputies per federated unit, the more populous states – especially the largest of these, São Paulo – are underrepresented. Since the Senate has powers roughly parallel to those of the Chamber and its representation is even more distorted in terms of national population distribution, it is easy to form coalitions in the Congress to block constitutional reform that might correct the political imbalances in the federation.

Even strong presidents, such as Fernando Henrique Cardoso, have found it very difficult to change or bend some features of the political and administrative structure that have a negative impact on intergovernmental relations, such as the system of constitutional tax transfers and the rather inefficient and regressive tax system itself (both defined in minute detail in the Constitution).

The electoral system also has a major impact on the play of forces within the federation. It combines proportional representation using an open list – which allows voters to choose any name from the party list, without the control of the party leadership – with districts corresponding with the geographic territory of the states. This system reduces the ability of the party leadership to control their members. The electoral system also allows state governors to put pressure on federal deputies, since they can raise or lower their chances of success in their political careers, not only in the legislature, but also at the state executive level, through the distribution of public offices. The design of the electoral and party systems increases the centrifugal force exerted on intergovernmental relations, since it rewards individualistic and opportunistic parliamentarians at the three orders of government.

Finally, the role of the Supreme Court in settling disputes between components of the federation is a new element, which so far has received little study. The legalist tradition of justice in Brazil has always been a brake on the political role of the Supreme Court as interpreter of the Constitution. In addition to interpreting the Constitution, the Supreme Court also acts as court of final appeal in all types of legal disputes. This means that its eleven justices have to judge tens of thousands of cases each year. As a result the heavy work load considerably limits their ability and willingness to engage in long legal battles over constitutional principles. While it is true that the Supreme Court has been called upon with some frequency by state and municipal governments to settle some jurisdictional and legal disputes, mainly against the federal government, so far no great constitutional conflict decided by the Supreme Court has had any influence on the workings of federalism, as happens with the Supreme Court of the United States.

In summary, the Brazilian political system combines plebiscitary features, typical of Latin American presidential government, with consociative features, proper to some European parliamentary systems. Interestingly, neither pillar of the system can support the regime by itself. The



new feature of Brazilian federalism is that it is no longer characterized by its former swings between centralization and decentralization, but depends on a balance, albeit precarious, among the processes mentioned above.

Next we will see what influence this political dynamic has on intergovernmental relations.

### **PART 3: THE PRACTICE OF INTERGOVERNMENTAL RELATIONS IN THE 1990S**

An important feature of Brazilian federalism is that the jurisdictions and the distribution of resources between the Union, states and municipalities tend to be spelled out in detail in the Constitution. The operational rules and the rules of the political and administrative institutions that should be responsible for coordinating or promoting intergovernmental cooperation are left completely informal.

The only institution established to coordinate intergovernmental actions is the National Council for Fiscal Policy (CONFAZ). Established during the military regime to coordinate the fiscal and tax policies of the states, today it performs purely formal functions.

In Brazil there is a total lack of intergovernmental coordination in the fiscal and tax sphere. One of the great problems of Brazilian federalism is the intense fiscal war among most of the states (except São Paulo) for large-scale industrial investment, especially in the automotive industry. The great weapon of the fiscal war is exemption from the ICMS, the main value-added tax (accounting for 25% of the country's tax revenues), whose collection and rate are controlled in practice by the state governments.

The lack of institutional or administrative structures designed to coordinate public policies, together with the trend toward horizontal or vertical cooperation between the orders of government, has resulted in a patchwork pattern of intergovernmental relations.

There are two predominant approaches in the various areas that call for coordinated or cooperative action on the part of the different levels of government. In fields such as education, health and fiscal management, which the current federal government has made its priorities, the predominant approach could be called top-down coordination, through Supplemental Laws, whose purpose is to flesh out principles laid down in the Constitution.

For example in the area of education, in which states and municipalities have broad constitutional autonomy, the federal government has enacted a Supplemental Law establishing a National Fund for the Promotion of Basic Education (FUNDEF). This requires state and municipal governments to transfer 15% of their tax revenue (including transfers) to the Fund, which then redistributes the revenues according to the annual school census that shows how many pupils are in each unit of the federation.

The impact of FUNDEF on the Brazilian education system has not yet been fully assessed, but its impact on state and municipal finances throughout the country has been enormous. Suffice it to say that, in the state of São Paulo, the richest state in the federation, there was a net transfer of some R\$ 600 million from the municipal governments to the state government, which has always played a greater role in education policy than the municipalities in that state. The opposite happened in the state of Rio de Janeiro, where the government had to transfer some R\$ 400 million to the municipalities. Despite consensus on the need for some action to redress the imbal-

ances in national public education funding, the linear and standardized transfer of resources between governments, without knowledge of exactly what is happening in each federal unit, does not seem an ideal model for redistributive policy, except as a last resort.

In 2000, the federal government passed the so-called Fiscal Responsibility Law, which strictly regulates the use of fiscal revenue by subnational governments and imposes heavy legal restrictions, including criminal penalties, for indebtedness by state and municipal governments. According to initial assessments, most of the governments have managed to adjust to the rigors of the law, but there are frequent calls by municipal mayors for changes to the rules of the FRL.

The case of health is the oldest and most successful, precisely because it was negotiated at length and implemented over the course of the 1980s and 90s. The most important point in the process came during the drafting of the Constitution, with consolidation of the Single Health System (SUS), whereby each federal unit participates voluntarily in the decentralization of federal resources for health, gradually assuming the management of hospital and health-care services. The great challenge facing the SUS is to encourage the thousands of small and medium-size municipalities to cooperate in setting up health consortiums that are able to manage more-complex systems, thus reducing the pressure on the overburdened and inefficient federal and state public systems. The problem here is the lack of legal and fiscal incentives to encourage the municipalities to cooperate systematically and continuously in building regional health networks.

The three cases mentioned above are considered successful examples of coordinated intergovernmental action initiated by the federal government. In none of them has there been any concern with the autonomy or sensitivity of the policies with regard to the great economic, social or fiscal differences among the subnational governments. In all of them, the key to success has been the federal government's ability to convince its broad parliamentary coalition of the need to solve serious and complex social problems, while at the same time dismantling coalitions that might block enactment of these laws.

In other cases that are equally or more important – such as the establishment of a tax equalization system that is more flexible and more sensitive to the country's complex social and regional disparities, or tax reform that is essential to bring the Brazilian economy into the process of regional integration (especially the FTAA) – the government has faced enormous difficulties precisely because of the formation of veto coalitions.

A conclusion on the dynamics of intergovernmental relations in Brazil, however, should not be completely pessimistic. There has been much progress, especially in the local sphere, where the emergence of a more active civil society has helped to strengthen democracy, not only in the relations between governments and citizens, but also in relations between governments.