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Federalism in Brazil

*Keith S. Rosenn**

I. INTRODUCTION

Unlike in Canada and the United States, where federalism was a technique for uniting states and provinces that had once been autonomous political entities, in Brazil federalism was a technique for dividing what had always been a unitary system of government.¹ Unlike her neighboring colonies of Latin America, Brazil followed a unique path that led to independence without war, and to the establishment of a constitutional monarchy that lasted for 67 years.²

Under the Empire, Brazil had a unitary system of government, divided into twenty provinces. The provinces served as election districts for a National Congress with a Senate and a Chamber of Deputies. The provinces elected deputies for four-year terms. The Emperor, however, selected the Senators, who would serve life terms, from a list of three names submitted by each province. Unfortunately, the election process was so manipulated by the central government that the Congress did little to represent the interests of the very limited electorate.

The Brazilian provinces were further subdivided into municipalities,³ with each province and municipality electing its own council. But these councils had no legislative, taxing, or adminis-

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1. In practice, however, the enormity of Brazil's land mass and the weakness of the Portuguese colonial regime meant that large parts of Brazil, especially in the interior, were ruled *de facto* by large landowners. Moreover, the Portuguese Crown began its reign in Brazil by creating a series of hereditary captaincies in which the King ceded vast powers to a small group of large landowners.

2. In the beginning of the 19th century, in response to Napoleon's invasion of the Iberian peninsula, the Portuguese monarchy relocated to Rio de Janeiro. In 1815, the Crown proclaimed the Joint Kingdom of Brazil and Portugal. Not until 1820 did the Portuguese finally persuade the reluctant King João to return to Portugal, but he left behind his son, Pedro, as regent. In 1822, Pedro declared Brazilian independence, and Portugal peacefully acquiesced.

3. The Portuguese term *município* is usually translated as municipality, but its administrative characteristics are actually closer to a county. This is because the *município* is not simply a city, but also includes the rural territory surrounding an urban area.

trative powers. Any resolution they proposed had to be submitted to the National Congress for enactment into law. Real authority to govern each province rested in a president, who was appointed and removed by the Emperor.⁴ Despite considerable unhappiness from the wealthier southeastern and southern provinces, who favored decentralization, devolution of tax revenues, and diminution in their subsidies to the economically backward Northeast, the Empire managed to hold the vast subcontinent of Brazil together until its forcible overthrow.

In 1889, the military, with the encouragement of certain civilian groups, staged a *coup d'état* and declared Brazil a federal republic. The 1891 Constitution, which was modeled upon that of the United States, institutionalized Brazilian federalism. Brazil did not adopt federalism for the traditional reasons of uniting polities that had previously been sovereign entities, nor as a device to govern different ethnic, linguistic, or religious groups. Indeed, there was no serious bargaining among the members of the federation about its future characteristics; the virtually powerless former provinces were simply converted into quasi-sovereign states, first by military fiat and later by the 1891 Constitution.

The Brazilians adopted federalism as a reaction against the Empire's authoritarian, heavily centralized rule in a country with enormous size and distinct regions with quite different traditions. Brazil has a land mass of roughly 8.5 million square kilometers, making it the fifth largest country in the world. Because federalism grants regional units significant political and economic autonomy, it is a useful system for governing large land masses with diverse regions and populations. Federalism has allowed Brazil to maintain national unity while creating a substantial measure of local autonomy to accommodate economically diverse regions. If only because of its immense size, federalism is a sensible form of government for Brazil.

Federalism is presently far stronger in Brazil than in any other Latin American country.⁵ Yet Brazilian federalism, like that of the other Latin American federalist nations, is far more centralized than it is in Canada or in the United States. British colonization synthesized Protestantism, Locke's social compact theory, and

4. HERMAN G. JAMES, *THE CONSTITUTIONAL SYSTEM OF BRAZIL* 5 (1923).

5. Keith S. Rosenn, *Federalism in the Americas in Comparative Perspective*, 26 U. MIAMI INTER-AM. L. REV. 1, 43 (1994).

the natural rights of Englishmen.⁶ This North American inheritance of theology and political theory was far more conducive to the structured dispersal of power among many regional centers than Brazil's inheritance of the centralized, hierarchical organization of Roman Catholicism coupled with the absolutism of the Portuguese monarchy.

II. A BRIEF HISTORY OF FEDERALISM IN BRAZIL

Since 1891, Brazil has oscillated between centralized and decentralized political governance. Brazilian federalism has gone through the following five distinct phases: (1) the Old Republic (1889-1930); (2) the authoritarian rule of Getúlio Vargas; (3) the Democratic Restoration period (1945-1964); (4) the Military Regimes (1964-1985); and (5) the New Republic (1985 to the present).

A. *The Old Republic (1889-1930)*

The era known as the Old Republic began by the conversion of twenty former provinces into quasi-sovereign states. Each state and the federal district elected three Senators to the National Congress. Representation in the National Chamber of Deputies was apportioned among the states in accordance with population, but each state had at least four deputies. States were given vast powers to govern themselves and to impose taxes, but the principal revenue sources allocated to the states were taxes on imports and exports, measures antithetical to the creation of a common market. States were also given the power to raise their own armies and to borrow money abroad. The federal government was relatively weak, and the country was dominated by the governors of two powerful states, São Paulo and Minas Gerais. Elections were marred by widespread manipulation and fraud, and the federal government not infrequently intervened in the operation of the weaker states. Because federalism functioned so poorly, Brazil adopted a constitutional amendment in 1926 that substantially

6. For the importance of the Protestant, particularly Calvinist, theological underpinnings for the development of federal democracy in the U.S. colonies, see Daniel J. Elazar & Ilan Greilsammer, *Federal Democracy: The U.S.A. and Europe Compared A Political Science Perspective*, in *INTEGRATION THROUGH LAW: EUROPE AND THE AMERICAN FEDERAL EXPERIENCE* 71, 77-79 (Mauro Cappelletti, Monica Seccombe & Joseph Weiler eds. 1986). See also Bernard J.S. Hoetjé, *The European Tradition of Federalism: The Protestant Dimension*, in *COMPARATIVE FEDERALISM AND FEDERATION: COMPETING TRADITIONS AND FUTURE DIRECTIONS* 117 (Michael Burgess & Alain G. Gagnon eds. 1993).

expanded the power of the federal government to intervene in the states and reduced state autonomy.

B. The Vargas Era (1930-1945)

In 1930, Getúlio Vargas, governor of the State of Rio Grande do Sul and a defeated presidential candidate in the elections held that year, came to power because of an armed rebellion of disaffected military officers, the *tenentes* (lieutenants), and members of the political elite. The rebellion was triggered by the failure to honor the bargain to rotate the presidency between the governors of São Paulo and Minas Gerais, and the assassination of the opposition's vice-presidential candidate. Vargas presided over the region during an era in which federalism was gradually reduced to an empty shell. The Vargas era was characterized by strong centralization of power in the hands of the federal government. In 1937, Vargas created the Estado Novo, a dictatorship in which the states lost their independent bases of taxation and were converted essentially into administrative divisions of a unitary state.⁷ Vargas publicly burned the state flags, closed Congress and the state legislatures, and replaced the state governors with intervenors.⁸

C. The Restoration of Democracy (1945-1964)

In 1945, another military revolt overthrew the Vargas dictatorship and reestablished a federal democracy. The 1946 Constitution granted significantly more autonomy for state and local governments. Federal intervention into the states, which had been common prior to this period, became a rarity. Governors were popularly elected, and states were given their own powers, especially the power to tax, although they were forced to share tax revenues with the municipalities. Certain measures were introduced to transfer revenues from the richer states to the poorer states, particularly those in the Northeast and Amazon regions.

7. JOSEPH LOVE, FEDERALISMO Y REGIONALISMO EN BRASIL, 1889-1937, in FEDERALISMOS LATINOAMERICANOS MEXICO/BRASIL/ARGENTINA 181, 209 (Marcello Carmagnani ed., 1993).

8. CELINA SOUZA, CONSTITUTIONAL ENGINEERING IN BRAZIL: THE POLITICS OF FEDERALISM AND DECENTRALIZATION 28 (1997).

D. The Military Regimes (1964-1985)

A military *coup d'état* in 1964 produced another cycle of strong centralization of the powers of the federal government at the expense of the states and municipalities. This was accomplished in large part by concentrating the bulk of the taxing power in the federal government.⁹ Unlike the Vargas era, the military permitted the Congress, the Judiciary, and state and local governments to function, albeit with certain restrictions. Presidential elections were held, but the franchise was restricted to generals. Congress was purged of so-called "subversive elements." State governors were also appointed by the military, and federal intervention into the states increased significantly. After 1974, as Brazil's economic growth began to stagnate and the tolerated political opposition party began to garner more votes than the government's party in the large urban areas, the military began a process of decentralization in order to try to hold on to power politically. Elections for governor were once again permitted, and substantial resources were allocated to the states and municipalities in an effort to improve the government's chances at the polls and to redress regional inequalities. The military created so-called "bionic" senators by giving each state a third senator, elected by the state assemblies, to try to ensure the government party a majority in the Senate. The military also created two new pro-government states, Mato Grosso do Sul and Rondônia, in the sparsely populated North and Center-West, and fused the opposition states of Guanabara and Rio de Janeiro into a single state called Rio de Janeiro. Eventually, after a gradual process of transition, the military permitted the return of civilian government.

E. The New Republic (1985-)

In 1985, Brazil elected its first civilian president since 1960, albeit indirectly through an electoral college selected under a set of rules skewed to favor the military government. In 1988, a new Constitution, drafted by a congress that included a group of "bionic" senators, significantly decentralized governmental powers and reinvigorated federalism.

9. See LUIS ROBERTO BARROSO, DIREITO CONSTITUCIONAL BRASILEIRO: O PROBLEMA DA FEDERAÇÃO 32-107 (1982).

III. SOME OF THE DISTINCTIVE FEATURES OF BRAZILIAN FEDERALISM UNDER THE PRESENT CONSTITUTION

A. *Allocation of Powers*

Every federal system has to resolve the problem of how to divide legislative powers between the federal government and the subnational units of government. Brazil's 1988 Constitution partly follows the allocative formula of the U.S. Constitution, but it delineates the distribution of governmental powers in far greater detail.¹⁰ The Brazil Constitution contains an usual innovation by making the Federal District and the municipalities integral members of the federation.¹¹ Brazil also borrows from the German Basic Law in permitting delegation of exclusive powers and in providing for joint and concurrent powers.¹² Article 21 of the Constitution specifically delegates to the federal government a broad array of powers that are meant to be exclusive even though not specifically denominated as such. These include the powers to maintain international relations; to declare war and states of siege and to make peace; to provide for defense; to regulate currency, exchange rates, and mineral prospecting; and to operate or to regulate radio and television broadcasting, the post office, and the federal police.¹³ Article 22 grants the federal government another broad array of powers specifically labelled "exclusive," although some of these powers overlap or repeat powers delegated in Article 21.¹⁴

In twelve areas the federal government, states, federal district, and municipalities have joint powers;¹⁵ and in sixteen areas the federal government, states, and the federal district have concur-

10. For a detailed explanation of this formula, see FERNANDO DIAS MENEZES DE ALMEIDA, *COMPETÊNCIAS NA CONSTITUIÇÃO DE* (1991).

11. BRAZ. CONST., art. 18. The Federal District is treated virtually as another state, electing its own governor and legislature. Moreover, the Federal District is represented in the federal legislature under the same allocational formula as the states. In contradistinction to the states, however, the Federal District may not have municipalities. *Id.*, art. 32.

12. German Basic Law, arts. 70-74.

13. BRAZ. CONST. art 21.

14. These include the powers to legislate with respect to civil, commercial, penal, procedural, electoral, agrarian, maritime, aeronautical, space and labor law; to regulate foreign and interstate commerce, ports and navigation, postal service, foreign exchange, expropriation, mining, informatics, national transportation policy, naturalization, social security, nuclear activities, and commercial advertising. With respect to Article 22 powers, Congress may adopt complementary laws (approved by an absolute majority) authorizing the states to legislate on specific matters in these areas of exclusive federal competence. BRAZ. CONST. art. 22 (I).

15. BRAZ. CONST. art. 23.

rent legislative authority.¹⁶ In the area of concurrent authority, the federal government's power is limited to establishing general rules.¹⁷ In the absence of federal legislation, the states may freely regulate an area; however, the supervenience of a federal law on general rules suspends the effectiveness of state legislation to the extent that it contravenes federal law. Whenever the federal government has adopted general rules, the states may adopt only supplementary legislation. The Constitution assures the political, legislative, administrative, and financial autonomy to the municipalities¹⁸ and grants them the power to legislate about subjects of local interest and to supplement federal and state legislation.¹⁹

The Brazilian Constitution contains a residual clause reserving to the states the powers not forbidden to them by the Constitution.²⁰ This clause, which stems from the 10th Amendment to the U.S. Constitution, has been included in Brazilian Constitutions since 1891, even though when the federation was first formed, the Brazilian provinces never had any powers of their own. The Brazilian Constitution does not grant specifically any exclusive powers to the states. The powers granted to the federal government are so extensive, and so much federal legislation has been enacted, that the states and municipalities are left virtually without any areas wherein they can legislate free from constraints set by the federal government.²¹ As Fábio Konder Comparato, one of Brazil's leading jurists, stated, "[T]he Union has supreme authority over other political entities in all economic and financial matters. This is true to such an extent that the old principle, that powers not forbidden to States are reserved to them, becomes entirely meaningless."²² Unlike the United States, virtually all important legislation in Brazil, such as the civil code, commercial code (what little remains in force), criminal code, procedural codes, labor code, consumer protection code, the corporation law, financial markets law, and electoral law are all federal statutes that apply uniformly throughout Brazil.

16. *Id.* at art. 24.

17. *Id.* at art. 24 (XVI) § 11.

18. *Id.* at arts. 18, 29, 30, 31, and 34(VII)c.

19. *Id.* at art. 30(I) & (II).

20. BRAZ. CONST. art. 25 § 11.

21. AUGUSTO ZIMMERMANN, CURSO DE DIREITO CONSTITUCIONAL 345-46 (2002).

22. Fábio Konder Comparato, *The Economic Order in the Brazilian Constitution of 1988*, 38 AM. J. COMP. L. 753, 758 (1990).

B. *Federalism and Judicial Review*

The 1988 Constitution significantly strengthened judicial review, creating a plethora of procedural devices by which the Brazilian courts could invalidate statutes and other norms for unconstitutionality.²³ Even though Brazil's highest court, the Supreme Federal Tribunal (*Supremo Tribunal Federal*) (hereinafter "the STF"), decides a large volume of cases,²⁴ the Brazilian judiciary really has not served as the ultimate arbiter of the balance of power between the states and the national government. That balance has usually been determined by complex political negotiations among the executive, the state governors, and the state's representatives in the national Congress.²⁵

This is not to say that the STF does not play an important role in the preservation of the federal system. Like other federal systems, the Brazilian Constitution contains a clause mandating the supremacy of federal law over state and municipal law.²⁶ The STF frequently strikes down state and municipal constitutional or statutory provisions because of conflicts with the federal constitution, federal law, or invading powers delegated to the federal government.²⁷ It also frequently resolves conflicts involving state governors and their legislatures.²⁸ What one does not find in Bra-

23. Keith S. Rosenn, *Judicial Review in Brazil: Recent Developments under the 1988 Constitution*, 7 Sw. U.J.L. & TRADE AM. 291 (2000); Keith S. Rosenn, *Brazil's New Constitution: An Exercise in Transient Constitutionalism for a Transitional Society*, 38 AM. J. COMP. L. 773, 794-98 (1990).

24. According to statistics published on its website, the STF decided a total of 107,867 cases in 2003 and 101,690 cases in 2004.

25. David J. Samuels & Scott Mainwaring, *Strong Federalism, Constraints on the Federal Government, and Economic Reform in Brazil*, in FEDERALISM AND DEMOCRACY IN LATIN AMERICA 85-125 (Edward L. Gibson ed. 2004). See also José Antonio Cheibub, Argentina Figueiredo & Fernando Limongi, "Presidential Agenda Power and Decision-Making in Presidential Regimes: Governors and Political Parties in the Brazilian Congress," Paper delivered at Am. Pol. Sci. Assoc. Annual Meeting, Boston, Aug. 29-Sept. 1, 2002.

26. BRAZ. CONST. art. 24 § 41.

27. See, e.g., ADI 1472 (D.J. Oct. 25, 2002); ADI 1918 (D.J. Aug. 1, 2003); ADI 2101 (D.J. Oct. 5, 2001); AI 2487 (D.J. Aug. 5, 2004); ADI 2024 (D.J. Dec. 1, 2000). In Representação No. 1.153-RS, Decision of May 16, 1985, 115 R.T.J. 1008 (Mar. 1986) (striking down a state law regulating toxic chemicals for agricultural use for federal preemption) the Tribunal quoted with approval the following two sentences from Professor Gonçalves Ferreira's treatise, COMENTÁRIOS À CONSTITUIÇÃO BRASILEIRA 92 (3d ed. 1982):

[T]he States are prohibited from taking any measure that prevents, makes difficult, or harms interstate commerce, whatever the means used and regardless of the motives. According to the Constitution, Brazil is one single market, governed exclusively by federal legislation.

115 R.T.J. at 1037.

28. Miyuki Sato, *Judicial Review in Brazil. Nominal and Real*, 3 GLOBAL JURIST ADVANCES 1, 15 (No. 1, art. 4, 2003).

zil, in contradistinction to the United States, is case law invalidating federal legislation for invading powers reserved to the states. Nor does one find in STF decisions debate about whether cases should be governed by state or federal law. This is because Brazilian Constitutions have granted far greater powers to the federal government than the U.S. Constitution. In addition, Brazil has no analogue to the Eleventh Amendment to the U.S. Constitution, nor has it had a group of Supreme Court judges who have assumed the role of protecting state's rights from infringement by the federal legislation.

On the other hand, the principle of reciprocal intergovernmental tax immunity is explicitly set out in the Brazilian Constitution. Not only does the Constitution prohibit the federal government, states and municipalities from taxing each others' patrimony, income, and services,²⁹ but it also prohibits the federal government from taxing state bonds or creating exemptions from state and local taxes.³⁰ In 1993, the STF declared a constitutional amendment permitting the federal government to impose a tax on financial transactions unconstitutional because the amendment exempted this tax from the general constitutional constraint on the federal government taxing state and local instrumentalities. The STF held that this constitutional amendment violated Art. 60 Section 4(I), which prohibits any constitutional amendment aimed at abolishing "the federalist form of the State."³¹

C. Federal Court Jurisdiction

The approach to federal jurisdiction is quite different in Brazil than in the United States and Mexico. In the United States, the ultimate arbiters of the meaning of state law are the state

29. BRAZ. CONST. art. 150 (VI)(a).

30. *Id.* at Art. 151 (II) and (III).

31. Ação Direta de Inconstitucionalidade No. 939 (Relator Min. Sydney Sanches, Dec. 15, 1993), 198 REV. DIREITO ADMINISTRATIVO 123 (Oct.-Dec. 1994); Agravo de Instrumento No. 182.536 (Relator Maurício Corrêa, Apr. 29, 1966), 205 REV. DIREITO ADMINISTRATIVO 238 (July, Sept. 1996). In *Collector v. Day*, 78 U.S. 113 (1871), the U.S. Supreme Court held that our dual sovereignty concept of federalism prohibited the federal government from taxing the salaries of state judges, a doctrine ultimately extended to any state instrumentality. The doctrine of dual sovereignty was repudiated after 1937, and the line of cases requiring state immunity from federal taxation was ultimately overruled in *Helvering v. Gerhardt*, 304 U.S. 405 (1938).

courts,³² while in Mexico, via *amparo* review, the federal courts become the ultimate arbiters of the meaning of state law.³³

In Brazil, the final arbiter of the meaning of state law can be either a state or federal tribunal, depending upon the parties or the type of case. Both state and federal courts have concurrent jurisdiction over claims based upon either federal or state law. The basic codes are federal, but whether litigants bring a case in state or federal courts usually does not depend upon the law involved. Rather, it depends upon whether the federal government has an interest in the litigation, and whether there is a federal judge in the judicial district. If the federal government or one of its agencies has an interest in the outcome, the case is normally brought in the federal courts.³⁴ If no federal judge exists in the district, such cases will be tried before a state judge,³⁵ and an appeal can then be taken to the appropriate Federal Regional Tribunal. Other cases are normally brought in the state courts, and an appeal can be taken to the State Tribunal of Justice. . If the decision contravenes a treaty or federal law, upholds a state or municipal law challenged as contrary to federal law, or interprets federal law differently from some other tribunal, the decision can be reviewed on special appeal by the second highest federal court, the Superior Tribunal of Justice. If the decision conflicts with a provision of the federal Constitution, declares a treaty or federal law unconstitutional, or upholds the constitutionality of a state or local act, an extraordinary appeal to the Supreme Federal Tribunal may be taken.³⁶

D. *Malapportionment*

A basic characteristic of federalism is that the states or provinces have entrenched representation within the national government.³⁷ Federal states are almost invariably bicameral. Representation in the lower house is usually apportioned on the basis of population. Many federal systems guarantee each state or prov-

32. *Murdock v. The City of Memphis*, 87 U.S. 590 (1874).

33. KENNETH L. KARST & KEITH S. ROSENN, *LAW AND DEVELOPMENT IN LATIN AMERICA* 130-31 (1975).

34. Reflecting the far greater centralization of federal jurisdiction in Brazil, every action to recognize and enforce a foreign judgment, every request for a letter rogatory, and every extradition fall within the exclusive original jurisdiction of the Supreme Federal Tribunal. BRAZ. CONST., art. 102 (I)(g) and (h).

35. *Id.* at art. 109.

36. *Id.* at arts. 102-08.

37. PRESTON KING, *FEDERALISM AND FEDERATION* 142-43 (1982).

ince equal representation in the upper house, thereby almost invariably producing a certain amount of malapportionment. Brazil goes one step further by allowing every state, regardless of population, and Federal District to elect three senators to the national Congress.³⁸

This constitutional rule, coupled with a history of eliminating old states and creating new states for partisan advantage, has given Brazil one of the most malapportioned upper chambers in the world.³⁹ After the military government created two new sparsely pro-government states and eliminated the populous anti-government state of Guanabara, the Constituent Assembly, which was actually the Congress elected under a system of electoral rules badly skewed by the military, voted to admit three sparsely populated new states, Tocantins, Roraima, and Amapá, bringing the total number of states in the federation to twenty-six. The disparities in population among Brazilian states is shocking. According to 2000 census data, the new state of Roraima has only 325,000 inhabitants, while São Paulo, Brazil's most populous state, has 37.5 million inhabitants. This means São Paulo has 116 times as many inhabitants as Roraima, yet each state has three senators. Hence, each senator from the state of São Paulo represents approximately 12.5 million inhabitants, while each senator from Roraima represents only about 108,300 inhabitants. A peculiar set of constitutional rules also renders Brazil's lower house, the Chamber of Deputies, badly malapportioned. While the number of deputies is theoretically apportioned on the basis of each state's population, each of the 26 states is entitled to elect a minimum of eight deputies, and each of the three territories is entitled to elect a minimum of four deputies. Yet no state, regardless of population, can have more than 70 deputies.⁴⁰ As a result, São Paulo, which on a one-person-one-vote system should have 114 times as many deputies as small states like Roraima, Acre, and Amapá, has only 8.75 times as many.⁴¹ Thus, the poorer, less densely populated states of the North, Northeast, and Center-

38. BRAZ. CONST. art. 46 § 1.

39. See Alfred Stepan, *Toward a New Comparative Politics of Federalism, Multinationalism, and Democracy: Beyond Rikerian Federalism*, in *FEDERALISM AND DEMOCRACY IN LATIN AMERICA* 29, 56 (Edward L. Gibson ed. 2004); Alfred Stepan, *Brazil's Decentralized Federalism: Bringing Government Closer to the Citizens?*, in "Brazil: The Burden of the Past; The Promise of the Future" (DAEDALUS), 129 *J. AM. ACAD. ARTS & SCI.* 145, 149 (Spring 2000).

40. BRAZ. CONST. art. 45 § 1.

41. See Alfred Stepan, *supra* note 39, 129 *J. AM. ACAD. ARTS & SCI.* at 150.

West are seriously over-represented in the Congress, while the more populous states of the South and Center regions are badly underrepresented. As Stepan points out, the result of this malapportionment is that states representing only 13 percent of the total electorate have 51 percent of the votes in the Senate,⁴² giving them an effective veto over the majority, as well as large bargaining chip to extract greater transfers of resources from the federal government.

IV. FISCAL FEDERALISM

Federalist systems have constant debates about the proper allocation of fiscal resources between the federal government and subnational units. No one is ever satisfied with the existing scheme, and political forces are continually being marshaled to promote greater centralization or greater decentralization.⁴³ The most difficult challenge confronting any federal system is to achieve and to maintain the appropriate balance between the resources and responsibilities of the central government and the resources and responsibilities of the constituent state and local governments.

As part of its transition to democracy, Brazil instituted important constitutional reforms aimed at transferring power and resources from the national government to the states and municipalities. These reforms were a reaction to the excessive centralization of the military regimes and were in large part motivated by a desire to strengthen democratic institutions by dispersing political power more widely and by increasing popular access to democratic decision-making. They were also motivated by a belief that local application and disbursement of governmental resources would lead to greater economic efficiency than centralized control. This belief turned out to be greatly mistaken. What the Constituent Assembly drafted was a Constitution that produced economic

42. Alfred Stepan, *supra* note 39, in *FEDERALISM AND DEMOCRACY IN LATIN AMERICA* at 58.

43. The debate over the "centralized-decentralized" nature of Canadian federalism has been unending. "Many have likened it to a national sport, suggesting that *whatever* solution is found to this conflict will not be the final solution because a substantial component of the Canadian population will never support it." Gregory S. Mahler, *Canada: Two Nations, One State?*, in *POLITICAL CULTURE AND CONSTITUTIONALISM: A COMPARATIVE APPROACH* 56, 67 (Daniel P. Franklin & Michael J. Baun eds. 1994).

chaos. In the opinion of the first four presidents operating under it, the new Constitution had made Brazil ungovernable.⁴⁴

A. *Restructuring of the Tax System*

The 1988 Constitution restructured allocation of tax revenues from the federal government to the states and municipalities. It did this partly by transferring certain taxes previously levied by the federal government to the taxing jurisdiction of the states and municipalities. It also did this by substantially increasing the obligation of the federal government to share tax revenues with subnational units. Unfortunately for Brazil, in effectuating this reallocation, the Constituent Assembly acted without any rational plan.⁴⁵ Instead of mandating a corresponding reallocation of the federal government's expenditure responsibilities to the subnational units, the Constitution actually increased the expenditure burden of the federal government. Because of the extremely generous transfer payments mandated in the 1988 Constitution, the federal government controlled only 36.5 percent of the tax revenues and bore 43.4 percent of the expenditure burden; the states received 40.7 percent of the total revenues and had 43 percent of the expenditure burden. The municipalities received 22.8 percent of total revenues, but had an expenditure burden of only 13.6 percent.⁴⁶

This fiscal imbalance was one of the principal causes of the huge federal deficit, which fueled extremely high levels of inflation. Brazil's annual inflation rate, which was 993% in the year the Constitution was enacted, nearly doubled in 1989 to 1,862%. Despite a series of unsuccessful stabilization plans, by 1993 the inflation rate had shot up to 2,489%. During this period, which has been dubbed an era of "predatory federalism," economic growth stagnated.

There are other serious problems with the tax structure adopted by the 1988 Constitution. For example, the principal source of state revenues is the Tax on the Circulation of Goods (hereinafter "ICMS"), a cumulative form of value added tax. Instead of being

44. Ernani de Paiva Simões, *A Discriminação de Rendas na Constituição Federal de 1988 e a Busca de um Novo Modelo Federativo num Mundo Marcado pela Globalização dos Mercados*, in ESTUDOS TRIBUTÁRIOS (Condorcet Rezende ed., 1999).

45. Flávio Bauer Novelli, *Notes on the Brazilian Tax System*, in A PANORAMA OF BRAZILIAN LAW 53, 60 (Jacob Dolinger & Keith S. Rosenn eds., 1992).

46. Anwar Shah, *The New Fiscal Federalism in Brazil* 18 (World Bank Discussion Paper No. 124, 1991).

levied by the state where the good or service is consumed, the ICMS is levied by the state of production. This flaw has produced competition among the states to attract investment from other states by selectively reducing the tax rates, and has the unfortunate effect of failing to exempt exports of goods and services, thereby making Brazil less competitive in world markets.

By substantially increasing the share of tax revenues that had to be transferred from the federal government to the states, and from the states to the municipalities, the 1988 Constitution undermined one of the political advantages of federalism -- local control. The federal government and/or the states had the political responsibility for levying and collecting the taxes, but the municipalities had only the responsibility for spending much of what were essentially free funds. This meant that there was little or no local citizen supervision over the way the municipalities spent tax monies, for the municipalities were not subjected to the political pressures of enacting and collecting taxes.

Even worse, Brazil had embedded the entire tax structure and allocational scheme in the Constitution. While the federal government could tap new sources of revenue by instituting "contributions," the states and municipalities were locked into the revenue sources established in the Constitution. This meant that any attempt to change the tax system or allocation of revenues required amending the Constitution. Achieving agreement from the necessary constituencies on improving the tax structure has proven exceedingly difficult.⁴⁷

B. State Indebtedness

Federalism contributed to Brazil's economic problems in other significant ways. Historically, Brazilian states have spent more than they receive, financing their debts with foreign and domestic borrowing. When the states were unable to pay those debts during the early 1980s, the federal government agreed to assume the states' foreign debts in exchange for the states' promise to repay the federal government. Since then, this process has been repeated several times, with the federal government each time granting generous repayment terms. Much of uncontrolled state

47. See Victor Duarte Lledo, "Tax Reform under Fiscal Stress: A CGE Analysis of the Brazilian Tax Reform" (May 31, 2001); Marcus André Melo, *When Institutions Matter: A Comparison of the Politics of Administrative, Social Security, and Tax Reforms in Brazil*, in *REINVENTING LEVIATHAN: THE POLITICS OF ADMINISTRATIVE REFORM IN DEVELOPING COUNTRIES* 211, 226-239 (Ben Ross Schneider & Blanca Heredia eds. 2003).

spending went towards increased personnel costs, which increased by 77% between 1985 and 1990 as a percentage of the Gross Domestic Product. The cost of servicing the states' huge debt, which by 1997 totaled \$139 billion in U.S. currency, helped fuel the inflationary process.⁴⁸

C. *State Banks*

Still another aspect of federalism that contributed to the federal government's inability to control inflation was the allowance of state ownership of commercial banks without the adoption of policies and controls needed to insure that these banks would operate in accordance with fiscally sound bank practice. Practically all of the Brazilian states and the Federal District owned commercial banks, which were primarily operated to serve the governors' political agendas rather than in accordance with sound financial principles. These banks operated with little effective supervision from the federal government. They racked up huge debts to finance the pet projects of governors and state enterprises.⁴⁹ These debts, which totaled \$96 billion in U.S. currency by 1998, were covered by state issued bonds or by the Central Bank. In essence, these profligate state banks were themselves part of the inflation problem because their operations effectively increased the money supply by their uncontrolled creation of credit. Until 1995, the federal government routinely bailed out the essentially bankrupt state banks because of a need to curry favor with state governors.

D. *Restoration of Fiscal Sanity*

In 1994, Fernando Henrique Cardoso, then Finance Minister and soon to become Brazil's President for the next eight years, began changing the institutional rules on fiscal federalism to bring some semblance of order to the economic chaos. In many federal systems, constitutional amendments require approval of the sub-national units, but this is not the case in Brazil. The Brazilian Constitution can be amended by three-fifths majorities in both houses of the Congress in two rounds of voting, a process that is usually doable, albeit costly in terms of pork barrel payoffs.⁵⁰

48. David J. Samuels & Scott Mainwaring, *supra* note 25, at 105.

49. Harry M. Makler, *Bank Transformation and Privatization in Brazil: Financial Federalism and Some Lessons about Bank Privatization*, 40 Q. REV. ECON. & FIN. 45-69 (2000).

50. The Brazilian Constitution has been amended 51 times since March 1992.

Amendments may be proposed by a majority of the state legislatures, but, fortunately, their consent is not required to approve an amendment.⁵¹

1. *The Plano Real*

In 1994, Fernando Henrique Cardoso came up with the *Plano Real*, a stabilization plan that actually worked. One of the reasons for the *Plano Real's* success was that it was accompanied by a constitutional amendment that changed the revenue sharing rules in the 1988 Constitution for fiscal years 1994 -1995.⁵² The amendment created an Emergency Social Fund that transferred an estimated nine billion dollars from state and local governments to the federal government. Because of strong political resistance from the states and municipalities, as well as a Congress with an insatiable appetite for pork, the federal government was never able to make the Emergency Social Fund a permanent part of the Constitution. Instead, successive constitutional amendments have extended the life of the Fund through the end of 1999.⁵³ In 2000, another constitutional amendment replaced the Fund with a transitory provision permitting the federal government to exercise complete fiscal autonomy with respect to 20 percent of its budgetary resources for the next three years.⁵⁴ In 2003, yet another constitutional amendment extended this 20 percent retention until 2007.⁵⁵

2. *Curbs on State Borrowing and Privatization of State Banks*

In 1994, the federal government also began the process of restricting state borrowing. Senate Resolution 11 of January 31, 1994, imposed two rules: (1) a state's total debt service cannot exceed the lesser of the state's operating surplus during the past year or 15 percent of the state's revenues, and (2) a state's new borrowing during any 12-month period cannot exceed the lesser of the state's present debt service or 17 percent of the state's reve-

51. BRAZ. CONST. art. 60.

52. Amendment of Revision No. 1 of Mar. 1, 1994, which added Art. 71 to the Transitional Constitutional Provisions Act.

53. BRAZ. CONST. AMEND. No. 10 of Mar. 4, 1996, extended the Emergency Social Fund through June 30, 1997; Const. Amendment No. 17 of Nov. 22, 1997 extended the life of the Fund through Dec. 31, 1999.

54. BRAZ. CONST. AMEND. No. 27 of Mar. 21, 2000.

55. BRAZ. CONST. AMEND. No. 42 of Dec. 19, 2003.

nues.⁵⁶ When the federal government refinanced state debts in 1997 and 1998, it required the states to sign contracts agreeing to adhere to specific targets with respect to their payroll expenditures, privatization and new investments.⁵⁷ It also prevented states from issuing bonds unless their total debt was less than one year's worth of real net revenues. Similar constraints were imposed upon the municipalities as a condition of refinancing their debts.⁵⁸ A resolution of the National Monetary Council in 1998 prohibited the states and municipalities from borrowing abroad.⁵⁹ When Itmar Franco, Governor of the State of Minas Gerais, refused to pay his state's foreign debt, President Cardoso withheld all federal transfers and seized funds in the state's bank accounts to pay the debt, an expensive lesson not lost on other governors. Since 1997, no states have defaulted with respect to debt payments due to the federal government.

The Cardoso government also succeeded in privatizing most of the state banks. The process took many years, and it was a costly one for the federal government, which usually had to refinance the debts owed by the state to the bank on terms highly favorable to the state. New constraints on state borrowing were imposed in 2000 by the Law of Fiscal Responsibility, discussed below.

3. *Controlling State and Municipal Expenditures*

The success of the *Plano Real* propelled Cardoso into the Brazilian presidency in 1995. By skillful and forceful negotiations, Cardoso was able to persuade Congress to enact a series of constitutional amendments and laws that substantially improved the fi-

56. Anwar Shah, *Fiscal Federalism and Economic Governance: For Better or For Worse?* (Sustainable Development Department, UN Food & Agric. Org., Dec. 1997) (www.FAO.ORG/SD/ROdirect/ROfo0013.htm). Resolution No. 11 was subsequently replaced by a more complex system set out in Senate Resolution No. 69 of Dec. 14, 1995.

57. Provisional Measure No. 1.560 of Jan. 17, 1997, reissued monthly; Law No. 9.496 of 1997. All but two of Brazil's twenty-six states signed agreements with the federal government accepting the terms of this law for debt renegotiation. Ilan Goldfajn & Eduardo Refinetti Guardia, *Regras Fiscais e Sustentabilidade da Dívida no Brasil*, 39 NOTAS TÉCNICAS DO BANCO CENTRAL DO BRASIL 18 (Jy. 2003). See also José Roberto Afonso, "The Brazilian Federation: Facts, Challenges and Prospects," (Working Paper No. 149, Aug. 2002, Ctr. For Res. On Econ. Devel. & Pol'y Reform, Stanford Univ.).

58. Municipalities had to agree to utilize 13 percent of their of their real net revenues for servicing their refinanced debt, to refrain from issuing new domestic or foreign bonds until after total liquidation of their refinanced debts, and to refrain from contracting new debts, including those from international financing agencies, until their total debt reached a level of less than one year's real liquid revenues. Provisional Measure No. 1.811 of Feb. 25, 1999. See also Provisional Measure No. 1.891-5 of June 29, 1999.

59. David J. Samuels & Scott Mainwaring, *supra* note 25, at 113.

nancial chaos of Brazil's previous fiscal federalism.⁶⁰ Because some of the states and municipalities had been spending more than 90 percent of their revenues on personnel, the so-called Camata Law of 1995 required that as of January 1999, all units of Brazilian Government had to limit their payroll expenses to 60% of their disposable revenues. In 1996, Congress enacted a complementary law called the Kandir Law,⁶¹ which exempted exported goods from the state value added tax (ICMS), thereby increasing the competitiveness of Brazilian exports. The price for securing state consent was an agreement by the federal government to compensate the states for revenue losses.

Constitutional Amendment No. 19 of June 4, 1998, made a number of important changes to control Brazil's bloated bureaucracy. First, it gave the federal government exclusive power to set general rules for bidding and contracting by all state and municipal entities. Second, it limited the salaries of state representatives to 75% of that paid to federal deputies, and limited salaries of municipal alderman to 75% of that paid to state representatives.⁶² Third, it restricted salaries of all civil servants, including governors, to that paid to a minister of Federal Supreme Tribunal. Fourth, it eliminated the constitutional prohibition on dismissing tenured civil servants. Fifth, it prohibited all governmental personnel expenditures from exceeding limits to be established by a complementary Budget Law. In February 2000, the Cardoso government secured another constitutional amendment to restrain spending by the municipalities. This amendment limits the salaries for aldermen in the smaller municipalities to 20 - 60 percent of the salary of a state representative. It also limits the total expenses of municipal councils to 5 - 8% of total revenues, depending upon the size of the municipality. No county council may spend more than 70% of total revenues on salaries. In addition, the amendment makes it an impeachable offense for any prefect (mayor) of a municipality to fail to comply with the Budget Law.⁶³

60. Fortunately, the Brazilian Constitution is far easier to amend than is the U.S. Constitution. All that is required is votes by Congress with an extraordinary three-fifths majority. There is no requirement that amendments be submitted to the states or popular assemblies for ratification. BRAZ. CONST., art. 60 (2).

61. Complementary Law No. 47 of 1996.

62. A similar provision was enacted previously as Amendment No. of Mar. 31, 1992, which also prohibited any municipality from spending more than 5% of its revenues on compensation of its aldermen.

63. Const. Amendment No. 15 of Feb. 14, 2000.

Congress also enacted amendments to reduce constitutionally mandated expenditures at all government levels and to reallocate expenditure responsibilities of the various federative units in the area of education and health. For example, a 1996 constitutional amendment reallocated responsibilities for organizing and financing education among the federal government, states, and municipalities.⁶⁴ Another constitutional amendment enacted in 2000 requires the federal government, states, and municipalities to allocate fixed percentages of their tax receipts over the next four years for public health.⁶⁵ Several amendments have been enacted to try to put the governmental retirement and social security systems on a sounder fiscal basis.⁶⁶ Other constitutional amendments have been enacted to permit the federal government to impose new taxes to avoid having to resort to inflationary financing.⁶⁷ Finally, after a bitter struggle, an amendment enacted in December 2003 partially reformed Brazil's overly complex tax system and improved cooperation among the different taxing authorities.⁶⁸

4. *The Law on Fiscal Responsibility*

In May 2000, Congress enacted a complementary law, the Law of Fiscal Responsibility (hereinafter "LRF"), which imposes a series of rules on all levels of government to try to insure fiscal responsibility and transparency in public finance.⁶⁹ This law represents a new stage of Brazilian federalism.

The LRF limits the public debt of states to two times current receipts. For municipalities, the debt limit is set at 1.2 times current receipts. If the public debt of the states or municipalities exceeds those levels, in the next year authorities must take measures to reduce excess debt by at least one fourth in the following

64. BRAZ. CONST. AMEND. No. 14 of Sept. 12, 1996.

65. BRAZ. CONST. AMEND. No. 29 of Sept. 13, 2000.

66. BRAZ. CONST. AMEND. No. 20 of Dec. 16, 1998; BRAZ. CONST. AMEND. No. 41 of Dec. 19, 2003.

67. *E.g.*, BRAZ. CONST. AMEND. No. 37 of June 12, 2002, extending for the third time the federal tax on financial transactions (CPMF); BRAZ. CONST. AMEND. No. 33 of Dec. 11, 2001, creating the Assessment for the Intervention on Economic Domain (CIDE). Brazil's latest amendment, however, points in the opposite direction, increasing from 25 to 29 percent the amount that the federal government must turn over to the states and Federal District from its collection of the CIDE.

68. BRAZ. CONST. AMEND. 42 of Dec. 19, 2003.

69. Complementary Law No. 101 of May 4, 2000.

four months.⁷⁰ The LRF also prohibits one level of the federation from bailing out another level and the refinancing of loans by anticipating revenue receipts, a much abused public financing mechanism in Brazil.

The LRF seeks to avoid the common practice of leaving debts for the next administration. Therefore, the LRF prohibits all levels of government from contracting new expenditure obligations in the last year of an administration unless officials can demonstrate that the expenditure can be fully paid off during the administration's term or that sufficient cash has been left to fund the obligation.

The LRF imposes new limits on governmental personnel expenditures. The federal government may spend a maximum of 50 percent of current revenue on personnel. The states and municipalities may spend no more than 60 percent of current revenues on their payrolls. Moreover, each branch of government is subject to a specific ceiling. The Federal Executive can spend no more than 37.9 percent, the Federal Legislature no more than 2.5 percent, the Federal Judiciary no more than 6 percent, and the Public Ministry no more than .6 percent. There are corresponding percentages at the state and local levels.

Finally, the LRF imposes transparency obligations. All levels of government must publish fiscal targets and report publicly on their debts, receipts, and expenditures. Common accounting standards were established, and officials are required to publish not only annual statements of account, but quarterly reports as well. Failures to comply with the rules set forth in the LRF are sanctioned with administrative penalties and withholding of federal transfers. Non-complying officials may also be removed from office, fined, or even imprisoned.⁷¹

V. CONCLUSIONS

Brazilian federalism under the 1988 Constitution has involved an enormous struggle to try to achieve monetary stability, a sound currency, and fiscal sanity, as well as to avoid debt default. Achieving the series of constitutional amendments and legislation necessary to rein in state and municipal profligacy and to loosen

70. A Senate addition to the Law allowed states with excess public debt in 2002 to reduce the excess by 1/15 each year for the next 15 years.

71. Criminal sanctions for officials who fail to comply with the LRF are imposed by the Law of Fiscal Crimes, Law No. 10.028 of Oct. 19, 2000.

the straightjacket of constitutional transfers and mandated expenditures has been a difficult and costly process for the federal government. The Brazilian Congress and the state governors have had a voracious appetite for pork that has had to be supplied by the federal government to secure the extraordinary majorities in Congress required to enact constitutional amendments. Moreover, the costs to the federal government of privatizing the state banks, refinancing the state debts, and compensating lost tax revenues have also been huge. That the federal government has never been able to rewrite the constitutional fiscal formula on a permanent basis, but must renegotiate it every few years, indicates the enormous political power of state and local governments. This power does not bode well for future federal governments that may be headed by persons less competent than Fernando Henrique Cardoso or those with less political support in Congress.

Starting from the U.S. model, Brazil has evolved its own unique form of federalism. That federalism is dynamic and vibrant, with the states and municipalities having real power and resources. Brazilian federalism is also constantly changing over time, as each regime struggles to achieve the "right" formula. Unfortunately, specifically embedding so many specific details in the Constitution means that Brazil will have to continue to amend the Constitution as the struggle for fiscal sanity and reduction in the enormous "Brazil cost" continues. The most sensible solution would be simply to deconstitutionalize all but the bare bones of the tax system and many of the specific federalist details. This is exceedingly unlikely, however, for the principal beneficiaries of the cottage industry in constitutional amendments are members of Congress.⁷² This is simply an additional "Brazil cost" resulting from the unfortunate decision to entrust the Congress with the task of drafting the 1988 Constitution,⁷³ and is not likely to change until Brazil adopts yet another constitution.

72. Bresser-Pereira, chief architect of the Cardoso regime's major reforms reports that his initial attempts at deconstitutionalization had to be abandoned as politically nonviable. Luis Carlos Bresser-Pereira, *The 1995 Public Management Reform in Brazil: Reflections of a Reformer*, in REINVENTING LEVIATHAN: THE POLITICS OF ADMINISTRATIVE REFORM IN DEVELOPING COUNTRIES 89, 98-99 (Ben Ross Schneider & Blanca Heredia eds., 2003).

73. That the Congress serve as the constituent assembly appears to have been a condition secretly imposed by the military high command. JAVIER MARTINEZ-LARA, BUILDING DEMOCRACY IN BRAZIL: THE POLITICS OF CONSTITUTIONAL CHANGE, 1985-95, 57 (1996); David Fleischer, *The Constituent Assembly and the Transformation Strategy: Attempts to Shift Political Power from the Presidency to Congress*, in THE POLITICAL ECONOMY OF BRAZIL: PUBLIC POLICIES IN AN ERA OF TRANSITION 210, 221 (Lawrence Graham & Robert H. Wilson eds. 1990). This was publicly confirmed (although later denied) by Fernando

The results of the federal government's imposition of fiscal responsibility upon the subnational units have been impressive. Between 1998 and 2002, states went from a primary deficit equal to 0.4 percent of Gross Domestic Product to a surplus of 0.7 percent of Gross Domestic Product. Only three states are still above the limits fixed by the LRF.⁷⁴ On the other hand, query whether the Brazilian approach, which essentially strips the subnational units of a critical aspect of their sovereignty, is consistent with genuine federalism.

Henrique Cardoso. After his denial, the reporter published the tape of Cardoso's confirmation in the May 21, 1990 issue of the *Folha de São Paulo*. See Jorge Zaverucha, "The 1988 Constitution and its Authoritarian Legacy: FORMALIZING DEMOCRACY WHILE GUTTING ITS ESSENCE," paper presented at the meeting of the Latin American Studies Association, Guadalajara, Mexico, April 17-19, 1997, pp. 6-7.

74. Eduardo Refinetti Guardia & Daniel Sonder, "Fiscal Adjustment and Federalism in Brazil," (Paper presented at IMF/NIPFP Conf. on Fiscal Pol'y in India, New Delhi, Jan. 16-17, 2004), p. 20.