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FEDERALISM, CONSTRAINTS ON THE CENTRAL GOVERNMENT, AND ECONOMIC REFORM IN DEMOCRATIC BRAZIL

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ABSTRACT

In this paper we attempt to contribute to the burgeoning literature on Latin American political institutions by discussing the elements and political consequences of contemporary Brazilian federalism. We hope to make two main contributions. First, we intend to add to the broad theoretical discussion of federalism. Theoretically, the puzzle we deal with is what institutional factors explain variance in the degree to which federalism constrains central government policy. Second, we illustrate the theoretical arguments about the institutional determinants of federalism's impact by analyzing the Brazilian case. If our theoretical arguments are correct, then on the basis of certain institutional features one should be able to predict how powerful a policy impact federalism would have. We examine whether federalism has had a significant policy impact in democratic Brazil, looking specifically at three policy areas: state debts, state banks, and the allocation of fiscal resources between the national and subnational governments. We attempt to bridge two literatures that often fall into different camps of political science: institutionalism and political economy. We argue that federal institutions sharply constrain what otherwise might be an extremely strong president and that federalism helps explains Brazil's delay in implementing economic reforms.

RESUMEN

En este artículo intentamos contribuir a la creciente literatura sobre las instituciones políticas latinoamericanas a partir de la discusión de los elementos y las consecuencias políticas del federalismo brasileño contemporáneo. Esperamos realizar dos contribuciones principales. Primero, contribuir a la amplia discusión teórica sobre el federalismo. Teóricamente, el problema con el que nos enfrentamos es determinar qué factores institucionales explican la variación en el grado en el cual el federalismo limita las políticas del gobierno central. En segundo lugar, ilustramos los argumentos teóricos sobre los determinantes institucionales del impacto del federalismo a través del análisis del caso brasileño. Si nuestros argumentos teóricos son correctos, entonces, sobre la base de ciertos atributos institucionales uno debería estar en condiciones de predecir cuán poderoso impacto debería tener el federalismo. Examinamos si el federalismo ha tenido un impacto importante sobre las políticas en el Brasil democrático, observando específicamente tres areas de políticas: las deudas del estado, los bancos estatales y la distribución de recursos fiscales entre el gobierno nacional y los gobiernos subnacionales. Intentamos vincular dos literaturas que habitualmente se localizan en distintos campos de la ciencia política: el institucionalismo y la economía política. Sostenemos que las instituciones federales limitan fuertemente lo que de otro modo podría ser un presidente extremadamente fuerte y que el federalismo ayuda a explicar la demora de Brasil para implementar reformas económicas.

In this paper, we attempt to contribute to the burgeoning literature on Latin American political institutions (Shugart and Carey 1992; Mainwaring and Shugart 1997) by discussing the elements and political consequences of contemporary Brazilian federalism. We hope to make two main contributions. First, we intend to add to the broad theoretical discussion of federalism. Theoretically, the puzzle we deal with is what institutional factors explain variance in the degree to which federalism constrains central government policy.

Second, we illustrate the theoretical arguments about the institutional determinants of federalism's impact by analyzing the Brazilian case. If our theoretical arguments are correct, then on the basis of certain institutional features one should be able to predict how powerful a policy impact federalism would have. All four institutional indicators we use suggest that Brazilian federalism should have a powerful policy impact in the post-1988 period. We then examine whether federalism has had a significant policy impact in democratic Brazil, looking specifically at three policy areas: state debts, state banks, and the allocation of fiscal resources between the national and subnational governments.

Although a literature has emerged that emphasizes the importance of federalism in understanding the Brazilian party system (Mainwaring 1999; Nicolau 1996) and Brazilian politicians (Ames 1995; Hagopian 1996; Samuels 1998; Stepan 1997), less work has been done on the policy implications of federalism. That is our focus in this paper. We attempt to bridge two literatures that often fall into different camps of political science: institutionalism and political economy. We argue that federal institutions sharply constrain what otherwise might be an extremely strong president and that federalism helps explains Brazil's delay in implementing economic reforms.

Federalism, Veto Players, and Policy Reform

In the 1980s and 1990s a burgeoning literature has addressed how institutions shape policy outcomes, both at a general theoretical level (e.g., March and Olsen 1984; Thelen and Stenmo 1992) and specifically with respect to Latin America (e.g., Linz and Valenzuela 1994; Shugart and Carey 1992). Nevertheless, relatively little has been written about federalism's impact on policy outcomes in Latin America. The explanation for the paucity of social science scholarship on Latin American federalism is obvious: only four countries (Argentina, Brazil, Mexico, and Venezuela) are federal republics, and of them only in Argentina and Brazil did federalism exercise much impact on political outcomes before the 1990s. In this decade, however, the importance of federalism in all four countries has expanded, making the subject more compelling.

Tsebelis (1995) developed the notion of veto players, which he defines as "an individual or collective actor whose agreement is required for a policy decision." He mentions two kinds of veto players: institutional, which are constitutionally specified (e.g., both chambers of the legislature when both have significant powers, the president or prime minister and sometimes both in semipresidential systems, state actors in some federal systems), and partisan (the parties needed to govern). With more veto players policy stability should be greater and, conversely, policy reform should be more difficult to achieve because more actors can block change.

Tsebelis's argument about veto players is relevant to understanding the way federalism can constrain the central government. Federalism adds one or two veto players in the politics of policy reform: the upper chamber and, when they are powerful actors in national politics, state governors. Other things being equal, with more veto players there are greater constraints on central government initiatives.

With his distinction between majoritarian and consensus democracy, Lijphart (1984) developed a similar argument. Majoritarian democracy refers to democracies in which a simple majority suffices to effect a wide range of policy reforms. There are relatively few checks on the democratic majority; in Tsebelis's terms, there are few veto players. Consensus democracy, in contrast, requires supermajorities (i.e., majorities beyond 50%) for many policy reforms, and it grants minorities extensive veto powers over policy reforms. Following a logic similar to Tsebelis's, Lijphart notes that federalism pushes democracy in a consensus direction in which multiple and sometimes multiple qualified majorities must agree with policy reforms in order to effect them. Their arguments fundamentally converge: Tsebelis treats federalism as adding one veto player in some policy areas, and Lijphart sees federalism as pushing a democracy in a consensus direction.

Both Tsebelis and Lijphart focus on institutions at a broad level and do not distinguish among federal systems. Although their seminal works facilitate large-scale comparisons, for other purposes it is essential to differentiate *among* federal systems, as Stepan (1997) has argued. Some federal systems impose powerful constraints upon policy reform, whereas others have little impact. Even if all federal systems create additional veto players, these veto players have very different powers from one system to the next. For example, in Mexico until the 1990s and Venezuela until the late 1980s *de jure* federalism had marginal policy impact in *de facto* highly centralized political systems. In other cases, however, federalism has very significant policy consequences. Similarly, federalism's policy impact can change significantly in a given country. In Brazil, for example, federalism had much greater policy impact after 1985 than it did under military rule (1964–85).

The Continuum from Weak to Strong Federalism: Four Institutional Variables

The variations in the extent to which federalism constrains the national government and therefore limits presidents' capacity to implement reforms depend significantly on the specifics of the federal institutions. Four institutional factors help shape the degree to which federalism constrains presidential initiatives.[1]

[1] As Gibson (1997) and Stepan (1997) argue, the degree of malapportionment can also affect the policy impact of federalism. This variable, however, is theoretically indeterminate in the sense that it is not ex-ante predictable whether significant malapportionment would facilitate or obstruct presidential reforms. It

Variable 1: The Resource Base of Subnational Governments

Federal systems vary widely in how fiscal resources are allocated among the various levels of government. As the resource base of subnational governments increases, the impact of federalism in shaping national politics and in constraining the central government also increases, other things being equal. Subnational governments with greater resources are more able to pursue their own policies. They can more easily undermine (deliberately or not) or constrain policies of the national government. Conversely, subnational governments that are bereft of fiscal resources are likely to have less autonomy in pursuing their own objectives and less impact on national politics. Thus an essential question is the distribution of resources among the various levels of government.

Variable 2: The Power of Governors

The power of governors in federal systems also varies considerably. If governors have greater power, they can exercise greater constraints on the center, and subnational governments tend to have greater autonomy. This question is related to, but cannot be reduced to, the resource base of subnational governments. One can envision a situation in which governors have ample resources to implement state-wide policies but in which they do not significantly influence national legislators. The United States is such a case. Conversely, if governors wield influence over national policy through influence of legislators from their subnational unit, they can more easily veto policy reforms proposed by the president.

Variable 3: The Articulation of Subnational Interests in the National Congress

The extent to which national legislatures articulate subnational interests varies considerably. If subnational interests are strongly articulated in the national legislature, the impact of federalism tends to be greater.

In democracies the articulation of subnational interests in the national legislature depends significantly on the powers of the upper chamber and on the electoral system and nomination process. The upper chamber in federal systems generally represents the states or provinces, and there is considerable variation in its powers (Tsebelis and Money 1997; Stepan 1997). In

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depends on the kind of reforms and the policy predilections of the president and congress. In Brazil, as in Argentina under President Menem (Gibson 1997), significant malapportionment has usually facilitated presidential reforms since 1985. During this period Brazilian presidents have usually enjoyed more support from the overrepresented regions, so malapportionment benefits them. However, this has not been true on all issues. Moreover, at least one previous president, Goulart (1961–64), generally faced greater opposition from the overrepresented states. Given the theoretical indeterminacy of this variable, we do not systematically incorporate it into our analysis.

some cases the upper chamber has diminished powers, whereas in cases of symmetrical bicameralism, by definition, the upper and lower chambers possess roughly equal powers. Symmetrical bicameralism enhances the capacity of states to constrain the central government because both houses are able to veto some policy reforms.

Some electoral systems and nomination processes encourage members of the national congress to focus on subnational interests and constituents as the primary key to building their political careers. Others provide incentives for national legislators to be responsive to national party leaders, who typically focus more on national policy issues.

Variable 4: The Distribution of Government Functions across Levels of Government Varies Considerably across Cases and Time.

Where subnational governments have more constitutional and paraconstitutional powers vis-à-vis the federal government, they can more powerfully constrain the latter.

Federalism creates two different kinds of constraints upon the central government. First is the kind that Tsebelis identifies: federalism enables actors from subnational units to block executive initiatives. In the national legislature, legislators who favor the interests of subnational units can block policy changes preferred by the executive. These legislators are typically favored in federal systems. All federal systems are bicameral, many have relatively symmetrical bicameralism in which the two chambers have roughly equal powers, and many deliberately overrepresent some territorial units. These mechanisms give legislators from overrepresented units greater veto power than they would otherwise have. Thus, federalism creates additional veto players.

A second kind of constraint on the center emanates from subnational political actors who carry out policies in their territory that undermine or counteract policies of the national government. We term such cases ‘constraints by undermining.’ Assume, for example, that the president is committed to improving a country’s human rights record but that the federal government has limited power over police, military, and judicial practices in the subnational units. If the leaders of these subnational units are not committed to curbing police violence and other human rights transgressions, the president is likely to enjoy limited success in efforts to effect change. Constraints by undermining need not imply a deliberate effort on the part of subnational actors to thwart the national government; it suffices that subnational actors have sufficient constitutional autonomy and resources to undertake policies in such a way that the central government cannot realize its objectives.

For the most part, policy vetoing constraints are imposed by members of the national congress. However, state assemblies or governors sometimes have veto power over policy change from the center. In the US, for example, constitutional amendments require ratification of three-quarters of the state legislatures. Similarly, for the most part, policy undermining constraints stem from actions or inaction of subnational governments. However, where subnational units are represented in the legislature, the national congress can also undermine the executive by approving legislation the president opposes.

Centralization under Military Rule, 1964–1985

Following a military coup in 1964, significant centralization occurred along each of these four variables, resulting in a weaker impact of federalism on national policies. Soon after taking power the military government centralized the distribution of government revenue and expenditures. Table 1 demonstrates the extent of this shift.

The military regime's efforts to centralize control reduced state and municipal political autonomy by forcing subnational authorities to increasingly come *com pires na mão* [with hat in hand] to central government authorities to plead for funds. Not until Congress regained some authority in the early 1980s would this trend be reversed (see below).

The military government also severely restricted the autonomy of state governors. Most importantly, direct gubernatorial elections were eliminated through Institutional Act #3 in 1965. From then on the military government nominated friendly politicians, and the state assemblies rubber-stamped the choice (the progovernment ARENA party dominated state assemblies). This move reduced the impact of federalism by eliminating the possibility that opposition to the regime would emerge from control over state government (Medeiros 1986; Sallum Jr. 1996).

In addition, the military attenuated the impact of federalism by proscribing the powers of Congress. From 1964 to 1979 the military regime emasculated the national Congress through a combination of repression, constitutional changes that strengthened the executive at the expense of the legislature, and an electoral system designed to favor the government party. The regime gave itself the power to purge elected officials from office, instilling fear in those members of Congress who were not purged shortly following the coup. Institutional Act #2 also reduced the number of congressional votes needed to approve constitutional amendments to a simple majority, transferred all budgetary control to the executive branch, imposed limits on congressional debate on any bill, and gave the regime the power to suspend or close Congress, which it did for several months in 1966 and again in 1968–9. In a symmetrical bicameral system like Brazil's, these actions greatly reduced states' capacity to articulate their interests and exert pressure on the executive branch.

Finally, the regime centralized administrative and legal authority. The organs of the central government dramatically expanded their scope and reach during this period (Medeiros 1986), and the regime attempted to streamline government administration through the imposition of Decree-Law 200, which gave financial incentives to states and municipalities to follow the central government's lead in administrative organization and procedure (Abrucio 1998). The federal government exercised greater control in most policy areas than it ever had before.

Strong Federalism in Post-1985 Brazil: Four Institutional Variables

In this section we show that in Brazil, the institutional reform of federal arrangements gave more and more power to state-based actors during the process of political liberalization, the transition to democracy, and the 1988 constitution.

Variable 1: The Resource Base of Subnational Governments

Following the opposition MDB party's gain in the 1974 election, the regime began to slowly decentralize revenue, encouraged by pressure from both the regime's supporters and the opposition. The 1987–8 constitutional convention capped this 15-year process, decentralizing revenue to the point where Brazil currently has one of the world's most decentralized divisions of revenue across levels of government. This situation limits the capacity of the central government to use fiscal policy as a tool for economic adjustment.

Afonso, Rezende, and Varsano (1992) estimated that as a result of the fiscal reform mandated by the 1988 constitution, by 1993 the federal government's tax revenue would decrease by 15.6%, the state governments' revenue would increase by 12.9%, and municipal governments' share would grow by 29.5%. From 1980 to 1995 state governments' total available revenue in Brazil went up 50%, and municipalities' increased 130% (Nogueira 1995, 32). Currently, the share of fiscal resources of subnational governments in Brazil exceeds that found in the United States, Germany, and Canada (Shah 1994). Directly comparable data on the share of national and subnational governments in public sector resources are surprisingly difficult to obtain, but Table 2 presents data for six Latin American countries. The resource share of subnational governments in Brazil dwarfs that of the other countries.

Table 2 indicates the portion of revenue each level of government spends but does not tell us how much control each level of government actually has over that revenue. If politically manipulable transfers comprise an important share of subnational revenue, the central government could favor friends while marginalizing foes. Conversely, if subnational governments control their own resources, their autonomy increases. This gives subnational actors—again

including members of congress as representatives of their states—considerable leverage in negotiations with the president and more easily enables them to undermine presidents' efforts to rein in spending.

Fiscal decentralization in Brazil increased subnational governments' political autonomy because they can use their newfound resources largely as they wish. Most state and municipal gains have come through increases in the revenue transferred through two constitutionally enshrined funds that the central government administrates, one for states (the FPE) and one for municipalities (the FPM). Only 10% of all FPE and FPM transfers are specifically entailed to certain programs or projects, while in comparison in the United States 90% of all central governments transfers (in 1986) went for specific programs (Bahl 1986, 14). In Brazil 60% of all FPE and FPM transfers have no entailments whatsoever, and another 30% are only generically linked to education and health (Afonso 1994, 356). This provides state governors, as well as mayors of the larger cities, with considerable political clout.

Extensive fiscal decentralization and Brazil's acute fiscal crisis have reduced the central government's ability to use its resources for political purposes, as was common during the military period. While constitutionally mandated transfers to states and municipalities have gone up 90% since 1978, unprogrammed, politically manipulable revenue in the central government budget has been halved (Nogueira 1995, 28). Politically negotiated revenue transfers from the central government amounted to only US $2.6 billion or 0.6% of GDP in 1992 (Roarelli 1994, 154). Of this amount, 74% went to state governments.[2]

Decentralization has also limited the central government's capacity to balance the national budget, pay off Brazil's huge debt, and find funds for needed investment, because during the constitutional convention subnational governments grabbed resources yet largely refused to assume new policy responsibilities (Bonfim and Shah 1991). Moreover, while mandating specific and substantial transfers of resources to state and local governments, the 1988 constitution remained vague regarding the division of responsibilities among the three levels of government in such fundamental issues as health, education, housing, and welfare. This vagueness has fueled conflict among federal, state, and local governments, enabling each one to claim that certain responsibilities pertain to another. Generally, the central government has ended up carrying the bulk of the burden, leaving it with diminished resources but growing demands (Tavares de Almeida 1995; Sola 1993; Abrucio 1998). As a result, one of the most important political games—and policy dilemmas—of the New Republic was the effort of state and local governments to push the federal government to continue providing all the services and resources it had previously, including funding bankrupt state-owned banks and refinancing state- and municipal-government debts.

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[2] Much of this money is only formally uncommitted in that it either goes to reimburse the Federal District of Brasília's expenditures or goes to the Unified Health System (SUS). What is left over can go towards credit-claiming investments (Afonso 1992, 28). Unprogrammed revenue distribution follows a similar pattern to that established for distribution of the FPE. In 1992 76% of all negotiated transfers went to the three less-developed regions in exchange for political support (Roarelli 1994).

Fiscal federalism in Brazil reflects the malapportionment of state delegations in Congress. As is the case in Argentina (Gibson 1997), fiscal federalism transfers resources to poorer, less populous, but significantly overrepresented states.[3] During the Constitutional Congress, under heavy pressure from organized state-government lobbying, members of the state delegations from the Northeast, North, and Center-West regions of Brazil united and not only increased the amount of money to be distributed through the FPE but also manipulated the shares of revenue to their disproportional benefit. They could do so because, as we show below, their delegations comprised an absolute majority of seats in the Constitutional Congress. While the percentage of state revenue from FPE transfers declined 24.6% in the South and Southeast regions between 1983 and 1992, it increased 37.4% in the three poorer regions (total state revenue has increased in all regions) (MF/STN 1994).

The irony of fiscal decentralization, which shows the extent to which state (and municipal) interests dominate Congress, is that sitting deputies shot themselves in the foot by devolving more money to subnational governments. By decentralizing, deputies forced the executive branch to cut back on discretionary spending, and the executive has therefore cut the politically motivated pork-barrel budget allocations that so interest deputies. Instead of increasing their own access to the pork-barrel, deputies devolved resources to states and municipalities.

In sum, given a steady or shrinking fiscal pie for the whole country, over the last 20 years states and municipalities have gained much larger slices. In consequence subnational governments now have greater autonomy, while the central government’s capacity to rein in subnational spending and boost central government revenue has diminished. Presidents’ difficulties in controlling state spending contributed to the failures to contain inflation between 1985 and 1994.

Variable 2: Federalism and Gubernatorial Power

A second institutional variable strengthening federalism in Brazil emanates from subnational governments themselves: the power of state executives to influence national legislators from their states. When governors exercise such power, they gain influence in national politics. In Brazil state governors command impressive political and economic resources, above and beyond the revenue they have gained over the past 20 years. Because of their influence over deputies and senators from their state, and because presidents need legislative support for many policy proposals, governors can thwart or facilitate presidential designs (Abrucio 1998).

During the transition to democracy, state governors acquired increasing political clout for several reasons. First and most important, in 1982 governors were popularly elected for the first time since 1965. Direct popular election meant that governors needed to be more attentive to state needs even at the expense of being less subservient to the federal government (Abrucio and Samuels 1997).

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[3] For historical perspectives on the consequences of malapportionment on fiscal policy, see Ames (1987)

In the post-1985 period, five factors have provided governors with sufficient influence to either proactively influence or reactively veto federal government initiatives: control over hiring and firing at the state level, significant resources at their disposal, Brazil's electoral system, control over municipal mayors, and the lack of oversight at the state level. First, governors control access to the resources that politicians need to claim credit and advance their careers. In the absence of strong party organizations and of a national legislature that controls the purse-strings, federal deputies rely on state governors to provide political sustenance. Governors have the power of the pen in the state-level bureaucracy, which can mean control over thousands of political jobs. Governors distribute these jobs, which range from unskilled labor positions to posts as state Secretary of Health or Housing, to deputies or deputies' political cronies. For example, currently the governor of the relatively poor state of Mato Grosso has 16,000 jobs at his personal disposition, practically equal to the total number of political appointments that Brazil's president can make (*Folha de São Paulo*, 27 April 1996, p. A10; Santos 1996, 224). State governors also control nominations to many federal government posts within their state, in the so-called *segunda* and *terceira escalões* (second and third rungs) of the bureaucracy, a fact not often recognized by students of Brazilian clientelism (Abrucio 1998; Samuels 1998).

Second, although deputies have access to pork-barrel funds in Congress, governors control much larger stocks of pork, and there exist few other ways for the average deputy to claim credit from his/her seat in Congress (Samuels 1998, chapter 6). Most deputies need governors to advance their careers. For example, in São Paulo, the richest state in Brazil, the governor announced that in 1997, a pre-election year, he would invest approximately US $1.6 billion, aiming to finish visible public works projects to improve his own reelection chances and help his copartisans and allies. In contrast, in the national Congress each deputy in 1997 submitted US $1.5 million in amendments to the budget, to use for pork-barrel public works projects. Even if all the deputies from São Paulo had all of their amendments approved, the executive branch could still withhold the money (from all deputies), as it has done in previous years; deputies have no guarantee that their pet projects will receive any money at all (ibid.). In a best-case scenario, the 70 federal deputies from São Paulo could bring home approximately US $100 million, which pales in comparison to the governor's ability to distribute funds according to his/her political whim.

For deputies from the less-developed regions the situation is different, but with similar consequences. In the less-developed regions, states depend heavily on fiscal transfers from the central government because state governments have less capacity to raise their own funds. Deputies from these regions, who typically emerge from small groups of elite politicians, serve as ambassadors from their state, as the link between their state and the central government, attempting to obtain funds for their state. Deputies from these regions tend to seek federal funds more than deputies from the more-developed regions, but these funds often pass through the hands of the state executive, leaving the deputy reliant on links with the governor to claim the credit for the work he/she has done (ibid., chapter 7).

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and Cohn (1976).

Control over hiring and firing and the pork-barrel gives governors considerable firepower to employ either for or against federal (and state) deputies. Federal deputies must take their governor's preferences into account when taking positions or seeking funds: as one former state Secretary of Education and Administration in São Paulo noted, the governor "doesn't even have to make his threats explicit. He just doesn't have to answer a deputy's phone calls. If the governor doesn't return a deputy's phone calls twice, that's a really bad sign because a deputy usually calls the governor in the presence of other people to show how close he is to the governor. So if the governor doesn't answer, that really complicates the deputy's life."[4] Due to governors' potential influence over federal deputies, gubernatorial power in Brazil resonates not only within states but also at the national level.

A third factor that contributes to federal deputies' vulnerability to gubernatorial influence is Brazil's electoral system. The open-list proportional representation system in which states serve as electoral districts forces politicians to compete against members of their own party as well as candidates from other parties for seats. Although some deputies concentrate their electoral bases in a few contiguous municipalities, they can and do seek out votes in any corner of their state. This ability is a double-edged sword, however, because it leaves deputies vulnerable: if a deputy turns against the state governor, or even waffles in his or her support of the governor, the governor can sponsor a competing candidate, feeding plum political jobs or credit for pork-barrel projects in the deputy's bailiwick to the deputy's rival (Abrucio 1998).

Governors also hold power over mayors, whom candidates for federal deputy rely upon to bring out the vote at the local level. Despite their recent gains in fiscal resources, the vast majority of municipal governments in Brazil are tremendously poor. Although mayors can try to obtain funds in Brasília, governors tend to lead the way in coordinating pork, using political criteria for the distribution of resources for public works projects at the municipal level. In addition, the number of municipalities increased 25% from 1988 to 1995, from 4,189 to over 5,500. This resulted in increased municipal competition for resources, giving governors the power to divide and conquer if they so desired.

Finally, almost no oversight exists at the state level, giving governors a freer hand. State legislatures across Brazil make little effort to oversee state-government spending. Instead, state deputies scramble to enter the governor's party coalition, knowing that if they fail to do so, they will be cut off from the resources they need to advance their careers (Abrucio 1998).[5] Governors control the nominations to organs that oversee state government, ensuring that their actions will never be closely scrutinized. In addition, little public accountability exists at the state level in Brazil: in comparison to municipal or national government, the public cares relatively little about what state governments do (Balbachevsky 1992).

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[4] Interview with Dr. Carlos Estevam Martins, São Paulo, 13 March 1997.

[5] In 15 states that Abrucio (1998) studied during the 1991–4 term, no governor initially had a majority in the state assembly, but in 14 of these states the governor used his influence to construct alliances that gave him one.

In sum, governors can influence federal deputies within their state. This gives them power that party leaders have in other countries: influence within Congress. Currently, any national policy proposal, which usually emanates from the executive branch, must pass through negotiations with a Congress fragmented both along party lines and by state delegations competing to obtain favors from the central government.

How does the existence of strong governors with significant resources constrain presidential powers? Brazilian presidents need to negotiate policy reforms along two axes: in Congress and with governors, whereas if governors were less central actors in national politics, they would be able to deal with Congress alone. In Tsebelis's (1995) terms, powerful governors add an additional veto player. Governors are divided by many issues, but they typically unite in defense of state-level resources and prerogatives. When they do so, they can thwart presidential reforms by engaging in practices that undermine presidential objectives, even if they do not deliberately coalesce in defense of state interests. For example, the president may attempt to rein in public spending, but because so much public spending in Brazil occurs at the state and local levels, the president faces difficulties accomplishing this objective without negotiating with state governors. Moreover, state governors can instruct members of Congress from their states to block presidential initiatives that threaten the resource base and autonomy of state governments.

Variable 3: The Articulation of Subnational Interests in the National Legislature

Federal institutions are more likely to constrain presidential reforms if the national legislature is bicameral, with the upper chamber representing states, provinces, or some other subnational unit, and if both have significant powers. Brazil is a case of symmetrical bicameralism in which the Senate and the Chamber of Deputies possess significant powers. Each chamber of the national Congress enjoys roughly equal powers. Either the Senate or the Chamber of Deputies can initiate a bill, and both must approve it. Both must approve constitutional amendments by the same (60%) supermajority. The Senate also has broad powers of appointment and approval of appointments (Article 52 of the 1988 Constitution): it must approve nominations for ministers of the Federal Accounting Court, Presidents and Directors of the Central Bank, the Attorney General, and a number of other important positions. It must authorize external financial operations, establish the limit to total internal debt, and determine the limits and conditions of internal and external debt of the federal and subnational governments. These powers make the Senate a central player in negotiations regarding state debts to the federal government.

The combination that characterizes Brazil, symmetrical and incongruent bicameralism (with different methods of selection and marked differences in proportionality between the two chambers), while not uncommon, is far from universal (Lijphart 1984, 90–105; Tsebelis and Money 1997). This is the combination that most constrains the central government and enhances the powers of subnational governments. In order to effect policy reform, presidents must obtain the support of two different majorities from legislative chambers whose electoral bases diverge markedly.

In terms of this variable, the key change between the military dictatorship and the democratic period is that the 1988 constitution restored some important powers to Congress, including the Senate. The 1988 constitution tilts power toward the executive branch (Figueiredo and Limongi 1994, 1995, 1997; Mainwaring 1997; Power 1998), but Congress can block presidential reforms and can extract many concessions that undermine presidential objectives.

The resurrection of congressional authority reinvigorated federalism because the electoral system and nomination process encourage a strong orientation toward state and local politics. The electoral system for both the Chamber of Deputies and the Senate pushes members of Congress to seek personal votes as opposed to running primarily on the basis of party labels (Ames 1995; Mainwaring 1999). The primary way of obtaining personal votes is by serving local constituents, especially through delivering public goods. Many members of the national Congress see their principal function as securing public goods for their home regions and defending subnational interests. The decentralized nomination process also encourages politicians to focus on local and state interests.

Even when serving in the national Congress, politicians' desire to maintain and expand their links with state-level machines strengthens the representation of subnational interests in the national politics (Samuels 1998, chapters 3–4). One can empirically demonstrate how much politicians value subnational positions in the political system by mapping political careers. During democratic periods since 1945 a significant percentage of sitting deputies have abandoned their seats during the legislature to take positions at the state or municipal level. In the 1991–4 legislature over 35% of sitting deputies either took a position outside of Congress or manifested a desire to do so by running for mayor (Samuels 1998, chapter 4). The number of national legislators who run for mayor and/or who take positions as state-government secretaries (e.g. of Education, Health, etc.) strongly supports our contention about the relative value attached to those political offices. Even if they do not 'rotate' out during the legislature, federal deputies maintain their links with political networks in the states, acting as 'ambassadors' of subnational governments, thus increasing the institutional representation of subnational interests.

Because political careers revolve around state-level issues, politicians must be closely attuned to the interests of state actors. Although such focus on state actors need not preclude the possibility of forging national alliances in Congress and elsewhere, it creates the possibility of a conflict between national leaders—the president, ministers, and other high appointments, national party leaders, and leaders of the national Congress—and other members of Congress, who tend to focus more on state-level interests. Moreover, aware that they might run for state or municipal office, members of Congress pay greater attention to the fiscal needs of subnational governments than to those of the national government. In these ways focus on state-level issues can block the capacity of presidents to implement reforms. Moreover, focus on state-level issues can shape the national political rules. Politicians whose careers revolve around such issues are likely to design other institutions to foster strong federalism. For example, aware that they themselves might run for state or municipal office, politicians are more tuned into the fiscal needs of subnational governments.

The state-based nature of political competition in Brazil strengthens the policy impact of federalism. Given that state-level organizations control access to the slate and alliance decisions and that national partisan identification is low, subnational elections tend to drive national elections, not vice-versa. In contrast to the presidential 'coattails' effect observed in the United States, in Brazil *gubernatorial* elections exert a coattails effect on national legislative elections (Samuels N.d), providing incentives for candidates for national legislative office to coalesce around gubernatorial candidates, not presidential candidates. This dynamic tends to increase governors' influence over 'their' states' congressional delegation and to limit the president's capacity to build congressional coalitions once elected, because state-level politics, not whether a candidate attached him/herself to a successful presidential candidate, determines electoral success or failure. Moreover, state political elites do not generally hold strong ideological-partisan convictions, and except for politicians from the leftist parties they tend to ignore national politics when negotiating electoral alliances.

In sum, in Brazil political careers tend to revolve around subnational politics, reinforcing the impact of federalism. Members of Congress do not build their careers around being loyal members of national parties, as has been the case in Mexico or Costa Rica, for example. Instead, they tend to focus primarily on state and local needs. Because politicians respond not only to those who helped them win election but also to those who might help them move up the career ladder, states and municipalities gain a form of institutional representation through members of the national Congress. As a result, the strengthening of the national Congress fortified the veto power of subnational actors in national politics.

Variable 4: The Policy Jurisdiction of Subnational Government

After 1985 many policy areas devolved to local and state governments. The 1988 constitution gives state and local governments ample jurisdiction over many policy areas, including the environment, education, taxes, health, social welfare, and housing (Articles 23–25 and 30). All policy areas that are not explicitly under the domain of the federal government are reserved for the state (Article 25, Section 1). In practice, state and local governments acquired much greater leeway over education, health, and housing policy, among many other policy domains (Tavares de Almeida 1995). These policy areas were of direct consequence in the federal government's efforts to rein in inflation and reform the state after 1985.

Strong Federalism, Economic Reform, and Constraints upon the Central Government, 1985–94

We have argued that the policy impact of federalism varies across cases and time and that four institutional features of political systems should help predict how strong the policy impact of federalism is. In the Brazilian case these four features all predict that federalism would have significant policy impact after 1988.

Federalism's impact varies by policy area. For example, state-based actors in Brazil have little influence over exchange rate policy, which rests in the executive's hands. However, federalism has mattered considerably in other important policy areas. In this section we briefly examine three critical policy areas where federalism constrained central-government reform initiatives in the post-1985 period: state-government debts, state-owned banks, and fiscal decentralization. These policies were crucial for the success of stabilization policies and state reform.

The 1988 constitution empowered Congress as a veto player particularly in the many areas in which policy reform required a constitutional amendment. Brazil's constitution embedded an extraordinarily wide range of policies. As a result presidential reform proposals that might otherwise be implemented via ordinary law instead require a constitutional amendment. Because reforming the constitution requires supermajorities, a small minority of politicians holds veto power over central-government policy proposals to change the status quo (Couto 1997; Stepan 1997).

The Brazilian case combines a very detailed constitution that prescribes a wide range of policies and moderate hurdles to constitutional amendments. In a survey of 189 constitutions in the contemporary world (Flanz 1997), the 1988 Brazilian constitution, with 211 pages and 320 articles, ranked as the second longest democratic constitution. To make any changes presidents must seek a supermajority of 60% of the total membership of both chambers of Congress, and each chamber must pass the amendment twice. Given the likelihood that some members favorably disposed to an amendment might be absent, in practice this requirement imposes the need for two majorities greater than 60%. This is a low hurdle compared to that imposed in the United States, but the Brazilian constitution is far more detailed than the US constitution, and amendments require substantially more consensus than an ordinary law. Thus, a minority on either chamber of Congress suffices to block presidential reforms. Among the constitutionally embedded polices in Brazil were many that affected state reform and economic stabilization (Couto 1997).

The reinvigoration of federalism in Brazil occurred concomitantly with democratization and with a protracted economic crisis. These three processes significantly affected each other. Political liberalization and democratization reinvigorated federalism as the military devolved power to states and local governments. In turn, political dynamics at the state level increasingly affected liberalization and democratization. The economic crisis was fueled in part by democratization as the military and its civilian allies governing at the state level used public resources, thereby creating fiscal imbalance, to garner political support.

Other scholars have addressed the relationship between reinvigorated federalism and democratization (Abrucio and Samuels 1997; Abrucio 1998); here we focus on the connection between federalism and the economic reforms spurred by the economic crisis. Since the return to democracy in 1985 Brazilian presidents have attempted to attain economic stabilization and state reform. Yet until the implementation of the *Real* stabilization plan in 1994, successive stabilization plans failed disastrously; only once between 1985 and 1994 was the annual inflation rate below 239%, and in 1989, 1990, 1992, 1993, and 1994 it surpassed 1,000%. The succession of failed stabilization plans in conjunction with a long period (1981–92) of no per capita growth led to a growing consensus about the importance of shifting from state-led development to more market-oriented approaches. Just as the stabilization policies failed, so did the early efforts at state reform. Brazil's program of state reform lagged behind that in most of Latin America (Edwards 1995; Haggard and Kaufman 1995; Packenham 1994).

It is impossible to understand these failures to accomplish economic reform more rapidly without examining the effects of federalism (Sola 1993). Federalism gave state-based actors—governors and members of the national Congress—the capacity to veto presidential initiatives. Federalism also gave state-based actors the power to constrain presidential initiatives by undermining them. These constraints partially offset sweeping presidential powers embedded in the 1988 constitution (Figueiredo and Limongi 1994, 1995, 1997; Mainwaring 1997; Power 1998; Shugart and Carey 1992).

In the following analysis we assume that the president is the primary agent interested in carrying out stabilization and state reform. This assumption is based both on deductive logic and inductive observation. Deductively it makes sense that the president, who is elected by a national constituency and has primary responsibility for economic policies, would be more concerned with macroeconomic results than a congress that has strong incentives toward particularism and clientelism (Ames 1987; Mayhew 1974; Shugart and Carey 1992). Similarly, governors have weaker incentives than presidents to focus on national-level policy results. Empirically in Latin America, presidents and not legislatures have been the main agents responsible for pushing for stabilization and state reform.

State Debts to the Federal Government

Federalism had a profound impact on stabilization policies and state reform in part by promoting fiscal irresponsibility on the part of the member states. States have been able to set their own fiscal policy without risk or cost because until recently they successfully forced the central government to assume their debts. This impeded the central government's ability to reduce Brazil's internal debt and establish macroeconomic stability. States were able to transfer their debts to the central government because presidents needed state governors to influence *their delegations in Congress and because the executive branch is constitutionally impeded from imposing its will in the fiscal realm.*

Over the past 20 years state governments used their autonomy to run up a debt that totaled US $139 billion as of late 1997 (*Sinopse*, 3 November 1997). The great bulk of the debt—89.7% in November 1996 (Souza 1998, 581)—came from the four states with the largest share of Brazil's GDP: São Paulo, Rio de Janeiro, Minas Gerais, and Rio Grande do Sul. From the early 1980s until Cardoso became president the central government was unable to limit state indebtedness (Kugelmas, Sallum Jr., and Graeff 1987; Abrucio and Couto 1996). Uncontrolled spending is largely responsible for this debt. Measured as a percentage of the GDP, state and local government payroll expenditures increased 77% between 1985 and 1990—an eloquent statement about the lack of fiscal restraint on the part of governors (Werneck 1992, 11).

Given states' fiscal largesse and capacity to push their debts onto the federal government, it is not surprising that several economists identified federalism as a major contributing factor to the lack of federal government control over monetary and fiscal policy in Brazil (cf. Werneck 1992; Bonfim and Shah 1991; World Bank 1990; Werlang and Fraga Neto 1992; Novaes and Werlang 1993). After the *Real* economic stabilization plan came into effect in 1994 real internal interest rates skyrocketed, making sweeping state debts under the carpet no longer a viable option. Still, states have continued to force the central government to assume their debts: for example, in May 1997 the government announced plans to purchase over US $110 billion in state-bank debts.

Because presidents rely on governors to drum up support in Congress and to realize important policy objectives and because governors have considerable power and autonomy, presidents from Sarney through Franco never devoted much political capital to forcing state governments pay their debts to the federal government, although they paid lip service to this objective. For example, in 1988 President Sarney attempted to call in states' debts, in response to the Constitutional Congress's decision to transfer substantial tax revenues from the federal to the state and local governments. Sarney demanded that state governments pay 25% of the interest and capital they owed the federal government. Refusing to pay more than 10%, Governor Newton Cardoso of Minas Gerais briskly commented that "The federal government will have to accept our proposal because, for it, an even worse outcome would be the defeat in Congress of its proposed budget."[6] The federal government backed off, losing a good deal of revenue: had Minas paid the 25%, it would have amounted to approximately $2 billion per year. Instead, to curry favor with governors for his pet projects in the constitutional assembly, Sarney rolled state debts over despite the tremendous costs to federal coffers.

In another example, in 1991 President Collor asked governors to pressure Congress to pass needed structural reforms, including a tax reform. The Collor proposal would have limited state autonomy and increased central-government power. After months of arduous negotiations, in December 1991 Collor won congressional approval for a modest fiscal reform. However, he won this support only by making major

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6 "Conta pendurada," *Veja*, 5 October 1988, p. 107.

concessions that partially offset the legislative victory: to convince governors to influence their congressional delegations, Collor agreed to roll over an estimated $60 billion dollars of debts that state and local governments owed the federal government. Moreover, because of a loophole, most states failed to live up to the agreements they had made and further indebted themselves with new money before they rolled over their old debts (Abrucio and Costa 1998, 41–4).

President Itamar Franco (1992–4) launched another effort to impose more stringent conditions on state debts in 1994, but with humble results. State debts to the federal government skyrocketed from 44 billion *reals* in 1993 to 97 billion in 1995 (Abrucio and Costa 1998, 45). Abrucio (1997, 42–3) concluded that "In all the debt rollover negotiations undertaken up to the present, the central government took the initiative, but it either was unable to break the resistance of the states, or, when it did manage to approve a rollover agreement, the terms were never completed. The states have even cheated their way out of agreements that they have signed…federal contracts have had little power to impose rules for all the players of the game."

State-Owned Banks

From 1985 until 1994 state-government-owned banks adversely affected the central government's initiatives regarding economic stabilization, and they continue to affect other policy areas, including the difficulty of achieving fiscal balance. As part of a broad expansion of the public sector, state-government-owned banking institutions proliferated under military rule. After the military government loosened central control over state finances in the mid-1970s[7] governors employed state banks for political purposes. These banks became notorious for their autonomy vis-à-vis the central government and for the way they have been politically manipulated. The governor, using political criteria, chooses the directors of the state banks. State-level banks have enjoyed broad authority to make their own loans and issue bonds.

As of 1993 25 of Brazil's 27 states (counting the Federal District) owned at least one financial institution (Novaes and Werlang 1993, 16). In comparative perspective the autonomy of these state banks is exceptional. Because state governments could spend without constraints and cover deficits with state-issued bonds, they had more fiscal and monetary autonomy vis-à-vis the federal government than member countries of the European Union have with respect to the EU; member countries must agree to keep their fiscal deficits within a targeted range and will not be allowed to issue new currency as Brazil's state governments effectively did by issuing bonds and pushing the debt onto the federal government. In the United States, no state has its own autonomous publicly owned bank.

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[7] Beginning in 1967 and continuing through the 1975–8 term the military nominated not only governors but also state Secretaries of Finance and of Public Security (positions akin to ministers in state government).

Brazil's state banks have had a reputation for profligate spending to bolster the political careers of the politicians who oversee them. With the advent of political liberalization governors had incentives to use 'their' banks politically. Consequently they made billions of dollars in unsound loans. State-bank debt totaled US $96 billion as of 1998. Governors used state banks to finance investments and hire personnel for political purposes, often attaching little importance to how economically sound the use of resources was. Neither the governors nor the bank directors were discouraged from such ruinous manipulation of the banks. The benefits of such practices accrued to the governors, the problems to their successors—or, more often, to the federal government. As political appointees who would be likely to remain in their positions only as long as the governors did, the directors of state banks also functioned with a short-term logic that often violated elementary principles of private banks (Werlang and Fraga Neto 1992). The combination of bad loans and borrowing to build political bases corroded the financial situation of most state banks. With loans from their state banks, governors could embark on wild spending sprees, and they then essentially refused to pay back the loans, sending the banks into financial ruin. The governors' political use of state banks explains why, as of June 1992, 67% of their assets were loaned to state governments (Novaes and Werlang 1993, 16). State banks loaned money to the state government and to public enterprises owned by the state; the state governments and enterprises then spent these funds in politically profitable ways. State governments frequently failed to pay back loans to these banks; for example, by 1995 the government of São Paulo and publicly owned São Paulo companies owed $13.8 billion to BANESPA, the state bank (Makler 1997). Between 1982 and 1993 the Brazilian Central Bank intervened in 60 of the 87 financial institutions owned by states because of their parlous situations.

For present purposes what is particularly fascinating about the state banks is the capacity of governors to transfer their debts to the federal government, as they have done with state-government spending. Until 1995 the federal government regularly bailed out state banks in exchange for political support in Congress; presidents feared gubernatorial wrath and needed congressional support for many measures. State governments have largely avoided paying for past errors. The state banks effectively pushed the Central Bank to intervene and lend them money, thus transferring debts from the state to the central government. Werlang and Fraga Neto (1992, 3) concluded that the reluctance of the federal government to control state banks led to a situation in which the latter "can emit money, practically without limits and without control from the Central Bank or the National Treasury." Between 1983 and 1987 alone the Central Bank injected $33 billion into efforts to rescue state banks (Abrucio and Couto 1996, 25). Despite broad awareness of the high costs of this noncooperative game, the central government failed to rein in state banks until Cardoso's presidency and even failed to prevent the exacerbation of the problem.

State banks' autonomy and ability to raise capital undermined national monetary and fiscal policy until 1994 (Bonfim and Shah 1991; World Bank 1990). Despite affirming a commitment to rein in these banks and to prohibit the Central Bank from covering their deficits, the Sarney, Collor, and Franco governments failed to overcome gubernatorial resistance to changes in state-owned banks' organizations or practices. In 1992, at the apogee of Brazil's fourteen-year-long inflationary debacle, Werlang and Fraga

Neto (7) wrote that "the largest states tend to generate monumental deficits, which…cause an immense lack of control of federal public finances, making the stabilization of the Brazilian economy practically impossible." They concluded that state banks had become one of the primary obstacles to resolving Brazil's macroeconomic problems, and they advocated state-bank privatization as the only solution. State banks with such capacity to undermine national economic policy made it difficult for presidents to implement stabilization policies.

Efforts to Revise Fiscal Federalism

Fiscal federalism (i.e., the significant distribution of tax revenue to local and state governments) also had an important impact on many policy areas in democratic Brazil, including on stabilization from 1985 to 1994. While mandating specific and substantial transfers of resources to state and local governments, the 1988 constitution is nebulous regarding what level of government has responsibility for such fundamental issues as health, education, housing, and welfare. The substantial increase in transfer of resources to states and municipalities mandated by the 1988 constitution therefore occurred without a corresponding transfer of responsibilities. This vagueness has fueled conflict among federal, state, and local governments, enabling each one to claim that certain responsibilities pertain to another. This situation has burdened the federal government, leaving it with diminished resources but growing demands (Tavares de Almeida 1995; Sola 1993; Abrucio 1998). As a result one of the most important political games—and policy dilemmas—of the New Republic has been the effort of state and local governments to push the federal government to continue providing all the services and resources it had previously, including funding bankrupt state-owned banks, refinancing state and municipal debts, etc. Governors and mayors used their power to leverage such concessions from the federal government. Meanwhile, successive presidents attempted to address a series of macroeconomic problems that entailed reducing deficits, cutting spending, and curtailing concessions to state and local governments, while at the same time cultivating the political support of governors.

From the early 1980s on many economists argued that fiscal imbalance was a major contributing factor to inflation in Brazil. Successive presidents attempted, albeit not always through consistent policies, to rein in the fiscal deficit in order to trim inflation. As part of these efforts presidents hoped to revise the fiscal redistribution that had proven deleterious to the central government in the aftermath of the 1988 constitution. The central government also considered, but did not seriously pursue, measures to push more of the public sector responsibilities onto state and local governments. Presidents simultaneously faced pressures from state governors, mayors, and federal deputies *qua* representatives of their states to retain the new status quo that was so favorable to subnational governments.

Because subnational governments have grabbed resources yet only gradually and grudgingly assumed new policy responsibilities, fiscal decentralization has made it difficult for the central government to balance the budget (Bonfim and Shah 1991) and has reduced the central government's ability to use its resources for political purposes, as was common during the military period. 'Unprogrammed' revenue in the central government budget has been halved since 1978, while transfers to states and municipalities have gone up approximately 90% (Nogueira 1995, 28). These negotiated revenue transfers from the central government amounted to US $2.6 billion, or 0.6% of GDP in 1992 (Roarelli 1994, 154). Of this amount 74% went to state governments.[8]

Sarney, Collor, and Franco (until 1994) failed to increase the federal government's share of the pie. Congress and the governors defended the current share of state and local governments in federal tax revenues despite a widespread perception that this arrangement contributed to fiscal problems and inflation. This share was constitutionally enshrined (Transitory Article 34), so it could be modified only through a constitutional amendment. For example, President Collor proposed a fiscal reform that would have shifted resources back to the central government, but he buckled in the face of opposition from the states. President Franco (1992–4) was also initially thwarted by governors and the national Congress in his endeavor to redesign Brazil's fiscal system in favor of the central government.

Summary

Abrucio (1997) coined the suggestive term 'predatory federalism' to characterize the relationship between the federal government and the states between 1985 and 1994; in this relationship the states prey on the central government. During its apogee, 1988–94, the costs of 'predatory federalism' were alarming. State spending and state capacity to push the resulting debts onto the federal government contributed to the inability of successive presidents to tame the fiscal deficit and curb inflation. States vetoed presidential efforts to reform predatory federalism.

Cardoso and the Effort to Modify Predatory Federalism

Brazilian federalism is dynamic, and the relationship between the federal and subnational governments changed substantially under President Fernando Henrique Cardoso (1995–present). Since his inauguration the constraints on the center have been more manageable. The president still needs to deal with governors and subnational interests, but he has accomplished some important reforms. The central government has evinced greater capacity to overcome the constraints imposed by strong federalism. He has curbed states' fiscal autonomy, reined in state banks somewhat, and effected modest changes in the distribution of fiscal resources between the national and subnational governments. These achievements were fundamental to the success of Cardoso's stabilization plan. The stabilization policies of his

[8] Much of this money is only formally uncommitted in that it either goes to reimburse the Federal District of Brasília's expenditures or goes to the Unified Health System (SUS). What is left over can go towards credit-claiming investments (Afonso 1992, 28). Unprogrammed revenue distribution follows a similar pattern to that established for distribution of the FPE. In 1992 76% of all negotiated transfers went to the three less-developed regions in exchange for political support (Roarelli 1994).

predecessors were sunk by governors and legislators anxious to protect their turf and resources; in contrast, Cardoso's stabilization plan quelled inflation while promoting moderate growth and income redistribution until 1998.

The Cardoso government was keenly aware of the importance of taming state spending as part of its efforts to achieve price stability, and it tackled the problems of predatory federalism with renewed vigor. Nevertheless, it has enjoyed only modest success in this endeavor. Governors and members of the national Congress, acting as representatives of their states, are still powerful veto players in interactions between the federal and state governments.

State Debts

The Cardoso government has increased the federal government's leverage over states in relation to state debts, and it has doggedly attempted to reduce states' ability to issue new debt while shoving the bad debt onto the federal government. It began such efforts from its first days in office. The perilous financial situation of state governments gave the federal government increased leverage in 1995. In 1995 the financial situation of state governments deteriorated, leaving them more vulnerable to pressures from the federal government (Abrucio and Costa 1998; Sola, Garman, and Marques 1997).

As Sola, Garman, and Marques (1997) have argued, the end of hyperinflation meant that state governments could no longer use the 'inflation tax' to implicitly roll over their debts. The financial crisis that subsequently confronted most states increased Cardoso's leverage because only the central government could offer debt relief. In this way the success of the *Real* Plan increased the federal government's political leverage over the states.

In 1995 a law (the 'Camata Law') was passed that stipulated that as of January 1999 states needed to limit their payroll expenditures to 60% of net receipts; otherwise, they would risk losing federal funds. This law gave the federal government leverage in dealing with state governments. More so than his predecessors, Cardoso has used state debts to the federal government to impose greater restrictions on state spending and state banks (Selcher 1998). His administration has pushed state governments to privatize bankrupt state banks. This marked a change in negotiating strategy for the federal government and strengthened its hand. When the Cardoso government refinanced state debts in 1997–8, it required states to cease issuing bonds to cover state debts until their total debt was less than one year of tax revenue. Given the magnitude of state debts, this was a stringent condition. In June 1998 the National Monetary Council prohibited subnational governments from contracting new foreign debt. The Cardoso government has also pushed state governments to privatize their public enterprises, many of which have drained public coffers and borrowed recklessly since 1979.

The debt game took a new twist after the Russian currency meltdown of 1998 led to a run on the Brazilian currency. In the waning months of 1998 the Brazilian government defended the currency through exorbitant interest rates, which had the undesirable effect of exacerbating the states' financial woes, leading to renewed brinkmanship between the federal government and the states. The situation ultimately strengthened the hand of the federal government, but not without a near crisis precipitated by the declaration by Minas Gerais Governor Itamar Franco of a moratorium on debt payments to the federal government in January 1999.

Beginning with Minas Gerais's January 1999 moratorium the government stepped up its efforts to rein in profligate states. It has repeatedly blocked federal transfers to the states (e.g., Minas Gerais and Rio Grande do Sul) that failed to meet debt payments. This practice has reinforced central government control over state management of debts. In January 1999, also in response to the moratorium declared by the governor of Minas Gerais, the government sequestered resources from states' bank accounts to cover arrears on debt payments. Also in January 1999, at the government's behest, the lower chamber approved legislation that imposed stiffer sanctions on state governments that did not comply with the Camata Law, which limited states to spending at most 60% of their tax revenue on payroll expenditures. If approved by the Senate, this bill would deprive nonconforming states of federal transfers.

Nevertheless, it would be misleading to assert that Cardoso has thoroughly weakened the effects of federalism. In 1997–8 the central government again rescheduled the debt of 24 of 27 state governments at an interest rate favorable to the latter. During this period the federal government refinanced $75 billion of state debts (Selcher 1998, 44), and it stretched interest payments out over thirty years. State debts pushed Brazil to the brink and triggered the devaluation of January 1999. The Brazilian currency, the *real*, was already under attack, but the declaration by Governor Itamar Franco of Minas Gerais of a 90-day moratorium on debt payments to the federal government raised the specter of widespread state defaults against the federal government and of subsequent federal government inability to comply with an IMF rescue package. Six other governors were also pressing for better terms for repaying the debt, and twelve states failed to make debt payments on time in January 1999. These defaults would have increased the central government's deficit and reduced its control over the currency, so Franco's actions shook investors' confidence in the currency, triggering the devaluation, the resignation of the President of the Central Bank, considerable capital flight, and a plunge in the Brazilian stock market in January 1999. On the heels of this fiasco, economist Paulo Vieira da Cunha (1999, 16) wrote that "Presently it is impossible for any subnational government in Brazil to fail financially, and the ascription of fault for services not rendered to the population tends to lie predominantly with the federal administration. Until this system of incentives is reoriented, financially and politically, it is difficult to believe that the Brazilian public debt will be well managed." Cunha may underestimate how much leverage the federal government has acquired in handling state government's debts since Cardoso became president, but his assessment is a poignant indication of how much autonomy the states still have.

Three factors impede the federal government from imposing stringent limits on state fiscal autonomy and debts. First, because Brazil's party system is highly federalized, the central government lacks the carrots or sticks to bring states into line; state elites view themselves as independent of each other and of the executive branch. The president has few carrots to offer state delegations, and in terms of sticks the central bank is weak in comparative perspective and subject to not only central-government manipulation for political purposes but state-government manipulation through the Senate.

Second, this situation is institutionally difficult to reform because many changes in intergovernmental relations require a constitutional amendment. As noted above, a small minority of states, representing an even smaller minority of the population, can block any such proposed change through their representation in Brazil's Senate. Given some instability of partisan coalitions and the strength of state (and municipal) interests within Congress, the balance of forces in terms of intergovernmental relations is unlikely to change significantly in the near future (Couto 1997).

Third, the central government confronts a norm of universalism in its dealings with state governments; it cannot divide and conquer. In October 1996 state governors united and informed the President and the Minister of Finance that from that point forward, all negotiations about state debts would take place in the Senate. As one governor stated, "All state governors think alike on this issue" (*Gazeta Mercantil* 14 October 1996, p. A6). In terms of intergovernmental fiscal relations, states play the following game in the Senate (the game could be portrayed in formal terms but for purposes of continuity of exposition we will not do so). The players are the central government, represented by the President, and the set of states, represented by governors and senators. The central government can fund states or it can attempt to rein in state spending. Each state can do the same individually: spend more or agree to spend less. States always want to spend more, while the central government wants states to spend less so that it can fulfill its national and international obligations.

For the central government the cost of profligate state spending is high, given that it continues to have to assume state debts. For each state the cost of agreeing to spend less is high because spending cuts mean dissatisfied voters. The benefits of spending more are obvious politically, whereas the costs are diffuse in one sense and concentrated in another: out-of-control state spending might lead to macroeconomic instability, but no single state, nor the conjunction of states, would be held responsible; the central government would.

The incentives of this game are clear for each state: spend more and defend all states' rights to do likewise. If the central government proposes that states spend less, state representatives won't cooperate with the President in the national interest but will defect in their own interest and in all states' interests. States had no incentive to cooperate for the general; the logic of free riding prevailed. Negotiations about state debts are in the hands of the Senate, which has constitutional authority to decide states' overall levels of indebtedness. As one senator openly admitted, there exists a gentlemen's agreement to give all states equal consideration in the Senate and roll over all states' debts independently of Central-Bank evaluations of the state's credit rating (*Folha de São Paulo*, 30 April 1997, p. A14). In political science parlance, this is a norm of universalism. If one state representative defected from this gentlemen's agreement and voted against a proposal to roll over a state's debt, his vote would be wasted and his state would then be punished by the other senators by having its debt called. No senator wants to be held responsible for pushing his state over the brink fiscally, so all senators agree to continue to roll over all states' debts. Even PT senators follow this norm when push comes to shove, despite their efforts to be perceived as paragons of fiscal virtue.

These perverse incentives, in which the central government sought solutions to macroeconomic problems while state governments had stronger incentives to defect (through profligacy) than cooperate, explain a seeming paradox: why state governments remained in difficult financial positions despite the massive infusion of resources after 1988. Because they have been able to push debts onto the federal government, most states have not seriously attempted to rein in spending. A few governors have been exceptions, believing that fiscal balance would allow them to undertake new initiatives—but the rule has been profligacy.

At what point would states prefer to reform for the general good? Unfortunately, the situation does not provide for optimism. States are swamped in debt, but they have been successful at passing their problems off without agreeing to across-the-board institutional changes. Even when some states have signed agreements, no institutional guarantees exist that impede the next governor from disobeying the terms. As a 1997 scandal over improper use of state-government debentures (*precatórios*) demonstrated, governors have continued to find new and creative ways to skirt around central-government austerity plans. It is not obvious that states' incentives and therefore their strategies would change even if state debts were several times larger than they are currently. The institutions of federalism continue to obstruct a quick resolution of Brazil's fiscal problems.

Brazil's federal arrangements have allowed state governments to gain in three ways: first, they have won favorable loan repayment plans with long-term below-market rates. Second, federal government assumption of their debts has given them budgetary freedom to execute more visible policies that have political payoffs. Finally, while the central government cannot avoid paying off these debts without placing the entire country's economic health at risk, states are under no obligation to fulfill their promises, and they can act as if their irresponsible behavior has no larger ill effects. In the past states have signed agreements and then failed to follow through on their part of the bargain.

State Banks

From the time of the intervention of the state banks of Rio and São Paulo in late 1994 the federal government indicated that it would not continue to bail out failed banks without extracting some leverage in return. Sola, Garman, and Marques (1997) convincingly argue that Cardoso has asserted greater control over state banks than his predecessors did. The Cardoso government moved to curb the autonomy of state banks and threatened to not rescue them. It intervened BANERJ the large bank owned by the state of Rio de Janeiro, and in June 1997 it privatized BANERJ.

Despite Cardoso's resolve to cease the drain on public coffers and to privatize many state banks, he has had only modest success in controlling state banks. In 1995, in the largest infusion of federal money into state banks, the federal government renegotiated a $15 billion debt owed by the government of the state of São Paulo to the largest state owned bank, BANESPA, on terms extremely favorable to the state (Abrucio and Couto 1996). Cardoso had intervened in BANESPA with the idea of privatizing the bank, but he initially succumbed to pressures, backed off, and agreed to pump billions of federal dollars to rescue the bank. Abrucio and Costa (1998, 82 ff.) show that the opposition of the governor of São Paulo and the state's members of the national Congress triggered the federal government's decision to back down. Faced with the deterioration of BANESPA's financial situation, the governor later agreed to privatize the bank. In the process, however, and consistent with our argument about the ongoing power of state governors, he obtained a favorable deal for the state. Other states subsequently insisted upon equally favorable treatment in renegotiating their debts.

Makler (2000) reports that as of January 1999 the Cardoso government had privatized 5 of the 34 state banks and noted that the heralded privatization effort has gone forward slowly. The main obstacle to faster privatization has been the president's need to court the support of governors and state based interests in the national congress.

Fiscal Federalism

Cardoso has also scored modest success in the effort to revise fiscal federalism. In February 1994, as part of the economic stabilization plan (the *Real* Plan, named after the new currency), Franco's government won approval for the Social Emergency Fund, later renamed the Fiscal Stabilization Fund (FEF). This measure, passed when Cardoso was Finance Minister, temporarily increased the federal government's share of revenue and has given it greater flexibility. As president, Cardoso won approval of the FEF, enabling the federal government to retain some fiscal resources that the constitution earmarked for subnational governments. In September 1996 the federal government further reduced state and local government revenue when it exempted exports from a sales tax (the ICMS) that benefited the states, but to win approval for the law (named the Kandir Law) it provided partial compensation. The combination of these measures slightly shifted the balance of fiscal resources back to the federal government.

Yet, as highlighted above for the other two policy areas, the federal government has often remained hostage to state interests. It continues to have difficulties enforcing agreements with states. It has not been able to impose unilateral decisions, notwithstanding the importance of the issues and notwithstanding the president's constitutional capacity to decree new laws. Consistent with this observation, in March 1999 Cardoso issued a presidential decree (*medida provisória*) that provided $1.74 billion to states as compensation for the Kandir Law. More important, on 5 May 1999, the government announced that it would terminate the FEF in December 1999; the FEF allowed the federal government to retain 20% of the tax transfers to states mandated by the 1988 constitution.

Even a president with considerable legitimacy and determination enjoyed only modest success in renegotiating federal-state relations until 1999. The huge state debts remain, and the institutional foundations of the system remain largely unchanged. Until his reelection in 1998 President Cardoso chose not to take up the issue of institutionalized fiscal reform, instead focusing on easier reforms such as the amendment that allowed presidential reelection. He has had to expend great political capital seeking two extensions for the *Real* Plan; the government has had to concede to state and municipal interests both times it has requested an extension for the Plan. It is extremely unlikely that the Cardoso government will be able to permanently reverse the strong federalism that the 1988 constitutional assembly codified. Moreover, even Cardoso's victories in reverting predatory federalism came after lengthy negotiations and major concessions to state-based interests. Nevertheless, barring poor leadership at the national level, it seems that the worst of predatory federalism is past because the Cardoso government succeeded in changing the terms of federal-subnational government relations.

On many national policy issues governors continue to be powerful actors. This is true especially in those unusual cases in which they have common interests—for example, defending state governments' share of tax revenue. It is also true in many other policy areas because governors influence the political careers of members of Congress, upon whose support the president depends for initiating many reforms. Presidents need to make many concessions to state-based interests, particularly governors and national legislators *qua* representatives of their states. The need to respond to state-based interests explains why cabinet formation follows a state- (as well as party-) based logic: presidents must build coalitions that represent not only different parties but also different states (Abranches 1988; Amorim Neto 1995). From 1985 to 1998 state actors and national legislators in their capacities as representatives from the states imposed a series of constraints on Brazil's presidents. Federalism drives the system in a center-constraining direction by forcing presidents to consider the patronage and policy preferences of state governors and the interests they represent. On issues such as state debts, state banks, and fiscal federalism, only by appealing to state governors, who in turn can influence their state's congressional delegation, can presidents construct coalitions in Congress. Although the modifications that have transpired under Cardoso are meaningful, federalism continues to exert considerable impact in the policy areas examined in this paper.

Conclusion

Our theoretical goal in this paper is to extend the insights of Lijphart (1984), Tsebelis (1995), Stepan (1997), and others on the importance of political institutions. Federal institutions always contribute to the number of 'veto players' in a political system, but the power of these veto players varies greatly. Four institutional factors shape the extent to which subnational governments constrain the national government in federal systems: the distribution of resources to subnational governments, the political power of state governors, the articulation of subnational interests in the national congress, and the policy jurisdiction of subnational and national governments. These factors help illuminate the variance over time in the policy impact of Brazilian federalism. During the military regime, because resources were centralized and the power of subnational actors to influence the political process were circumscribed, federalism had only a limited impact on the central government. As the transition to democracy evolved subnational actors acquired greater capacity to constrain the central government, and since 1988 federalism has had a major policy impact in Brazil.

Strong federalism has constrained many reform initiatives of the central government, especially the executive branch. Even exceptionally strong constitutional powers for the president cannot fully counteract the constraints created by strong federalism. Strong federalism made it difficult for presidents to implement reforms that limited states' resources, that reduced their autonomy vis-à-vis the central government, and that curbed the power of governors and mayors to hire and spend. Federalism centrally affected the capacity of presidents to implement state reforms and economic stabilization, two of the most important challenges facing Brazil after 1980. Federalism has even constrained a president who enjoyed high public opinion ratings during his first term. Cardoso has had only modest success in reining in state banks, in renegotiating the terms of state debts to the federal government, and in renegotiating fiscal relations between the central and subnational governments.

The policy impact of Brazilian federalism stemmed from the four factors analyzed in our theoretical discussion. Powerful governors and the national Congress blocked presidential reform initiatives with state debts, state banks, and fiscal federalism. The large share of fiscal resources and broad policy jurisdiction of subnational governments meant that noncompliance with federal governments reforms had high costs for the center.

The four variables analyzed in the section on "Federalism, Veto Players, and Policy Reforms" had an interactive effect in Brazil. Because state governors wielded influence over members of the national Congress, the latter became more inclined to defend state interests. The resources and power at the subnational level drove members of the national Congress to orient their careers towards state and local politics (Samuels 1998). In turn, this orientation toward subnational politics reinforced legislators' willingness to protect state interests even at the expense of obstructing presidential efforts to rein in state debts and state banks and to revise fiscal federalism.

Federalism simultaneously constrains the central government and grants autonomy, veto power, and policy initiative to subnational actors. In principle, strong federalism can have many virtues, as Riker (1975), Lijphart (1984), Linz (1997), Stepan (1997), and others have suggested. At its best, strong federalism can encourage innovation at the subnational level. However, greater constraints on policy reform also bring disadvantages, particularly during periods when maintaining the status quo incurs high costs. In Brazil in the 1980s and first half of the 1990s these disadvantages generally loomed larger than the advantages. During this time the Brazilian context was one of poor economic performance, an overloaded and increasingly inefficient state, and the exacerbation of egregious socioeconomic inequalities. Under these circumstances major constraints upon the president impeded systemic capacity to address the crucial challenges of economic stabilization and state reform.

In normal times in established democracies modest policy reform may suffice to retain democratic legitimacy and efficacy. However, in the 1980s and early 1990s the new democracies of Latin America faced daunting challenges that required broader reform: implementing a new model of economic development, increasing equity, reforming states that had become inefficient, and building stronger democratic institutions, for example. In this context strong federalism in Brazil hindered the capacity of the federal government to resolve daunting challenges.

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TABLE 1

RESOURCE BASE BY LEVEL OF GOVERNMENT, BRAZIL

	Share of Total Government Tax Revenue Collected by Level of Government				Share of Total Resources Available by Level of Government			
	Central Government	States	Municipalities	Total	Central Government	States	Municipalities	Total
1957–63	49.8	43.5	6.7	100.0	42.6	47.3	10.1	100.0
1964–68	49.6	44.6	5.8	100.0	39.3	46.1	14.6	100.0
1969–74	57.2	39.1	3.7	100.0	48.5	37.6	14.0	100.0*
1975–80	61.8	33.4	4.8	100.0	51.3	34.5	14.2	100.0
1981–83	62.1	33.3	4.6	100.0	52.5	32.9	14.6	100.0
1984–86	61.8	34.3	3.9	100.0	49.0	34.9	16.1	100.0

Source: Afonso, Rezende, and Varsano 1992: 115.

For more current but somewhat different (and noncomparable) figures, see Affonso and Silva 1995: 206.

* Discrepancies due to rounding.

TABLE 2

DISTRIBUTION OF RESOURCES BY LEVEL OF GOVERNMENT, SIX LATIN AMERICAN COUNTRIES

	Share of Total Government Tax Revenue Collected by Level of Government				Share of Total Government Expenditure by Level of Government			
	Central	Intermediate	Local	Total	Central	Intermediate	Local	Total
Chile, 1992	100.0	-	0.0	100.0	87.3	-	12.3	100.0*
Venezuela, 1989	96.9	0.1	3.1	100.0*	77.7	15.7	6.5	100.0*
Mexico, 1992	82.7	13.4	3.9	100.0	87.8	9.5	2.8	100.0*
Colombia, 1991	81.6	11.1	7.3	100.0	67.0	15.7	17.3	100.0
Argentina, 1992	80.0	15.4	4.6	100.0	51.9	39.5	8.6	100.0
Brazil, 1988/93	47.1	49.4	3.6	100.0*	36.5	40.7	22.8	100.0

Source: Garman, Haggard, and Willis 1999: Table 4.

For Brazil, the share of total government tax revenue refers to 1988. The share of total government expenditure refers to 1993.

* Discrepancies due to rounding.