

# The relations between different levels of government in Brazil

*José Roberto Rodrigues Afonso*

**B**razil is now one of the most decentralized federative countries in the world, with the special feature that its decentralization is not the result of an economic strategy, but of a political initiative of the 1988 Constitution. The distribution of income and expenditure between the different spheres of government —central, state and municipal— shows the considerable relative importance of the subnational levels of government. Decentralization has not prevented extraordinary progress in the structural reform of the Brazilian public finances in recent years. The Fiscal Responsibility Law consolidated a process of change in fiscal “culture”, reversing the tendency towards primary deficits and growing indebtedness. The central government has formulated dynamic social policies and shared programme execution with the subnational governments, particularly in fundamental education, basic health services and social assistance. What the Brazilian federation now needs to do is not to reconstruct itself, but to improve itself still further, through greater transparency in public actions and accounts and more investments to modernize management.

José Roberto Rodrigues Afonso  
Economist of the National Bank for  
Economic and Social Development (BNDES)  
and technical consultant to the  
Chamber of Deputies of Brazil

 [ze.afonso@terra.com.br](mailto:ze.afonso@terra.com.br)

# I

## Introduction

This article analyses the nature of intergovernmental financial relations<sup>1</sup> within the Brazilian federation's advanced process of decentralization. The analysis centers on the effects of these relations on fiscal and macroeconomic policy management and the provision of public goods and services in recent years.

The case of Brazil is particularly interesting because it departs widely from the theoretical models and experience of most countries, where decentralization is generally a process planned and coordinated by the central government, as Shah (2003) rightly notes, and the financial transfers between the different levels of government—central, state and municipal—are normally for purposes related with general or sectoral public policies. In Brazil, these transfers are designed above all to ensure the fiscal and financial autonomy of the subnational levels of government.

After the present introduction, the article refers briefly to the special features of Brazilian federalism (section II); describes the most salient features of the system of intergovernmental financial relations (section III); assesses the recent behaviour of the public deficit and indebtedness from the point of view of economic policy (section IV); likewise assesses the new role of intergovernmental relations in the areas of education, health and social protection in terms of the services provided (section V); and in the conclusions (section VI) it analyses options for improving the system and advocates investment in the modernization of public management, rather than trying to reduce the constitutional allocations (*vinculações*) of given percentages of the budgetary resources, in order to improve the system's performance.

# II

## Federalism, Brazilian style

The federalism of Brazil is marked by conditioning factors that must be taken into consideration from the start when analysing its fiscal aspects.<sup>2</sup> Wiesner (2003, p. 76) sums this up by saying that, for various reasons, the decentralization of Brazil is a special case, with special normative and institutional characteristics.

This country, which is of continental dimensions and has 177 million inhabitants, is a democratic federation in every sense. Early in 2003, for the first time in four decades, a directly elected civilian president was succeeded by another who was not only elected under the same conditions but was also his bitterest opponent.<sup>3</sup> Furthermore, in the largest states of the federation, governors were elected who were members of parties in opposition to that of the federal government.

The most outstanding feature of the Brazilian fiscal system is that its decentralization is not based on political and economic policies formulated and implemented under the orders of the federal government. On the contrary, most of the intergovernmental

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<sup>1</sup> In this article, "intergovernmental" means the mutual relations between the federal (central), intermediate (state) and local (municipal) levels of government in the Federative Republic of Brazil.

<sup>2</sup> For recent detailed analyses of Brazilian federalism, see Rezende and Afonso (2002), Serra and Afonso (2002) and Rezende and Oliveira (2003), among others. We also suggest consulting the specialized website <http://www.federativo.bndes.gov.br/>.

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<sup>3</sup> The formation of a transitional cabinet and the political and administrative smoothness of the change of president were internationally praised. The University of Notre Dame even presented an award to the two presidents involved in recognition of this.

relations cannot be established or modified by the federal political and economic authorities according to their own arbitrary wishes.

In Brazil, the main political option for decentralization was adopted by the Constituent Assembly which drafted and approved the Constitution which has been in force since October 1988. This was the basic framework for the process of re-democratization after twenty years of military dictatorship. The idea which prevailed in the Constituent Assembly was that the reduction of the fiscal and financial power of the central government and the corresponding strengthening of that of the state and municipal governments—especially in the less developed regions—should form a kind of financial arm of a broader political movement.

The “federative pact” is a principle which has always been invoked but has never really been formulated as such. It is based on the detailed text of the Constitution regarding the tax system, in which exclusive powers of taxation are assigned to each of the three spheres of government: specifically, important indirect taxes are assigned to the subnational levels of government (a sales tax on goods for the states and a tax on services in general for the municipalities). The text of the constitution details a series of basic rules for the collection of subnational taxes, which ensure great autonomy for the levels of government in question. It does the same with regard to the constitutional distribution of taxes, even specifying the percentages applicable, the limitations of the use of the resources in question, and in some cases detailed criteria for their apportionment.

The situation is not very different with regard to the respective areas of competence in terms of responsibilities and expenditures. Although the Constitution also indicates some division of attributions among levels of government, in practice there is overlapping of activities, due above all to the great differences between regions, not only in terms of economic and social conditions but also the executive capacity of the state and municipal public administrations. At all events, it is important to note that most of the subnational public expenditure does not correspond to tasks delegated by upper spheres of

government. The lower spheres of government assume such expenditures—even when there is no official act or law formally giving them responsibility for such outlays—in order to take care of the interests and needs of the local community. In spite of the lack of an institutional mechanism explicitly imposing such responsibility, like that for tax income, public expenditure was increasingly decentralized from the 1988 reform onward.

Under the National Constitution, the states and municipalities enjoy broad autonomy as regards levying their taxes and collecting other forms of income, making expenditures, and even hiring public employees, defining their salaries, and contracting debts. The budgets and corresponding rendering of accounts are submitted to the legislative powers of the subnational governments themselves and do not depend on *ex ante* or *ex post* authorizations or evaluations by the federal government. The so-called voluntary transfers and possible loans obtained from federal bodies are exceptions and therefore have little weight in the present fiscal system. The subnational governments also have a reasonable amount of leeway with regard to larger federal transfers connected with fundamental education and public health programmes,<sup>4</sup> which operate as what are called “general purpose subsidies”.

These initial observations aim to cover the main institutional elements conditioning the Brazilian fiscal system which must be taken into account when analysing intergovernmental relations. Decentralization is not the result of public policy options adopted by the government, nor is it a mere fiscal strategy within overall economic policy. Instead, it has a higher rank, intimately linked with the permanent structure with which the Brazilian federation has always been endowed in the Constitution, since the federative form of organization of the State was adopted in the very first Constitution of the Republic, in the late 19<sup>th</sup> century.

<sup>4</sup> In Brazil, since 1996 education has been organized in two levels: i) basic education, which comprises pre-school education (0-6 years of age), compulsory fundamental education (7-14 years of age), and secondary education (15-17 years of age), and ii) higher education.

### III

## An outline of the relations between the different spheres of government

Among the federative countries of the world, Brazil displays one of the most advanced levels of fiscal decentralization, whatever the standard used. Strangely enough, Brazilians do not see it in this way, especially in political circles, where there are more and more protests against the centralization of the fiscal system.<sup>5</sup> This perception may reflect the changes in the general thrust of the federal distribution of tax revenue defined by the 1988 Constituent Assembly but little publicized and discussed in the country as yet.<sup>6</sup>

The division of the main fiscal flows and stocks among the different levels of government—central, state and municipal—highlights the considerable relative importance of the subnational levels.

The states and municipalities directly collect 31% of the high global tax burden, which was estimated to amount to 35.5% of the gross domestic product (GDP) in 2003 (table 1). After the transfers provided for by the Constitution, this relative proportion rises to 41%. According to the national accounts, this amount is almost equal to the proportion of total fiscal expenditure (41.1% of GDP in 2002) corresponding to the subnational levels of government. In the case of the distribution of expenditure, the aggregate result conceals great differences by category: the federal government is responsible for 80% or more of expenditure for social benefits (14.7% of GDP) and interest on the debt (nearly 10% of GDP in 2003), while the state and municipal levels are responsible for 70% of the payroll for active public employees (10.1% of GDP) and 82% of gross fixed capital formation (2.2% of GDP).

According to the official methodology for analysing the net public sector debt and its financial

needs (which, unlike the previous data, include state enterprises), a little over a quarter of the primary surplus (4.3% of GDP in 2003), 30% of the expenditure, including interest, and almost 40% of the net public sector debt (58.2% of GDP in December 2003) corresponded to the sub-national levels of government.

The national accounts make it possible to prepare a complete updated picture of the intergovernmental flows registered in the public administration accounts. The latest data released by the IBGE refer to the financial year 2002. They cover the constitutional distribution of revenue and the other transfers allocated in the same way in those accounts. They include both regular transfers and those made in connection with the Fund for the Maintenance and Development of Fundamental Education and the Upgrading of Teachers (FUNDEF), the Unified Health System (sus) and also the federal commitments in respect of support for the government of the Federal District and the former Emancipated Territories (now the states of Amapá and Roraima). They also include the so-called voluntary transfers, authorized only for special purposes but always included in the budget of the transferring government.<sup>7</sup>

The total flow of resources among the three spheres of government is considerable, amounting in 2002 to 7.8% of GDP (table 2). This is equivalent to a little over one-fifth of total national tax income and, when other items are also taken into account, to almost 18% of the current income of the governments and 16% of total fiscal expenditure. As a general rule, the transfers are from the upper spheres to the lower ones. The balance between the amount granted and the amount received is positive, even in the case of the states: 1.1% of GDP, equivalent to 10% of their own budgets.<sup>8</sup>

<sup>5</sup> This was also the main theme of the electoral campaign of the present President, who laid stress on his promise to review the federative pact—in order to increase the income of the subnational governments—as the feature differentiating his tax reform project from others.

<sup>6</sup> These changes became clearer in the two-year period 2003-2004: the statistical evidence indicates a growing federal share of direct tax revenue and available income. The data for 2004 given in this article were taken from budgets which were adopted months before the beginning of the financial year, so that the actual results may naturally be considerably different.

<sup>7</sup> The annual balance sheets of the various units of the three spheres of government referred to throughout this article are prepared by the National Treasury Ministry (STN) and are consolidated under the title *Finanças do Brasil*. They are available on the Internet website of that ministry ([http://www.Tesouro.fazenda.gov.br/estados\\_municipios/index.asp](http://www.Tesouro.fazenda.gov.br/estados_municipios/index.asp)).

<sup>8</sup> Exceptionally, with the creation of FUNDEF horizontal transfers increased, even involving a redistribution of resources between state and municipal governments, as described below.

TABLE 1

**Brazil: General aspects of the Brazilian federation,  
by the three spheres of government<sup>a</sup>**

Spheres of government		Units	Tax resources <sup>b</sup>		Public expenditure <sup>b</sup>			Financial needs and net indebtedness			
			Direct collection (%)	Available income (%)	Active staff (%)	Social benefits (%)	Fixed capital formation (%)	Total (including surplus interest) (%)	Primary surplus (%)	Interest (responsibilities) (%)	Net debt (%)
Central	Unión	1	68.8	59.0	30.0	85.0	17.6	57.8	73.1	70.7	61.2
Intermediate	States	26+1	26.6	24.9	43.2	12.9	41.4	25.5	23.7	25.0	34.3
Local	Municipalities	5 532+27	4.6	16.1	26.8	2.1	41.0	16.6	3.2	4.3	4.6
Total		5 586	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
As % of GDP			35.5	35.5	10.12	14.67	2.20	41.08	-4.3	9.5	58.2
Year			2003	2003	2002	2002	2002	2002	2003	2003	2003

Source: Prepared by the author on the basis of data from the Brazilian Geographical and Statistical Institute (IBGE), the Central Bank of Brazil and the Ministry of Finance.

<sup>a</sup> Political organization: state sphere (26 states plus the Federal District); local sphere (5,560 municipalities officially established and receiving federal transfers, 26 capitals, 5,532 municipalities in the interior), and the Federal District.

<sup>b</sup> The tax resources and public expenditure include social security (with extra-budgetary funds such as the Unemployment Insurance Fund-FGTS) but exclude business activities.

<sup>c</sup> Financial needs and net debt: measured above the line (IMF methodology). Include the Central Bank in the case of the Union and state enterprises in each sphere of government (unlike other items).

TABLE 2

**Brazil: Structure of intergovernmental financial relations, 2002<sup>a</sup>**

Intergovernmental flows <sup>b</sup>	Amount			As % of expenditure		As % of income		
	Billions of reales	% of GDP	% of total	Gross (%)	Own expenditure (%)	Gross (%)	Own expenditure (%)	Tax income (%)
<i>Expenditure<sup>c</sup></i>	104 936	7.80	100.0	16.0	19.0	14.9	17.7	22.3
Union	73 570	5.47	70.1	18.7	23.0	17.1	17.1	22.3
States	30 784	2.29	29.3	17.9	21.8	17.0	23.1	25.9
Municipalities	582	0.04	0.6	0.6	0.6	0.6	2.0	2.9
<i>Income<sup>d</sup></i>	104 936	7.80	100.0	16.0	19.0	14.9	17.7	22.3
Union	103	0.01	0.1	0.0	0.0	0.0	0.0	0.0
States	45 026	3.35	42.9	26.2	31.9	24.9	33.8	37.9
Municipalities	59 807	4.44	57.0	64.6	65.0	64.4	201.1	294.2
<i>Balance</i>	(0)	0.00	0.0	0.0	0.0	0.0	0.0	0.0
Union	(73 467)	-5.46	-70.0	-18.7	-23.0	-17.1	-17.1	-22.2
States	14 242	1.06	13.6	8.3	10.1	7.9	10.7	12.0
Municipalities	59 225	4.40	56.4	64.0	64.4	63.8	199.2	291.3

Source: Prepared by the author on the basis of data from IBGE (2003, table 39).

<sup>a</sup> Transfers do not only include those corresponding to the constitutional distribution of tax income, but also other regular transfers (from FUNDEF and SUS) and voluntary transfers.

<sup>b</sup> The intergovernmental flows correspond to the difference between gross or own income and expenditure.

<sup>c</sup> Expenditure includes intermediate consumption, payment of employees, subsidies, social benefits, interest and gross fixed capital formation.

<sup>d</sup> Income includes taxes, property rents and sundry income.

On the side of the transferring governments, there is a concentration of 70% of the flows in the Union, which transferred an amount equal to 5.5% of GDP in 2002 and consumed one-fifth of its global fiscal expenditure, equivalent to 22% of its tax revenue or

17% of all that it collected. Although the states account for the remaining 30% of transfers, these too weight quite heavily in their budgets, since they represent about a fifth of their expenditures, or a quarter if only direct tax revenue is considered.

On the side of the recipient governments, in 2002 the municipalities benefited more than the states (4.4% versus 3.3% of GDP): the transfers they received were three times the size of their direct tax revenue and double their own income, so that 65% of the municipalities' expenditure was financed with the money transferred. The states, for their part, received transfers equivalent to one-third of their own income, covering a quarter of their expenditure.

It may be noted that this diagnosis of the sub-national governments as a whole involves significant variations between the different government units, mainly because of the profound economic and fiscal inequalities. The extent to which each unit depends on transfers—especially from the funds for sharing in the income from federal taxes—is directly related with its level of development. Consequently, when the evolution of their own income is very different from that of resources transferred from other levels, the characteristics of the sub-national finances are also very different.

After this more global diagnosis of intergovernmental financial relations, we will concentrate our analysis on the tax system, since the constitutional distribution of income (6.3% of GDP in 2002) accounts for 80% of the total transfers between levels of government.

Although a deeper reform of areas of competence in terms of taxes has not been made, the global tax burden has increased considerably, and continues to do so, after the serious external crisis suffered by the country at the end of the 1990s. In order to cope with this crisis, an austere fiscal stability programme was adopted, based on a sharp rise in federal taxes. Between 1998 and 2003 the global tax burden increased from 29.6% to 35.5% of GDP.

This increase coincided with a renewed centralization of direct tax revenue, although this was partially offset by intergovernmental transfers. Before the radical decentralization provided for in the 1988 Constitution, the Union directly collected 70% of national taxes (22.4% of GDP). In 1991, this proportion went down to 63%, but after the creation of the Real, the introduction and/or increase in social contributions allowed it to rise to 69% in 2002-2003.

There was also a slight change in the trends in available tax income, which includes the revenue collected by the spheres of government themselves plus (or less) the income from the constitutional distribution of tax income among the different spheres.

From a historical perspective, the states have lost much relative importance. In 1960 they received 34% of national tax income, but as they were the spheres

most affected by the centralization of the military government, this proportion went down to 22% by 1980 (table 3). Eight years later, when the last major constitutional reform was approved, the greater political openness enabled them to recover five percentage points. Their share even rose to 29% in 1991, but from that time on it went down steadily, so that in 2003 it is estimated that the states received only a quarter of national tax income, which is less than in 1988. It should be noted that the loss was only in terms of their percentage of tax resources received, since in absolute terms the volume of tax income received by the states grew faster than GDP (as did the tax burden). It should also be noted that the fiscal war over the sales tax on goods and services (ICMS) is one of the reasons why the performance of this tax was inferior to that of the expansion in indirect federal taxes.

The municipalities, in contrast, were the main beneficiaries of the tax reform, increasing their proportion of national taxes received from 11% to 17% in the first ten years of operation of the new system (to such a point that some persons asked whether, in practice, the reform was not giving rise to a federation of municipalities).<sup>9</sup> As from the external crisis of the late 1990s, however, the federal advance brought with it marginal losses for the municipalities, which were receiving 16% of national tax income at the end of 2003 (table 4).

The only reason why the situation of the local levels of government did not deteriorate in recent years was that they obtained an increasing share of state tax income through the redistribution effected by FUNDEF. Account should also be taken of the increasingly large transfers by the SUS, which, as they are not of a structural nature, are not included in table 4. Nevertheless, there are discrepancies according to the category of municipalities, due to the big differences in the financing model. Note in particular, for example, the recent reduction in the Municipal Participation Fund (FPM), which affects above all the smaller municipalities and those located in the poorest areas of the interior.<sup>10</sup> In

<sup>9</sup> This was the main subject that Afonso and de Mello (2002) had to address at a conference of the International Monetary Fund (IMF) on comparative federative experiences.

<sup>10</sup> When the local balance sheets for 2002 are grouped in categories according to the number of inhabitants, it is seen that the FPM accounts for almost 60% of the available tax income or half of the current income of the municipalities with fewer than 5,000 inhabitants. As the population grows, this dependency goes down, but even in the case of cities with 50,000 to 100,000 inhabitants the FPM alone represents a quarter of the available tax income and one-fifth of current income.



TABLE 3

**Brazil: Evolution of tax income by spheres of government,  
selected years between 1960 and 2004<sup>a</sup>**

	Tax burden (% of GDP)				Composition (% of total)			
	Federal	State	Local	Total	Federal	State	Local	Total
<i>Direct collection</i>								
1960	11.10	5.50	0.80	17.40	64.0	31.3	4.8	100.0
1980	18.50	5.40	0.70	24.60	75.1	22.0	2.9	100.0
1988	15.79	5.94	0.65	22.40	70.5	26.5	2.9	100.0
2002 <sup>b</sup>	24.39	9.47	1.68	35.54	68.6	26.7	4.7	100.0
2003 <sup>b</sup>	24.42	9.45	1.63	35.49	68.8	26.6	4.6	100.0
2004 <sup>c</sup>	24.99	9.46	1.74	36.18	69.1	26.1	4.8	100.0
<i>Available income</i>								
1960	10.40	5.90	1.10	17.40	59.4	34.0	6.6	100.0
1980	17.00	5.50	2.10	24.60	69.2	22.2	8.6	100.0
1988	14.00	6.00	2.40	22.40	62.3	26.9	10.8	100.0
2002 <sup>b</sup>	20.56	9.06	5.92	35.54	57.9	25.5	16.7	100.0
2003 <sup>b</sup>	20.94	8.83	5.73	35.49	59.0	24.9	16.1	100.0
2004 <sup>c</sup>	21.42	8.90	5.87	36.18	59.2	24.6	16.2	100.0

*Source:* Prepared by the author on the basis of data from the Getulio Vargas Foundation (FGV)/IBGE, national accounts, the National Treasury Ministry (STN), the Federal Inland Revenue Secretariat, IBGE, the Ministry of Social Security and Assistance, the Federal Economic Fund, the National Council on Finance Policy, and *Finanças do Brasil* (STN, various years).

<sup>a</sup> The methodology used is that of the national accounts, which includes taxes, charges and rates —such as the Provisional Contribution on Financial Movements (CPMF) and the Unemployment Insurance Fund (FGTS)— as well as the active debt and interest. Direct collection corresponds to tax collection by the relevant levels of government themselves. Available income corresponds to the amount collected, plus (or less) that corresponding to the constitutional distribution of tax income.

<sup>b</sup> Preliminary estimates.

<sup>c</sup> Budget of the Union.

2003, the FPM was reduced by 16% compared with the previous year and stood at less than 20 billion reals —the smallest amount transferred in a year since 1995.<sup>11</sup>

The Union, which had suffered the serious initial effects of the introduction of the present tax system —its share in national tax revenue went down from 62% in 1998 to less than 55% in 1991 (its worst year)— recovered considerably (to 59%) in 1994, the year in which the real was created. Subsequently its share began to go down again, sinking to 56% in 1998. From then on, two movements with the same origin increased the national tax burden and also the proportion corresponding to the Union, whose share in

2003 came to 59%, only three points below the level registered in 1988, before the last major amendment to the Constitution, thus mitigating somewhat the trend towards decentralization in the distribution of tax revenue (table 5); it should not be forgotten that the marked increase in the total tax mass greatly benefited the subnational levels of government.

The tax policy of the present federal government gives an unprecedented degree of priority to the collection of social contributions which are not shared with other spheres of government. This acts to the detriment of the relative and absolute importance —at constant values— of the revenue from income tax and, above all, from the taxes on manufactured products, which are distributed through the participation funds.

If we compare the revenue from income tax and the tax on manufactured products, which form the basis of the FPE and the FPM, with the revenue from the four main social contributions —the Contribution for the Financing of Social Security (COFINS), the Social Integration Programme (PIS), the Social Contribution on Net Profits (CSLL) and the Provisional Contribution on Financial Movements (CPMF)— we

<sup>11</sup> The contraction in the FPM caused serious financial problems in the small municipalities of the interior. Over 2,000 of them were unable to pay the “thirteenth month” bonus to their employees in December 2003. This contraction speeded up the deterioration in local finances already observed in the balance sheets for the previous year. 44% of the municipalities (2,423) ended 2002 with fiscal deficits, according to the Brazilian Institute of Municipal Administration (IBAM, 2003), the highest proportion being observed in the case of cities in the North and Northeast.

TABLE 4

**Brazil: Annual distribution of available tax income,  
by spheres of government, 1988-2004<sup>a</sup>**

Years	As % of GDP				As % of total			
	Federal	State	Municipal	Total	Federal	State	Municipal	Total
1988	13.96	6.03	2.42	22.40	62.3	26.9	10.8	100.0
1989	14.73	6.03	3.36	24.13	61.1	25.0	13.9	100.0
1990	16.95	7.94	3.89	28.78	58.9	27.6	13.5	100.0
1991	13.78	7.47	3.96	25.21	54.7	29.6	15.7	100.0
1992	14.23	7.03	3.73	24.98	57.0	28.1	14.9	100.0
1993	14.90	6.81	4.07	25.78	57.8	26.4	15.8	100.0
1994	17.65	7.47	4.64	29.75	59.3	25.1	15.6	100.0
1995	16.52	8.00	4.88	29.41	56.2	27.2	16.6	100.0
1996	16.30	8.04	4.75	29.09	56.0	27.6	16.3	100.0
1997	16.62	8.18	4.76	29.56	56.2	27.7	16.1	100.0
1998	16.66	7.89	5.09	29.64	56.2	26.6	17.2	100.0
1999	18.08	8.25	5.39	31.71	57.0	26.0	17.0	100.0
2000	18.53	8.63	5.52	32.67	56.7	26.4	16.9	100.0
2001	19.58	8.86	5.70	34.14	57.4	25.9	16.7	100.0
2002 <sup>b</sup>	20.56	9.06	5.92	35.54	57.9	25.5	16.7	100.0
2003 <sup>b</sup>	20.94	8.83	5.73	35.49	59.0	24.9	16.1	100.0
2004 <sup>c</sup>	21.42	8.90	5.87	36.18	59.2	24.6	16.2	100.0
Variation 2003/1998								
as % of GDP	6.98	2.80	3.31	13.09	53.3	21.4	25.3	100.0
Relative variation	50.0%	46.5%	136.8%	58.4%				
Variation 2004/1998								
as % of GDP	7.46	2.87	3.45	13.78	54.1	20.8	25.0	100.0
Relative variation	53.5%	47.7%	142.5%	61.5%				

Source: As in table 3.

<sup>a</sup> The methodology used is that of the national accounts, which includes taxes, charges and rates —such as the Provisional Contribution on Financial Movements (CPMF) and the Unemployment Insurance Fund (FGTS)— as well as the active debt and interest. Available income corresponds to the amount collected, plus (or less) that corresponding to the constitutional distribution of tax income.

<sup>b</sup> Preliminary estimates.

<sup>c</sup> Budget of the Union.

TABLE 5

**Brazil: Increase and division of the global tax burden in the  
period after the Constituent Assembly, 1988-2004<sup>a</sup>**

Period		Increase in burden		How much of the increase went to each sphere of government?					
		As % of GDP	Per phase (% total)	As % of GDP			As %		
				Union	States	Municipalities	Union	States	Municipalities
After the Constituent Assembly	1988-2003	13.09	100	6.98	2.80	3.31	53	21	25
Before the Plano Real	1988-1993	3.38	26	0.95	0.78	1.65	28	23	49
Immediately after the Plano Real	1993-1998	3.86	29	1.76	1.08	1.02	46	28	26
After the exchange rate crisis	1998-2003	5.85	45	4.27	0.94	0.64	73	16	11
Administration of Pres. da Silva (two years)	2004-2002	0.65	100	0.85	-0.16	-0.05	132	-24	-8
After the Constituent Assembly	1988-2004	13.78	100	7.46	2.87	3.45	54	21	25

Source: As in table 3.

<sup>a</sup> The methodology used is that of the national accounts, which includes taxes, charges and rates —such as the Provisional Contribution on Financial Movements (CPMF) and the Unemployment Insurance Fund (FGTS)— as well as the active debt and interest. Available income corresponds to the amount collected, plus (or less) that corresponding to the constitutional distribution of tax income. For 2002-2003 preliminary estimates were used, and for 2004, budget projections.



see that the aggregate amounts were practically the same in 1994 and 2002. In those eight years, there was a difference of only five percentage points, which was due to the fact that the income from contributions grew faster than that from taxes. There was a rapid change in 2003, however, when the income from those contributions exceeded to income from taxes by 13 percentage points. In the 2004 budget, the difference is expected to rise to 27%: a 25% increase in only two years.<sup>12</sup>

Whereas initially decentralization led to the municipalization of public resources, the recent advance by the federal government in its share of

national tax resources (while not forgetting that the global tax burden also increased) means that the relative importance of the state governments in this respect went down, reflecting the tendency to centralize direct tax collection and, to a lesser extent, the income available as from the 2003-2004 period.<sup>13</sup> Consequently, if it is considered that the federation is going through a crisis, then this would be a structural crisis at the intermediate levels of government (and, at this time of smaller transfers from the participation funds, a crisis in the situation of the subnational levels of government, especially in the case of small municipalities, which depend to a large extent on those transfers).

## IV

### The new fiscal culture

The greater or lesser decentralization of the fiscal system has not been an obstacle to the achievement of notable progress in the structural reform of the Brazilian public finances in recent years. Monetary stability was attained with the 1994 Plano Real and was consolidated in spite of the decentralized federation. The same thing occurred in the case of fiscal stability, which was achieved through a new economic policy, applied in the late 1990s, which was based on a system of inflation targets, a fluctuating exchange rate, and responsible fiscal management.

The existence of a system of intergovernmental relations which mobilizes a considerable flow of resources for the purpose of vertical and horizontal decentralization of the tax system did not prevent the above-mentioned economic policy from being formulated and implemented, even taking into account

the demands for the faithful fulfillment of the fiscal targets, increased primary surpluses even in the case of the subnational levels of government, and the restrictions on the respective levels of net indebtedness. Nor did it affect the changes in strategy as regards tax policy—including the increase in the global tax burden already referred to— or the policies regarding expenditure (greater austerity in terms of the payroll, the social security of public employees, and investments) or the improvement and decentralization of social policies. The latter include both universal policies (education and health) and the new programmes of targeted assistance, for whose application close collaboration between different spheres of government was of fundamental importance.

Behind this turnaround in the fiscal, economic and social spheres, there was a process of restructuring of

<sup>12</sup> The joint revenue from income tax and the tax on manufactured products increased by almost 42 billion reales between 1994 and 2002, compared with the increase of around 46 billion reales in the main social contributions (COFINS, PIS, CSLL and CPMF). This means that the base for the participation funds contracted in relative terms. The situation has changed a great deal between 2002 and 2004, however. According to the federal government's own budget, revenue from the two taxes in question will go down by almost 10 billion reales (-0.75% of GDP), while the income from contributions will increase by some 18 billion reales (+0.86% of GDP). Thus the ratio between the two aggregates will rise from 97% in 1994 and 102% in 2002 to 113% in 2003 and 127% in 2004. This is the main evidence of the relative weakening of the base of the participation funds.

<sup>13</sup> Late in December 2003, a constitutional amendment was approved which was supposed to promote reform of the tax system on the basis of the draft submitted by the new government at the end of April. The proposed modifications are far from reformulating the system, however. The amendment basically addresses the most pressing needs to maintain the fiscal adjustment by extending until 2007 the collection of the Provisional Contribution on Financial Movements (CPMF) and the mechanism for the budgetary delinking of the Union (the so-called DRU), which represents 20% of the freely usable contributions. The reform did not affect any form of tax collection powers and changed intergovernmental relations only very slightly. It introduced the distribution of a quarter of the economic contribution on fuels in order to finance investments in transport (Contribution for Intervention in the Economic Field-CIDE).

the State which culminated in the approval of the Fiscal Responsibility Law —applicable to all three spheres of government— in mid-2000. Rather than initiating modifications, this Law consolidated the existing changes. *Made in Brazil* is a legal device almost without parallel in other countries. Much more important than the Law itself was the change in mentality it provoked, which made it possible to create greater awareness of the need for macroeconomic stability, on which there is now a practically complete national consensus.

Generating primary surpluses and keeping the public debt under control are the most important aspects of the fiscal policy of a country obliged to apply a rapid and vigorous fiscal adjustment in order to meet its debt obligations and weather a succession of external crises. These crises occurred throughout the second half of the 1990s and, more recently, in the second half of 2003, because of the expectation over the Presidential elections.

In short, up to the mid-1990s the country suffered a process of uncontrolled indebtedness of the states and municipalities, sometimes induced by the economic policy itself, and in some cases even without proper recording of the debts. After the creation of the Real, the federal government embarked on a new and definitive process of renegotiation and assumption of all debts by the National Treasury—even those with banks and those in respect of movable property. In return, among other things, a fiscal adjustment programme was signed with each state and municipality, which included performance goals and the prohibition of new indebtedness until the total debt was reduced to a national maximum level. The programme also provided for the payment to creditors of a monthly debt service quota as a fixed proportion of current income and—as the main condition—the provision of solid guarantees (blocking and automatic withholding of constitutional transfers and own income).

One day after the process of signing the series of debt refinancing programmes was completed, the Fiscal Responsibility Law was published, prohibiting the granting of new credits by the Union and the signing of new agreements regarding what had already been renegotiated (with the sole exception of guarantees for foreign loans, provided there was sufficient and suitable collateral). In the view of some, this provision alone was sufficient to ensure the success of the Law. Indeed, once the umbilical cord between the federal government and the subnational governments had been cut, this made it possible to

combine autonomy and responsibility for the first time in the history of the Brazilian Federation. It may be noted that it is no easy matter to amend this Law, which is a complementary law, because this would require the assent of an absolute majority of each chamber of the Congress.

As from 2000, there was a considerable ongoing flow of payments in respect of the renegotiated debt. There were very few cases in which some state or municipal government failed to pay the monthly installment on the debt. In any case, this would result in the blocking of that government's resources by the Treasury. Since the access of the larger subnational governments to the credit market was practically eliminated and the service payments of the renegotiated debt were regularized, the states began to generate substantial and growing primary surpluses.

After the serious external crisis of the late 1990s, the country signed a series of agreements with the IMF. The target for the primary surplus began with 3.1% of GDP in 1999, rising to 3.75% of GDP at the beginning of 2002. After the crisis of confidence caused by the Presidential campaign, this percentage went up to 3.8% and later 4.25% of GDP: a target which the new federal government extended until 2006. The country systematically managed to comply with these requirements, but the situation evolved differently in the case of the net debt, because of the continuation of the process of recognition of liabilities (the so-called "skeletons") and because of the effects of the rise in real interest rates and currency devaluation. Thus, the first target for the net debt was its reduction from 53% of GDP—after the spectacular devaluation of the currency—to 46.5% at the end of 2001.

In the adjustment of financing needs, in accordance with the methodology defined by the IMF, 1998 was the last year in which the subnational governments registered primary deficits, although the GDP went down by 0.2% because of the poor results of the states. The following year, there was a primary surplus of +0.2%, which continued to grow in subsequent years until it reached 0.9% of GDP in 2003 (exceptionally, in the period from January to November). The results surpassed the goal which had been set: at the end of 2003 the net debt was 913 billion reals, which was well below the limit of 955 billion agreed with the IMF.

On the other hand, the drastic increase in 2003 in interest rates on the public debt (9.5% of GDP) ate up the whole of the increase in the primary surplus and gave rise to the biggest nominal deficit in the decade

(5.2% of GDP), seriously prejudicing the National Treasury (table 6).

The state and municipal components of the net debt (table 7) evolved less favourably at the turn of the decade, not because of the generation of a deficit or the past placement of paper at excessive spreads, but because of the recognition of old debts which had not been properly recorded and, above all, because the element used for indexing the refinancing contracts with the Treasury—the general price index-internal supply (IGP-DI) calculated by the Getulio Vargas Foundation—was much higher than the consumer price indexes, mainly because it is more sensitive to exchange rate devaluation.

Thus, the net debt of the subnational governments increased from 14.1% to 18.3% of GDP between 1998 and 2001, after the conclusion of the refinancing process with the Treasury. In 2003 this proportion rose to 19.3% of GDP, but the increase was not due to primary deficits but to the correction of debts renegotiated with the Treasury (table 7), for which an over-inflated index (the general price index) was used in periods of currency devaluation. This does not affect the amount paid by the subnational governments, which is calculated as a proportion of their income, but it can lead to an increase in the amount that must be refinanced at the end of the period originally contracted.

TABLE 6

**Brazil: Public sector finance needs<sup>a</sup>**  
(As a percentage of GDP)

	1998	1999	2000	2001	2002	2003
<i>Nominal finance needs</i>	7.46	5.78	3.61	3.58	4.59	5.16
Central government	4.93	2.7	2.27	2.11	0.75	4.06
States	1.8	2.68	1.81	1.93	3.25	1.50
Municipalities	0.22	0.47	0.27	0.1	0.58	0.27
State enterprises	0.51	-0.07	-0.74	-0.56	0.01	-0.66
<i>Nominal interest</i>	7.47	8.97	7.08	7.21	8.48	9.49
Central government	5.48	5.03	4.13	3.94	3.12	6.59
States	1.39	2.84	2.23	2.53	3.89	2.28
Municipalities	0.44	0.52	0.4	0.37	0.73	0.39
State enterprises	0.16	0.58	0.32	0.37	0.74	0.23
<i>Primary result</i>	-0.01	-3.19	-3.47	-3.63	-3.89	-4.32
Central government	-0.55	-2.33	-1.86	-1.83	-2.37	-2.53
States	0.41	-0.16	-0.42	-0.6	-0.64	-0.78
Municipalities	-0.22	-0.05	-0.13	-0.27	-0.15	-0.12
State enterprises	0.35	-0.65	-1.06	-0.93	-0.73	-0.89

Source: Prepared by the author on the basis of data from the Central Bank of Brazil (time series).

<sup>a</sup> Positive figures indicate a deficit and negative figures a surplus.

TABLE 7

**Brazil: Net public sector debt, 1998-2003<sup>a</sup>**  
(As a percentage of GDP)

	1998	1999	2000	2001	2002	2003
<i>Total</i>	41.71	48.68	48.77	52.63	55.49	58.53
Central government	25.00	29.80	30.57	32.79	35.32	37.23
States	12.23	13.94	13.96	16.20	16.25	17.71
Municipalities	1.92	2.15	2.09	2.08	2.20	2.47
State enterprises	2.56	2.79	2.15	1.56	1.72	1.13

Source: Prepared by the author on the basis of data from the Central Bank of Brazil (time series).

<sup>a</sup> Includes both internal and external debt.

It is interesting to observe the differences in behaviour between the states, which are much more heavily indebted and are also obliged to achieve larger primary surpluses, and the municipalities. Although the budget of the former is not even twice that of the latter, the primary surplus demanded from the states (0.9% of GDP up to November 2003) is almost seven times larger than that generated by the municipalities (0.1% of GDP). The same proportion is observed in the case of indebtedness: 17.4% of GDP for the states, compared with only 2.4% of GDP for the municipalities.

The concentration of state and municipal debt in the federal government (almost 95% of the total) is another striking feature: at the end of 2003 the total amount of debt renegotiated by the National Treasury came to 16.5% of GDP (263.5 billion reales), 91% of which corresponded to the state governments.

Once again, the differences between the different units of government are very evident, since some are much more heavily indebted than others (over half the municipalities of Brazil have not contracted any bank debts at all, for example). Consequently, the improvement in the fiscal results is a generalized phenomenon, whatever the size of the federated entities or the region they belong to.

In short, decentralization has not prevented the formulation and implementation of a far-reaching policy of fiscal austerity.<sup>14</sup> The heavy intergovernmental transfers, which formed both the basis for the calculation of the debt service quotas and a guarantee for the retention and transfer of net values, helped directly and decisively to make the subnational governments take part in the national fiscal programme. The transfers make it possible to increase the size of the quotas to be paid and to ensure the payment of the subnational debts renegotiated with the Treasury, which represent almost the whole of the total amount owed by the states and municipalities.

In spite of their significant and growing loss of participation in the distribution of national tax revenue, in 2003 the states generated a primary surplus equivalent to 9% of their available tax income: not much less than the 12% achieved by the federal government, which has a bigger and more diversified income base. In the case of the municipalities, the surplus corresponded to only 2% of that income. The states are making a big sacrifice in order to pay—and pay dearly—for the sins of previous administrations marked by budgetary and financial imbalance.<sup>15</sup>

## V

### Dynamic social policies and associations between different spheres of government

The intergovernmental relations most strongly developed in Brazil since the mid-1990s were those related with the fields of finance and association for the provision of services, against the background of the greater efforts reflected in the adoption of dynamic and creative social policies. The two most representative cases were the reform of the financing of fundamental public education and subsequently of the health system, which involved the assumption of the obligation to assign those areas certain percentages of the available resources, the modification of the apportionment criteria for the main transfers of tax revenue, and an increase in the contributions made by the federal government, in order to induce greater and more effective participation by the states and municipalities.

It should be noted that such relations are not always of a financial nature, since they do not necessarily involve movements of resources between the different levels of government. This is so, for example, in the case of the new social protection and assistance programmes. Generally speaking, their financing is federal (sometimes complemented with finance or parallel programmes in some states and municipalities), but the subnational governments play an important role in the implementation of the services

<sup>14</sup> Aratijo (2003, pp. 74-75) found that the fiscal adjustment of the state governments in the late 1990s was based largely on cuts in expenditure.

<sup>15</sup> The same conclusion was reached by authors such as Guardia and Sonder (2004).

provided or their follow-up and evaluation (for example, they make a census of the population benefited and check up that families are complying with their obligations).

### 1. Fundamental education: redistribution of state resources

The most important change in intergovernmental financial relations was the establishment of a constitutional obligation to allocate resources for the maintenance and development of education. In September 1996 a constitutional amendment created FUNDEF in order to modify the system for the financing of fundamental education.<sup>16</sup>

In practice, a transitory decision was taken that for ten years every unit of the federation should allocate to FUNDEF 60% of the quarter of state and municipal tax income that the Constitution obliged those units to spend on education. It is a kind of reservation of resources (a specific allocation from within the larger allocation) resulting from 15% of the federal transfers of the participation funds<sup>17</sup> corresponding to each state, plus 15% of the respective states' own revenue from the sales tax on goods and services (ICMS), for subsequent allocation to the FUNDEF of each state (in reality there is not just one FUNDEF but 27). While 85% of the participation funds is distributed among the subnational governments according to normal apportionment criteria and 85% of ICMS is divided between the state (three quarters) and its municipalities (the remaining quarter, according to a predetermined formula), the funds collected by the FUNDEF of each state are divided between the state government and those of the municipalities according to the number of students enrolled in the fundamental educational establishments maintained by each federated unit.

As well as redistributing resources among the subnational governments, the Union also undertook to provide a compensatory supplement when a state's own funds were not sufficient to attain a minimum level of expenditure per student per year. The aim of this federal subsidy was to make it easier to secure the approval and support of the subnational governments for the proposal, but it subsequently became irrelevant to the functioning of FUNDEF. Ever since it came into

operation in 1998, the base level for the subsidy was set below the national average, and subsequently it was adjusted less than the nominal growth of the tax income feeding the Fund; thus, the coverage of the compensatory supplement was considerably reduced (eight states were benefited in the first year, but only four in 2003) and the financial outlays went down (the corresponding expenditure went down even in nominal terms during the period in question, falling from around 500 million reales to some 300 million).

Thus, FUNDEF represents an innovative instrument which is still unique in the Brazilian fiscal system, because it involves a far-reaching periodic (annual) redistribution of resources either vertically (from the states to the municipalities) or horizontally (between municipalities). The size of the school system of each unit of government has become the only (and decisive) criterion for defining this new form of intergovernmental financial relations in the country, and it consequently directly influences the increase in the provision of services. Unfortunately, it has also led to the commission of some statistical frauds. Although only a few isolated cases have been denounced, this has led to the strengthening of controls and joint measures—sometimes even of a penal nature—by the Ministry of Education, the Public Accounts Tribunals and the Ministry of Justice.<sup>18</sup>

Since the financial health of the municipalities is generally better than that of the states, the same process has been accompanied both by the decentralization of the corresponding resources and expenditures and by much more rational resource distribution criteria than those applied to the FPM (which were based on population brackets with excessively high minimum and excessively low maximum values).

Although the federal government finally took on a dominant role in the planning, formulation, coordination and evaluation of the new policy on the financing of education, this did not change in any way the responsibilities of the states and municipalities with regard to the provision of services. Decentralization took place by voluntary adhesion, as a natural process in which the local spheres took over the role previously played by the state. Municipalization was not imposed by the constitutional amendment which set up FUNDEF,

<sup>16</sup> Constitutional Amendment No. 14 of 12 September 1996.

<sup>17</sup> The FPE, the FPM, the Compensation Fund on exports of manufactured goods (FPEX), and the Kandir Law.

<sup>18</sup> In this respect, the Ministry of Education works with the state prosecutors to detect possible irregularities and take measures against those responsible; since 2003 it has published on the Internet a text entitled "Subsidies to the Ministry of Justice for the Monitoring of FUNDEF" (<http://www.mec.gov.br/sef/fundef/pdf/fundef.pdf>).



and much less by the federal government, but was induced by the changes in intergovernmental financial relations.

The constitutional allocation of resources to FUNDEF has considerable weight in the overall Brazilian fiscal picture: in 2003 it mobilized 25.2 billion reals, equivalent to 1.6% of GDP and over 11% of available subnational tax income. The vertical redistribution was very significant, since the municipalities received 51% of the total amount mobilized (the difference was greater in the case of the distribution of income from the sales tax on goods and services, 75% of which went to the states and only 25% to the municipalities).

In financial terms, this means that without FUNDEF the tax income available to the states would be 4.8 billion reals higher (0.3% of GDP). This was the amount (5.5% of their original income) which the states lost to the municipal governments in a single year, 2003. In that year, 26 state governments redistributed income to their municipalities through FUNDEF.<sup>19</sup>

These figures give some idea of the degree of decentralization caused in the provision of this service. In physical terms, the great advance in municipalization was evident, even before the creation of FUNDEF. In 1997 the municipalities accounted for 40.7% of total enrolment in the public school system, and this figure rose by ten percentage points in the following five years.

The most important form of evaluation therefore refers to the increase in the number of children in school: practically universal coverage has been achieved in fundamental education. Between 1997 and 2001, the rate of enrolment of children between 7 and 14 years of age rose from 87.5% to 96.3%.<sup>20</sup>

FUNDEF has been analyzed in the most diverse professional fields. Abreu (2003), for example,

discussed the possible options for financing the expansion of basic education<sup>21</sup> in the country and the operational aspects of funds of this type, especially as regards the coverage of expenditure that they should accept. In principle, those who support the expansion of fundamental education consider that, in order to increase the budget available for its final activities, FUNDEF should not cover expenditures in connection with retired teachers or complementary actions such as the distribution of school meals and books or the transport of students. The fiscal managers of the governments naturally hold the opposite position, since the broader the list of expenditures accepted, the greater their freedom of action in the fields of the budget and financial execution.

Now that a good deal of experience has been accumulated, the discussion is centered on another challenge: the transformation of the transitory constitutional rule on FUNDEF into a permanent rule. The same thing happens with regard to the new challenges that are arising and which may even be derived from the earlier successes. In the case of fundamental education, once a child is already going to school, the next great objective is to improve the quality of the education provided and—in so far as possible— increase the number of hours of schooling, especially in the poorest regions. In the case of secondary education, it will be necessary to be able to meet a sharp, rapid rise in demand, because of the larger number of children completing their fundamental education.<sup>22</sup> In the case of pre-school education, what is needed is to expand the current low level of coverage, although it will be difficult to attain universal coverage, because the cost per child is high and exceeds that of the following levels.<sup>23</sup>

The problem is how to finance the expansion of the levels of education which are not covered by FUNDEF. It is no use trying to repeat the successful system of redistribution of that Fund, because pre-school education is the responsibility of the municipalities, while the states are responsible for secondary education. The tendency is rather that the Union should be called upon to play a more active role in financing the new areas of expansion of education, which is what it finally did in a somewhat

<sup>19</sup> In regional terms, the effects of the redistribution of state income to the municipalities were more marked in the less developed regions. In the Northeast, because of FUNDEF the available income of the state governments went down by almost 8%, while that of the respective municipalities increased by nearly 15%. In the South and Southeast, the variations were around 3% and 6%, respectively. Taking isolated cases, the repercussions of decentralization were greatest in the states of Ceará (a drop of 11% in the state government's income), Alagoas and Maranhão (-9%) and Rio de Janeiro (-8%). The government of the state of São Paulo was the least affected by the creation of FUNDEF: it lost only a little over 1% of its available income through redistribution, while its municipalities received an increase of around 3%.

<sup>20</sup> The federal government publishes detailed annual reports on the financial and physical effects of FUNDEF. See the website of the Ministry of Education: <http://www.mec.gov.br/sef/fundef/default.shtm>.

<sup>21</sup> See footnote 4 for a definition of basic education and its components (pre-school, fundamental and secondary).

<sup>22</sup> Between 1997 and 2001, total enrolment in secondary education increased by 71%.

<sup>23</sup> During the period in question, total enrolment in pre-school education increased by 20%.



marginal way through FUNDEF. This is inevitable, especially in secondary education, where it is most urgent to increase the number of school places, since the fiscal crisis of the states prevents most of them from meeting these commitments.

## 2. The Single Health System (sus): reforms induced by the federal authorities

The 1988 Constitution provided for universal access to public health through the introduction of a single decentralized health system known as sus. In order to gain an idea of the social impact of this system, it may be noted that currently 28.6% of the population of Brazil uses exclusively the sus, 61.5% complements it with another system, and only a small minority of 8.7% never use it at all.

The federal government has always played a predominant role in its financing and also in the provision of health services, both directly and through a network of service agreements, once medical assistance was linked to the social security system itself. Health policies never clearly defined the function of each sphere of government in all this. Thus, for example, the big hospitals of Rio de Janeiro were mostly federal, while those of São Paulo belonged to the state government. Although there was a single health system, it was marked by overlapping of functions and a high level of centralization of financing and management.

As from the mid-1990s, however, as the finances of the Ministry of Health were strengthened, a firm policy of decentralization of activities and services was established, once again with the idea of delegating to the municipalities the entire management of the system in their respective territories. This was achieved in almost 600 municipalities (in 16 states it continues to be in the hands of the state government), while a further 5,000 have already assumed responsibility for running basic health attention services. The management of the federal health units was gradually transferred to the state sphere and —preferably— to the municipalities. These levels of government assumed responsibility for the contracting and payment of services supplied to the ambulatory and hospital system subject to service agreements, including non-profit-making entities (such as the *santas casas*) and private firms. The federal government was responsible for ensuring their financing.

Once the federal budget of the Ministry of Health had been reorganized and the financial flows to the

programmes in question had been placed on a regular basis, the federal government supported a constitutional amendment —proposed by the Labour Party, then in the Opposition, and practically unanimously adopted in 2000— which authorized the transfer of its own tax revenue to the sus, subject to a complementary Law and compulsory five-yearly evaluations.<sup>24</sup> This amendment laid down, on a temporary basis, that federal expenditure in this respect should be the same as the year before, adjusted by the nominal variation in GDP. In the case of the states and municipalities, a timetable was set for the gradual allocation to the sus, as from 2004, of an increasing proportion of the income from state and municipal taxes, until that proportion reached 12% and 15%, respectively. There is nothing to prevent a future complementary Law from altering those percentages or changing the form of allocation (for example, by requiring each government to apply a per capita value from its own income).

We can thus see that this form of allocation is different from that for education, firstly because the calculation criteria do not figure in the permanent text of the Constitution, and secondly because they do not modify the apportionment criteria of the transfers. The implementation of this initiative has given rise to doubts and discussions, especially about its scope, since the dividing line is very thin in the case of sounder financial practices and assistance offered to public employees. There are also discussions about the basis used for both the federal allocation criteria and the respective estimates of GDP.

The data provided by the Ministry of Health (2003, p. 5) give us an idea of the enormous magnitude of the sus: ambulatory attention involves more than 63,000 units and nearly 153 million procedures per year, while hospital attention covers more than 5,800 units, with 441,000 beds and nearly 11.7 million admissions per year. Of these admissions, 2.6 million correspond to births, 83,000 to cardiac surgery, and 60,000 to cancer surgery.

Once the process of regularization of traditional health assistance had been completed, the federal government began to establish and expand basic health services. Once again, the subnational governments were enlisted as partners and were made responsible for the execution of most of the corresponding actions, such as the hiring of doctors, nurses and auxiliary personnel for the family health programmes and the

<sup>24</sup> Constitutional Amendment No. 29 of 13 September 2000.

appointment of community health agents, and the purchase of medicines, vaccines and other actions forming part of the periodic per capita transfer of responsibility for providing a minimum level of basic health attention.

Thus, the active health policy included, among other things, the expansion of the Family Health Programme (PSF), free access to the main medicines, expansion of the number and coverage of vaccinations, expansion and improvement of the quality of prenatal care (there was an increase of 89% in the number of prenatal consultations between 1997 and 2001) and high levels of investment in the rehabilitation and technological modernization of the physical infrastructure of the SUS. According to the impressive data of the Ministry of Health (2003, p. 5), which show the enormous scope of the system, 1 billion basic medical attention procedures were carried out, 251 million laboratory tests were made, and 8.1 million ultrasonic examinations were carried out. The development of the SUS brought it to 90% of the cities of Brazil, where by the end of 2002 55 million persons had been attended and over 17,600 family medical teams were in operation.

Unlike what happened in the case of education, in the health sector federal financing still predominates and there is no fund which unifies the allocation of resources and still less carried out horizontal or vertical redistributions, as FUNDEF does.<sup>25</sup> Although there are important intergovernmental financial relations, these are in only one direction: from the federal government to the subnational governments.

According to the Ministry of Health (2003, p. 9), 74% of its budget corresponds to transfers to lower units. There are two main lines of transfer, and although in the budget they figure as transfers between levels of government, in practice they correspond rather to income for services rendered, either directly or through agreements. The first of these lines is connected with the supply of services through the SUS network of suppliers under agreements.

The second line concerns basic health attention services. Part of these go through the subnational accounts as a traditional transfer, especially in the case of the municipalities. Since the transfers are on a regular basis and the apportionment criteria are predetermined according to technical definitions, these

movements are more similar to distributions of income than to typically voluntary and irregular transfers (furthermore, the Fiscal Responsibility Law excluded transfers to the SUS by the latter sphere). Sometimes the resources for primary assistance are paid directly by the federal government to professionals and other contract suppliers, although the management of the services is the responsibility of the local authorities.

With the growing decentralization promoted by the SUS, the transfers corresponding to this system have taken on a fiscal dimension which is as important as many of the sources of distribution of tax revenue. For the subnational governments receiving these transfers, the amount received from the SUS in 2002 was 7.9 billion reals: equivalent to 0.6% of GDP, nearly 4% of the available tax income, and 15% of the total federal taxes distributed.

The advance of municipalization is evident from the fact that 79% of these resources were received by local levels of government. The 6.3 billion reals received from the SUS in the total income of the municipalities is equivalent to 30% of their direct tax revenue and 38% of the FPM. As these transfers are closely linked to population distribution, two-thirds of them were for the benefit of the municipalities of cities with more than 100,000 inhabitants. Federal transfers under the SUS are undoubtedly the most important, constituting one of the largest sources of income of municipalities with over 500,000 inhabitants: they surpass those of the FPM by 74% and are equivalent to 19% of direct tax revenue and a little over 9% of available tax income.

This health policy has had very positive results, which may be summarized in the rapid and considerable decline in infant mortality, from 38.4 per thousand live births in 1994 to 28 per thousand in 2001. This amounts to a 27% reduction in the national average, notwithstanding the marked regional disparities (in the Northeast, despite a relative reduction which exceeded the national average, the figure was still 44 per thousand in 2001).

Periodically, reports are published on the activities of the SUS; among them is the recent report of the Ministry of Health (2003).<sup>26</sup> Various specialists and national and multilateral organizations have also made appraisals. Thus, for example, Medici (2003)

<sup>25</sup> Oliveira (2003, p. 268-269) also highlights this difference between the recent reforms of the SUS and FUNDEF.

<sup>26</sup> For a more detailed analysis, the Ministry provides an extensive Virtual Library on its website <http://dtr2001.saude.gov.br/bvs/biblioteca.htm>.

made a specific analysis of decentralization for the Inter-American Development Bank (IDB) and Biasoto (2003) reviews the historical background with special reference to intergovernmental relations.<sup>27</sup>

Although great progress has been made in recent years, much remains to be done in order to expand the supply and improve the quality of public health services. Perhaps the main problem to be faced in the management of the SUS is to increase the productivity of the expenditure in this field.

At the macroeconomic level, we know that the best policy for reducing future expenditure on medical and hospital attention is to invest in more preventive measures, especially through the formation of new teams and the expansion of the coverage of family health programmes and community agents. At the microeconomic level, major improvements are needed in the control and quality of expenditure, for example through the long-overdue adoption of an electronic identity card for users and the use of electronic means in order to expedite purchases and reduce their cost.<sup>28</sup> Such changes must take account of the following factors: the magnitude of the task (suffice it to say that the data processing department of the system, DATASUS, handles one of the biggest data banks in the world); the pressing need to maintain and further develop the associations with the subnational governments, which is of vital importance for applying solutions at the macroeconomic and microeconomic levels, and, lastly, the fact that the system of obligatory percentage allocations of the subnational governments' own tax

income is necessary in order to ensure a minimum contribution of basic resources by the federal government and in order to try to finance the expansion of the system with increasingly large contributions by the state and municipal governments.

### 3. Transfers of income: an incipient social safety net

The above-mentioned changes in general educational and health policies were followed by more dynamic social policies, when, at the beginning of the present decade, new assistance programmes were created which are targeted on the poorest sectors of the population. Some of these consist of programmes for the payment —by cards— of financial subsidies for children withdrawn from slave labour, in order to keep them in school (the Child Labour Eradication Programme-PETI); for the promotion of school enrolment and assistance for schoolchildren (the *Bolsa-Escola* scholarship programme); for the promotion of breast feeding and proper infant nourishment (*Bolsa-Alimentação*), and for compensation of the effects of the withdrawal of household gas subsidies (*Vale-Gás*). After the reforms promoted by the new federal government, these programmes were placed under unified management under the name of *Bolsa-Família*; the criteria for eligibility and payment and the counterpart requirements for beneficiaries continue unchanged.

As a broader concept, the set of government actions involving the payment of social benefits was named Social Safety Net. These actions include other older programmes, some of them calling for some kind of contribution, such as those for unemployment insurance, the payment of a wage bonus for poorly-paid workers, and, most of all, the rural social security programme (in the rural sector, the vast majority of rural dwellers retired without attaining the actuarial minimum number of contributions).<sup>29</sup>

<sup>29</sup> In order to gain an idea of the magnitude of the social protection provided by these programmes, it should be noted that in 2003 the unemployment insurance programme benefited nearly 4.6 million unemployed workers; the social assistance programmes (under the Organic Social Assistance Law-LOAS) provided a minimum monthly wage for 616,000 persons aged 70 or more or suffering from physical incapacity and 1,684,000 disabled persons aged 67 or more (with a total expenditure of 6.5 billion reals), and the rural social security programme provided an income for almost 6,734,000 rural retired persons (with a total expenditure of 20.1 billion reals), according to the budget execution figures of the Ministry of Planning, Budget and Management.

<sup>27</sup> The conclusions reached by Biasoto (2003, p. 49) are as follows: "Health policy has been marked in recent years by three different challenges. The first was the decentralization of health activities and services proposed by various sectors of society as part of the democratization process and carried forward by many managers of the system. The second was the transition from the assurance model to the universal access model, which also incorporated various elements of a federative nature, apart from the aspect of health assistance proper. The third was the great struggle, in the area of social security and the government budget, to guarantee federal resources for health and validate the allocation of resources in the three spheres of government. None of these contributed to the final design of the new institutions and policies. Nevertheless, the accumulation of experience, the consolidation of rights and the definition of fields of action created roots and fields of political negotiation. It can be said that the efforts of the federal and state authorities to recover their conditions for participation in the process is proof of the success of decentralization, which obviously has to reformulate new problems all the time" (translated from the original Portuguese).

<sup>28</sup> For an updated analysis of the Brazilian experience and the enormous potential for the control and reduction of costs through electronic purchasing channels, see Fernandes (2004).

The most prominent innovation, which even attracted the attention of other countries, was that the benefits were not distributed in the form of goods (such as milk or food), but took the form of cash payments, preferably to mothers; the beneficiaries use magnetic cards to make withdrawals from bank cash machines and buy their staple needs directly from established local retailers as they see fit.<sup>30</sup>

The association with subnational governments has played a crucial role in the application and follow-up of these assistance programmes, because the local authorities and officials, especially of the municipalities, were vital for identifying, registering and subsequently following up the progress of the children and families assisted (table 8). Although the resources do not pass through the municipal accounts, they are nevertheless an important form of intergovernmental relations, in so far as the participation of the municipalities is of fundamental importance for defining and identifying the beneficiaries.<sup>31</sup>

<sup>30</sup> According to the newspaper *O Globo* of 9 February 2004: "A study made by the Coordinator of the *Bolsa Família* programme shows that in cities with up to 75,000 inhabitants the resources transferred are equivalent on average to 16% of the FPM—in many cases the main source of income of the municipalities—. With respect to FUNDEF, whose resources are to be used only for education, the *Bolsa-Família* transfers are equivalent to almost 30% .... In São Francisco (Minas Gerais) the amounts received by the programme represent 40% of the sum received by the municipality from the federal government. This is only 7.5% of the municipality's income, but it will have direct consequences for the amount that the city will collect this year. In Damiano (Pernambuco) the difference is even greater. This city is among the 10 cities where the arrival of the *Bolsa-Família* programme had the greatest effect on local income. The transfer to this programme now represents 20.1% of its inhabitants' income" (translated from the original Portuguese).

<sup>31</sup> In a summary evaluation of the implementation of this new mechanism for intergovernmental relations and the provision of social services, Almeida (2003, pp. 2-3) says:

"The agenda for the reform of the Brazilian social protection system did not emerge rapidly. It was a political and social project which involved debates, conflicts and an arduous learning process for many actors: the governments of the three levels of the federation, members of the opposition, and various organizations of Brazilian society. Moreover, .... it was gradually enriched with new issues and new ways of looking at old issues, throughout the 1990s .... The reforms in social security, social assistance, basic health attention, education, housing and actions to relieve extreme poverty were its main aspects.

"The reform of the social protection system required changes in the institutions, many of them achieved through changes in the laws or, in many cases, the Constitution itself. This reform also involved, in the cases of health, social assistance and education, the transfer to the municipalities of powers and responsibilities of the federal government—and, to a lesser extent, of the state governments—and the construction of mechanisms for cooperation among the three levels of government" (translated from the original Portuguese).

In the poorest regions and localities of the country, the benefits paid by the income transfer programmes have come to play an increasingly large and important role in the local economies, since a considerable part of the local commerce has come to depend on the consumption of the beneficiary pensioners and families.

Although these programmes continued to operate normally in the period immediately after the change of administration in the federal government in 2003, doubts soon began to arise. The year began with the launch of *Fome Zero* (Zero Hunger), a new programme to combat the causes of poverty. There was a great deal of controversy, especially over the initial idea of distributing food instead of giving financial assistance, which was considered to be a backward step in terms of social policy. Because of many operational difficulties, the budget of the programme was drastically reduced from 1.7 billion reales to 416 million between 2003 and 2004.

Later on, the idea of unifying assistance programmes was put forward, but because of the criticisms that this would entail the loss of various control mechanisms (in such areas as vaccination or the frequency of school attendance), the federal government finally decided to unify only the records of the different assistance programmes (a measure which was already under way) under the title of *Bolsa-Família*. Although associations with the subnational governments had become more necessary than ever, by the end of 2003 no state had volunteered to join in the new federal programme.

Specialists in social programmes are increasingly worried by the perception, which seems to be gaining ground, that the new government authorities are more concerned with changing or trying to change the denomination or evaluation of programmes established by previous governments than with perfecting and expanding programmes that already existed and were giving results. Intergovernmental relations are a particularly decisive variable for the success of the existing programmes.

Everything seems to indicate that, instead of trying to reinvent the wheel in the field of social policies, it would be better to correct the distortions, increase the degree of association and improve control mechanisms: in other words, to improve the existing social programmes rather than trying to innovate—and innovate on a large scale—in something that the poor of Brazil need so much.

TABLE 8

**Brazil: Social actions carried out by the federal government in association with other spheres of government, 2003**

Government actions	Ministry	Beneficiaries	Type of benefit	Number beneficiaries	Expenditure (millions of reales)
<b>Social safety net</b>					
<i>Bolsa-Escola</i>	Education	Children between 6 and 15 years of age in families with a per capita income of up to half a minimum wage	15 reales per child, for up to 3 children per family	5.4 million children	1,658.2
<i>Vale-Gás</i>	Mines and Energy	Families with a per capita income of up to half a minimum wage	7.50 reales per family	7.9 million	809.0
<i>Bolsa-Alimentação</i>	Health	Children of up to 6 years of age, pregnant women and nursing mothers, in families with a per capita income of up to half a minimum wage	15 reales per child, for up to 3 children per family	2.9 million children	355.1
Elimination of Child Labour (PETI)	Social Assistance	Children from 7 to 14 years of age engaged in unhealthy, heavy or degrading work and coming from families with a per capita income of up to half a minimum wage	25 reales per child in rural areas and 40 reales per child in urban areas	810,000 children	475.1
Young Development Agents	Social Assistance	Young people between 15 and 17 years of age living in low-income communities and coming from families with a per capita income of less than half a minimum wage	65 reales per young person	55,500 young people	55.9
<b>Other actions</b>					
School meals	Education	Children in pre-school and fundamental education, in public and charitable schools	0.60 reales per pre-school child and 0.13 reales per student in fundamental education	36.9 million	895.1
Medicines	Health	Population without access to strategic and exceptional medicines	Distribution of medicines	AIDS: 152,000 persons Tuberculosis, malaria and diabetes: 59.2 million Neurological ailments: 214,000	1,148.3
School books	Education	Fundamental educational establishments in the public system	Distribution of books	111 million	50.8
<i>Fome Zero</i> ("Zero Hunger": food purchase card)	Office of the President	Low-income families, initially in arid areas of the Northeast	50 reales per family	1.9 million families	633.0

Source: Prepared by the Ministry of Justice/Secretariat for the Federal Budget/Office of Senador Lucía Vania/Integrated Financial Management System of the Federal Government (SIAFI)/National Treasury, and Chamber of Deputies System.



# VI

## Conclusions: improvement yes, restructuring no

The findings of an evaluation of the effects of intergovernmental relations on macroeconomic management and the provision of public services are positive. In the first case, the Fiscal Responsibility Law firmly established a process of cultural change and emphasized the principle of autonomy within the federation: after the adoption of that Law, each unit of government became more responsible for its accounts and affairs. With regard to the provision of services, in the second half of the 1990s the federal government recovered its capacity to formulate and execute dynamic social policies and once again began to play the main role in their formulation, coordination and financing. In addition, wherever possible it delegated programme execution to the subnational governments or shared this responsibility with them, especially in the fields of fundamental education, medical and hospital attention (especially in respect of basic health attention), and in new social assistance programmes.<sup>32</sup> This does not mean that social problems are on the point of being solved, nor that the associations between levels of government with regard to social programmes do not call for review and correction.<sup>33</sup>

The present results were achieved even though intergovernmental relations in Brazil were not explicitly designed for these purposes. They do not provide for mechanisms for the apportionment and evaluation of the constitutional distribution of tax income (the main source of transfers) so as to make the distribution of income among the subnational governments not only ensures and rewards both the generation of primary surpluses and the containment of indebtedness within predetermined limits and also the provision of public services.

Although the Brazilian federal system does not permit direct specific intervention by the central government in the activities of the subnational governments, this has not prevented it from pursuing the principles of social control through the adoption of mechanisms for measuring the performance of the states and municipalities in the most diverse areas.<sup>34</sup> This is a field in which there is considerable room for progress in the production and publication of performance indicators with a reasonable degree of sectoral detail, in order to stimulate comparisons between the governments of similar regions and economies, with similar budgets and institutional frameworks, but always bearing in mind the profound disparities between regions. It should be understood, however, that such performance indexes will not serve

<sup>32</sup> For a brief analysis of comparative international experience, especially in the cases of education, health and social assistance, see de Mello (2003, pp. 24-25).

<sup>33</sup> In this connection, it is interesting to reproduce the conclusions of Wiesner (2003, pp. 76 and 80) on the case of Brazil, in his extensive recent analysis of fiscal decentralization in Latin America: Wiesner considered that the most noteworthy feature of the Brazilian case was the integral nature of its efforts and results in the following four interdependent processes: i) fiscal decentralization at the state and municipal levels; ii) market-oriented decentralization (such as privatization and regulation); iii) sectoral decentralization (in education and health, for example), and iv) its response to macroeconomic constraints in a globalized environment. It was also noteworthy, he considered, that Brazil together with Chile and to a certain extent Mexico, was increasingly forming an integrated institutional framework in order to provide a coherent normative context for all these demanding interrelated processes. This really was a great challenge. Finally, he said, Brazil was an example of how difficult but nevertheless possible that task could be, since that country had tackled a number of those problems and was now in a leading position among the Latin American countries, thanks to its correct approach. It was a country that was completely aware of the need for "integral and coherent policies".

<sup>34</sup> Souza (2004, p. 24) also arrives at a similar conclusion when he analyzes the new trends in terms of governance in the local Brazilian governments:

"In this study we have shown that the Brazilian experience in terms of local governance has been marked by great institutional innovation and a complex system of intergovernmental relations, especially between the Union and the municipal governments. These innovations arose initially from the commitments assumed during the re-democratization process and subsequently from decisions taken by the governments themselves, both federal and local. Ultimately, in spite of the unequal capacity of the Brazilian municipalities to form part of this new system of institutions, there are some signs of change in the forms of local governance. Despite the greater participation of local governments in the provision of universal social services, however, it is not yet clear whether these new institutions will be sustainable without the financial support and leadership of the federal government" (translated from the original Portuguese).



for the calculation of the amounts to be transferred to subnational governments in the future.

The aim is that greater transparency of fiscal management should induce the local authorities to improve their performance in their respective communities.<sup>35</sup> In this context, the role of the central government should be aimed more at generating information to promote the debate, which should be taken to the forums with Constitutional powers to redefine intergovernmental relations (i.e., the National Congress).

Even if the central government has the power to link the provision of services to the amounts of resources distributed, its field of action is not as broad when a technical evaluation (even a simple one) is involved. Let us take the example of health. If, when the effectiveness of the use made by municipalities of the transfers for the provision of basic attention is evaluated, it is concluded that the performance of a particular municipality was worse than that of others (for example, infant mortality increased, instead of going down as it did in the rest of the region), this raises various problems. Should the federal government reduce or cut off future transfers? Could that locality, with fewer resources for investing in health, reverse a situation which had deteriorated even when its budget in that area was higher? Who should be punished for the poor performance evaluation? The municipal authorities, or the families who would continue to lose babies at birth? The same kind of doubts may arise with respect to education, social assistance, or other social areas.

Common sense indicates that, in the case of basic social services—which involve the ongoing provision of public services which are indispensable for the population, and especially its poorest strata—the punishment (or possibly reward) resulting from a performance evaluation should not affect the financing or expenditure on such activities, but other parts of the local budget (for example, by permitting greater access to credit for investments in infrastructure). Moreover, social recognition of the performance of local authorities is very important in a democratic regime in which elections are held every four years to appoint

<sup>35</sup> The potential interest of the population in such indicators may be seen from the amount of space devoted in the mass media to the recently published human development indexes by states and municipalities—and in some cases even by neighbourhoods—which tend to arouse greater interest through the comparison of local indicators with those for nearby federated units.

the Chief Executive and the legislatures of each state and municipality.

Finally, there are grounds for criticizing the idea which is beginning to spread among those responsible for national macroeconomic strategy that the best way to secure good fiscal performance and greater efficiency and efficacy in the provision of services is to eliminate the obligation to allocate certain percentages of budgetary resources for particular types of expenditure. This criticism is based essentially on the fact that there is no relation of cause and effect: in other words, neither establishing such allocations, nor much less eliminating them, can ensure good or bad performance in terms of expenditure.

It is not in the macroeconomic field that the most pressing fiscal difficulties are to be observed; consequently, it is not macroeconomic measures (such as the elimination of such allocations) which will make it possible to solve those difficulties. The biggest and most undeniable problems with regard to expenditure are connected with the management of activities and projects. The roots of both the distortions and their solutions are in what is called public sector microeconomics.

A consensual way to a solution is through the modernization of the public authorities. Some time ago, the initiative of modernizing all the spheres of government was taken up once again in Brazil, and successful results were obtained, especially with regard to electronic government (“e-gov”).<sup>36</sup> In this latter field, the advances made have been so numerous and considerable that they have received important international recognition from multilateral organizations, universities, and even private consultants (Comité Executivo do Governo Eletrônico, 2003, pp. 42-43).<sup>37</sup> For some time past we have been asserting that the next step that should be taken after the Fiscal Responsibility Law is to take measures to give greater continuity to projects and actions to improve public management, and above all to deepen their effects (Afonso, 2002).<sup>38</sup>

<sup>36</sup> For a first full analysis of the experience in e-government in different fields, organs and spheres of government, see Fernandes and Afonso (2001).

<sup>37</sup> Special mention may be made of the study by United Nations/American Society for Public Administration (2002) which analyzes the experience in electronic government in over a hundred countries, with Brazil occupying the 18th position among the 36 most advanced countries in this respect (“high e-gov capacity”).

<sup>38</sup> We realize that this perception has not yet been fully assimilated by the new federal government, which, so far, has limited itself to declaring its confidence in that Law (although when it was approved by Congress in the year 2000 the Labour Party voted against it

In order to modernize such management it is necessary to train officials, secure the widespread adoption of planning and strategic management practices, invest heavily in informatics and take advantage of every opportunity offered by advances in that field, and promote those reforms in the legislature and judiciary, as well as in the thousands of subnational units of government. These measures have nothing to do with the elimination of obligatory allocations of resources, nor do they run counter to them. The successful experience in the field of electronic purchasing, which is still only used to a limited extent, should be rapidly extended to all the federal organs, the other State powers, and also the subnational governments. There is an enormous field for exploration as regards integrated tenders.

Since the last change of leadership in the federal government, it is frequently said that little has changed

in the field of macroeconomic policy, but the same cannot be said of the microeconomic management of the State, in view of the lack of continuity in a series of initiatives<sup>39</sup> and the undeniable existence of flagrant problems in respect of social policies, with increasingly obvious setbacks.<sup>40</sup>

Fortunately, this disorder is conjunctural rather than structural, so that if the government recovers the political will to give priority and effectively implement the plans for the modernization of management practices it will be possible to start acting again soon and obtain results, especially because the new information and communication technologies increasingly offer more and better opportunities.<sup>41</sup>

The general conclusion is that the Brazilian federation needs to be improved, but not reconstructed.

(Original: Portuguese)

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unanimously and subsequently tried to have it annulled by the Federal Supreme Court). Moreover, the new government confuses structural reform with conjunctural measures, claiming that the best proof of its new commitment to fiscal responsibility is that it raised the primary surplus target —although the IMF did not ask it to do so— and exceeded that historical goal throughout 2003, with the Ministry of Finance preening itself on promoting cuts in expenditure for the first time.

<sup>39</sup> For example, there are operational difficulties in expanding and renewing the lines of finance for modernizing the fiscal management of the subnational governments. This is so in the case of the resources transferred by the IDB —as in the case of the establishment of a new stage of the National Programme of Support for the Fiscal Administration of the Brazilian States (PNAFE), or the implementation of its municipal version (PNAFEM) or even the contracting of other programmes for the Accounts Tribunals and the state planning and administration systems— or those established with their own resources by local banks (reducing the spread of the Municipal Tax Administration Modernization Programme —PMAT— of the National Bank for Economic and Social Development (BNDES)).

<sup>40</sup> One symptom of these problems is the 80% reduction in the amount allocated for the child labour eradication programme in 2004, decided upon by the present federal government in its first budget, so that the allocation of only 100 million reales thus decreed will only permit coverage of some 200,000 children, compared with the 841,000 covered in 2003 and the target (established by that government itself) of eventually reaching 1.5 million children.

<sup>41</sup> The federal government already announced an ambitious management plan whose success would appear to be of more decisive importance for tackling the above-mentioned problems than more thorough-going changes in the institutional structure of the federation and finances (see Secretaría de Gestión, 2003).

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