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**Non-discretionary intergovernmental grants in
Brazil: evolution and recent trends**

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1 - INTRODUCTION

The advent of the French and the U.S. revolutions in the late eighteenth century marked the emergence of modern republics, influenced by the federalist ideas of Immanuel Kant¹. This new model of state has put in doubt the conception, attributed largely to Rousseau and Machiavelli, that states with large dimensions are not suitable for republican models, due to the difficulty of implementing representative systems of government in large nations (ARAUJO, 2002, p. 39-54).

In particular, the U.S. model, in antagonism to the monarchical model of nation state, adopted the formula of federalism², dodging the "natural" despotism as suggested by Montesquieu for large territorial extensions. That is, the U.S. adopted a model that included "[...] a plurality of power centers [each member state of the federation], coordinated by the Union to ensure, legally, the political and economic unity without suppressing diversity." (LAFER, 1989, p. 220).

Among the benefits identified in federalism, Rezende (2001, p. 87) stated that: "Among other things, decentralization brings together rulers and ruled, causing the nation to find a better balance between the demands of society and the government's willingness to meet them". In fact, this might have been the greatest contribution of federalism, which was not foreseen by Rousseau. Decentralization strengthens the control by society and ensures more proximity between government and the governed. Thus, decentralization was the prerequisite that ensured that republican principles were present, even in large territories.

Accordingly, the American federalist principle was incorporated into Brazilian policy discussions during the nineteenth century and was a major guideline in the Proclamation of the Republic in Brazil, as portrays this declaration of Julio de Castilhos, during the Republican Constituent:

[...] We are gathered here to establish the Federal Republic.

[...] We understand, as always we sustained, that the Federal

¹ The original thinking of Immanuel Kant was based on pacifist thoughts, where federalism was conceived primarily as a means of achieving world peace through a world confederation, in which national sovereignty would yield space for a confederation of nations (LEVI, 2004).

² Levi (2004) argues that the U.S. federalism, the first example of federal pact among sovereign states, was presented more as a means to solve political problems among the U.S. states than as a model for world peace, derived from Kant's federalist ideas.

Republic is the only means of securing political unity and, at the same time, preserving the variety and the customs of the nation. Furthermore, if the Federation does not become established in the Constitution, we will see revival, under the Republic, the same agitation that swelled under the Empire (ROURE, 1920 *apud* LAFER, 1989, p. 220).

As a distinction between unitary and federal models, we can affirm that the federalist model is essentially marked by a decentralized policy, which means a distribution of power, in a vertical way, between central government and regional governments, so that each government has a unique authority in its coverage area, but about the same population and territory (ARRETCHE, 2001, p. 29).

Thus, discussions about the fiscal and political decentralization, transfer and allocation of resources and delegation of taxing power to the different entities of the Federation have recurred throughout the history of the Brazilian republic. As pointed out by Arretche (2001, p. 27), the Brazilian Federation and major political institutions have undergone several transformations from its origin to its contemporary version, which ultimately resulted in significant changes in the nature of federal relations.

After the Proclamation of the Republic, in 1889, the Brazilian federalism has been marked by different periods of greater or lesser strength³. As history demonstrates, Brazil emerged from a unitary state model, during the Empire era, went through periods of a merely formal federalism, as occurred during the Old Republic, and reached a high level of decentralization which is characteristic of robust federations, as pointed out by Arretche (2001), Lemgruber (1997), Mainwaring (1999) and Souza C. (2002).

Specifically, the recent promulgation of the Constitution of 1988, reinforced by the return of democracy, marked a new moment for the Brazilian federalist model, assuring to both states and municipalities a greater share of public income and stronger political responsibilities. The current Constitution ensured an improved balance between the three levels of government: Union, States and Municipalities.

However, the dynamic process of consolidation of the Brazilian federal model has not ended yet and was not stabilized with the 1988 Constitution. As pointed out by Mora and Varsano (2001), the Brazilian federalist system is still facing a

³ Mora and Varsano (2001), for example, relate the oscillation between periods of greater or lesser decentralization in Brazilian federalism to the political regime in each period, be it more or less democratic.

consolidating process, with significant changes and transfers of responsibilities between the three levels of government.

The dynamics of this process can be perceived by the outbreak of federal taxes in recent years which are not shared with the other levels of government. The central government has used its residual power to raise taxes, mostly social contributions, as part of a strategy to strengthen its budget without sharing revenue. In other words, some federal taxes that have been created or raised were not part of intergovernmental transfers, such as the State Participation Fund (FPE) and the Municipal Participation Fund (FPM). Of these taxes, social contributions are the most distinctive and represent a large portion of the federal tax revenues (NETO; SOUSA, 2002, p. 15).

Moreover, as a compensatory initiative, decentralizing measures have also had space in federal agenda recently. New non-discretionary funds were created to transfer resources between the central government and the regional and local governments. Some previous intergovernmental grants were also reinforced.

Therefore, It remains a major goal to understand this process (political and administrative) that took place after the implementation of a robust federal model, established during the redemocratization process, marked by the democratic Constitution of 1988 (GOMES; MAC DOWELL , 2000).

It is necessary to check to what extent the creation of new contributions and the emergence of new transfers of resources between different levels of the Federation represent a consolidation and expansion of the decentralized model established in 1988 or, in the opposite direction, suggest a return to a somewhat more centralized federal model.

Therefore, this study intends to seek an answer to the following question: **have non-discretionary intergovernmental transfers in Brazil been undergoing a process of expansion, stabilization or regression, since the promulgation of the 1988 Constitution?**

To answer this question, this paper will seek to: i) introduce fundamental concepts for understanding the process of fiscal decentralization; ii) characterize the current revenue sharing model, designed by the 1988 Constitution and its amendments; iii) discuss the process of creating new federal taxes that are not shared; and iv) provide data that characterizes the evolution of the volume of

resources transferred through non-discretionary intergovernmental funds, since the monetary stabilization in 1994.

2 - THEORETICAL FRAMEWORK

2.1 FUNDAMENTAL CONCEPTS

2.1.1 Decentralization and Political Decentralization

Decentralization is an issue that has grown in importance throughout the world, mostly from the 80's, as shown by Tanzi (1995), Oates (1999) and Gremaud (2001). According to Tanzi (1995, p. 295), issues such as political decentralization received little attention and were restricted to specialists in public finance years ago. However, the issue has gained a lot of notoriety in the 80's and 90's and became a subject of much debate since then. Professional interest in decentralization and its advantages crossed the U.S. border and several countries established national commissions to study decentralization (Tanzi, 1995, p. 295).

As noted by C. Souza (2002, p. 434), the concept of decentralization is broad, ambiguous and there is a wide range of definitions. Therefore it requires a clear definition so that there is no overlap with other similar concepts, which often are used as synonyms. As an example of the difficulty in conceptualizing what might mean "decentralization", one can see conceptual concerns in the work of Gomes and Mac Dowell (2000, p. 8), Gremaud (2001, p. 129), Oates (1999, p. 1121), Prud'homme (1995, p. 201) and Tanzi (1995, p. 299), all related to the different interpretations of the decentralization phenomenon.

Gomes and Mac Dowell (2000, p. 8) define the broadest perspective of decentralization, also called political decentralization. For the authors, political decentralization is both a historical and a social movement, a process that involves the redistribution of power, and hence, of rights, resources and responsibilities, from the government to society, from the central government to the state and local governments, and from the executive to the legislative and judiciary.

This would be a broader conceptualization of the phenomenon of decentralization. In this definition, Gomes and Mac Dowell (2000) refer to the redistribution of power in a wider perspective, be it between members of a federation

or between the different branches of government, or, simply, between state and society. The authors argue that the phenomenon of political decentralization encompasses many different manifestations of other more restricted phenomena, such as fiscal decentralization.

2.1.2 Fiscal Federalism

Given the amplitude of different concepts and definitions found for decentralization in the rich literature on the subject, it is necessary that other similar concepts are introduced. In fact, the concepts of fiscal decentralization and fiscal federalism are often presented in the literature as synonyms. It is also common to find these expressions being used as substitutes of the word “decentralization”. However, there seems to be greater similarity between the concepts of decentralization and fiscal federalism, leaving the concept of fiscal decentralization, a more restricted scope.

Following the concept presented by Oates (1999), a major author on the subject, it is possible to realize that fiscal federalism assumes a connotation of decentralization broader than simply financial decentralization as, at first, one might think. As the author argues⁴, the subject of fiscal federalism encompasses much more than the financial aspect, namely the whole range of issues relating to the vertical structure of the public sector.

For Oates (1999, p. 1120), the object of study of fiscal federalism is to understand which functions and instruments are best suited to different levels of government. In other words, the concern is for the allocation of public functions, activities and public services which would be best suited to national, state or municipal level.

According to Giambiagi and Além (1999, p. 46) and the fiscal federalism theory, in general, it is more rational that the national government should be responsible for activities in which there are economies of scale in delivering the service or when dealing with services that the authors classify as “typically national”. The authors illustrate the question by giving the example of military and national

⁴ Oates (1999), himself, considers that the choice of the term “fiscal federalism” was probably an unfortunate one, since it suggests a narrow concern with budgetary matters.

defense, which guarantee the sovereignty of the country, typical activities that are more suitable to the central government.

On the other hand, activities that should be subject to the control, accountability and daily monitoring of the population are more suited to more decentralized levels of government. Issues related to urban sanitation, for example, should be a local government responsibility (GIAMBIAGI; ALEM, 1999, P. 46).

By following the thought of Oates (1999), fiscal federalism can be seen as a subtheme of public finance that deals with the different possibilities of vertical structures in the public sector, the roles and responsibilities of different levels of government and the relationships/exchanges that exist between these levels, including the transfer funds between federal and state/local governments.

Thus, to address the most appropriate allocation of public functions across different levels of government, fiscal federalism deals with political and public services that are not restricted to the financial aspect, *per se*.

2.1.3 Fiscal Decentralization

In turn, the fiscal decentralization concept as explained by Bahl (2001), Gomes and Mac Dowell (2000) and Oates (1999, 2001) actually incorporates a narrower view of the decentralization process, limited to the budgetary perspective, featuring a less comprehensive, and more focused, perspective of the political decentralization. The fiscal decentralization process is characterized by a relative increase of financial resources made available to states and municipalities, compared to the Union. Thus, fiscal decentralization is the main object of study of this paper (GOMES; MAC DOWELL, 2000, p. 8).

From the definitions presented in these three works (BAHL, 2001; GOMES; MAC DOWELL, 2000; OATES, 1999), it is possible to identify a connotation quite similar for the concept of fiscal decentralization, which is used in this paper. In the mentioned papers, fiscal decentralization is characterized by the transfer of financial autonomy from a national government to one or more different levels of decentralized government in the same country. In this concept, financial autonomy refers both to the transfer of responsibility for spending and to the different methods of transferring resources.

In order to accomplish this transfer of fiscal autonomy, federations have adopted different arrangements for transferring resources across different levels of government, including the following: i) the transfer of power to impose taxes; ii) financial transfers through intergovernmental grants, since non-discretionary grants; and, iii) permission to contract and incur in debts.

Oates (1999, p. 1128) and Bahl (2001, p. 102), however, emphasize that fiscal decentralization cannot be properly configured without a significant distribution of power to impose taxes, at the risk of fiscal indiscipline (OATES, 1999 p. 1129). For these authors, the mere transference of resources through intergovernmental grants does not constitute an appropriate fiscal decentralization.

In this sense, all the cited authors seem to agree on one point: the real decentralization implies a certain level of autonomy for state and local governments that can be obtained either by imposing taxes or by receiving unconditional transfers. Therefore, while the distribution of powers to impose taxes plays itself a key role, it might represent only a supplementary income to the budget of state/local governments in some cases.

2.1.4 Devolution

Once known the different definitions for decentralization in its different approaches, it is important to make a differentiation between "decentralization" and "devolution", as emphasized by Gremauld (2001). In fact, these terms though similar, and often used interchangeably, have fundamental differences in their conceptualization.

As presented previously, the concept of decentralization implies greater autonomy, either in resource availability as in independence to spend. The process of devolution, in turn, is used to implement policies previously defined by the highest levels of government, *i.e.* has a character closely linked to issues of executive/administrative nature. Devolution occurs through administrative subunits, which act as regional offices of a higher level of government. In this sense, no major decision-making autonomy is transferred. If it is, it can be easily taken back by the central government when only devolution occurs (GREMAUD, 2001, p. 129).

Likewise, as claimed by Gremaud (2001, p. 129), the mere delegation of responsibilities in the management of certain public services does not imply effective decentralization, featuring mere devolution. In addressing the same phenomenon, Tanzi (1995, p. 297) classifies this concept as administrative decentralization.

To Tanzi (1995), administrative decentralization exists when the majority of taxes are set centrally, but funds are allocated to decentralized entities that manage their spending as agents of central government, according to guidelines and controls imposed by the central government (Tanzi, 1995, p.297).

Accordingly, transfer grants to state/local governments that are devoid of spending autonomy and are subject to the discretion of the central government cannot be classified as effectively decentralizing measures, for much of the literature. Therefore, for the purpose of this study, these initiatives are classified as simple devolution. Thus, this paper aims to evaluate the variation in transfers exclusively characterized by clear rules laid down in the Constitution, not subject to restrictions from central government, known as non-discretionary grants.

2.2 THE ROLE OF INTERGOVERNMENTAL GRANTS IN THE FIELD OF FISCAL FEDERALISM

Despite the considerable benefits⁵ attributed to fiscal decentralization by the specialized literature and many international multilateral organizations, decentralization should not be seen as a perfect instrument, only endowed with virtues and free of negative consequences.

Moreover, decentralization should not be taken as a tool to solve all the problems of an inefficient government or as an end itself, to be pursued at any cost and at an increasing rate. As noted by Mora and Varsano (2001), there might be an optimal level of decentralization that does not really fit indiscriminately to all countries. Contingent factors, related to the institutional structure of each country, should be considered so that each country could find the level of decentralization that is most appropriate to its institutional reality (MORA; VARSANO, 2001, p. 1).

⁵ Among the main benefits attributed to decentralization are: i) stimulating intergovernmental competition and fall of the tax burden, ii) more efficient allocation of public resources and services, iii) it provides higher levels of accountability; and iv) it provides a greater degree of innovation in the provision of public services (OATES, 1999).

To illustrate this issue, it is important to emphasize the position of Musgrave (1997), who sees decentralization as an extreme theoretical simplification which can be considered excessive. For the author, the various regions and communities of one country have different realities and do not behave as isolated parts of each other. Therefore, in his particular view, it is imperative that some part of the public income should be conducted and distributed by the central government in order to attain the growth of the whole federation and the balance between the different regions/states, which have, in most cases, a different economic reality.

In the view of Mora and Varsano (2001), richer states have a greater ability to grant tax incentives and lower taxes than poorer states. Therefore, according to the authors' perception, if decentralization and intergovernmental competition are taken to the extreme, the richest states would be capable of attracting more investments, generating more tax revenue and wealth, as a consequence. On the contrary, the poorest states would face a race to the bottom.

In fact, different authors point out that as a greater degree of financial autonomy is granted to regional governments, it tends to increase concentration of resources in the richest states, while the opposite is true in the poorest regions, contributing to increasing regional disparities (PRUD'HOMME, 1995).

Mieszkowski and Musgrave (1999) point out that the public finance literature suggests two ways to combat the problem of regional disparities.

The most traditional way to mitigate or minimize this problem is the implementation of vertical intergovernmental transfer funds, between different levels of government, in a federation for instance. This model is adopted in federations like the United States, Germany and Brazil and seeks to correct two major distortions: i) through devolutionary transfers, aimed to balance the distribution of resources between different levels of government, and ii) through redistributive transfers, aimed at reducing regional differences among subnational governments.

The alternative solution to mitigate regional disparities comes from the original studies of James Buchanan⁶, 1950, which proposed a solution by means of horizontal equalization of resources, *i.e.* people who are in a given financial condition should be taxed equally, regardless of jurisdiction, state or province where they live.

⁶ Buchanan (1997) sees federalism as a principle derived from market analogy. In this sense, the federation should be arranged or organized so as to allow for the workings of competition, without the interference of a central planning government.

It is the execution, strictly speaking, of the legal principle of equality: equal tax treatment for people who are under equal conditions.

In other words, as Musgrave argues, the traditional theory of vertical transfer grants tries to tackle inequalities by focusing interregional, interstate or inter-counties disparities, whereas the alternative theory proposed by Buchanan addresses the issue from the standpoint of interpersonal disparities (MIESZKOWSKI; MUSGRAVE, 1999).

As Mieszkowski and Musgrave (1999) note, despite the considerations of the theory of horizontal equalization, the vertical equalization model, which prescribes the use of intergovernmental grants, has become widespread throughout the world, including Brazil. As a consequence of this popularity, the vertical equalization model has been subject to much research in recent years. Particularly, Prud'homme (1995) criticizes the horizontal equalization model of Buchanan and suggests that personal income inequality does not have perfect correlation with regional disparities, so that countries with good distribution of income can still produce reasonable regional inequalities.

According to Prud'homme (1995), a radical decentralization⁷ is noticeably ineffective in solving problems of income inequality and regional disparities for two main reasons. The first one relates to the isolation that decentralization imposes to each one of the subnational jurisdictions. With this isolation, people at the very same level of both income and needs that live in different jurisdictions would receive different treatment by the government, although suffering the same deprivation, simply because the autonomous jurisdictions may use different policies to tax, redistribute income or provide public services. The second reason relates to the capacity of citizens to move to regions that offer lower taxes and greater benefits to their residents, thereby contributing to the increase in inequality between poorer and richer regions.

As a result of these observations, most of the literature, including Oates (1999) and Prud'homme (1995), considers that a major responsibility to redistribute income and resources should be assigned to the central government. However, Prud'homme (1995) points out that the opposite way, centralization *per se*, is not an

⁷ The concept of decentralization adopted by Prud'homme (1995) is characterized by a radical transfer of power to tax, without the presence of intergovernmental transfer grants: "[...] a system in which pure local governments raise pure local taxes and undertake pure local expenditures without the benefit of central government transfers."

efficient way to solve inequalities issues. The author argues that there are many highly centralized countries that make no distribution of resources or adopt policies of regional equalization, such as intergovernmental grants.

In this sense, the literature indicates the vertical equalization model, through intergovernmental funds, as an alternative to address the problem of regional inequalities (MIESZKOWSKI; MUSGRAVE, 1999; OATES, 1999; PRUD'HOMME, 1995).

In Brazil, the 1988 constitution⁸ favored the vertical model of transfers, both as a mechanism to balance the interregional differences in the federation and as a simple devolution tool, responsible for devolving to municipalities the revenue derived from federal taxes. In this sense, the Brazilian intergovernmental transfers are intended either to return more funds to municipalities, which have little ability to collect, as to balance the distribution of public resources among states and municipalities with economic disparities.

2.3 THE RISKS BEHIND AN EXCESSIVE FISCAL TRANSFER POLICY

Despite the benefits of equalization of regional disparities that are assigned to intergovernmental transfer funds, the literature suggests that there might be some dangers associated with the indiscriminate use of this tool.

As Oates (1999) argues, local governments tend to act with more fiscal responsibility when they are largely responsible for their source of funds, *i.e.*, when their source of funds depends largely on their own efforts, collection itself, and not on central government transfers.

In this sense, the literature argues that the indiscriminate use of intergovernmental transfers can stimulate uncontrolled behavior in the conduct of fiscal policy that, ultimately, may result in dangerous expansion of fiscal deficits and public debt.

Prud'homme (1995) illustrates this issue with the cases of Brazil and Argentina, which have seen their public debt growing vigorously during the 80s and 90s, largely represented by a surge in the debts of state and local governments.

⁸ It is the federal constitution that establishes the non-discretionary intergovernmental grants model.

In the Argentine case, the author argues that the central government transfers, which consisted largely of *a posteriori* discretionary grants aiming at the reorganization of the growing state debts, ended up encouraging a mismanagement behavior by regional governments that counted on increasing transfers. Something very similar to that happened with Brazil, according to Mora and Varsano (2001). The central government became, at that time, the principal creditor of the states as well as a guarantor of state borrowings⁹.

Thus, there seems to be a balance between the transferring of power to raise taxes and the transferring of funds, as grants, to solve inequality problems among different regions within a federation. In fact, this is one of the main discussions behind the issue of federalism. What is the ideal level of autonomy to raise taxes that should be given to subnational governments so that they can raise the amount of money they need? Is there an optimum level of transferring funds from central government to state and local governments aimed to solve regional inequalities?

In fact, there is no consensus to these questions. Alternatively, regardless of the solution that each country finds, the literature converges to point out that there should exist some kind of mechanisms of control over regional/local governments expenditures and indebtedness in order to prevent uncommitted behavior that might create imbalances in public accounts. Otherwise, in some cases, this regional behavior could contribute to a fiscal imbalance and to a bad economic performance of the whole federation (Tanzi, 1995).

3 - FISCAL DECENTRALIZATION AND THE USE OF INTERGOVERNMENTAL GRANTS IN BRAZIL

3.1 THE 1988 BRAZILIAN CONSTITUTION: A NEW MILESTONE IN DISTRIBUTION OF TAX REVENUES AND RESPONSIBILITIES

In the years before the democratic openness of the country, during the late 80's, the federal model suffered major restrictions. Part of the centralization trend observed during this period, from late 60's to late 80's, might be explained by both the undemocratic character of the regime prior to 1988, which controlled the electoral process at all three levels of government, as the central planning of public finances,

⁹ In order to solve this problem, the Fiscal Responsibility Law (LRF), enacted in 2000, imposed borrowing constraints to states/municipalities and severe fiscal discipline to all levels of Brazilian public administration.

which resulted in the exhaustion of the financial capacity of state and local governments (SOUZA, S., 2003).

After this centralizing period, with the transition to a democratic regime, following the winds that blew across Latin America, the Brazilian Congress began to play a more important role in the national political scene. Added to this, the redemocratization period was marked by the strengthening of subnational authorities, with the addition of new political actors to the federal arena and the return of the multiparty system (*Idem*, 2003).

This scenario, coupled with a strong regional and local demand for public services and autonomy, suppressed for more than 20 years of centralization and military dictatorship, gave way to a constitution that could only focus on political, administrative and tax decentralization in the country. In this way, the Constitution of 1988 is widely recognized as an effectively decentralizing constitution with regard to many respects by the literature (REZENDE, 1995; SANTOS, 2003).

Thus, one of the major milestones of the new democratic constitutional order of 1988 is undoubtedly the new structure of Brazilian fiscal federalism. According to Santos (2003), the democratic Constitution

[...] came up with a vigorous tax decentralizing model in favor of subnational governments. In particular, municipalities were the biggest beneficiaries. The Constitution ensured them both a greater participation in the total public income as a greater autonomy concerning public expenditure (SANTOS, 2003, p. 61).

About this broad distribution of powers and responsibilities institutionalized by the new constitution, Loureiro (2001) states that the 1988 Constitution assured wide autonomy to subnational governments to set tax rates, define organizational structures, and freely apply their own resources and transfers granted from the Union. All these initiatives were aiming at the benefits of fiscal decentralization and at narrowing the distance between the government and society.

As for the distribution of tax powers institutionalized by the 1988 Constitution, it can be seen from Table 1 that the number of levies under the responsibility of the central government (the Union) decreased, while state and municipal tax powers were increased, pursuing the goal of increasing the tax base under the responsibility of state and local governments (Cossio, 1998).

Table 1
Tax assignment by level of government, before and after 1988 Constitution

| Level of government | 1967 Constitution | 1988 Constitution |
|-----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| The Union | <p>?Taxes:</p> <ul style="list-style-type: none"> - Import Tax (II) - Export Tax (IE) - Tax on industrialized Products (IPI) - Tax on Financial Transactions (IOF) - Rural Property Tax (ITR) - Income Tax, over corporation and natural person (IRPF e IRPJ) - Extraordinary Tax (IE) <p>- Unique Consumption Taxes - Impostos Únicos (IULC, IUEE, IUM)</p> <ul style="list-style-type: none"> - Tax on Transportation (IT) - Tax on Communications (ISC) <p>?Public Fees ?Improvement Contributions ?Social Security Contribution</p> | <p>?Taxes:</p> <ul style="list-style-type: none"> - Import Tax (II) - Export Tax (IE) - Tax on industrialized Products (IPI) - Tax on Financial Transactions (IOF) - Rural Property Tax (ITR) - Income Tax, over corporation and natural person (IRPF e IRPJ) - Extraordinary Tax (IE) <p>- Tax on accumulated fortunes (IGF) (not implemented yet)</p> <p>?Public Fees ?Improvement Contributions ?Social Contributions, in general</p> |
| States | <p>?Taxes:</p> <ul style="list-style-type: none"> - Tax on consumption of goods (ICM) - Tax on property transfers - <i>inter vivos</i> (ITBI-IV) - Tax on motor vehicle property (IPVA) <p>?Public Fees ?Improvement Contributions</p> | <p>?Taxes:</p> <ul style="list-style-type: none"> - Tax on consumption of goods and services (transportation, telecommunications and electricity) (ICMS) - Heritage and endowment Tax (ITCMD) - Tax on motor vehicle property (IPVA) <p>?Public Fees ?Improvement Contributions ?Social Security Contribution for State public servants</p> |
| Municipalities | <p>?Taxes:</p> <ul style="list-style-type: none"> - Tax on Urban Property (IPTU) - Tax on other services (ISS) <p>?Public fees ?Improvement Contributions</p> | <p>?Taxes:</p> <ul style="list-style-type: none"> - Tax on Urban Property (IPTU) - Tax on other services (ISS) - Tax on property transfers - <i>inter vivos</i> (ITBI-IV) - Sales tax on fuel (IVVCL) <p>?Public Fees ?Improvement Contributions ?Social Security Contribution for Municipalities public servants</p> |

Source: made by the author, adapted from Cossío (1998) and Rezende (1995).

For the Union, there was a quantitative reduction in the number of taxes under its jurisdiction, from twelve to seven. However, those taxes with greater collection potential remained under its purview, except for the ICMS¹⁰ (SANTOS, 2003). The former *Impostos Únicos* (Unique consumption taxes), including taxes on transportation and communications, were abolished by the 1988 constitution and

¹⁰ The ICMS is a consumption tax (for goods and services) very similar to a Value Added Tax (VAT) that is under the responsibility of states and is currently the major tax in Brazil with respect to collection (21.28 % of total tax collection in 2009).

their bases have been added to ICMS base, which has made it a major source of collection (AFONSO; SERRA, 1999). The novelty was the possibility of imposing a tax on large fortunes (IGF) by the Union, originally designed to tax the rich and to serve as an instrument to reduce social inequalities. However, despite the constitutional provision, the Union has never implemented such a tax.

The states, in turn, did not have a quantitative increase in the number of taxes under their jurisdiction. However, the strength assigned to the new ICMS, with the expansion of its base, including services such as telecommunications and electricity, was able to greatly strengthen the tax collection of states.

Municipalities remained with the property tax (IPTU) and the services tax (ISS). Additionally, they have been added two new taxes: the tax on transfers of real estate property (ITBI-IV) and the retail sales tax on liquid and gaseous fuels (IVVC). Therefore, after the new Constitution, the number of taxes under the jurisdiction of municipalities increased from two to four. However, the proceeds from the collection of the land tax (ITR), previously collected by the Union and fully intended to municipalities, were distributed only half, or 50% each, after 1988 (BRAZIL, 1988).

Despite these changes in the distribution of tax powers, it is important to note that the 1988 Constitution, besides conferring a greater number of taxes to subnational governments, expressly has forbidden the possibility of any intervention or interference by the Union in the administration of state or local taxes, giving strength and authenticity to the Brazilian fiscal federalism (COSSÍO, 1998).

3.2 NEW TAXES: THE GROWTH OF SOCIAL CONTRIBUTIONS

A major difference between the constitutional tax system implemented in 1988 and the previous system lies precisely in the fact that social contributions¹¹ have been given an explicitness highlighted in the text (BRAZIL, 1988), making then a new species of tribute.

Out of the five main types of tributes in Brazil (taxes, social contributions, public fees, improvement and economic contributions and compulsory loans), taxes

¹¹ According to the Constitution, the social contributions are a kind of tribute that must finance entirely social security, public health and welfare.

and social contributions represent almost the totality of federal, state and local revenues and are the main source of funding for the government¹² (BRAZIL, 2009).

There is one important aspect, however, that differ taxes from social contributions in the new constitutional order that was crucial for changes in the structure of fiscal federalism in Brazil in the post-1988 constitution period. Whereas the power to impose taxes was distributed more equitably between the different federal entities, as it could be seen in Table 1, the same did not happen with social contributions.

First, the 1967 Constitution guaranteed to the Union exclusive right to establish and collect the social security contribution, a particular kind of social contribution. Then, the 1988 Constitution maintained and actually enhanced this exclusivity, by giving the Union the possibility to establish new social contributions, besides the social security contribution. The only exception to this rule was the conferral of jurisdiction to states and municipalities to impose a social security contribution on their public servants, in order to finance their own pension systems (BRAZIL, 1988).

Precisely through this residual power, the Union began to seek new sources of funding. After 1988, it could be seen a process of creating new social contributions by the Union aimed to finance the services under its responsibility and to address the fiscal imbalance experienced by the country in the 1990s. This contributed to the vigorous growth of the tax burden of the country in recent years (Vianna *et al.* 2000).

So the emergence of new social contributions under the responsibility of the Union raised suspicions about a new concentration trend of resources in the Union, since the collection from new social contributions was not distributed to or shared with states and municipalities, such as taxes were, according the 1988 Constitution.

There are some examples of new social contributions imposed in the recent period by the Union such as: i) the social contribution on corporation income (CSLL), a social contribution with a calculation basis very similar to the Income Tax, ii) the check tax (CPMF), a social contribution on financial transactions that no longer exists, iii) CIDE, an economic contribution levied on consumption of fuel. Besides the imposition of additional contributions as mentioned, it could be observed a significant

¹² In 2008, taxes and social contributions accounted for more than 90% of the total collected.

increase in the rates of previous existing social contributions, such as PIS and *Cofins*, a kind of turnover tax.

3.3 NON-DISCRETIONARY INTERGOVERNMENTAL GRANTS

In spite of granting higher autonomy and implementing significant changes in the distribution of tax powers between states and municipalities, the reform implemented in 1988 did not represent a restructuring of the tax system established in 1967 (VARSANO, 1996; COSSÍO, 1998). In fact, the small changes implemented by the new constitution in the structures of the taxes represent more an adaptation to the new democratic reality of the country than the establishment of an entirely new tax system.

Despite this important finding, from the federalist perspective, in terms of public revenue sharing between the three levels of government in Brazil, the reform of 1988 introduced profound changes and innovations such as new intergovernmental grants (REZENDE, 1995). Most of these transfers aimed at achieving the goal of equalization of regional differences, overlooked by the previous model. Thus, the previously predominant devolutionary transfers gave way to redistributive transfers, focusing mainly the poorest and least developed cities and states.

Importantly, most of the interjurisdictional grants for transferring resources established in 1988 strictly followed the fundamentals of fiscal decentralization principles. In other words, the states and municipalities that benefited from the constitutional grants had total autonomy for spending. There was no type of binding or targeting of expenditures for unconditional transfers. States and municipalities were free to manage their resources in a manner that was best suited for their interest, with the exception of the resources directed to health and education (BRAZIL, 1988; OATES, 1999).

In the words of Loureiro (2001, p. 85), "[...] the Constitution of 1988 gave autonomy to the governors and mayors to fix tax rates, establish administrative structures, to fix wages, apply freely own resources and transfers they receive from the Union."

For Varsano (1996) and Souza C. (2002), the 1988 model ended up favoring the transfer system in relation to the collection capabilities, especially in the case of municipalities.

In the next pages, Table 2 presents the structure of the non-discretionary, or unconditional, interjurisdictional transfers between the three levels of government that was institutionalized by the Constitution of 1967 and compares with the new structure established in 1988. By using Table 2, it becomes easier to see the strengthening of intergovernmental transfers promoted by the 1988 Constitution, both devolutionary as redistributive transfers.

Note that only the revenues derived from taxes have been shared. The revenue from social contributions remained under the Union responsibility, as established by the constitutional model of 1988.

Table 2

Main unconditional Intergovernmental transfers under the constitutions of 1967 and 1988.

| Constitution of 1967 | Constitution of 1988 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Transfers from the Union to States | |
| <ul style="list-style-type: none"> - Fundo de Participação dos Estados (FPE) (originally, 10% of the collection from Income tax (IR) and IPI)* - Fundo Especial (2% of the collection from Income tax (IR) and IPI)** - 60% of IUEE; 90% of IUM and 40% of IULC - Withheld income tax (IR) from state's public servants | <ul style="list-style-type: none"> - Fundo de Participação dos Estados (FPE) (21.5% of the collection from Income tax (IR) and IPI) - Fundos de financiamento do Nordeste (FNE), do Norte (FNO) e do Centro-Oeste (FCO) (3% of the collection from Income tax (IR) and IPI) - 20% of tax revenue that the Union would impose (Not included social contributions) - Withheld income tax (IR) from state's public servants - Compensatory transfer to exporting states (FPEX) - 30% of the collection from IOF on gold as a financial asset |
| Transfers from the Union to Municipalities | |
| <ul style="list-style-type: none"> - Fundo de Participação dos Municípios (FPM) (originally, 10% of the collection from Income tax (IR) and IPI)* - Withheld income tax (IR) from Municipalities' public servants - 100% of the collection from ITR - 10% of the inflow of IUEE and 20% of IUM, IULC and IT | <ul style="list-style-type: none"> - Fundo de Participação dos Municípios (FPM) (22.5% of the collection from Income tax (IR) and IPI) - Withheld income tax (IR) from Municipalities' public servants - 50% of the collection from ITR - 70% of the collection from IOF on gold as a financial asset |
| Transfers from States to Municipalities | |
| <ul style="list-style-type: none"> - 20% of ICM | <ul style="list-style-type: none"> - 25% of ICMS - 50% of IPVA - 25% of the compensatory transfers to exporting states (FPEX) |

Source: made by author, adapted from Brasil (1988) and Cossio (1998).

* After several changes, the percentages for the FPE and FPM values were established as 14% and 17% respectively of the total IR and IPI collection.

** Created shortly after the 1967 Constitution, in 1968, by the Complementary Act 40.

As noted, with the new constitution, the main instruments of intergovernmental transfers in Brazil have expanded. First, the main interjurisdictional grants of Brazilian federalism - FPM and FPE - have had their values adjusted progressively, resulting in a dramatic change in volume. At the same time, these funds have been redefined in order to achieve more redistributive purposes. Complex criteria were established for allocating funds among different states and municipalities, which took into account the territorial extension, population and *per capita* income, for example, to ensure greater participation to poorer states and municipalities (BRAZIL, 1988; SANTOS, 2003).

All these changes have meant major changes in the vertical structure of the division of resources between the three levels of government, after the constitutional transfers. Varsano (1996) notes that, in practice, these modifications imported in a transfer of federal funds for municipalities. Moreover, according to him, it appears that states, which "[...] since 1976 were net recipients of transfers, now have less disposable revenue than the amount raised by them, after the interjurisdictional transfers [...]" (VARSANO, 1996 , p. 16). In other words, municipalities have benefited both by funds transferred from the union as from the states.

3.4 THE BRAZILIAN FISCAL FEDERALISM DYNAMICS AFTER 1988

Despite some important changes implemented in 1988 and the emergence of a new institutional framework for the country, the period after 1988 has been marked by several institutional reforms in different areas of the Brazilian government. According to Oliveira and Silva (2000), in the last decade there has been a major change process, an institutional one, with the redefinition of the role of the state in the Brazilian economy.

As part of this process, some remarkable structural changes in fiscal institutions have taken place in the country. On one hand, from the perspective of the disposable revenue regarding the three levels of the federation, new fiscal institutions changed the arrangement of the Brazilian fiscal federalism, especially with the emergence of new taxes and the creation of new constitutional transfer grants. On the other hand, restrictions on the borrowing capacity of states and

municipalities also have altered the dynamics of the Brazilian fiscal federalism, but from the perspective of public spending¹³.

All these changes were perhaps the natural continuation of an unfinished process of fiscal decentralization introduced by the 1988 Constitution, reflecting the more decentralized and democratic reality of the country.

Although political forces have played a major role in boosting the entire process of institutional change after the Constitution, as noted by Loureiro (2001), this paper does not address the issue of political contingencies that have permeated and influenced the various institutional changes that marked the period. The main concern of this study rests on the analysis of possible effects of these institutional changes in the structure of fiscal federalism in Brazil, with emphasis on its effect on intergovernmental transfers.

As seen in the previous topic, during the years following the Constitution, successive measures were taken that kept increasing the collection of social contributions by the Union. Such initiatives have been taken in order to provide the Union more financial capacity. Note that the period after 1988 was marked by a strong increase in overall tax burden in the country. All three spheres of government have increased their disposable revenue in the period.

Studies of Mora and Varsano (2001) indicate that the tax burden during the 70 years stood at around 25% of GDP, when it suffered a small reduction in the late 80s. With the new constitution in 1988, the tax burden went up again and reached 28.8% of GDP in 1990. After the monetary stabilization plan (Plano Real) in 1994, the burden went up successively, jumping from about 29% to 35.86% in 2002 and reached 35.91% in 2004, where it seems to have found a new plateau, as it will be seen in the next chapter.

However, it is necessary to emphasize that a deliberate and premeditated re-centralization of power in the Union, as suggested by several recent institutional changes, did not find space on the agenda of the federal government, given the lack of political support and resistance from congress. According to Afonso and Serra (1999), this re-centralizing trend was not successful because it made no sense "[...] from the standpoint of administrative efficiency and social welfare, especially in such

¹³ On the evolution of state and municipal debt, its effects and restrictive measures adopted by the government, such as the Fiscal Responsibility Law (LRF) adopted in 2000, see Souza (2003) and Versiani (2003).

a heterogeneous country, with large population and territory." (AFONSO; SERRA, 1999).

In this sense, ongoing decentralization measures were taken recently to counter balance recentralizing initiatives, perhaps lead by the great pressure from regional political forces and from the congress.

Given the noticeable dynamics of Brazilian fiscal federalism in recent years, additional changes aimed at redistributing resources among the three levels of government were added to the constitution through a number of constitutional amendments in response to the creation of non-shared contributions by the central government. New unconditional intergovernmental grants were added to the Constitutional text.

Therefore, after the last changes and amendments¹⁴, for the purposes of this paper, we considered the following non-discretionary intergovernmental transfers, shown at right in Table 3, in the next page:

¹⁴ Updated up until the 44th constitutional amendment, in 2004.

Table 3

Main unconditional intergovernmental transfers under the 1988 original constitution and after its amendments, up until the 44th amendment in 2004.

| Constitution of 1988 | 1988 Constitution after amendments |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Transfers from the Union to States | |
| <ul style="list-style-type: none"> - Fundo de Participação dos Estados (FPE) (21.5% of the collection from Income tax (IR) and IPI) - Fundos de financiamento do Nordeste (FNE), do Norte (FNO) e do Centro-Oeste (FCO) (3% of the collection from Income tax (IR) and IPI) - 20% of tax revenue that the Union would impose (Not included social contributions) - Withheld income tax (IR) from state's public servants - Compensatory transfer to exporting states (FPEX) - 30% of the collection from IOF on gold as a financial asset | <ul style="list-style-type: none"> - Fundo de Participação dos Estados (FPE) (21.5% of collection from Income tax and IPI) - Fundos de financiamento do Nordeste (FNE), do Norte (FNO) e do Centro-Oeste (FCO) (3% of the collection from Income tax (IR) and IPI) - 20% of tax revenue that the Union would impose (Not included social contributions) - Withheld income tax (IR) from state's public servants - Compensatory transfer to exporting states (FPEX) - 30% of the collection from IOF on gold as a financial asset - 29% of the collection from CIDE (1/4 of this goes to the municipalities) - Fundef/Fundeb. Just in case it needs complementation - 2/3 of the collection from Salário-Educação (to be shared with municipalities) - 75 % of the resources from Kandir law |
| Transfers from the Union to Municipalities | |
| <ul style="list-style-type: none"> - Fundo de Participação dos Municípios (FPM) (22.5% of the collection from Income tax (IR) and IPI) - Withheld income tax (IR) from Municipalities' public servants - 50% of the collection from ITR - 70% of the collection from IOF on gold as a financial asset | <ul style="list-style-type: none"> - Fundo de Participação dos Municípios (FPM) (22.5% of the collection from Income tax (IR) and IPI) - Withheld income tax (IR) from Municipalities' public servants - 50% of the collection from ITR - 70% of the collection from IOF on gold as a financial asset - Complementary part of Fundef/Fundeb - Part of the 2/3 collection from Salário-Educação - 25% of the resources from Kandir law |
| Transfers from States to Municipalities | |
| <ul style="list-style-type: none"> - 25% of ICMS - 50% of IPVA - 25% of the compensatory transfers to exporting states (FPEX) | <ul style="list-style-type: none"> - 25% of ICMS - 50% of IPVA - 25% of the compensatory transfers to exporting states (FPEX) - Complementary part of Fundef/Fundeb |

| | |
|--|-----------------------------------------------------|
| | - 1/4 of the states' transfers from CIDE collection |
|--|-----------------------------------------------------|

Source: made by the author, adapted from Brasil (1988).

4 - THE RECENT EVOLUTION OF RESOURCES TRANSFERRED BETWEEN THE THREE LEVELS OF GOVERNMENT IN BRAZIL: 1995-2009

Once raised the main features of the Brazilian federal model and its recent changes, especially regarding the creation of new contributions and the concomitant establishment of new intergovernmental transfers, we must evaluate the result of these changes on the amount of resources transferred between the three levels of government, after the stabilization of the currency in 1994.

Some very specific data could shed some light on this issue and help to clarify what measures - centralized or decentralized - had the greatest impact in the Brazilian fiscal federalism model. In this sense, this paper presents some data about the Gross Tax Burden¹⁵ progress and the evolution in the amount of the Constitutional Transfers: i) from the Union to the states; ii) from the Union to the municipalities; and iii) from the states to the municipalities; in the last years.

The data presented refer to the recent period of monetary stability, given the difficulty of comparison with figures from other periods prior to *Real*, established in July 1994. The data were obtained from the Brazilian Internal Revenue Service and consolidated. It should be noted that the years leading up to the *Real* were hugely influenced by hyperinflation and there were innumerable currency changes in a short period of time.

Accordingly, in order to avoid discontinuities due to factors unrelated to the dynamics of fiscal decentralization in the period, the chosen data period deals exclusively with the period of monetary stabilization, or the *Real* era, which goes from 1995 to 2009.

The total amount transferred annually between the different spheres of government is presented in relative terms with reference to its share in GDP. It should be noted that GDP is the benchmark in studies of tax burden by being named as the main factor influencing the growth of revenues, excluding inflation.

The use of GDP as a benchmark is justified because changes in nominal or absolute volume of transfers do not necessarily mean increased decentralization. It

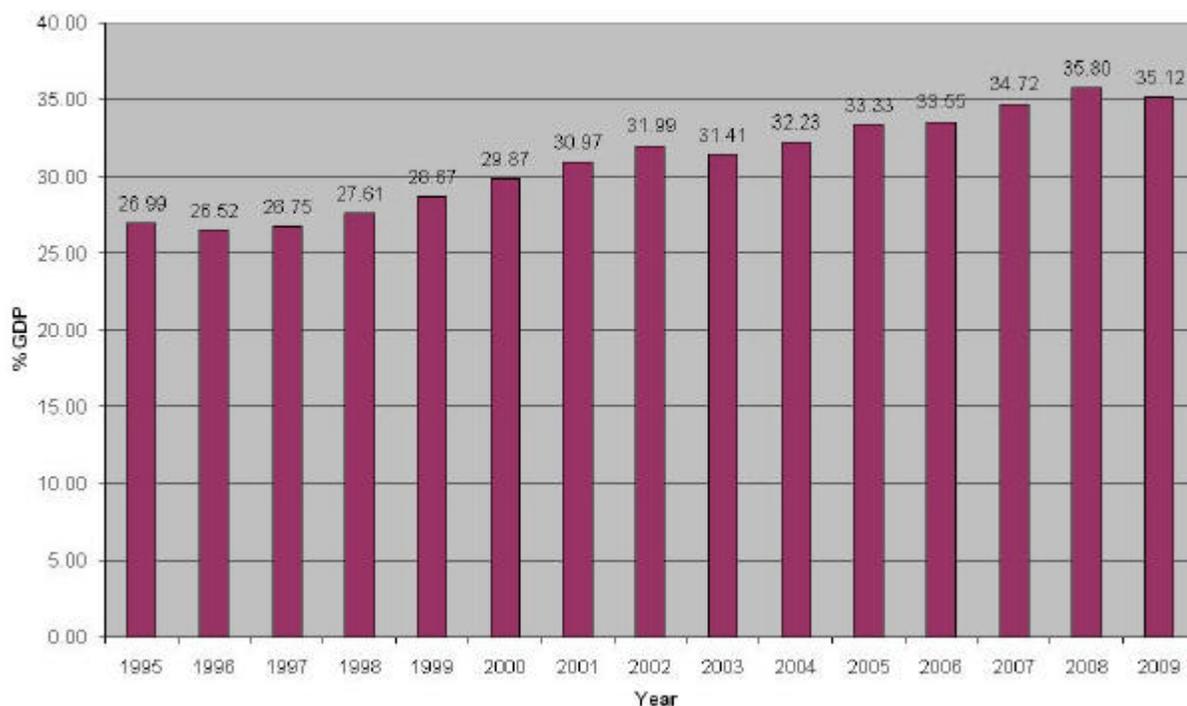
¹⁵ The concept of Gross Tax Burden adopted in this paper is quite wide and follows the concept used by the Brazilian Internal Revenue Service (BRAZIL, 2009). It corresponds to the total amount collected from the three spheres of government, serving as an indicator of the whole society effort to fund the government activities.

is important to measure the transfers in relative terms, considering the evolution of GDP in the period, in order to eliminate the unwanted effect of variables such as inflation in the period. The presence of inflation could ascertain whether there was actual increase in resources available to regional governments or not.

As a simplification adopted in this study, it is assumed that the effect of inflation on the collection of taxes and on intergovernmental transfers is the same that incurs on nominal GDP over the period studied, thus it can be assumed, as a consequence, that inflation has no effect on the analyzed data¹⁶.

As a benchmark, Graph 1 shows the evolution of Gross Tax Burden in the Real era.

Graph 1 - Brazilian Gross Tax Burden in the Real era (% of GDP)



Source: made by the author, data from the Federal Revenue Department (RFB)

Confirming what was stated in the previous chapters, Graph 1, above, shows that the Brazilian Gross Tax Burden, in relative terms, regarding the three levels of government presented a general trend of growth in the analyzed years, despite some variation in the period. From 1995 to 2009, the Brazilian tax burden increased

¹⁶ By adopting this simplification, the deflector of the nominal GDP becomes the same as for the nominal Gross Tax Burden and for the intergovernmental transfers. Therefore, the deflators which were in the denominators get canceled up when the transfers are divided by the Gross Tax Burden.

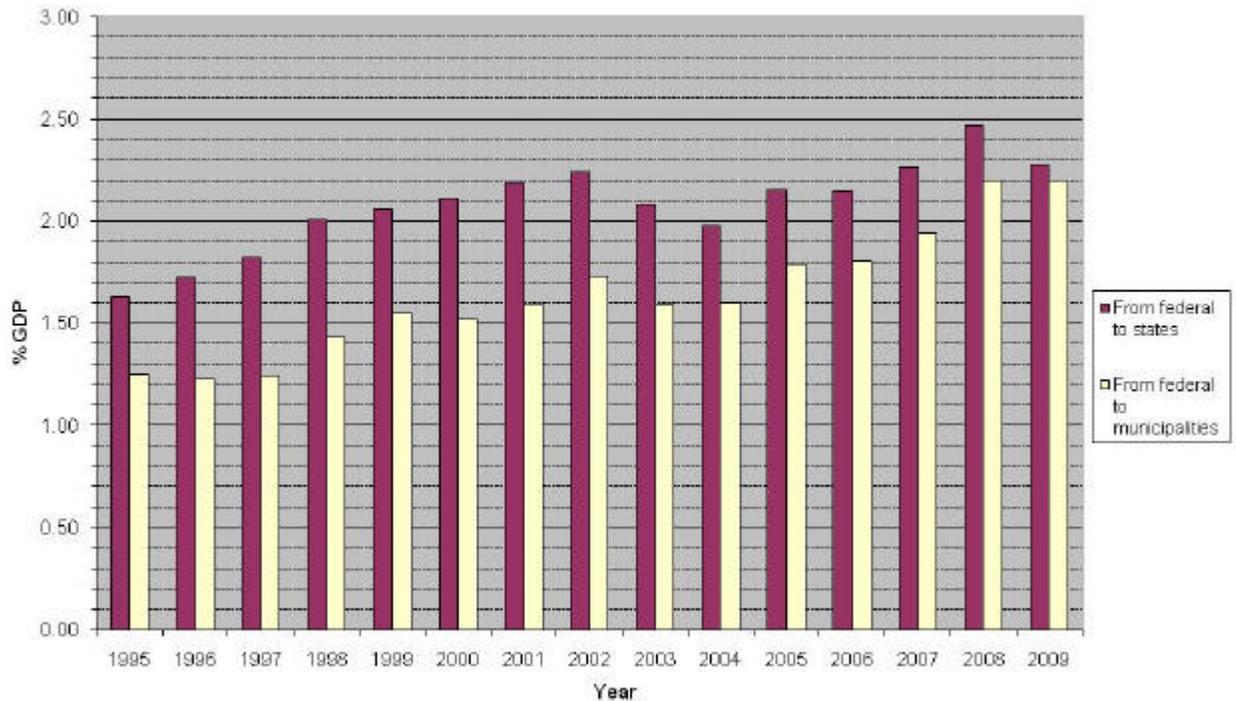
by just over 30% and reached its peak in 2008, when the burden accounted for about 35.8% of the GDP.

The growth of the tax burden in the recent years can be explained either by the creation of new taxes, especially social contributions, as by an increase in tax/contributions rates, as the increases in PIS and Cofins, as mentioned in the previous topics. Graph 1 confirms this increasing tendency and illustrates the “collecting efficiency” of the fiscal instruments adopted by the central government in order to get more resources to meet the growing social demands.

However, as an objective of this paper, it is still necessary to assess whether this vigorous growth of the tax burden took place with a corresponding increase in the intergovernmental transfers or, unlikely, contributed to a greater concentration of resources in the Union.

In order to clarify this matter, Graph 2, below, shows the recent evolution of the total amount of resources unconditionally transferred¹⁷ from the Union to states and municipalities, also as a percentage of GDP.

Graph 2 - Transfer grants from the federal government to states and municipalities (% of GDP)



Source: made by the author, data from the Federal Revenue Department (RFB)

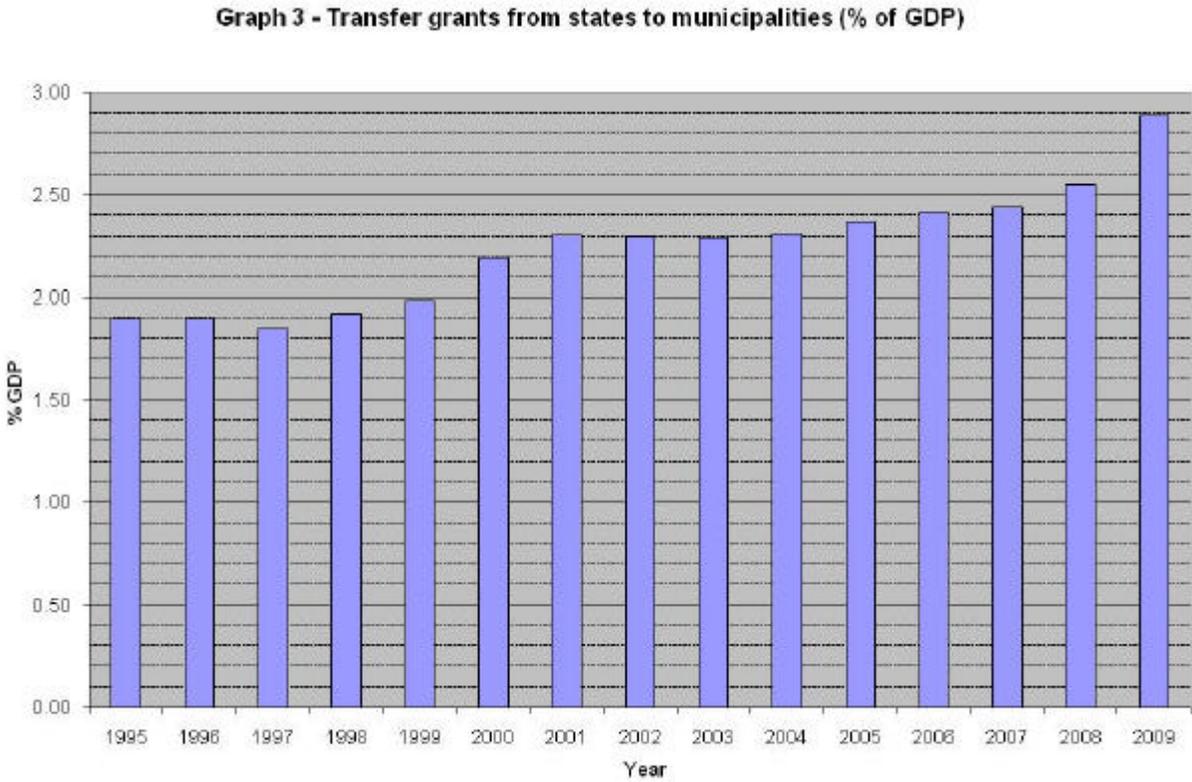
¹⁷ Non-discretionary intergovernmental transfers according constitutional directives.

According to Graph 2, it is possible to note that despite some fluctuation the volume of resources transferred from the Union to the states and Municipalities showed similar trends and variations in the analyzed years, with actual real growth of both transfers in relation to the GDP in the analyzed years.

In 1995, the first full year of the Real as a currency, transfers from the Union to states represented just over 1.5% of GDP. However, by the end of the period analyzed, in 2009, that figure represented more than 2.25% of GDP, with significant growth of 39.73% over the period analyzed.

At the same time, the volume of resources transferred from the Union to municipalities jumped from about 1.25% of GDP in 1995 to about 2.25% of the GDP in 2009, representing a growth even higher than the proportional increase in transfers from the Union to states. Throughout the study period, transfers from the Union to municipalities soared impressively 76.05%.

Finally, Graph 3, below, shows the evolution of transfers from states to municipalities during the Real era, in relative terms (% of GDP).



Source: made by the author, data from the Federal Revenue Department (RFB)

Graph 3, above, illustrates the growing trend throughout the period for the transfers from states to municipalities, also following the tax burden growth. However, unlike the previous transfers, the peak of the state-municipalities transfers shown in Graph 3 was reached last year, in 2009, when the amount transferred from states to municipalities reached more than 2.75% of GDP.

Throughout the years analyzed, the volume of transfers between states and cities went up by about 52.38%. This growth rate also exceeds the growth rate observed for the gross tax burden in the same period.

5 - CONCLUSIONS

Aiming at achieving the goals listed in the introduction of this paper, this study sought to follow the paths that could lead to an answer to the research question, presented in the introduction.

First, after a brief review of the literature on current issues involving the study of fiscal federalism, encompassing the main concepts and hot issues, this study tried to build up a bibliographic research to characterize the model of fiscal federalism implemented by the last Brazilian constitution, in 1988. This characterization also sought to uncover the origins of the current model for allocating resources between the three levels of government in the Brazilian federation.

As a second step, after highlighting that the federal model implemented by the 1988 Constitution had been suffering from several institutional changes, as perceived by the specialized literature, this study intended to point out the main changes that could have had some influence on the pattern of tax collection or distribution of resources among the federation.

Considering the changes implemented, it could be observed that the federal government indeed has adopted a policy of establishing new fiscal instruments, such as new social contributions, resulting in the growth of the Gross Tax Burden rate in the years analyzed, as indicated by Vianna *et al.* (2000) and several other authors. Although, at the same time, it was possible to point out that there was a concomitant growth in the number of non-discretionary transfers from the central government to the regional and local governments.

Given that, in order to elucidate which of the initiatives had the greatest effect on the Brazilian fiscal federalism, this paper tried to identify a series of data that could reflect the growth in the tax burden *vis-à-vis* the growth in intergovernmental grants, during the same period.

By analyzing the data that reflected the evolution of the volume of resources transferred between each of the spheres of government, compared with the growth in the tax burden in the same period, it is possible to conclude that the volume of fiscal transfers between the three levels of government — i) from the Union to states; ii) from the Union to municipalities; and iii) from states to municipalities — has grown more quickly than the tax burden itself, both as percentage of GDP.

Thus, these results confirm that the Brazilian federation, despite the imposition of new contributions that initially were not shared by the Union, has been expanding the use of intergovernmental transfers as a way to strengthen fiscal decentralization in the country, especially during the period from 1995 to 2009.

The amount of resources transferred through the three examined types of transfers grew more than the global tax burden on a comparative basis with the GDP in the period, especially the transfers from the Union to the counties, which grew more than 76% in terms of percentage of GDP, indicating that the municipalities were the most benefited, as suggested by the studies of Varsano (1996) and Souza C. (2002).

Moreover, confirming previous results of Varsano (1996), it was shown that states had a negative balance of available resources after intergovernmental transfers. While the volume of funds received from the Union grew 39.7%, the volume of resources allocated to municipalities through transfers soared about 52.4% in the period, resulting in a net loss of resources at their disposal.

In this sense, it can be argued that the recent growth in the volume of intergovernmental transfers has benefited mainly the municipalities, representing an effective transfer of resources from both the Union and states.

However, it is equally important to assess whether this increase in decentralization will effectively lead to a more efficient government, as sustained by the theory of fiscal federalism. As the theory suggests, the local government, as a closer element, should allocate resources in a better way to meet the needs of population.

Moreover, to ensure all the benefits related to a more decentralized country, initiatives that could promote a greater level of accountability at the lower levels of government should be pursued. It seems to be vital that an appropriate institutional framework, focusing in accountability, be set in the country in order to foster the benefits of a more decentralized model, especially at the lower levels of government.

It also seems that this process of keeping the country as a strongly decentralized federation has had a positive impact in the current economic boom experienced by Brazil. By benefiting the poorest states of the nation, the increasing redistributive grants might have helped to trigger the economic sector of these less developed regions.

All in all, despite all the benefits associated with decentralization, it should be noted that it is also important to monitor whether this process of expansion of intergovernmental transfers will stabilize at some point or will continue to increase. In the case it continues growing, it is crucial to assess the effectiveness of decentralization in improving efficiency and combating regional inequalities, the main argument for the extension of intergovernmental grants.

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