Competitive Federalism and Distributive Conflict in Democratic Brazil

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Abstract

Given the weakness of Brazil's political parties, the fragmentation of the federal congress, and the historical influence of the governors, we should not expect much change in the highly decentralized configuration of Brazilian federalism. Despite the absence of political reform, or any other change in the political institutions of Brazilian democracy, President Fernando Henrique Cardoso (1994-2002) has engineered ad hoc and stopgap fiscal re-centralization. I argue that explaining this process requires moving beyond a focus on political institutions. This paper analyzes the politics of decentralization in Brazil as a process of distributive conflict between presidents and governors. I argue that this conflict is shaped by path dependent factors (enduring interjurisdictional rivalries) and it is played out in two arenas: the executive-legislative and intergovernmental (executive-governors). As a result of enabling legislation and presidential strategy during the 1990s, bargaining leverage shifted to the presidency before and during the Cardoso administration. This shift allowed Cardoso's administration to exert notable controls over subnational fiscal policy.

The evolution of Brazilian federalism has continued to create both possibilities and obstacles to the deepening of state reform. If during the 1980s the governors and mayors were clearly positioning for their own political benefit and overspending in ways that threatened the national reform agenda, the 1990s saw a different dynamic. The loose and somewhat disjointed nature of the fiscal decentralization process shaped by the military regime, the subsequent transition to democracy, and the 1988 Constitution, allowed reformist presidents during the 1990s to re-centralize fiscal authority through the use of stopgap measures.

In this essay, I explain this ad hoc reassertion of executive authority by examining the decentralization process as a path dependent, distributive game played in two arenas: the executive-legislative and intergovernmental (president-governors) spheres.[1] I argue that bargaining leverage shifted to the presidency before and during the administration of Fernando Henrique Cardoso (1994-2002). This shift allowed Cardoso's administration to exert notable controls over subnational fiscal policy. The causes of this shift are path dependent and strategic.

Two major path dependent factors aided the reequilibration of central authority: (one) historical rivalries among Brazil's poor and industrial regions and (two) more recent fiscal rivalries involving competing investment incentive schemes.[2] Both of these factors kept states from ganging up on the presidency in a sustained 'all-on-one' fashion. Even when the states enjoyed common interests and favored coordination, these persisting divisions and rivalries weakened the credibility of their commitments to one another. Regional inequalities and persisting interjurisdictional competition have kept Brazil an asymmetrical, competitive federal state.

The president's strategic ability to shape a progressive reform agenda in the executive-legislative arena strengthened the presidency vis-à-vis the states and helped weaken interstate coordination. Intergovernmental distributive conflicts, involving and often overlapping the two arenas (executive-legislative and president-governors) have shaped the evolving federal pact (Afonso, 1996: 34). In the first arena, conflicts between the president and a bicameral assembly delineated the structural reform agenda in ways that affected the capacities and strategies of players in the second arena. In turn, the intergovernmental game involving presidents and governors helped configure the costs and possibilities for reform in the executive-legislative arena (Souza, 1998). On both levels, the presidency achieved strategic gains that gradually tipped the equilibrium of political leverage in his favor.

My argument assumes that the capacity of the state governments to engage in credible coordination is essential to determining the final outcome. While the states are seen by some scholars to act as "veto players" in the reform process, their capacity to reinforce the status quo is determined by the coordination of the governors, or what Tsebelis (1995) would term the "internal cohesion" of the veto players. This cohesion is, in turn, shaped by numerous and iterated strategic interactions with the president as he negotiates the terms of reform with federal legislators and the governors.

The analytical framework used here improves upon earlier studies of changes in the federal pact in Brazil. Several studies have focused on the way political institutions shape the Brazilian policymaking process by analyzing prohibitive factors such as balanced bicameralism and fragmented party systems (e.g., Willis, Garman, and Haggard, 1999; Garman, Haggard, and Willis, 2001; Mainwaring, 1999; Ames, 2001). Yet strictly institutional approaches cannot exclusively explain change in intergovernmental relations. Non-institutional factors such as macroeconomic policy shifts and corruption scandals prompt change in federal structures even when political institutions do not change (Montero, 2002a). Furthermore, explanations that focus exclusively on the executive-legislative arena tend to ignore the capacities of the executive vis-à-vis the states in the intergovernmental arena. These approaches also tend to focus too much on the most proximate institutional factors and ignore historically specific and path dependent conditions that explain the motivations, and hence the propensity to cooperate, of individual politicians and subnational governments (Montero and Samuels, forthcoming).

In the sections that follow I develop an understanding of the evolution of decentralization in Brazil as a path dependent, two-arena game. In the first section I provide an outline of these levels of analysis and highlight the most relevant actors and processes in the Brazilian context.

In the following section I examine the politics of the intergovernmental game in terms of these three levels of analysis. This section lays out a periodization of the decentralization/recentralization process in Brazil during the bureaucratic authoritarian and most recent democratic periods. The final section offers conclusions.

Distributive Conflicts In Brazilian Federalism as a Path Dependent, Two-Arena Game

Distributive conflicts involving federal, state, and municipal governments have historically shaped the "pendulum swings" between centralization and decentralization that characterize the legacy of Brazilian federalism. Lacking either a coherent model of federalism or the sustained dominance of the states by the central government, the history of decentralization in Brazil is characterized by paradoxes and reversals. Periods of decentralization, such as the Old Republic (1889-1930), set the stage for recentralization by exacerbating the problems of national governance in a decentralized state. Episodes of centralized rule, such as Getúlio Vargas' *Estado Nôvo* (1937-1945), created precedents that enhanced decentralization subsequently. State governments, even in the *Estado Nôvo*, collected most taxes and implemented welfare policies. This experience would give the governors and mayors critical inroads into developing their capacities in the pluralist democratic period (1945-1964). The same was true during the bureaucratic authoritarian (1964-1985) and the democratic "New Republic" (1985-present) periods. Although the military centralized control over subnational governments, the generals also decentralized taxes that would become crucial to financing the governors' dispensation of patronage during the transition to democracy. Although the early history of the New Republic and the 1988 Constitution was shaped by the interests of subnational elites, the president and central regulators of the economy, such as the Central Bank, gained an increasing capacity to restrain the unbridled tendencies of fiscal decentralization.

Examination of this latest transition reveals that the distributive conflicts that shape the federal pact in Brazil are themselves given form by certain path dependent factors. These variables affected the distribution of intergovernmental leverage that mediated the politics of cooperation and conflict between the presidency and the governors during the 1990s. The arena of executive-legislative relations also regulated the relative bargaining power of the national executive and the governors. In the subsections below, I analyze each of these levels of analysis.

The Path Dependency of Intergovernmental Relations

Two persisting factors shaped the intergovernmental bargaining game in the 1990s in Brazil: (1) continuing historical inequalities among the regions and (2) the balkanization of political loyalties around competing subnational interests (*bancadas subnacionais*).

Regional inequalities in Brazil have historically shaped the interests of subnational governments, particularly among the poorest states. The rich southern and southeastern states of Brazil have three times the per capita GDP of the poorer northern and northeastern states. The Southeast accounts for roughly 43 percent of the population, but 59 percent of the GDP and 66 percent of all industrial production. São Paulo alone is responsible for 38 percent of the GDP and 22.2 percent of the national population. By contrast the Northeast has 29 percent of the population and only 14 percent of the GDP and 12 percent of industrial production. These socioeconomic inequalities have bred historical conflicts between states in each region (Souza, 1998; Selcher, 1998: 29-30). Northeastern resentment against the economic dominance of São Paulo and the Southeast spurred on efforts by the military to distribute fiscal resources to the poorer states, where its party, ARENA (the National Renovating Alliance), enjoyed conservative support. Congressional overrepresentation of the center-western, northeastern, and northern states prevented the political domination of the federal assembly by *paulista* interests. The same system prevailed into the democratic period as the Congress elected under the old rules composed the Constituent Assembly in 1987 (Selcher, 1998: 34). The 1988 Constitution set a limit of 70 federal deputies per state in the Chamber of Deputies, effectively sanctioning the malapportionment of the lower house to São Paulo's detriment. The many small states of the Northeast are also overrepresented in the Senate where each state retains three senators. Since the politics of the poor states tend to be more clientelistic than the Brazilian norm, overrepresentation has increased the salience of regional redistribution in policymaking. In defense of their own interests, underrepresented states in the Southeast and South have often responded with antagonism toward these mechanisms.

Another continuing aspect of the federal system is the persistence of subnational political loyalties as opposed to partisan ones. Numerous studies have shown that the governors and local political machines, a few originating in the pluralist and bureaucratic authoritarian periods, continue to dominate Brazilian politics (Hagopian, 1992, 1996; Samuels, forthcoming). Local "notables" determine political career paths for federal politicians. Subnational office continues to be an important point in a politico's development, especially *after* serving in federal congressional office (Samuels, 1998 and forthcoming). These tendencies have weakened the party system and balkanized political loyalties around subnational interests.

An enduring aspect of this balkanized matrix of subnational interests (*bancadas subnacionais*) is that they have always had a history of competition over a common pool of fiscal resources. During the pluralist period, the *bancadas subnacionais* operated in support of governors in contending for national development projects, public firms, and regional incentives (Oliveira, 1995: 82-84). State governments competed with each other for public sector investments during the bureaucratic authoritarian regime and especially as the generals expanded the Second National Development Plan (Montero, 2002b: chapter 3; Schwartzman, 1982). The *bancadas subnacionais* assumed center stage during the transition to democracy and especially the Constituent Assembly where divisions between the Northeast and South/Southeast shaped the rules governing fiscal decentralization. The sequencing of subnational elections for governor prior to the direct election of the president and the fight over the rules of fiscal federalism to be codified in the Constitution of 1988 enhanced the influence of these groups (Sallum, 1996; Souza, 1997, 1998). Yet the fiscal crisis of the state also made interstate competition over a more scarce pool of resources, particularly in infrastructure investments, more intense (Rodriguez, 1995: 435-436).

Although joined around a generalized norm favoring decentralization, the *bancadas* *subnacionais* remained *competitive* due to regional inequalities. Escalating "fiscal wars" involving competing fiscal incentive schemes deepened interstate distrust in the post-1988 period. The commitment of the states to the fiscal war reflects both a reaction to regional inequalities and the failure of the Constitution to credibly prevent collectively irrational competition (Affonso, 1995: 60). Interstate competition raised the costs of interjurisdictional coordination throughout the 1990s.

The Executive-Legislative Arena

In the executive-legislative arena the process of reforming fiscal federal institutions is fraught with obstacles. The requirement that significant reforms pass through two three-fifths votes in both chambers of Congress keep presidents from submitting legislation until they have bargained to generate sufficient votes. The fragmentation of party loyalties in a multiparty, open-list proportional representation system adds significantly to the president's bargaining costs.[3] Each piece of legislation is contingent on the outcomes of numerous deals involving ministerial and subministerial appointments, the outcome of "decree games" in which presidential initiatives lie in limbo before being voted on, and pork-barrel discretionary spending projects negotiated between the president and party leaders, interest groups, and individual politicians (Ames, 2001; Power, 2000).

Despite these hindrances, the overall pathway of reform has been *progressive*. During Cardoso's two terms, the five center-right parties "allied" to his government - PSDB, PMDB, PFL, PTB, and PPB - provided somewhat consistent support of the president's reform agenda, but the executive had to dispense ministries and pork to sustain these loose coalitions (Mainwaring, 1999: 313-317). Presidential decree power (*medidas provisórias*) reinforced the reform agenda, but congressional approval required that Cardoso distribute patronage.[4] These concessions allowed Cardoso to sustain a macroeconomic and structural adjustment agenda that moved forward, albeit slowly (Almeida, 1996 and in this volume). More important, each reform was reinforced by the bargains that preceded it (Couto, 1998: 72-73; Montero, 2000).

Macroeconomic stabilization policies such as the Fiscal Stabilization Fund (FEF), passed in February 1994, allowed the federal government to retain 20 percent of constitutionally mandated federal transfers from tax revenues to the states and municipalities, making these resources available for stopgap fiscal adjustments.[5] By enhancing fiscal pressures on subnational governments, the FEF made subsequent presidential side payments that much more valuable. Cardoso also used his enhanced prerogatives over revenue sharing to coerce Congress to extend the FEF, making it more of an *ongoing* de facto fiscal reform.[6] Cardoso was able to use these threats strategically to create support for other pieces of stopgap fiscal adjustment legislation - the Camata Law, the Kandir Law, and the Law of Fiscal Responsibility (LRF). The *progressive and cumulative* nature of the reform agenda was shaped by several factors.

First, the president was able to take advantage of weak party discipline and coherence to forge policy-specific coalitions. This was particularly evident in macroeconomic reform where the multidimensional nature of the policy and the broad range of provisions upon which the executive could cajole individual deputies to support him made passage more probable (Ames, 2001: 264-265). In this context, presidential patronage traded off legislators' short-term interests in acquiring pork with the long-term interests of their office. Given high turnover, especially in the Chamber, legislators were willing to take short-term compensation in return for their votes on behalf of structural reforms that would limit access to patronage later (Weyland, 2000: 50; Power, 1998a: 61-62). This served to divide and limit subnational opposition to the FEF and subsequent legislation.

Second, the progressive sequencing of reform helped move the agenda forward. The success of the first phase of reforms, which involved macroeconomic stabilization (the Real Plan), the National Destatization Program (PND) (privatization), and the emerging autonomy of the Central Bank, strengthened the president vis-à-vis legislators. The success of the Real Plan created support both in the legislature and among business constituencies for fiscal reform. Passage and periodic renewal of the FEF was costly in terms of pork, but it gave Cardoso more bargaining chips for later reform negotiations by enabling the president to exert influence on the fiscal accounts of the states and their *bancadas subnacionais.* The Real Plan's success in reducing inflation and the economic team's tactic of maintaining high interest rates raised the costs on the erstwhile state practice of rolling over debt. This made the states more receptive to Central Bank intervention in state banks and privatization of enterprises owned by the state governments.

Finally, corruption scandals prompted Congress to move reform forward at different points. The FEF's passage was enhanced by the "budget mafia" scandal on the Joint Budget Committee in October 1993, which discredited Congress and forced the retirement of several ranking deputies. Fearing a popular anti-political backlash that would surely have strengthened Lula's persisting lead in the presidential polls, conservative politicians supported Cardoso and his Real Plan. While passage ultimately relied on promising compensation to municipalities and distributing pork to individual politicians, support for the FEF was a residual of this momentary political shift (Melo, 1997: 69-70; Couto, 1998: 66-67). The *precatórios* scandal of the late 1990s raised serious concerns about debt bond issuance and this led to new limits on the practice. Ongoing corruption scandals, and particularly *o caso "Lalau"* in 1999-2000 focused public attention once again on official malfeasance in the months prior to the passage of the LRF.

By winning a couple of large and several small battles in the assembly, Cardoso became increasingly equipped to win in a second arena: the game of intergovernmental distributive conflict involving the presidency and state governors. The Lei Kandir, the Camata Law, the FEF, and the LRF greatly expanded Cardoso's bargaining position in comparison to his predecessors, yet the shift of leverage was far from automatic. The president's strategy was instrumental in dividing subnational opposition.

The Intergovernmental Game

As in all coordination games, intergovernmental coordination has multiple equilibria.

Different configurations of intergovernmental bargaining will lead to distinct reform outcomes. Two variables are important: (a) the ability of states to credibly commit to reinforce each other in the face of federal attempts to limit subnational autonomy (Solnick, 1998) and (b) the capacity of the center to use selective benefits and costs to divide the states.[7] The first variable is essential for coordinating interjurisdictional resources in opposition to federal efforts to restrain subnational autonomy. The *credibility* of commitments by states to such coordination is crucial. Historic rivalries and other forms of competition will undercut the credibility of horizontal coordination. Steven Solnick (1995: 57), referring to the Russian case, puts it simply: "Ultimately, the viability of any bargaining coalition will depend on whether subnational actors distrust each other less than they each distrust the center." For the federal government, the capacity to foment interjurisdictional rivalries and selectively reward and punish states will mitigate subnational coordination.

[Figure 1 about here]

Figure 1 models intergovernmental coordination. Where interjurisdictional commitments are credible and the executive's capacity to dispense sanctions is low (lower left cell), the configuration of intergovernmental bargaining will take the form of "all-on-one." Credible interstate coordination acts to veto federal reform and maximize subnational autonomy. If the center's capacity for distributing selective costs and benefits is high, then efforts by the center to divide states will prevent the "all-on-one" scenario but allow for some subnational coordination ("some-on-one"). Federal reforms will be limited due to the capacity of the coordinated group to hinder the universal application of a change in rules. Even partial reforms will require significant concessions to states in the coordinated group. Where interstate commitments are not credible, states will oppose reform *individually*. "One-on-one" configurations that give an advantage to the central government (upper right cell) provide federal reformers with the capacity to impose universally applicable reforms. However, application requires the selective distribution of side payments of both positive and negative sanctions to keep states from coordinating their opposition. If the center's sanctioning capacity is weak, the configuration of intergovernmental bargaining remains "one-on-one" but states will have the advantage in individual bargains by being able to hold out for improved terms (lower right cell). Under these conditions the federal government cannot impose uniform restrictions on all states.

Only by converting some-on-one or one-on-one (advantage to the states) configurations to the one-on-one (advantage to the federal government) matrix will the center be able to implement universal restrictions. If the center is initially successful in changing the matrix, the iteration of the game will undercut further the ability of the states to make their interjurisdictional commitments credible. The costs of distributing selective costs and benefits will decline as initial reform successes reduce subnational autonomy and hence the capacity to forge interstate collective action. As the credibility of *federal will and capacity* to limit subnational autonomy increases, the costs of interstate coordination increase. This "policy feedback" effect helps explain the progressive path of reform despite Cardoso's weakened congressional position following the 1998 elections.

Path-dependent factors shaped the initial game in both the legislative and intergovernmental arenas in ways that gave Cardoso the opportunity to gain leverage over the states. The weakness of parties, which otherwise would have allowed state delegations a means for coordinating cross-jurisdictionally, helped fragment the *bancadas subnacionais*. Historic rivalries between northeastern and southern states that continued into the democratic period kept the states divided, although negotiations over the constitution produced moments of universal collaboration ("all-on-one") regarding the rules of fiscal federalism. Yet as powerful as the states were in universalizing a set of fiscal rules in the new constitution that protected their interests, the persistence of rivalries and partisan weakness undercut prolonged coordination. This was more than apparent in the emerging "fiscal war" among state tax incentive schemes to attract investors during the late 1980s and throughout the 1990s. Cardoso's ability to periodically take advantage of these rivalries prevented the intergovernmental game from becoming "all-on-one." The dominant configuration was "one-on-one" in favor of the states. The governors retained a capacity to resist constitutional fiscal adjustment and to individually negotiate debt workouts with the federal government. Broader coordination (a “some-on-one” matrix) was limited due to the historic rivalries deepened by the “fiscal war.”

With the Real Plan, the costs of financing state debt and the “fiscal war” soared. This shift in the political economic context of federalism aided Cardoso’s efforts to strengthen regulations of subnational spending and finance. As central monetary authorities - the Central Bank, the CMN, and the Finance Ministry - gained leverage over state banks and fiscal accounts, the center’s capacity to sanction expanded, undercutting interjurisdictional commitments to coordinate subnational opposition. The slow but progressive passage of enabling legislation that gave the federal government increased control over fiscal transfers and set limits on subnational spending gradually shifted the intergovernmental bargaining matrix from a “one-on-one” configuration that advantaged the states to one that tipped in favor of the executive.

Tipping the Intergovernmental Equilibrium to the Executive

The three levels of analysis outlined above interacted in the Brazilian context in complex ways. During the bureaucratic authoritarian and early democratic transition periods, the states gained important fiscal and policymaking authority. But subnational rivalries and constitutional and extra-constitutional precedents would later facilitate ad hoc recentralization. In the meantime, the expanded fiscal powers of the states deepened perverse macroeconomic and financial crises that would bedevil national reform. State profligacy, particularly in the form of competing tax abatements to attract foreign investors (“the fiscal war”), would help divide the states and later increase the fiscal pressure on the governors to commit to structural reform. The Real Plan would end the years of mega-inflation and finally set the stage for a series of stopgap fiscal reforms that would take place in the dual arena of executive-legislative and intergovernmental relations.

The Bureaucratic Authoritarian and Democratic Transition Periods

Although it is tempting to generalize that the bureaucratic authoritarian period was one of centralization and the democratic period (the New Republic) was one of decentralization, the periodization analyzed here shows little evidence of a distinctly sequenced centralization-decentralization process. Rather, each period created precedents that shaped and even enhanced the opposite process. The military centralized control over fiscal federalism but it also devolved important taxation powers that would prove crucial to the autonomy of state governments during the democratic period. The states expanded these powers during the New Republic, and particularly during the Constituent Assembly, when they moved to an "all-on-one" position. But they also accepted precedents that would enhance federal regulation of fiscal federalism during the 1990s. Moreover, the path dependencies of subnational rivalries remained apparent in both periods. During the authoritarian regime, the military solicited subnational support among the conservative center-western, northeastern, and northern states. During the New Republic, the rich states opposed efforts by poor states for redistributive fiscal rules and all engaged in an escalating "fiscal war."

The bureaucratic authoritarian period initiated with the coup of 1964 strengthened federal authority over the states and municipalities in unprecedented ways. In late 1965 the military government centralized control over the state governments as a means of undercutting subnational politicians who were poised to resist the deepening of authoritarianism (Sallum, 1996: 30-32).[8] Institutional Act number 3 suspended the direct election of governors in February 1966 and gave the military regime the power to veto candidates put forth by state legislators. In addition to the military's centralization of security forces (e.g., police, state militias, etc.), the regime also took greater control over subnational taxation and spending. Through a constitutional amendment in 1967, the federal government gained control of 10 out of the country's 14 taxes. States administered the tax on the exchange of real estate (Imposto sobre a Transmissão de Bens Imóveis, ITBI) and the new value-added tax, the tax on the circulation of goods (Imposto sobre Circulação de Mercadorias, ICM).[9] Yet the military government controlled ITBI and ICM rates and determined how revenues would be spent.

The military also used its discretion over resources to reward supporters and punish opponents to the regime. The armed forces used decentralization to build support for the regime among the conservative states of the North and Northeast by creating new fiscal transfers (Selcher, 1990). These states had small tax bases and therefore depended upon transfers from a revenue-sharing fund (Fundo de Participação dos Estados e Municípios, FPEM) that was split 50-50 between states (FPE) and municipalities (FPM). More than 51 percent of total revenues for the northern states and more than 26 percent of total revenues for the Northeast came from fiscal transfers (Sallum, 1996: 37). At the same time, the generals undercut the southeastern states, where most of the civilian opposition was based, by moving or granting new public firm investments in alternative areas. During the liberalization period (1974-1985) developmentalist projects were allocated to states under the control of regional elites that had shown their dedication to the regime.

The dynamic changed with the direct election of the governors in 1982. These contests, which occurred seven years before the president was directly elected, made the governors leaders of the popular movement against authoritarianism and the chief civilian negotiators of the terms of transition (Almeida, 1996: 225). Empowered by a reservoir of democratic legitimacy, the governors mobilized support through distributional and clientelistic networks in favor of increased federal transfers and enhanced subnational control over ICMS (Abrúcio, 1998). In 1983 the Congress passed the Passos Porto Amendment, which expanded the FPEM funds and enhanced subnational discretion over these resources. Another fiscal reform in 1984 (the Airton Sandoval Amendment) increased subnational tax collection authority. Thus imbued with political and resource autonomy, the *bancadas subnacionais* emerged in their strongest position yet during the New Republic. They exerted their influence most clearly in the Constituent Assembly of 1987-1988 where they played a leading role in shaping the rules governing fiscal federalism to favor subnational autonomy (Souza, 1997; Martínez-Lara, 1996).

The *bancadas subnacionais* succeeded in locking in constitutional rules that decentralized fiscal resources. The 1988 Constitution eliminated federal taxes on transportation, electricity, fuel, and mining and combined these into the ICMS. It also expanded the Passos

Porto Amendment by increasing state and municipal transfers. The growth of federal transfers and the expansion of the ICMS led to a drop in federal shares of tax revenues and an increase in state shares. Municipalities had their share of ICMS raised from 20 to 25 percent. State constitutions bestowed other powers on the states, including the autonomy of state banks from central monetary authorities. The governors then used these banks to finance expenditures and dispense patronage (Sola, 1994:165, 1995).

The 1988 Constitution, however, was not a complete subnational coup against the federal government. First, the politics of the assembly deepened historical rivalries among the *bancadas subnacionais*. While the poor northern and northeastern states pushed for redistributive tax rules, the southern and southeastern states fervently opposed such efforts. Second, the new constitution did not prevent the federal government from imposing borrowing constraints on subnational governments - just the contrary. The Constitution authorized the federal government to limit the growth of subnational debt, a precedent that would prove useful during the 1990s as presidents, their finance ministers, the Central Bank, and the National Monetary Council (CMN) maneuvered to do just that. Finally, the Constitution proscribed the financing of state expenditures through state banks.

The Vicious Financial and Monetary Circle

The states had achieved a brief coordination of their common interests in the Constituent Assembly. This allowed them to garner resources and use them with little regard for macroeconomic stability or fiscal responsibility. The right to be irresponsible might have been a universal norm, but regional rivalries and the “fiscal war” would keep the governors from forming a more coordinated strategy in response to more concerted efforts by presidents in the 1990s to recentralize. However, presidential capacity to recentralize was limited initially due to President José Sarney’s dwindling popularity and the fragmented congressional support of his successors. As a result, the configuration of intergovernmental relations throughout this period remained one-on-one (advantage to the states).

The dangers of fiscal decentralization in the context of macroeconomic instability were more than apparent. The governors' potential for excessive profligacy was great as many had already proven adept at maneuvering fiscal resources to their clientelistic bases during the transition (Hagopian, 1996). Not surprisingly, state spending expanded during the 1980s as the governors consolidated their political machines through appointments, expansion of government payrolls, and project spending. By 1995, the states had 3.6 million civil servants; double the number of the federal government (Afonso, 1996: 50). State payrolls averaged over 65 percent of current receipts.

The military had allowed the states' banks to finance government expenditures by carrying state bonds, issuing finance, and emitting money. Such practices continued during the New Republic as spending escalated according to electoral cycles. By 1992, the debt of the state banks was twice their total liquidity. Seignorage increased inflation and when state banks encountered liquidity problems in the early 1990s, the Central Bank was compelled to bail them out, generating a "moral hazard" problem (Hillbrecht, 1997: 60; Silva and Costa, 1995). By this time the states owed their banks $22.8 billion and subnational governments composed roughly half of Brazil's operational deficit (Afonso, 1996: 37). What Lourdes Sola (1995: 48) calls the vicious financial and monetary merry-go-round (*ciranda financeira e monetária*) undermined federal efforts to create and maintain price stability. The profligacy of the states added to the dismal failure of seven consecutive anti-inflation plans from 1985 to 1993.

Paradoxically, other aspects of what seemed to be unbridled and dangerous fiscal decentralization would set the stage for ad hoc recentralization later. True to their history of regional rivalries, the states used their newfound policy authorities and resources to compete against each other. As industry tended to concentrate in São Paulo and development policies designed for poor states, such as the Superintendency for the Development of the Northeast (SUDENE), failed to reverse regional inequalities, the governors of poor and developing states created competing tax abatement schemes to lure foreign direct investors (Oliveira, 1995: 84-87; Rossi and Neri, 1995).[10] In addition to competitive incentives, the governors spent on behalf of economic constituencies. In pursuing their own political interests, the governors were also protecting various interest groups linked to their states. The governors spent on behalf of indebted agrarian and industrial interests and failing banks (Almeida, 1996: 225). These positions were competitive in that they not only opposed national reform efforts, they sought to protect economic interests in their states by passing the costs of adjustment off to rival states.

Although the *bancadas subnacionais* were able to coordinate in "all-on-one" fashion during the Constituent Assembly, the years that followed saw escalating interstate competition that reduced the credibility of commitments to coordinate subnational interests. The 1988 Constitution granted the states the authority to offer tax incentives on ICMS and many states did so in an attempt to attract automotive firms during the 1990s. The "fiscal war" escalated during the 1990s as states such as Rio de Janeiro, São Paulo, Minas Gerais, Rio Grande do Sul, Ceará, and Bahia, in particular, competed very publicly for automotive investments. Despite attempts by reformist governors such as Eduardo Azeredo (Minas Gerais), to coordinate a common strategy among the governors to limit the costs of fiscal competition, the states retained their competitive posturing (Cavalcanti and Prado, 1998; Arbix, 2000).

Persistent efforts by state governments to *weaken* interstate coordination of fiscal policy followed a perverse universal norm that competition was preferable (Rodriguez, 1995: 438-440). This could not have been more apparent than on the National Council of Fiscal Policy (CONFAZ), a constitutionally mandated entity under the command of the Ministry of Finance and composed of all the state finance secretaries. CONFAZ' purpose was to regulate state fiscal incentive schemes, but the *bancadas subnacionais* crippled CONFAZ by requiring that all decisions be made unanimously. Since all state governments preferred to have the authority to employ tax abatements competitively, no new scheme was proscribed by CONFAZ. States tended to barter their votes on the council in exchange for approval of their own programs (Affonso, 1995: 60).

As interstate coordination weakened, the federal government developed capacities for dealing with the problems generated by the *ciranda*, although they would not be fully utilized until much later. First, the Central Bank gained the ability to intervene state banks *temporarily* under Decree Law 2321. This experience for the Central Bank would prove important during subsequent governments as the failure of state banks would require more permanent solutions resulting from Central Bank intervention. Second, while the Sarney administration appeared impotent in the face of the *ciranda*, it took important steps to reinforce the powers of the executive in ways that would prove crucial to later macroeconomic stabilization efforts. Most notably, Sarney's interpretation of the constitutional power of decree as allowing him to re-issue provisional measures (*medidas provisórias*) expanded the presidency's legislative authority (Power, 1998b: 204-205). It is doubtful that, absent this precedent, the Real Plan and ancillary fiscal reforms would have occurred during the 1990s (Couto, 1998: 77).

Partial Reequlibration: Collor and Itamar

Neither the Fernando Collor de Mello (1990-1992) nor the Itamar Franco (1992-1994) governments produced durable corrections to the problems posed by the *ciranda monetária e financeira*. However, these two presidencies initiated important neoliberal structural reforms that would play a role in building support for fiscal restructuring during the Cardoso administration. More important, these administrations practiced techniques that enhanced the powers of the presidency in the economic reform process. Collor and Itamar used their line-item veto authority, the power to issue and reissue provisional measures, and the presidential prerogative to shape annual budgets as the primary mechanisms to implement reforms. These experiences would prove valuable to Cardoso in his relationship with Congress and the governors for he would soon far exceed his predecessors in the exercise of executive authority.

Collor's initiatives in structural reform, and particularly the PND, created an early record of successful reform upon which Franco and Cardoso could rely. Most important, these subsequent administrations were not saddled with the responsibility of overseeing the restructuring of firms to be privatized nor did they have to fight the first and most difficult judicial contests against the opponents of structural reform. The modalities of privatization, which paid generous side payments to workers, divided working class opposition to structural adjustment well before Cardoso's presidency (Montero, 1998). Opposition in the legislature to the structural adjustment agenda also changed in the 1991-1995 period as support by a broad array of parties of the center and center-right in favor of the PND ran in excess of 60 percent (Almeida and Moya, 1997).

Several moves during the Collor and Itamar administrations helped stave off the deepening of the *ciranda monetária e financeira*. First, Collor threatened state banks with Central Bank intervention unless they initiated procedures to stop the taking on of nonperforming debt. While these threats were not backed up as strongly as they would later be, they were accompanied by more credible actions by central monetary authorities. Second, the federal government curtailed the states' access to credit. In May 1990, the National Monetary Council enforced stricter limits on state banks seeking to issue loans to the public sector. These signals repelled private investors away from state debt. Then, in 1993, the Senate passed constitutional restrictions on the emission of new state bonds used to roll-over debt. Third, both Collor and Itamar raised federal tax revenues through crackdowns on tax evasion and administrative improvements to the main tax-collecting agency, the *Secretaria da Receita Federal*. Much of the increase in tax revenues accorded to funds not subject to revenue-sharing with the states. The COFINS (Contribution for the Financing of the Social Security System) and the CSLL (Employers' Social Contribution for Social Security) increased between 1992-1995 by 173 and 66 percent, respectively (Souza, 1998). These funds amounted to 40 percent of federal revenues in 1994 and they continued to claim a larger share in subsequent years during the Cardoso administration (Montero, 2000: 68; Samuels, 2001: 10-11). Finally, both administrations decentralized service responsibilities, particularly in health care.

Perhaps the most important precedent for the exercise of presidential authority was Collor's penchant for implementing macroeconomic reform, including his ill-fated stabilization plans (Collor I and II), through the use of *medidas provisórias*. Although Cardoso faced the need to enact sweeping constitutional reforms that fell outside the purview of these decree powers, the use of *medidas provisórias* would prove crucial in implementing the Real Plan in 1994.

Shifting the Context of the Intergovernmental Game: Cardoso and the Real Plan

The inauguration of the Real Plan and the subsequent election of Fernando Henrique Cardoso in 1994 marked a turning point in the executive-legislative and intergovernmental arenas. Although the three previous administrations were unable to consolidate a constitutional reform agenda, they left valuable precedents for Cardoso to employ in both arenas. Unlike his predecessors, Cardoso could count on growing support for fiscal reform in Congress and the business sector, and an enhanced capacity by central monetary and financial regulators to implement restrictions on subnational debt and spending. The states, which had briefly coordinated their interests for the Constituent Assembly and then reverted to a one-on-one (advantage to the states) during the *ciranda financeira*, showed no signs of being able to unleash an unbridled fiscal decentralization of the state. A combination of the end of inflation, the increased regulatory power of central agencies, and stopgap fiscal reform legislation such as the FEF, set the stage for recentralization.

Macroeconomic stabilization continued to dominate the economic reform agenda throughout the Collor and Franco governments, but the acute sense of crisis that permeated this issue by 1994 was unprecedented. Thus by the time Fernando Henrique Cardoso, Franco's finance minister, was prepared to launch what would become Brazil's most successful stabilization measure to date, the Real Plan, in 1994, significant support existed for a stepped-up program of economic restructuring (Mainwaring 1999: 314-315). Most major businesses, including those that had been privatized under Collor and Franco, had already initiated productive restructuring and were eager to see an end to mega-inflation (Kingstone, 1999). In contrast to the political fragmentation evident in Congress, a "pragmatic consensus" existed among Cardoso's economic team, business, and some liberal wings of major parties such as the

PSDB, PMDB, and the PFL in support of inflation-control and some structural adjustment (Melo, 1997: 70-71; Almeida, 1996). One recent study by Power (1998a) found that an absolute majority of representatives in the 50th Congress (1995-1999) described themselves as economic liberals.

Having succeeded in controlling inflation and surviving the Mexican peso crisis, Cardoso's government could count on a reserve of political support among centrist and conservative parties in Congress and major segments of business for fiscal reforms (Couto, 1998: 68; Power, 1998a: 60-62). Given an earlier shift in Congress in favor of the PND and structural adjustment, Cardoso faced not an ardently divided legislature set against macroeconomic and structural reform but one willing to move the agenda forward, and to do so with legislation proposed by the president rather than the Congress (Figueiredo and Limongi, 2000a). The passage of the FEF in February 1994 was an early indicator of this shift.

The price stability created by the Real Plan laid bare the need to adjust fiscal accounts. In a reversal of the classic logic that posits central bank autonomy as a precondition for monetary stability, the price stability created by the Real Plan greatly strengthened the central monetary regulatory bodies - the Central Bank, the CMN, and the Finance Ministry. These entities gained leverage over the states and the state banks, who opposed centralization of monetary authority (Sola, Garman, and Marques, 1998). The Real Plan undercut the ability of the governors to use their state banks to finance expenditures. By cutting off the cash-strapped state banks from inter-bank credit, they were forced to turn to Central Bank bailouts. Central Bank intervention in the state banks removed these as financiers of state spending, further pressuring state fiscal accounts. Meanwhile, the end of mega-inflation increased these pressures by raising the real costs of servicing debt and eliminating the tactic of using inflation to reduce public payroll and supplier costs. The need to raise interest rates to stave off inflation effectively increased state and municipal debt and discouraged further borrowing (Dain, 1995: 359).

The Real Plan reduced information asymmetries that had previously bedeviled federal attempts to control subnational spending. First, the Real Plan enhanced the Central Bank's ability to measure subnational debt by eliminating "floating" debt with state banks (Afonso, 1996: 40-41). Second, by forcing Central Bank intervention in state banks and negotiating debt workouts, federal agencies gained insights into the composition and amount of subnational debt. Finally, the credit crunch in the private sector and federal restrictions preventing states from contracting foreign debt, greatly restrained the degree to which state governments could significantly expand their primary deficits.

The Real Plan became a turning point in the intergovernmental game as Cardoso was able to employ the stick of Central Bank intervention in state banks and the carrot of debt workouts to compel and cajole the governors, one after another, to implement fiscal reforms and privatization of state utility and financial going concerns (Affonso, 1997; Montero, 2000). Under the Program to Support Restructuring and Fiscal Adjustment in the States, the federal government began negotiating the terms of debt workouts.[11] These required the governors to privatize state firms, transfer holdings to the federal government, and initiate downsizing of the civil service. The workouts involved exchanges of state bonds for treasury bonds and Central Bank bonds. Given high interest rates on federal bonds (e.g., 22-25 percent in 1995), the stock of bond debt grew during the mid- to late-1990s. States contracted federal loans to pay off payroll and contractors' obligations. The National Treasury thus garnered more than 87 percent of all subnational debt. By mid-1999, the central government had rescheduled the debt of 24 of 27 state governments and bailed out the states involved in a $22 billion public bond scandal (the *precatórios*).[12] These conditions are indicative of a shift from a "one-on-one" (advantage to the states) configuration to a "one-on-one" (advantage to the federal government) configuration.

Three pieces of legislation heightened the fiscal pressures on the states to comply with the terms of federal intervention. The FEF continued to constrain state government accounts, forcing most to consider privatizing their major public enterprises (Tavares, 1997). The Camata Law, passed in March 1995, threatened states with the suspension of constitutionally mandated federal transfers if they failed to reduce their public payrolls to under 60 percent of net annual revenues. The federal government then reduced state revenues by exempting all primary and semimanufactured exports from ICMS in September 1996. The Kandir Law, named after Cardoso's planning minister, Antônio Kandir, added a vague promise that state governments would be compensated for their revenue losses. Yet delays and false promises hindered compensation. Reimbursement for their losses became a generalized demand of the governors. However, Cardoso held out the possibility more as a carrot to cajole subnational support for structural adjustment than as a serious commitment.

As the FEF and the Kandir Law especially became the targets of subnational protests, the presidency took additional steps to keep the states uncoordinated in their opposition. Cardoso exacerbated the fiscal war by continually avoiding opportunities to legislate impediments to competitive fiscal incentives.[13] He even added to the competition by offering selective federal incentives to prospective investors. In March 1997, Provisional Measure 1532 escalated interstate tensions by offering federal tax incentives for automotive investments locating in the Northeast, North, and Center-West. In a highly public example of the extent to which Cardoso would go to keep the states divided, he promised federal incentives for a new Ford plant in Bahia that was originally promised to the opposition governor of Rio Grande do Sul. The deal sparked competition between the northeastern states that rallied behind Bahia and the industrial states of the South, but it had a more generalized effect of reminding the governors that they were competitors.[14]

As the presidency assumed the new leverage accorded it by the Camata and Kandir laws, federal monetary authorities closed off some of the financial channels that would otherwise have allowed the governors to continue the *ciranda financeira*. In August 1996 the CMN was able to halt states' issuance of new bonds until their annual revenue exceeded their debt. This restriction effectively eliminated new bond finance for a period in most cases exceeding 10 years.

Cardoso used his prerogative to shape the annual budget (Lei de Diretrizes Orçamentárias - LDO) to distribute discretionary carrots to state *bancadas* in return for political support for reform. After the 1993 budget scandal, key congressional leaders avoided taking on greater protagonism over the budget (Werneck, 2000: B2). The breakup of the "budget mafia" in which a few deputies controlled amendments to the budget, distributed the share of budget "pork" more evenly. But Cardoso used his discretion over the programmed transfer of funds to reward supporters and punish opposition deputies (Ames, 2001: 230). This helps to explain why the PFL, an archetypal clientelist party, provided some of the most consistent support to Cardoso's reform agenda during the 50th Legislature (Power, 1998a).

Whatever the combination of carrots and sticks in the president's employ, the strategy worked to push the fiscal reform process forward. The pace of subnational structural adjustment picked up markedly during the 1997-2000 period as the governors sold off their state banks and utility companies as part of their debt rescheduling agreements with the federal government.[15] During this time, seven state-owned or recently federalized state banks sold (Banerj, Credireal, Bemge, Bandepe, Beneb, Banestado, and Banespa) for $5 billion. Seven more, with assets totaling $8 billion, awaited sale at the end of 2000. The list includes financial institutions from the four largest debtor states - São Paulo, Rio de Janeiro, Minas Gerais, and Rio Grande do Sul, which together account for 90 percent of all subnational debt. Additionally, numerous utility, public works, and transport companies have already been sold off, generating over $23.5 billion as of 1999. The federal government gained shares in privatized firms and bargained for other concessions as part of specialized packages negotiated with each state government.

The permanent quality of subnational adjustments such as privatization suggest that, unlike previous attempts to limit the governors' profligacy, Cardoso has been able to engineer several endgame conditions. First, federal restrictions on the growth of subnational debt are much tighter and permanent. In June 1998, the CMN halted the states' abilities to contract new foreign debt. In September 1998, the Senate passed Resolution 78 empowering the Central Bank to impose debt ceilings and other limits on subnational borrowing, including proscriptions against the emission of bonds until 2010. Second, debt workouts elicited commitments to restrain the growth of new debt. States agreeing to reschedule their debt were prohibited from emitting new debt notes (although agreements have not stopped capitalization of interest on continuing bond debt). Finally, the "one-on-one" dynamics of the intergovernmental game have produced selective benefits for the federal government as particular states have used their resources in creative ways to restructure their debts. For example, the state of Rio de Janeiro granted the federal government the state's royalties from petroleum exploration (10 percent of annual receipts in the sector) for thirty years in order to halve Rio's debt with Brasília.[16]

To be sure, federal solutions to the problem of state debt incurred massive fiscal costs. The restructuring of state banks cost an estimated $43.9 billion in federal loans to the states at below-market real interest rates not over 6 percent. These costs might be greater still in the absence of hard budget constraints on subnational government. However, with the passage of the Law of Fiscal Responsibility (LRF) in June 2000, the presidency may finally be in a position to fundamentally alter the intergovernmental game.

Endgame(?): The Law of Fiscal Responsibility

A condition Barbara Geddes (1994) identifies as one requisite for congressional support for reform is the rough parity of advantages/costs among politicians. In the wake of the extension of the FEF and implementation of the Kandir law, many governors and federal legislators complained that the costs of fiscal austerity were being shifted unfairly to the subnational level, while the president and his ministers had unrestricted access to patronage. The LRF, however, offered a credible set of commitments that the federal government would also "tie its hands" by adopting the same stringent spending limits.[17] This prompted more congressional support for the LRF than would otherwise have been possible (Greggianin, 2000). Although some judicial challenges lingered into the end of 2000, the measure passed in June and survived with few modifications into 2001.

The LRF mandates that states and the federal government follow a stringent set of spending ceilings. Articles 19 and 20 establish a spending limit on payroll of 60 percent of revenues, which is divided among the various powers (executive, legislative, judicial and public ministries).[18] As of the end of 1998, expenditures on the civil service were 65.7 percent of current revenues. The LRF commands that fifty percent of the excess be cut within the first year of the law (2001), with the remainder to be eliminated within the following year. Article 17 determines that no new spending can occur without a corresponding increase in revenues. Article 35 sets limits on contracting of new debt until all old debt is paid. Most important, the LRF ended the moral hazard of having the Central Bank roll-over state bank debt by prohibiting further rescheduling of subnational debt after May 2000. Taken together the LRF's proscriptions are substantial, as are the penalties for non-compliance: the freezing of federal transfers, restrictions on external finance, and criminal penalties for officials found guilty of violating the law.[19]

By forcing states to finance current expenditures with revenues, states and municipalities have had to enforce drastic cuts and bureaucratic restructuring but also initiate structural reforms. For example, after November 2000, Mato Grosso do Sul's governor, José Orcírio Miranda dos Santos ("Zeca") of the Workers' Party, cut the number of political appointees in state government by half, initiated voluntary retirement programs for the civil service, increased workers' pension contributions, and increased tax revenues (*The Economist*, 2001: 35). Other states, such as Bahia, used proceeds from state privatizations to finance public pensions and reduce civil service costs (Lavoratti, 2000). Similar reforms have emerged in several states. In the municipalities, the use of new management systems and technologies has improved service delivery and revenue performance (Afonso and Mello, 2000). Overall, the fiscal health of subnational governments is steadily improving. Since the time that the LRF was first discussed in Congress in 1999, the overall fiscal standing of the Brazilian states has moved from one of primary deficits to surpluses. To be sure, the sustainability of these efforts remains the main question. The advent of the LRF will help. Through the beginning of 2001, the LRF remained (despite several court challenges and intense lobbying by newly elected mayors) the source of a new level of hard budget constraints imposed on states and municipalities by the center (Mignone, 2001: 6).

In the wake of the LRF many states have also taken a second look at their fiscal incentives schemes (Cavalcanti, 2000: A3). Complementary Law 101/2000 requires that states increase taxes to compensate for the concession of tax revenues to firms. Independently, the governors have also started to use the courts to impose restrictions on the use of fiscal incentives by their rivals.[20] These restrictions will not eliminate the "fiscal war" but they will compel governors to be more fiscally strategic and politically judicious in the way they engage in interjurisdictional competition (Herrisson and Frazão, 2000).

Overall, the LRF broadens the president's capacities to limit subnational profligacy. However, a couple of caveats are worth noting. First, the implementation of many of the LRF's key provisions will depend upon the *maintenance* of good relations between the executive and the legislature. For example, changes in subnational debt levels must still be approved by the Senate in response to a formal request by the president. This provision opens the door to the possibility that a president will compromise the fiscal probity of a sound request in order to get the Senate's approval for another piece of reform legislation.[21] Second, actual implementation will depend on the *capacity* of state and municipal governments, and not just their interests. The LRF employs a number of 'sticks' to extract compliance, but it is short on 'carrots' to enable subnational governments to provide public services while they attempt to meet fiscal targets. The National Bank of Economic and Social Development (BNDES) and some international financial institutions such as the World Bank and the Inter-American Development Bank are actively promoting efforts to improve subnational government capacity. Yet it is not clear that time is on their side. Growing region-wide and global financial crises may deepen the parlous situation of many subnational governments and make them beyond these kinds of help.

Conclusions

The LRF was only the latest in a series of stopgap fiscal reforms that tended to slow and in some aspects stop the *ciranda monetária e financeira*. Such legislation enabled the president in the second arena of intergovernmental distributive conflict, even as several years of "fiscal war" fed by historical regional inequalities and rivalries kept the governors from coordinating in a sustained manner. Path dependent factors and strategic choices in both the legislative and intergovernmental arenas tipped bargaining leverage in favor of the executive, producing an ad hoc reequilibration of fiscal authorities.

A more exclusively institutional approach to explaining change in Brazilian federalism would emphasize the heavy costs and inefficiencies of the process due to the weakness of political parties and the pervasive obstacles created by numerous “veto players” in the country’s politics. Given the slow, stopgap nature of the reforms and the lateness of seemingly “endgame” conditions created by the LRF, the evidence in this essay would support such evaluations. However, the capacity of institutional theories to explain the *dynamics* of decentralization in Brazil are limited since political institutions and the number of veto players did not change significantly during the process. Non-institutional or “historical institutional” factors involving presidential strategy and path dependency explain how the changing distributive context of the intergovernmental game altered the politics of decentralization in ways that favored recentralization.

The Brazilian experience demonstrates the importance of studying the politics of decentralization with a broad temporal and multidimensional lens. Analyses that focus exclusively on executive-legislative dynamics, the party system, the interests and powers of the governors, or the legislative policymaking process miss the way that the intergovernmental distributive game overlaps these areas and subsumes them into two linked arenas. Both are shaped by historical legacies involving interjurisdictional rivalries and presidential powers.

For Brazil, the story revealed in this paper suggests that although policymaking regarding fiscal federalism remains disjointed and costly, presidents may still engineer progressive reforms of the system. Unable to produce the sweeping constitutional reform he wanted in 1995, Cardoso settled for a prolonged, two-term strategy that will no doubt make him the most successful Brazilian president in the country's short democratic reform period. Yet enduring success may depend more on a more assertive reform of the very fiscal and political institutional constraints that have made the recentralization process so stopgap and tortured.

FIGURE 1

President: Capacity to Sanction	Governors: Credibility of Commitments — HIGH	Governors: Credibility of Commitments — LOW
HIGH	Some-on-one	One-on-one (advantage to the federal government)
LOW	All-on-one	One-on-one (advantage to the states)

Notes

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[1] In this essay I focus upon governors as the chief representatives of state government interests. State assemblies have historically been subservient to governors, whose power has only grown with their right to run for reelection (passed in 1997). This constitutional reform also gave the president the right to be reelected.

[2] In my analysis I emphasize the "increasing returns" aspect of path dependency. That is, the tendency for "previous events in a sequence [to] influence outcomes and trajectories." See Pierson (2000: 251-52).

[3] In recent years, numerous scholars have argued against this position. Based mostly on analysis of roll call votes, these scholars argue that Brazilian parties are routinely cohesive in the legislature. See, for example, Figueiredo and Limongi (1995, 1999, 2000a, 2000b) and Nicolau (2000). Yet this work only demonstrates that the parties *appear* cohesive when their members actually vote in the legislature. This scholarship does not account systematically for the pork barreling *prior to the vote* that generates high costs for presidents trying to get reform passed. Barry Ames (2001) has demonstrated that these costs are real and that they even preclude the president, including Fernando Henrique Cardoso, from initiating some legislation in the first place. This work also does not account sufficiently for the weakness of electoral incentives for politicians to adhere to their party leaders' directives. The lack of party identification in the electorate facilitates party-switching and other cohesion-weakening practices. See Mainwaring (1999). Nevertheless, the present study does not attempt to advance the case for either position. It seeks instead to explain what the work on legislative pork barreling does not: the progressive nature of the reform agenda. Even if partisan cohesion were real, my argument would attempt to explain some of its non-institutional causes and antecedent conditions. Yet there is little evidence that either 'real' or 'chimerical' party cohesion in Congress accounts completely for reform outcomes during the 1990s. Both sides to the debate focus on the executive-legislative arena, which I argue is insufficient to understand the outcomes of intergovernmental conflicts. For example, cohesion arguments would not explain the increasing ability of the national government to *enforce* regulations and legislation.

[4] *Medidas provisórias* take the form of provisional laws until they are either approved within 30 days or expire. See Figueiredo and Limongi (1997). Brazilian presidents could reissue these decrees indefinitely, giving the executive extraordinary legislative powers. However, the unmitigated ability to reissue was curtailed in 2001.

[5] When it was passed originally, the FEF was termed the Social Emergency Fund (FSE). It was renamed when it was renewed in November 1995. The actual amount that the FEF made available for federal control was less than the 20 percent of transfers that is commonly cited. The FEF removed 5.6 percent of total personal income tax and all income taxes paid by federal government employees from the total of transfers to subnational governments. This occurred only after taxes were increased by the same amount. Therefore the FEF caused the states and municipalities to forgo a relatively small share of their future revenue. I thank David Samuels for this insight.

[6] See *Folha de São Paulo*, "FHC ameaça cortar gastos federais," 5 April, 1997: 1-8.

[7] These dynamics are most apparent regarding president-governor relationships. Brazil's 5,500 mayors are far too disparate in their interests and too dependent upon their governors as their main interlocutors with the federal government to form strong horizontal associations (Selcher, 1998: 38).

[8] Some of these included politicians such as Carlos Lacerda and Ademar de Barros, who had "participated" in the 1964 "revolution."

[9] Municipalities collected two taxes: the urban property tax (Propriedade Territorial Urbana, IPTU) and the tax on services (Imposto sobre Serviços de Qualquer Natureza, ISS), which did not apply to services already subject to the ICM.

[10] Subnational fiscal incentives were allowed by the military's Lei Complementar Nº 24/75 (1975). According to the law, all fiscal incentive schemes had to be approved by the unanimous vote of the Secretaries of Economy representing their states on the *Conselho Nacional de Política Fazendária* (CONFAZ). These constraints were strengthened under a new law (LC Nº 87/96) enacted during the Cardoso administration. Despite these federal restrictions, the states have flouted the law and continue to grant incentives competitively.

[11] The *Programa de Apoio à Reestruturação e ao Ajuste Fiscal dos Estados* was approved by resolutions 162/95 and 175/95 of the CMN in 1995. The *Caixa Econômica Federal* and the BNDES concede financing to the states under this program to faciliate reform efforts.

[12] Of the three states that have not signed agreements, only the Federal District has requested rescheduling. The other two - Tocantins and Amapá - have not requested federalization of their debt.

[13] The bill that ultimately became the Lei Kandir carried amendments that would prohibit state incentive schemes. However, Cardoso removed the amendments. See *Folha de São Paulo*, "Vetos manterão a guerra fiscal." (13 September, 1996): 2-4.

[14] Governor Anthony Garotinho (Rio de Janeiro) affirmed that fact when, referring to the Ford deal, he argued: "You can say that Fernando Henrique is a lucky man. Before the Ford issue, we might all be against his government. Now, the Ford case has spoiled the relations among the governors." See *Jornal do Brasil*, "Estados pressionam por solução imediata." (14 July, 1999): 2.

[15] Most banks were closed or sold by 1998. Of 33 state banks in 1994, only 10 remained in public hands in 1998.

[16] The Cardoso government agreed to assume R$13 billion of Rio de Janeiro's R$24.4 billion debt. Due to the state's offer of its petroleum royalties (worth R$156 million per year), Rio de Janeiro received better terms for rescheduling its debt than the other 23 states that agreed to have Brasília assume their commitments. See *Jornal do Brasil*, "Dívida do Estado é abatida em 50%." (15 July, 1999): 21.

[17] Cardoso also offered to delay the full implementation of the spending ceilings in the Lei Camata as a tool to allay the opposition of the governors. See *Folha de São Paulo*, "Governo prevê meta para Estados em 99." (29 October, 1998): 4.

[18] The spending limits envisioned in article 20 are, in practice, lower than they seem. For example, the LRF does not allow states to allocate funds from an area in which spending is below the limit to another area that is at the limit. Hence, the law provides few incentives for cost-cutting in any one area, but rather across the board (Greggianin, 2000: 12).

[19] The opposition parties and some subnational governments moved quickly to short-circuit the LRF in the courts but to little avail. In the most serious court challenge, the *Supremo Tribunal Federal* (STF) on 11 October 2000, in a narrow majority (6 v. 5), upheld article 20, which allows the executive to limit the spending of the other branches, as constitutional.

[20] See *Folha de São Paulo*, "Governo de São Paulo entra com Adin contra incentivo fiscal em GO." (16 April, 2001).

[21] On these caveats, see Samuels (forthcoming and 2001).

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