THE FEDERAL REPUBLIC OF BRAZIL

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This chapter provides an overview of the distribution of powers and responsibilities in Brazil's federal Constitution, tracing its historical development and describing how it works in practice. Brazil has a vast territory and a complex federal system. Its economy, in terms of gross domestic product (GDP) in U.S. dollars, is among the ten largest in the world. Attempts to implement a federal form of government can be traced back to 1831. It was in 1891 that the first republican federal constitution was promulgated. The present Constitution has been in operation since 1988, when democracy was re-established. It demonstrates a clear trend to decentralization, intended to bring power closer to the people. Moreover, the 1988 Constitution has been in constant evolution through legislation known as complementary laws. The objectives of the Constitution are to consolidate democracy, to implement decentralization, and to improve social conditions. Meanwhile, the country has been trying to achieve economic stability while struggling against social inequalities and regional disparities. Constitutional rules have been changing over time, to a great extent in order to adapt to the new economic context. Republican federalism as a form of government organization, however, has shown remarkable stability.

THE FEDERAL CONSTITUTION IN HISTORICAL-CULTURAL CONTEXT

Territorial and Demographic Background

Brazil occupies 47.7 percent of the South American continent, covering a total of 8,511,965 square kilometres. It has the fifth largest territory in the world, after Russia, Canada, China, and the United States. According to the latest estimated demographic figures, Brazil's population totalled 174.7 million in 2002. Annual population growth has been falling steadily from 2.48 percent in 1970 to 1.32 percent in 2002. Its workforce stood at 83.2 million in 2001. The Brazilian federation consists of twenty-six states plus the federal district. The states are grouped into five major regions: North, North-East, Centre-West, South-East, and South.[i] The population is mainly concentrated in the southeast, northeast and south regions. The capital, Brasília, with a population of 2.05 million, is located in the central plateau. The largest cities are São Paulo (10.4 million), Rio de Janeiro (5.8 million), Salvador (2.4 million), and Belo Horizonte (2.2 million). The rural population, which in 1940 accounted for 69 percent of the total population, had fallen to 21 percent in 2000.

Economic and Social Context

The Brazilian economy (GDP) grew at an annual average rate of 9.32 percent in the 1970s. Job creation did not, however, keep pace and was insufficient to absorb the growing workforce. Economic growth was limited to capital-intensive sectors such as mining, heavy industry, and import-substitution industries. Employment expanded most in the services sector, however. In the mid-1970s public spending focused mainly on the basic industrial and energy sectors, with giant state-owned corporations being set up in key sectors. To finance this drive, the government relied on foreign capital. However, international market conditions towards the end of the decade led to the collapse of this growth pattern. This collapse triggered an external credit squeeze and

debt crisis, with consequent difficulties in financing the public sector in the decades of the 1980s and the 1990s. As a result, annual inflation leapt to three-digit figures.

The 1980s marked the longest period of economic stagnation in Brazil's history. According to the Central Bank of Brazil, annual GDP growth averaged 2.3 percent whereas per capita GDP fell by 2.7 percent. By the end of the decade the fiscal deficit had soared to almost 7 percent of GDP. The government proved unable to perform its basic social responsibilities, failing to guarantee the investment required for maintenance of GDP growth rates. Growing concerns regarding political instability led to the election of a national constitutional assembly with the aim of writing a new constitution. The political scene began to change in the early 1990s, clearing the way for the implementation of a new pattern of distribution of powers, according to the new Constitution, and for monetary reform and an economic stabilization policy introduced in 1994, known as the "Real Plan."

There has been a great drive to promote growth and to improve the social conditions of the country. It should be noted, however, that improvement in certain social indicators (such as life expectancy, infant mortality rate, adult literacy rate, secondary school net enrolments, and public spending in education and health) do not reflect the often glaring differences encountered from one region to another in Brazil. The country's Human Development Index (HDI)[ii] formulated by the United Nations Development Program (UNDP) in 2000, is 0.766 for the year 2000. If the same criteria are applied to Brazil's regions separately, the HDI for the South is 0.807, South-East 0.791, Centre-West 0.800, North 0.725, and North-East 0.675, which reveals wide interregional disparities.

Government Structure

Brazil has a presidential system of government. The president and vice-president are elected by direct ballot for a four-year term in office. They are presently assisted by thirty-six ministers of state, all directly appointed by the president. Together they make up the executive branch of the federal government. State governors and municipal mayors are also elected by direct vote.

The legislative branch consists of the bicameral National Congress, in which the lower house, the Federal Chamber of Deputies, represents the population as a whole, and the upper house, the Federal Senate, represents the states and has among its specific duties the supervision of federal financial matters. The eighty-one senators in the Federal Senate are elected by majority vote (three per state) and serve a term of eight years. Two-thirds of the members of the Federal Senate are renewed at the end of eight years and one-third four years later, at the end of their eight-year terms.

The Chamber of Deputies has 513 members elected for a four-year term by an open list proportional representation system for each state and the Federal District. The highest court in the judicial branch is the Federal Supreme Court, whose brief is to safeguard the federal Constitution. The Court is composed of eleven judges appointed by the President of the Republic and submitted to the Federal Senate for approval.

The states' government structure is similar to that of the federal government. It is comprised of an executive branch, a state assembly, and the judicial branch. The state legislature's size in terms of number of deputies is, in general, triple the state's representation in the Federal Chamber of Deputies. If this number exceeds thirty-six, then a state's local representation is increased by the number of the state's representation in the Federal Chamber of Deputies, minus twelve, as dictated by Article 27 of the federal Constitution. According to

Article 11 of the federal Constitution, each state also has its own constitution. Municipal government structure differs from that of the federal and state governments insofar as it does not have its own judicial branch. The legislative branch of municipal government is in charge of writing so-called "organic municipal law" (OML), which embodies local administration government plans and passes annual budget laws.

A particular feature of Brazil's Constitution is the special role of municipalities as they have acquired full political autonomy, independent of the federal and state governments (discussed more fully below). Municipal citizens are able to elect their own mayors and vice-mayors as well as representatives in local municipal chambers.

Present Constitution

The process of federation started in 1831. The current Constitution, however, was promulgated in 1988 by a national constitutional assembly (drawn from both houses of Congress) elected for this particular task. It is based on a civil law tradition, as it explicitly grants the private rights of citizens. Common law (unwritten law developed from old customs) does not play a predominant role. The 1988 Constitution was approved by two rounds of roll-call voting in the National Congress.

The drafters of the federal Constitution aimed to achieve a decentralized organization, seeking to bring people closer to government in order to enhance the consolidation of the democratic process in the country. There is no indication that the Constitution was influenced by any kind of foreign interference or that any type of specific pressure moulded the distribution and sharing of powers. In fact, all orders of government are considered autonomous (Article 18), and any change to the original division of the country into states or municipalities is only possible if authorized by a public vote on the part of the populations who are directly affected. The creation, division, or merging of any state has to be approved by a complementary law (CL) passed by Congress, requiring a two-thirds majority vote in both houses. On the other hand, the creation, division, or merging of any municipality requires a state law and depends on a referendum of the population in areas directly involved.

It is difficult to assert that the drafters of the federal Constitution followed a particular political theory or a philosophical, cultural, or political economy outlook. Article 1 of the Constitution asserts that the federation is formed by a permanent linkage between the federal government, states, and municipalities, with the aim of preserving sovereignty, citizenship, the dignity of human beings, the social value of labour and of private business, and political plurality. Article 2 states that the fundamental objective of the federal republic is to build a free, just, and united society and to guarantee national development, eradicate poverty, and reduce social and regional inequalities. Nonetheless, it is apparent that, besides its main goal of legitimizing democracy, the present Constitution is guided towards achieving new goals such as improving the social conditions of the country and adjusting to a new economic reality, which means adapting to a new pattern of fiscal discipline.

The autonomy of the municipalities marks a major change in the political scene. Interventions by higher orders of government (the federal government on the states and municipalities, and the states on the municipalities) are only allowed under the strict conditions established by Articles 34 and 35 of the Constitution. In such cases interventions have to be required by the legislative branch of government or by a court. Most common is a request for intervention when a state or a municipal administration has not complied with provisions for the

payment of the public debt. By the same token, removal of mayors or local officials, either by the federal or state governments, is also restricted to cases explicitly stated in the above mentioned Articles. Moreover, municipalities are now empowered to take decisions in most important areas, such as territorial management, land development, environment, local taxation issues, and industrialization.

Finally, Portuguese is the predominant language, despite Brazil's being a multiracial and multicultural society. Roman Catholicism is the most widely practised religion, although Article 5, items VI and VIII, of the Constitution assures the right of any individual to profess any other religion. In fact, there is a tendency for a decline in adherents to the major religious denominations in favour of smaller and local religious associations. Ultimately, all federal units (the union, states, municipalities, and the Federal District) are strictly forbidden from establishing any specific religious preference. Likewise, no distinction between races and racial groups among Brazilian citizens is permitted.

CONSTITUTIONAL DISTRIBUTION OF POWERS AND RESPONSIBILITIES

With the exception of the 1988 Constitution, the federal pattern laid down by previous constitutions makes it impossible to characterize Brazilian federalism by a single label with regard to the distribution of powers and responsibilities. Likewise, history reveals that the shape of Brazilian federalism has been neither one of consistent centralization nor one of consistent decentralization. It has always been adjusted according to political and economic circumstances. Since the first attempt to implement a federal organization in Brazil in 1831, there have been tensions between the different orders of government. Thus the constitutional process of the Brazilian federation has hardly been systematic. Under the terms of the 1988 Constitution, however, Brazilian federalism can best be described as "cooperative" or "collusive," depending upon the issue under discussion. Although decentralization as an issue has been the overriding imperative, controversies remain when fiscal and financial matters are considered. Recent measures, such as the restructuring of the financial debt of states and municipalities and consequential fiscal adjustment, have apparently given rise to a new trend towards centralization in the federal government. This is, however, a wide open issue in present federal relations in Brazil.

Nonetheless it is important to stress that the path of Brazilian history clearly reveals that centralization and decentralization trends have alternated over time. In the main, political and economic circumstances have determined the direction of events and, therefore, the profile of the distribution of responsibilities and powers.

Evolution of Power Shifts in the Federation

After the Emperor's abdication in 1831 the first Constitution was promulgated in 1834, with an emphasis on decentralization. Local assemblies were created, with new powers being assigned to the provinces (states were introduced after the 1891 Constitution). A revenue-sharing system was introduced as well as a local judicial system; local councils were established to rule on local issues; and a national guard was created. The dissatisfaction of the provinces with the provisions of the revenue-sharing system and local political ambitions gave rise, however, to a difficult period in which four regional rebellions emerged: Cabanada in the State of Pará (1835-40), Balaiada in the State of Maranhão (1838-41), Sabinada in the State of Bahia (1837-38), and the

Farrapos War in the southern state of Rio Grande do Sul (1835-40). Thus, the first attempt at federalizing resulted in a fractured political system, and a new conservative constitution was promulgated in 1841, which tended towards centralization. The pattern of the distribution of powers was reversed, the role of local assemblies reduced, and a new federal judicial system and police force were introduced. The centre of power was brought back to Rio de Janeiro, the country's capital at the time.

The next attempt to implement federalism during the Imperial period (1841-89) took place in the 1870s. A budgetary dispute between the civilian chief of Cabinet and the army resulted in the fall of the Cabinet and in the publication of the 1870 *Republican Manifesto*. Later on, in 1885, a republican bill proposing new federal rules was submitted to the imperial Cabinet, but it was not approved. A few years later, in 1889, when a new dispute between the army and the National Assembly over military funding was not resolved satisfactorily, an internal crisis emerged within the imperial government. The outcome of this crisis was the abolition of the imperial system of government and the proclamation of Brazil as a federal republic on 15 November 1889.

The immediate challenge to the new republican federal government was to form a national congress when most of the representatives were still sympathetic to the monarchy. Republicans had little popular political appeal, and the National Assembly remained in the hands of the monarchists. The republicans adopted a strategy to curb the power of monarchists, and this involved the creation of the Federal Supreme Court by the Constitution of 1891. A constitutional amendment was introduced, and from then on the Federal Supreme Court has had the power to veto any law passed by the National Congress or by local assemblies – either from the states or by local councils - that contravene the federal Constitution. Thus, judicial control of the constitutionality of laws in Brazil was created by a republican need to eradicate political memories of the empire.

In the early years of the republican era, however, the strong presidential power was reinforced against the increasing influence of state "presidents," not yet known as governors. In this period Brazil witnessed a latent conflict between the federal government and the states and municipalities, and this remained the case until 1930. Interventions by the federal government and confrontations among states and among municipalities were common.

During the 1930s the rationale behind the political system and the distribution of responsibilities and power became clear: to reduce the power and responsibilities of the states. The 1934 Constitution introduced important new elements. The "presidents of the states" became simply "governors," and two fundamental elements of their power were removed. First, they lost control of their military police. They now had to submit the men and equipment they had to the control of the National Army. Second, the 1934 Constitution established a new degree of autonomy for the municipalities as a means of offsetting the power of the state governors. Governors also lost control over the mayors of local communities. Interference by the state governors in any municipal issue could now give rise to intervention in the state government by the federal government. Whenever the opposition won local elections, they could count on the protection of the president of the republic.

The development of federalism, therefore, suffered various setbacks. In the 1930s the tendency for centralization became clear and was confirmed by the dictatorial rule imposed in 1937. In 1945, after the Second World War, calls from the international community and from the Brazilian political establishment for a liberal democracy became frequent. Free elections, then, were held in 1946 and a new Constitution promulgated. The 1946 Constitution opened the door

to some modest decentralization. First, a revenue-sharing scheme was again introduced in order to address the vertical imbalance. Second, specific steps towards decentralization were introduced by the new Constitution. The equilibrium between both houses in Congress, the upper house (the Federal Senate) and the lower house (the Federal Chamber of Deputies) was ruptured. According to the new rules, the Senate assumed added responsibilities, such as looking after the interests of the states, ratifying certain appointments to key positions in the executive branch of government, and deciding on financial matters (credit operations) relative to states and municipalities. This meant that the Senate could approve legislation related to financial issues of interest to states and municipalities without interference from the Federal Chamber of Deputies. On the other hand, due to changes in the internal rules of Congress, bills not related to financial issues of the states and municipalities could be approved by the Federal Chamber of Deputies and promulgated by the president without necessarily being approved by the Senate.

These new legislative procedures had clear repercussions for decentralization. First, because of the structure of the Federal Senate, with eighty-one members (three from each state), the upper chamber began taking a more cautious approach when dealing with federal government issues and started defending the interests of the states. Furthermore, whenever constitutional issues emerged relating to a federal law allegedly interfering in the states' and municipalities' jurisdiction, the Federal Supreme Court was called on to have the final say. As such, the Federal Supreme Court held the last word on constitutional interpretation.

Under the new dictatorial military rule following the 1964 military coup, no new constitution was immediately issued. However, there was a massive centralization of power and responsibilities in the hands of the federal government as tax reform and a new revenue-sharing system were introduced. The Constitution of 1967, with the amendments introduced in 1969, provided a legal structure to the new pattern and boosted the centralization of political power and responsibilities, including public finance. Complementary Act no. 40 of 1968 allocated 88 percent of personal and corporate income tax (IR) and the selective value-added tax on industrialized products (IPI) to the central government. At the same time, participation (i.e., revenue-sharing) funds were created: the Participation Fund for the States (FPE) and the Participation Fund for the Municipalities (FPM). Each received 5 percent of the total tax revenue from both IR and IPI taxes.

The budgetary rules and the tax reforms introduced by the 1967-69 Constitution were an attempt to implement a new pattern for distributing powers and responsibilities. Efforts to foster economic development were carried out by a kind of "cooperative federalism" and gave rise to fiscal "asymmetries" that characterize the Brazilian federal system today. Fiscal asymmetry is understood as the unbalanced redistribution of financial resources (through the revenue-sharing system) towards the least developed states (i.e., those from the North and North-East regions). On the other hand, "cooperative federalism" was implemented for all states through the investment programs established by the federal government. These were aimed at fostering investment in economic infrastructure such as transportation, telecommunications, and energy in order to support industrialization. Funding for such activities was raised by specifically linking contributions on fuel, electricity, and telecommunications, which were shared by federal agencies, states, and municipalities.

Thus, the "cooperative federalist model," as conceived by the 1967 Constitution, was based on three elements: participation (revenue-sharing) funds, budgetary allowances from the central government directed towards investment in infrastructure, and the cooperative efforts of states and municipal governments (which operated through fiscal incentives) geared towards

implementing industrial investments. The system worked relatively well throughout the 1970s, and some degree of convergence of per capita income levels was achieved among the different regions of the country.[iii]

As has been the case throughout Brazil's constitutional history, tensions between the different orders of government have persisted, and what occurred after the 1988 constitutional reform has been no exception. These tensions became more evident as the municipalities were granted full autonomy by the new Constitution. The drafters, mainly from opposition parties, emphasized a decentralization process with the major aim of bringing power closer to the people in the ultimate hope of enhancing democratic institutions.

Since the 1988 Constitution, federalism in Brazil has adopted a more visibly "cooperative" pattern, especially in areas such as health, education, social welfare, law and order, and social security. However, federalism in Brazil can now also be seen as "collusive" whenever there emerges an issue of national interest such as balanced development and national welfare. On such occasions the federal government usually exercises its clout in order to convince Congress of the need for emergency legislative approval. The drift of power towards the federal government in such cases has included issues of extreme importance to the economic stabilization programs. The various attempts to implement stabilization programs since 1986 are good examples of both cooperative and collusive federalism as, at some stage, all of them were approved by Congress.

Finally, one may note that Brazilian "competitive" federalism emerged in the early 1990s as a consequence of the vertical redistribution of resources – the new revenue-sharing system introduced by the 1988 Constitution.[iv] States and municipalities benefited from the substantial increase in intergovernmental transfers. However, most of the new financial resources, which were supposedly aimed at improving social conditions and reducing regional inequalities, were now directed towards stimulating new investment so as to generate income and employment. Competition between states and municipalities developed with the aim of securing comparative advantage for new investment projects, especially in the industrial sector. The conspicuous face of competitive federalism, the so-called "fiscal war," was a complex bidding process for investments from abroad and/or from neighbouring states. Generally, states and municipalities offered to finance infrastructure costs and to provide tax holidays without proper cost-benefit appraisals.

Responsibilities and Powers in the 1988 Constitution

The 1988 Constitution, in Chapter II of Title III (Articles 20, 21, and 22), assigns the areas that are the exclusive property of the federal government (Article 20), areas of exclusive operational responsibilities and powers of the federal government (Article 21), and areas in which only the federal government is entitled to legislate (Article 22).

Properties of the federal government include all the existing physical assets, such as federal buildings, unexploited land, lakes, rivers in borders between states and foreign countries, islands in rivers and the territorial sea, potential hydroelectricity sites, mineral resources, and caves and land occupied by the Indian (Aboriginal) communities.

The federal government has exclusive power over, and operational responsibility for, declaring war, running foreign affairs, ensuring national defence, administering foreign monetary reserves, supervising financial operations and exchange rate policy, elaborating regional development plans, maintaining the postal service, exploiting natural resources (either directly or

through concessions), telecommunications, radio services, electricity services, aviation, railways, and maritime and interstate highway services.

Areas in which only the federal government is entitled to legislate include civil rights, penal, electoral, agrarian, maritime, space and labour relations matters, water, energy, telecommunications, postal service, credit, foreign exchange policy, insurance, foreign trade, transportation policy, citizenship, emigration and immigration, judicial organization, federal police, social security, education guidelines, public notary, nuclear activities of any kind, and general rules for government procurement.

Article 23 defines the areas of operational joint responsibility of the federal, state, and municipal governments, such as preservation of the Constitution, laws, democratic institutions, and public assets; health and protection and guarantees of the handicapped; protection of historical documents and assets of historical, cultural, and artistic value; provision of access to education, culture, and science; environment and pollution control; preservation of fauna and forests; fostering agrarian production and organizing food supply; housing; sewage services; poverty reduction; exploitation of natural resources; and traffic control. The terms and conditions of these areas of concurrent jurisdiction must be set by complementary laws approved by Congress (Article 23, para. 1º).

Article 24 specifies the areas in which the federal government, the states, and the Federal District are entitled to legislate concurrently, such as taxation, finance, the penal system, the economy and urbanism, budgeting, costs of the judicial system, production and consumption, forestry, hunting, fishing, environment, education, social security, health and public health, the handicapped, protection of children, and civil police. However, the federal government is in charge of general (or framework) rules (Article 24, para. 1º). Whenever federal legislation does not yet exist, legislation of the states and municipalities prevails (Article 24, para. 2º), but federal legislation would prevail in the case of conflict with state or municipal laws (Article 24, para. 4º).

States and Municipalities

Chapter III, Articles 25 through 28, deals with the powers and responsibilities of the states. Article 25, para. 1º, explicitly says that states' powers and responsibilities are those not explicitly prohibited by the federal Constitution (i.e., a reserve of powers). However, as has been seen above, complementary laws passed by Congress can enable mechanisms for joint responsibilities between the federal government, states, and municipalities, especially in social policy areas. As well, Articles 26, 27, and 28 determine how the administration of the states should be organized, including electoral rules and mechanisms defining salary rules for governors, vice-governors, and elected representatives in local assemblies.

Chapters IV and V, Articles 29 through 32, define the powers and responsibilities of the municipalities. As for the states, rules for the administrative organization of the municipalities are explicitly expressed, and Article 30 establishes the following responsibilities of municipalities: to legislate on issues of local interest; to supplement federal and state legislation whenever necessary; to collect local taxes established by the Constitution (mainly property taxes, taxes on services, and duties on water, sewage, and waste collection); to rule on concessions for public services; to maintain technical and financial cooperation with the federal and state governments in programs of primary and secondary education; to maintain technical and financial cooperation with the federal and state governments in programs of health; and to

regulate land use and the preservation of historical, artistic, and ecological sites.

Taxation: Responsibilities and Powers

Taxation autonomy is one of the key issues in the federal Constitution of Brazil. The National Taxation System (STN), defined in Title VI, Chapter I, Articles 145 through 156, details the powers and taxation responsibilities of each order of government. The federal government, the states, the municipalities, and the Federal District can use the following revenue instruments: (1) taxes; (2) fees, by virtue of the exercise of police power or for the effective or potential use of specific and divisible public services, rendered or made available to the taxpayer; and (3) benefit charges, resulting from public works. Benefit charges cannot use the same fiscal base as do taxes. A complementary law approved by two-thirds of Congress is required to resolve any tax conflict among the units of the federation. Such a law can impose compulsory loans under specific conditions, such as war or imminent danger to the nation.

The federal government may also apply special "Contribution" levies, usually on payroll or business turnovers. Originally temporary measures, these are now a permanent feature and are the main source of financing for the federally run social security system. Their main characteristic is that they are not shared with states and municipalities. They cannot be applied either to exports or to the commercialization of oil or its byproducts. However, an exception to that rule was approved by the latest attempt at tax reform, in 2003, when a contribution on liquid fuel began to be shared by the three orders of government (i.e., the Contribution for Intervention in the Economic Dominion, the so-called CIDE). The incidence of the special levy can be either in "ad valorem" terms or as a percentage of unit value.

More generally, the federal government has the power and the responsibility to impose the following taxes: (1) importation of foreign products (customs duties and tariffs) (II) ; (2) exportation to other countries of national or nationalized products (IE); (3) income and earnings of any nature (IR); (4) a selective value-added tax on industrialized products (IPI); (5) credit, foreign exchange, and insurance transactions, or transactions relating to bonds and securities (IOF); and (6) rural property (ITR), under the terms of a specific Complementary Law. Additional forms of taxation may occur. In the case of gold, when considered a financial asset, IOF is incurred. The proceeds of "IOF gold" are shared with the states (30 percent) and the municipalities (60 percent).

The states have only three types of taxes. The first is a tax on transactions relating to the circulation of goods and to the rendering of interstate and intermunicipal transportation services and services of communication, even when such transactions and rendering begin abroad (ICMS). The ICMS is the most productive tax and the most nationally lucrative. The second is transfer by death and/or donation of any property or rights (ITCD). The third is tax on the ownership of automotive vehicles (IPVA). As noted, the Federal Senate is responsible for supervising and representing the interests of the states on any taxation issue.

The municipalities have the power to impose three taxes: (1) on urban buildings and urban land property (IPTU); (2) on *inter vivos* transfer (ITBI), on any account, by onerous act, on real property, by nature or physical accession, and on real rights to property (except for real security) as well as on the assignment of rights to the purchase thereof; and (3) on services of any nature not included in Article 155, II (related to the ICMS, as explicated above), as defined in a complementary law (ISS).

Public Expenditure and Borrowing: Responsibilities and Powers

The borrowing, taxation, and spending powers of each order of government was regulated recently by Complementary Law (CL) 101/2000, entitled the Fiscal Responsibility Act (LRF). It has been a major breakthrough in Brazilian public finance because it establishes general rules for financial administration by each order of government. In fact, Complementary Law 101/2000 implemented the constitutional stipulation, expressed in Article 165, Paragraph 9º, that rules for the financial management of both direct and indirect administration (state-owned companies, foundations, and other government institutions) should be regulated by complementary laws. The LRF deals with public finances, internal and external financial debt, concession of guarantees by any government entity, issuance and payment of any government bond, control of government-owned financial institutions (especially government-owned banks), foreign exchange operations, and control of financial institutions devoted to regional development. The LRF has also imposed limits on government spending (particularly relating to payrolls) and on public debt, and it has set a number of control parameters for public finances. In a sense, the LRF could be understood as a movement towards centralization. However, such legislation has been passed as a major guideline for all orders of government and has been required by Article 165 of the Constitution. Since the objective of the new constitutional provisions was to enforce coherent fiscal behaviour and discipline and, thus, contribute to the harmonization of fiscal policy in the country as a whole, it would not be appropriate to see it as centralization as such.

Further Political Aspects of the Distribution of Responsibilities and Powers

Implementation of the present constitutional rules still requires, in certain important political areas, specific complementary laws. For instance, in terms of the federal structure of government, Article 23 explicitly states that complementary law will rule on cooperation between the federal government, states, and municipalities regarding balanced development and national welfare. Balanced development and national welfare must be understood as policy efforts and institutional mechanisms aiming to reduce regional and social inequalities. However, given the complexity of intergovernmental relations among the twenty-six states and the Federal District, existing regional disparities, and a fractured party system, it has not yet been possible to devise a project for a complementary law on this topic to be submitted to Congress. This would require a great deal of political and financial negotiation. In other words, implementation of the constitutional rules promulgated in 1988 is an ongoing process in areas such as health, education, social welfare, social security, and, more recently, law and order, but it has yet to begin in the more politically sensitive areas of balanced development.

As Celina Souza points out, "Brazil has had difficulties in maintaining a stable federal democracy able to prevent periods of authoritarian rule, reduce social and regional inequality and poverty, and reconcile social democracy with the constraints of the world economy."[v] The main problem is the difficulty that governments face in changing policy priorities when they encounter economic constraints that were unforeseen by the makers of the Constitution. There is, in fact, a gap between constitutional governance and political and economic circumstances, with the latter prevailing over constitutional mandates.

THE RATIONALE BEHIND THE CONSTITUTIONAL DISTRIBUTION OF POWERS AND

RESPONSIBILITIES

As noted, the distribution of powers and responsibilities in Brazil's Constitution do not follow a particular philosophical, cultural, or economic theory. The Constitution's ultimate aims are to build a free society, guarantee national development, reduce poverty and regional inequalities, and promote well-being without discrimination on the basis of colour, race, sex, or religion. The historical context for establishing a new, free, democratic constitution after twenty-four years of military rule has determined the nature of this document: the implementation of a process of gradual change in Brazilian society within a stable democratic environment. Combining a decentralization process with political stability and economic progress has been politically complex and economically costly**.** In this context, the redistribution of responsibilities and powers reflects pragmatic responses to particular issues.

Many of the powers and responsibilities held by the federal government can be seen as the minimum requirement for overall governance. Some responsibilities aim to secure national sovereignty (e.g., national defence, declaration of war, issuance of money, control of foreign reserves, naturalization, and national and regional development plans). Governments must also have the right to use their power to establish law and order and to secure access of citizens to basic services (e.g., education, health, and housing).

In terms of the overall political and administrative structure of government, the Constitution introduced a symmetrical distribution of responsibilities and powers. Symmetry, in this context, is understood as the harmonious and balanced correspondence of the distribution of powers among the orders of government. Each order has its independent branches of government (executive, legislative, and judiciary), and one order of government can only intervene in the area of another in strict accordance with prescribed constitutional rules. However, from an economic and social viewpoint, in practice the Constitution does not produce symmetry. The federal Constitution embodies the explicit presumption that, as long as it is implemented, it will address endemic social and regional inequalities. The emphasis on social aspects is unequivocal; yet Brazil is far from being a modern welfare-state. The distribution of powers and responsibilities has limited the powers of the federal government to the provision of guidelines for the majority of social policies and services; the states and (mainly) the municipalities, are responsible for their implementation. Primary and secondary education, health care, care of the elderly, and childcare are all state and municipal responsibilities. In a sense, however, they are shared responsibilities as the federal government remains a major provider of funds and dictates general rules. Nevertheless, there is an ongoing process of "trial and error." Financial constraints, the absence of previous successful experience, geography, and lack of managerial expertise all hamper the task.

The basic mechanism employed to redress economic asymmetry is the revenue-sharing system of the States Participation Fund (FPE) and the Municipalities Participation Fund (FPM). These funds are deliberately tilted to favour the poorest regions: the North and North-East. This bias reflects the principle that governments generally have a positive social welfare obligation regardless of whether they are federal, state, or municipal. Notwithstanding the social emphasis, the system exhibits a major flaw as it has not linked the transfer of funds to specific social or economic targets. Therefore, the welfare objective has not yet been fully implemented.

In addition to the revenue-sharing system, and as an attempt to remedy the growing concern with social conditions, constitutional rules relating to social sectors such as health, education, social welfare, social security, and law and order have received special priority. A

substantial amount of complementary regulatory legislation has already been passed by Congress, but the implementation of the Constitution is not complete in this respect**.** Many areas (e.g., sanitation, water supply, environment, metropolis management, and land development) have yet to be subjected to complementary legislation. Undoubtedly, the evolutionary process has been positive; yet it remains affected by the constraints of the country's public finances and the complex multiparty political system. These are difficulties of a federal system in which substantial regional economic and social disparities still prevail.

EVOLUTION OF THE CONSTITUTIONAL DISTRIBUTION OF POWERS AND RESPONSIBILITIES

The Brazilian constitution has shown a remarkable degree of flexibility. The constitutional amendment process is regulated by Article 60. Proposals for amendments can be submitted by the president of the republic, by a minimum of one-third of the members of Congress (Federal Chamber of Deputies and Federal Senate), or by half of the state assemblies, each one having previously approved the proposal by a majority of its members. A constitutional amendment has to be twice voted on by both houses of Congress. Its approval requires three-fifths of the votes in each house. Proposals for constitutional amendments aimed at abolishing the federal organization of the state, the secret direct ballot, the separation of powers (executive, legislative, and judiciary), and individual rights and guarantees are prohibited.

There is also a provision for the direct role of the people in changing the Constitution. Article 61, para. 2º, states that any popular proposal can be submitted to the Chamber of Deputies when signed by a minimum of 1 percent of voters, distributed in a minimum of five states, and signed by a minimum of 0.3 percent of the voters in each.

The provision for a formal constitutional review was established when the Constitution was enacted in 1988. Article 3 of the transitory provisions stated that, after five years, a formal review procedure would be set up by Congress. As a result, six constitutional amendments were approved in 1994. The most important amendment was the creation of the Social Emergency Fund, which reduced the constitutionally mandated transfers to the states and municipalities in order to allocate additional financial resources in 1994 and 1995 to health, education, social welfare, social security, and other governmental programs considered to be of social relevance. Apart from this and according to the provision of Article 60 mentioned above, forty-two constitutional amendments were approved from 1992 to 2002. Of the forty-two amendments most were more important in terms of procedural or textual adjustments than in terms of substance. In some cases the amendments dealt with short-term economic and financial matters, but two important amendments were related to concessions for public services and to the installation of natural gas infrastructure.

With respect to the distribution of powers and responsibilities, Amendment 31/2000 has been the most important. It created the Fund for the Reduction of Poverty under which the states and municipalities are required to create a similar fund in order to receive federal funds destined for the same social welfare program. Otherwise, the most significant changes in the constitutional distribution of powers and responsibilities have come as a result of demands for improving the social conditions of the population. Constitutional provisions related to such areas as health, education, social welfare, social security, and (later) law and order have occurred mainly through complementary laws, which require a qualified majority (two-thirds) of votes in

both houses of Congress. In the case of health care and primary education, it is not only complementary laws that have been issued but also constitutional amendments for each of these services, earmarking federal, state, and municipal revenues. However, complementary laws can be considered as essentially a constitutional mechanism for implementing the actual distribution of powers and responsibilities. The evolution of such a process has been of substantial significance and has started a gradual change in the country's social policies.

Following a general propensity in favour of decentralization, the 1988 Constitution introduced important provisions that added health services to the new responsibilities of the municipalities. As the municipalities have always been the major provider of health care, a concurrent responsibility emerged (Article 23, item II) under which the power of the federal government was limited to the issuing of general rules. As a result, a new system of revenue sharing was created for the health sector. This was clearly expressed, in terms of decentralization, in Article 198, I, and in terms of the participation of municipalities in Article 198, item III, forming the embryo of a Unified System of Health – the so-called SUS. After the passage of the Organic Law of Health (Law 8080, 1990), it took three years to spell out a clear strategy for the decentralization process. The Basic Operational Rule was issued by the Ministry of Health (NOB/SUS 01/93), and this defined the rules and procedural regulatory measures of decentralization for the health sector.

Given the diversity of economic conditions, populations, and administrative capacity of Brazil's municipalities, the redistribution of responsibilities for health care adopted, from its beginning, three patterns: incipient, partial, and semi-complete management authority**.** This system has recently evolved into only two categories: municipalities with "complete" health systems and those with "advanced" health systems. Municipalities classified as complete do not receive block grants for their health system; rather, they negotiate with the federal and state governments for specific funds for health care. An advanced system implies that the municipalities have full authority to distribute the funds according to their own priorities and are, thus, able to use the full amount of financial resources from the federal government for funding their hospitals and unit care centres. As for the education sector, Article 22, item XXIV, of the Constitution was implemented by Complementary Law 9394/1996, which defined general rules for the national education system. This legal instrument provided that the federal government, the states, and the municipalities are responsible for the administration of public education in Brazil. Each order of government is in charge of one category of public education within the current educational system. The states are mainly responsible for secondary education and the municipalities for primary and pre-school education. In this latter case the states and the federal government provide technical and financial assistance. A system of cooperation has thus been established in order to maintain and finance public education.

According to Complementary Law 9394/1996 the federal government, in cooperation with states and municipalities, is responsible for financing certain official teaching institutions (federal universities and technical schools located in each state) as well as for the elaboration of the National Plan for Education. According to the same 9394/1996 Law, each order of government is prohibited from acting in any category of education other than the one originally and legally allocated to it (unless the educational requirements of the population for which it is responsible are fully satisfied).

In 1996 the federal government went beyond its responsibilities for the general supervision of the educational system. The constitutional amendment 14/1996 created the National Fund for the Maintenance and Development of Education (FUNDEF), which introduced

deep changes to primary and secondary education financing. New federal funds were made available to states and municipalities under Article 2 of Complementary Law 9424/1996, according to the number of enrolments at each local school. The implementation of FUNDEF has been extremely important for the municipalities as it has enabled them to increase their responsibilities with regard to basic education.

Articles 203 and 204 of the Constitution established the guidelines for the country's social welfare system. The major aim of this system, according to Article 203, is to provide protection to families, children, teenagers, elderly persons, and the handicapped; to integrate them into the labour market; and to maintain a minimum subsistence income. Government action in this area is to be carried out within a decentralized system in which the federal government is in charge of coordination and general rules (Article 204). States and municipalities are in charge of actual program implementation, with the cooperation of private and non-governmental institutions. The legal framework for implementing this aspect of the Constitution was established by Complementary Law 8724/1993 and by the Operational General Rules issued by the federal government on 16 April 1999. Social welfare benefits include medicines, food, transportation, school teaching materials and services (e.g., books, teaching equipment, school meals, and school buses), a minimum monthly income, family assistance, funeral assistance, and maternity assistance. The distribution of all these benefits is carried out by the municipalities.

The distribution of responsibilities regarding social security was implemented by Complementary Laws 8112/1990, 8212/1991, and 8213/1991, which established the rules for a new system (in line with the Constitution). The first two complementary laws concerned social security in the private sector (including rural areas), which is funded by the federal government. These reforms comprise one of the most contentious and, at the same time, one of the major social achievements of the present Brazilian Constitution. Social security payments to rural workers in impoverished areas of the North and North-East regions are considered to be a major income redistribution mechanism, at least for the time being.[vi] The third complementary law relates to social security for public servants, which is funded by each order of government. On 31 December 2004 the constitutional amendment 41/2003 revamped the financial rules for the funding of the social security system; however, as far as responsibilities are concerned, each order of government remained in charge of the pensions of their respective civil servants.

In sum, the evolution of the distribution of powers and responsibilities in Brazil has been marked by a deliberate decentralization towards states and municipalities**.** Whether or not this constitutes genuine decentralization remains an issue. It has been argued that, as most of the 5,585 Brazilian municipalities are not able to finance their own social needs and remain dependent on federal transfers (the FPM), centralization persists. The federal government is still the major provider of funds and provides the main guidelines for receiving and spending them. However, the federal government has become weaker, particularly in fiscal terms. The added pressure for more financial resources and an increase in revenue-sharing schemes with the states and municipalities has been straining the fiscal capacity of the federal government since the adoption of the 1988 Constitution. A review of the fiscal performance of the public sector in Brazil reveals that the country's tax burden has reached the extremely high level of 36 percent of GDP. This has mainly been accomplished through the implementation of "contributions" that are not shared with other constituent governments. According to the taxation system ratified by the 1988 Constitution, direct and indirect taxation should be the main source of federal revenues. However, 47 percent of these revenues are redistributed to the states and municipalities. Throughout the 1990s the federal government became weaker in fiscal terms and gradually

introduced special levies, or "contributions," for social security. The latest constitutional amendment (EC) (EC 42, 31 December 2003) has not adequately addressed this trend, largely due to latent fiscal conflict between the federal government and the states. The state governors have, in this context, re-emerged as key political actors in influencing Congress on taxation matters, through lobbying and representation to their state representatives in the two houses of Congress.

MAINTENANCE AND MANAGEMENT OF THE DISTRIBUTION OF POWERS AND RESPONSIBILITIES

The maintenance and management of the distribution of powers and responsibilities in Brazil's federal system is based on the assumption of cooperation. Collective responsibilities underlie the functioning of the whole system, but the role of each order of government, in many instances, is still indeterminate. The most conspicuous example of this is Article 23 of the Constitution. This article requires a complementary law to rule on cooperation schemes among the federal government, states, and municipalities with respect to balanced development and welfare conditions nationwide. So far, no bill has been submitted to Congress. The success of any such bill requires a favourable political context involving a major cooperative effort among the parties in Congress. In the meantime, the issue is not ready to be resolved, and legal deliberations generate many controversies. The governors are able, informally, to block its path in Congress. This commonly occurs with international matters, issues of taxation, allocation of major industrial and infrastructure investments, industrial relations, and the environment.

Notwithstanding the cooperative assumptions in the sharing of responsibilities and powers among the orders of government, latent conflicts of interest between the federal government and the states and municipalities emerge frequently. The federal government, in some instances, has to use its clout to offset specific initiatives by the states and municipalities**.** The most important tool at the federal government's disposal is its financial power, which enables it to fund investments in the deputies' and senators' constituencies and thus induce the compliance of the two subnational governments. This involves voluntary transfers of funds on the part of the federal government, which uses federal budget mechanisms to release funds for special projects proposed by members of Congress (obviously in favour of their respective constituencies). This financial power is, in practice, an important instrument for keeping the government coalition in Congress together whenever a crucial majority vote is needed.

Thus, in relative terms, the executives of the federal government, the Federal Senate, the Chamber of Deputies, and the political parties are the main actors with regard to the distribution of powers and responsibilities. Decision making in Congress, which is regulated by its internal procedural rules, provides sufficient transparency for citizens to know who is voting for or against their wishes.

When states or municipalities are not adequately carrying out their responsibilities, there is no mechanism for providing direct orders to their executives or legislatures; instead, the federal government has to act cooperatively in order to assess operational difficulties or, as a last resort, to submit new legal rules to Congress in order to enforce actions that need to be taken. In exceptional cases of a threat to public security or damage to established law and order, the federal government can intervene in any state or municipality. Because such an intervention can only be implemented as a last resort, and because it departs from the normal autonomy of a constituent government, no new constitutional amendment can be undertaken while it lasts. On the other hand, whenever an incumbent administrator in the federal government or a state or

municipal government is identified as not functioning in accordance with the constitutional distribution of powers and responsibilities, a legal impeachment process can be initiated. This procedure has been used frequently in cases of financial or electoral corruption, and, in the interest of better governance, removals from office have also been frequent.

ADEQUACY AND FUTURE OF THE DISTRIBUTION OF POWERS AND RESPONSIBILITIES

The present distribution of powers and responsibilities in the Brazilian federal system conforms to the original constitutional framework, although smooth relations between the federal government and the constituent state and municipal governments have yet to be achieved. The distribution of powers and responsibilities is compatible with the ability to democratically respond to citizens' demands**.** However**,** there are several reasons why Brazilian federalism faces considerable future challenges**.**

First, the design of the 1988 Constitution was the result of a wide consultation process, which aimed to introduce new democratic rules and to address social and regional inequalities. Second, the Constitution evinces a decentralizing tendency with regard to a number of public services, especially in the social sectors. Third, the substantial increase in transfers to the states has had a great impact on the public finances of the country. Interestingly, the social nature of these objectives was never in dispute; rather, the differences were over the exact source of funds to finance them. Fifteen years after the promulgation of the Constitution, public finances have not yet reached a balance between available resources and the required level of expenditures. The executive branch is still struggling to raise revenues and to reorganize public expenditure in order to achieve permanent and sustainable rates of growth**.**

As can be seen, the excessive emphasis on decentralization without a corresponding redistribution of responsibilities is a source of great difficulty. In Brazil, decentralization has always been seen as a way to guarantee the maintenance of democracy.[vii] Furthermore, decentralization has been regarded as a good control mechanism with regard to the supply and quality of public goods and services as well as a means to achieving greater transparency. However, decentralization is costly. It makes difficult the achievement of a balance between public expenditures and tax revenues in the finances of the public sector as a whole. Moreover, the substantial increases in FPE and FPM (the constitutionally mandated transfers of shared revenues to the states and municipalities, respectively) has had a negative impact on the general health of the country's public finances. The structure of the constitutional revenue-sharing system is unbalanced and has thus far failed to address Brazil's regional and income disparities. Nonetheless, fiscal balance is an important prerequisite for lower inflation, greater economic stability, sustainable growth, and the reduction of regional and social inequalities**.**

In practice, the distortions now arising within the federal system may also have their roots in the inadequacies of the current electoral and political systems. Partisan politics poses a major challenge to Brazilian federalism. The process of building a "majority" in Congress is costly. The structure of Brazilian political parties remains fractured because political mandates belong largely to individuals. Election votes are generally for the candidate rather than for the party. The political parties concentrate on obtaining a high proportion of votes in order to obtain a high electoral quota (number of votes required to get a candidate elected). Candidates with the number of votes equal to or higher than this quota in each state are considered elected. Therefore, political parties always try to enroll as many candidates as possible, and, in turn, candidates are

chosen by the number of votes that they can bring to a particular political party. It is very common, however, to see several candidates from the same party competing for votes in a particular constituency. Such an electoral system raises the costs of political campaigns to extremely high levels. Once Congress is elected, then, given the individual agendas of the representatives, building a majority becomes a major task. This weak party cohesion means that the president and the executive branch have to participate in difficult negotiations over each bill discussed in Congress.

As part of this executive-legislative interplay at the federal level, state governments use their political influence to obtain concessions from the federal government. This was the case in several bailing-out operations for state domestic and external debts in the 1990s. On such occasions, the federal government engaged in technical assistance and assisted the states in designing a medium-term fiscal adjustment program.

As for changes in the future, the "overrepresentation" issue is key, deserves more investigation, and is likely to be at the top of the political reform agenda. José Serra and José Roberto Afonso[viii] have dealt with this issue in detail. They have demonstrated that overrepresentation causes a major redistribution of power within the federation. For example, representation in the Federal Chamber of Deputies requires representatives from the South-East and South regions to have sixteen times more votes than do representatives from the North and North-East regions. These peculiarities in the Brazilian representation system were, in fact, constructed deliberately in order to offset the economic preponderance and political influence of the more prosperous states of the South-East and South regions.

This being the case, "per capita" federal transfers in 1998 to states of the North region were US$360, while states of the South-East region received less than US$90 (at the current exchange rate). On the other hand, for each dollar collected as tax by the federal government in the South-East and South regions, only $0.18 returns to them as their share of the participation funds. With regard to social contributions (special levies), 70 percent are collected in the South-East region while returns from the federal government in the form of basic social programs are 23 percent for rural social security, 29 percent for social welfare programs, 37 percent for school lunches, and 40 percent for primary health care programs. The North-East region, which collects 10 percent of the overall social contributions, receives a share ranging from 45 percent to 30 percent of social security, education, and health care programs.

As in the rest of the world, in Brazil federalism is seen as the model of government best capable of reconciling the simultaneous pressures of small and large states with the requirements of the modern world. In Brazil in particular, the adoption of a form of federalism that emphasizes decentralization is seen as a practical way to enhance democratic rule for all orders of government. Centralization or decentralization trends have alternated through different periods of Brazil's history as, accordingly, have the distribution of powers and responsibilities.

Future modifications to the allocation of powers and responsibilities will have to address the reform of the political system, resolve the fiscal war among the states, design a new and sustainable mechanism for restructuring the financial debt of the states and of more than 100 municipalities, deal with the overrepresentation issue in the Chamber of Deputies, and, last, but not least, tackle the country's social and regional inequalities. Indeed, there is no better way to describe Brazilian federalism than to say that it is a system in constant evolution.

[i] The states and the regions in which they are located are: North region (Amazonas, Pará, Rondônia, Acre, Roraima, Amapá and Tocantins; North-East region (Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraiba, Pernambuco, Alagoas, Sergipe, Bahia); South-East region (Minas Gerais, Espírito Santo, Rio de Janeiro, São Paulo); South region (Paraná, Santa Catarina, Rio Grande do Sul); and Centre-West region (Goiás, Mato Grosso, Mato Grosso do Sul, Distrito Federal).

[ii] United Nations Program for Development (UNDP), *Human Development Report* (New York: Oxford University Press, 2000); and UNDP/IPEA/FJP/IBGE, *Atlas do Desenvolvimento Humano no Brasil* (Brasilia: UNDP/IPEA, 2000).

[iii] Afonso Ferreira, "Convergence in Brazil: Recent Trends and Long-Run Prospectus," *Applied Economics* 32 (2000): 479-489.

[iv] Marcelo Piancastelli and Fernando Perobelli, "ICMS: Evolução Recente e Guerra Fiscal," *Texto Para Discussão Nº 402* (Brasilia: IPEA,1996), pp. 7-53.

[v] Celina Souza, "Constitutional Aspects of Federalism in Brazil," in *A Global Dialogue on Federalism.* Vol. 1: *Constitutional Origins, Structure, and Change in Federal Democracies,* eds. John Kincaid and G. Alan Tarr (Montreal and Kingston: McGill-Queen's University Press for Forum of Federations, 2005).

6. Guilherme C. Delgodo, "Previdência Rural: Ralatório de Avaliação Socioenconômico," *Texto de Discussão No. 477*, ed. IPEA (Brasilia: IPEA, 1997): pp. 1-55.

[vii] For discussion, see Bruno Frey, "Is Decentralization Really Bad? The Answer Is: No, It Is Good," *8th International Forum in Latin America Perspectives* (Paris: OECD, 1997), pp. 1-11; Eduardo Wiesner, "Fiscal Decentralization and Social Spending in Latin America: The Search for Efficiency and Equity," *Working Papers Series 199* (Washington: Inter-American Development Bank, 1994), pp. 1-34; Remy Prud'homme, "On the Dangers of Decentralization," *Policy Research Working Paper* (Washington: World Bank, 1994), pp. 1-36.

8. José Serra and José Roberto Afonso, "Federalismo Fiscal à la brasileira," *Revista do BNDES* 6, 12 (1999): 3-33.