Inter-American Development Bank
Banco Interamericano de Desarrollo
Latin American Research Network
Red de Centros de Investigación
Research Network Working Paper #R-509

Political Institutions, Policymaking Processes and Policy Outcomes in Brazil

by

Lee J. Alston*
Marcus André Melo**
Bernardo Mueller***
Carlos Pereira****

*University of Colorado, NBER
**Universidade Federal de Pernambuco
***Universidade de Brasília
****Michigan State University

March 2006

**Cataloging-in-Publication data provided by the
Inter-American Development Bank
Felipe Herrera Library**

Political institutions, policymaking processes and policy outcomes in Brazil / by Lee J. Alston … [et al.].

p. cm.
(Research Network Working papers ; R-509)
Includes bibliographical references.

1. Political planning—Brazil. 2. Fiscal policy—Brazil. 3. Policy sciences. I. Alston, Lee J., 1951-. II. Inter-American Development Bank. Research Dept. III. Latin American Research Network. IV. Title. V. Series.

320.62 P823--------dc22

The Research Department (RES) produces a quarterly newsletter, *IDEA (Ideas for Development in the Americas)*, as well as working papers and books on diverse economic issues. To obtain a complete list of RES publications, and read or download them please visit our web site at: http://www.iadb.org/res.

Abstract

We found that the driving force behind policies in Brazil is the strong set of powers given to the President by the Constitution of 1988. To have strong powers does not mean unbridled powers. Several institutions constrain and check the power of the President, in particular the legislature, the judiciary, the public prosecutors, the auditing office, state governors and the Constitution itself. The electorate of Brazil holds the President accountable for economic growth, inflation and unemployment. Because of the electoral connection, and perhaps reputational effects, presidents in Brazil have a strong incentive to pursue stable fiscal and monetary policies as their first priority. At least for the past ten years, and particularly in the new administration of Lula, executive power has been aimed at pushing policy towards macro orthodoxy. Although orthodoxy may not lead to short-term growth, international financial markets provide additional incentives for discipline, as deviations are instantly punished, with unfavorable consequences that are readily recognized by the electorate. Achieving stable macro policies required constitutional amendments as well as considerable legislation. To attain their goals, the past administrations (Cardoso and Lula in particular) used their property rights over pork to trade for policy changes. The rationale for members of Congress to exchange votes on policy for pork is that the electorates reward or punish members of Congress based on the degree to which pork lands in their district. With the exception of the devaluation of 1999, macro policy has become more stable over time. We categorize macro policies in Brazil as "stable but adaptable."

The pursuit of macro orthodoxy comes at a cost; some policies in Brazil are "volatile and unstable." We found volatility and instability in policies that have an ideological component (e.g. land reform, the environment, and poverty alleviation), or whose gains accrue at the Congressional district level (e.g., infrastructure projects). The volatility on ideological policies is no surprise and happens most when administrations change. For policies having a local rather than national impact the volatility results from spending being based on the residual left in the budget after the President takes care of hard-wired and pork expenditures. The negative side of this is that many infrastructure projects (e.g., sanitation and local roads) have fallen into this residual category.

1. Introduction

The Brazilian Constitution of 1988 defined the political institutions in Brazil and the powers of the political actors in the policymaking process following the end of the military government in 1985. As a result, 1988 is used as the point of departure for this analysis. In Brazil, strong presidential powers drive the policymaking process, though they are checked by the constitutionally defined powers of Congress, the Judiciary, state Governors, and the *Ministerio Público*. Policymaking starts with an interaction between the President and members of Congress, though it is always in the shadow of the other political actors. Significantly, the President's electoral connection relies on a strong economy that is perceived as satisfying the goals of economic growth, economic opportunity, and the reduction of poverty. Members of Congress generally care more about redistributing gains to their constituents, e.g., geographical redistribution.

Given the different preferences and relative powers of the legislative and executive branches, they can both benefit by exploiting the gains from trade. To achieve the goal of a strong economy, presidents focus first on fiscal and monetary stability (e.g., the *Real* plan), as well as on pension reform and tax reform. To achieve these ends, presidents have used pork as well as other benefits as the mediums of exchange with members of Congress in return for their votes on critical pieces of legislation. A key element in this exchange is the allocation of selected ministerial positions and appointments in the bureaucracy. Given that a large proportion of the budget is "hard-wired" with policies such as health and education, once the trades of pork-for-policy reform on monetary and fiscal policies have been consummated, the surplus will be spent on more ideological policies such as land reform and the environment. The residual policies have different electoral effects on the President and members of Congress depending on the degree to which they achieve national goals (whereby the President can claim more credit) or geographic goals such as poverty reduction in the Northeast (in which case the Deputies and Senators receive relatively more electoral benefits).

This "game" can be viewed as sequential, with veto players as well as external shocks constraining the President and Congress. Constraints from the other political actors and external shocks have budgetary implications, either positive or negative. This analysis views the policymaking "game" as one in which the President has an overriding incentive to keep the budget as a percentage of GDP within some target range, because greatly exceeding the budget-to-GDP ratio can have serious monetary and fiscal penalties imposed through international capital markets. This tendency to strive toward a target range of debt to GDP is called the budgetary equilibrium. The dynamics of the policymaking game yield policy outcomes that are classified as falling into four broad categories: “stable but adaptable,” pork, hard-wired, and residual.

The next section describes the outer features of public policies in more detail. Section 3 discusses the political institutions and how they constrain the political actors. The Constitution is viewed as a foundational moment from which the President, Congress, Judiciary, Governors, *Ministério Público* and the TCU derive their powers. Section 3 will also illustrate how the institutional players enter the game, constraining the Executive and Congress, and will provide examples along with systematic evidence on the impact of the other players on policy outcomes. Section 4, uses a specially developed framework to analyze specific policy outcomes: stable monetary policy and the fiscal responsibility law, with stable but adaptable outcomes; land reform and other social policies, with volatile outcomes; and health and education policies, with rigid outcomes. Section 5, analyzes how the Brazilian policy process responded to two shocks: the economic shock associated with devaluation in 1999 and the political shock associated with the election of President Luis Inacio da Silva (Lula). In Section 6 offers some concluding remarks about the overall policymaking process in Brazil since 1988.

2. Dependent Variable: Outer Features of Public Policies

The purpose of this paper is not to analyze the details of any specific policy adopted in Brazil, but rather to explain the outer features of public policies, that is, the common characteristics that systematically permeate those policies. These characteristics are qualities such as stability vs. volatility, flexibility vs. rigidity, coordination vs. coherence, decisiveness vs. resoluteness (Haggard and McCubbins, 2001), overall quality and investment-related qualities, private vs. public regardedness, and balkanization. The analysis of these outer features follows the framework developed in Spiller, Stein and Tommasi (2003); Scartascini and Oliveira (2003); and Spiller and Tommasi (2003) in which a country’s political institutions, together with the features of the specific policy issues are key determinants of the characteristics of public policies. In the process of producing policy, political actors undertake complex inter-temporal transactions that are often beset by political transaction costs. These costs are determined by the country’s political institutions and by the nature of the policy being considered. The political institutions determine the key players, the payoffs to the players, the forum in which they interact and the frequency of their interaction. In addition, each policy area has its own features that can increase or reduce those transaction costs, for example regional vs. national, spot vs. long term, complex vs. transparent, etc. In the absence of political transaction costs, political actors would always have an incentive to adapt to economic and political shocks in ways that maximize the greatest gain from political exchange, with side-payments compensating those who could otherwise block those changes. However, in political markets, even more so than in economic markets, transaction costs are typically significant (Weingast and Moran, 1987). The higher the political transaction costs, the more difficult it will be to make those side-payments and the more probable that cooperation will not ensue, leading to sub-optimal policies. In other words, where political institutions are well developed, political actors will be able to cooperate so as to better adapt to economic and political shocks, resulting in policies with positive characteristics such as stability, adaptability and public regardedness. Where political institutions promote high political transaction costs, cooperation will be more difficult and policies will tend to have more detrimental qualities, being either too rigid or too volatile, as well as being more private regarding and incoherent.

The previous section introduced the basic game that characterizes the Brazilian political system. The following section further elaborates upon that game, focusing on how Brazilian political institutions and the features of various different policy areas map into the outer features of public policies. Then, having presented the dependent variables and a basic model of their determinants, each of the players and their role in that model will be described in greater detail.[1]

Starting with the dependent variable, the characteristics of policies in Brazil are observed to vary markedly across specific policy issues. The policies have been separated into four categories according to those characteristics. The first category consists of policies that are stable and adaptable to shocks. These are basically macroeconomic policies, such as fiscal and monetary policies, that is, those with a direct impact on stabilization and economic growth. The second category involves policies used by the President to provide patronage to other political actors in exchange for support in approving his agenda of reforms, that is, geographically concentrated transfers, or "pork." The third category includes policies that, having been hard-

[1] The Appendix presents a formal model of the framework.

wired, cannot be easily changed and are consequently rigid and less susceptible to economic and political shocks. In Brazil, policies such as education and health that have national purpose and important second-round effects have been hard-wired. "Second-round effects" refers to the fact that these policies generate important positive externalities for society that are realized not in the short term but in future periods. Thus there is always a temptation for short-sighted policymakers to postpone them in favor of policies in the first category, which is why at some point a consensus was reached to insulate those expenditures. The final category consists of residual policies, which include issues that are given priority only once the objectives of the policies in the first category have been secured. These are policies related to issues such as security, environment, poverty, land reform, etc. These policies tend to be volatile, oscillating according to political shocks, such as when a new president comes to office. In general it is expected that policies with a larger ideological component such as land reform and poverty alleviation will be in this group. But infrastructure has also increasingly been treated as a residual policy. It is significant to note that Brazil is pushing strongly for expenditures on infrastructure to count as meeting fiscal targets.

Having described the dependent variable, the analytical task is now to show how the same set of political institutions leads to political transactions that result in public policies with the characteristics described in each of the three categories when mapping across specific policy issues with different features.[2] The key features of Brazilian political institutions can be understood in terms of separation of power and separation of purpose (Huggard and McCubbins, 2001). Although the details changed, the Constitution of 1988 maintained the notion of strong powers for the President inherited from the military dictatorship of 1964-1985.[3] The details of

[2] The point of departure of this analysis is the 1988 Constitution, which defined the current set of political institutions that determines players and their powers. Although this analysis technically covers the entire period since 1988, the fit is clearly stronger in the post-1994 period, which includes the two terms of President Fernando Henrique Cardoso as well as Lula's current term. It is more difficult to see a pattern in the period from 1988 to 1994, since it covered the final year of the Sarney Presidency (1989), the impeachment of the Collor presidency (1990-1992) and the interim years of Itamar Franco (1992-1993). During this time the new political institutions were still in the process of being implemented and developed. Nevertheless, the model presented here already applies to this period as well, since many of the subsequent changes were built on institutional changes that occurred during this time, which was also an important period for political players to define and learn the rules of the game. Therefore this claim of this paper that presidents have incentives to pursue sensible macroeconomic policy is not invalidated by unorthodox behavior during this early period.

[3] This is due to the fact that the transition from military dictatorship to civilian government in 1985 occurred voluntarily and without rupture, so that the Constitution of 1988 was written by Congress, with intense interference by President Sarney, who inherited strong presidential powers. It is logical that a strong military president would

the political institutions that underlie those powers (decree power, veto power, legislative rules, budgetary process, etc.) and evidence of their effects will be provided in the next section. This section simply states that strong presidential powers have generally allowed the President to initiate, pursue and approve much of his policy agenda. Whereas such a scenario may seem perilous given Latin America's history with strong presidents, Brazilian political institutions provide two sets of safeguards against abuse of those powers. The first is the fact that the electoral connection for the President is such that he has incentives to pursue sensible macroeconomic policies, as he is seen by the electorate as being responsible for outcomes related to basic issues such a strong economy, economic growth and stabilization. Given the strong presidential powers, failure in these areas cannot be credibly blamed on other political actors such as Congress or the Judiciary. The second safeguard is the fact that although the separation of powers is clearly biased towards the President, several other political actors with different motivations (separation of purpose) are able to check the President's actions in different ways. Thus, if an incompetent or ill-intentioned president were to come to power, strong presidentialism would not mean a blank check to pursue misguided policy. Section 3 will describe in detail the roles played in this balance of power by the other main players, that is, Congress, the Judiciary, state Governors, the *Ministério Público*, the bureaucracy, and regulatory agencies, showing that they can and often do constrain the President's actions.

The contention of this paper is that the end result of these interactions yields policies with the characteristics mentioned in the four categories described above. The President uses his powers to pursue an agenda of stable and adaptable policies and reforms. Because the separation of purpose inherent in the political institutions has the President pursuing broad national public goods, as opposed to other actors with a say in producing legislation (particularly Congress and to a lesser degree governors), who have more narrow constituencies, there is the potential for conflict. However, this conflict is diffused by legislative rules that result in trades of support for patronage between Congress and the President (Alston and Mueller, 2003). The President is able to use his powers to control the legislative agenda and to create a stable supporting coalition that enables policy reform.[4] Any other coalition not coordinated by the President would be inherently

want to assure that the new Constitution would not reduce those powers. In fact, one of his greatest concerns at the time was to be granted an additional year in office by the Constitution, in goal in which he was successful.

[4] This is necessary because, as described in Section 3, Brazilian electoral rules (open list proportional system) induce a multi-party system where the President's party will never hold a majority of the seats in Congress.

unstable, as it would not have any enforcement mechanism to ensure compliance and prevent defections. In addition, the President possesses considerable discretion over patronage (such as jobs and individual budget amendments), which, together with the career incentives of members of Congress (discussed in Section 3), leads to the well-institutionalized trade of policy support for patronage. Although these exchanges are often seen as being less than legitimate by the press and much of society, they form the basis of Executive-legislative relations in Brazil, and this paper argues that they lead to high levels of governability that allow important reforms to get accomplished. Furthermore it can also be argued that this comes at relatively low cost to the Executive since political institutions facilitate the trades (see discussion of individual budget amendments in the next section), and the patronage that is dispensed is a very small part of the budget (Pereira and Mueller, 2002 and 2003).[5]

The result is that Congress tends to approve much of the policy reforms proposed by the Executive, yet Congress still holds checks on the powers of the President.[6] It is this interaction that determines the qualities of policies in the first and second categories discussed above: stable macro policies on the one hand and pork on the other. Only when the divergence of preferences over specific policy issues between the President and members of Congress is sufficiently high will there be no gains to trade. That is, the cost of the patronage necessary to approve those reforms is higher than the benefits to the President. This may lead to either; 1) gridlock over that issue; 2) the President dropping the issue or significantly watering it down; or 3) attempts by the Executive to get around Congress, for example through decree power (discussed in Section 3), which may then prompt other political actors such as the Judiciary or the *Ministério Público* to intervene. The next sections argue and present evidence, however, that except in a few high-profile cases such as pension reform during the Cardoso presidency and tax reform during Lula's term, the President has generally gotten what he wanted, with these other outcomes being exceptional.

Depending on his success in achieving the top priority policy objectives, the President will decide which residual policies will be pursued, and how. This is the case because the political institutions give the President control over the legislative agenda and because the

[5] This notion is contrary to much of the received literature in Brazilian politics that states that the Executive's need to maintain the support of a coalition leads to high costs (Ames, 1995a, 1995b, and 2001).
[6] This interaction between the President and Congress in Brazil is formally modeled in Alston and Mueller (2003). See Melo (2002) for the Executive's recent success in amending the constitution.

President will generally want to secure the national macro policies in the first place. Thus the residual policies are contingent on there being space in the legislative agenda as well as on budgetary availability. These in turn are affected by both economic and political shocks. Section 5 provides one example of each shock: the effect of the 1999 devaluation of the *real*; and the uncertainty resulting from the election of Lula as president. In each of these cases it will be shown how the budgetary process was bring about a recovery by reducing the execution of the residual policies in the budget. This implies that many of these residual policies will be characterized by high volatility. Whenever the economic and political conditions are favorable they are given priority and get implemented. But when negative shocks occur they are suspended or put on hold to help secure the first-category policies. Residual policies thus have a tendency to oscillate unpredictably. Also, because these policies only produce results in the medium- and long-term, politicians have more leeway to pursue their own visions of what is the right thing to do than is the case with the first-category policies, where mistakes are more quickly perceived and punished by internal and foreign markets. Thus, residual policies with a larger ideological component will, *ceteris paribus*, tend to be more volatile. Additionally, political shocks where new politicians come to office tend to result in policy reversals.

Given this inherent tendency towards volatility of the residual policies, political actors may often choose to hard-wire some policies where it is considered that the volatility can be particularly damaging. This is the especially the case with education and health policies that are crucial for social and economic well-being, since some politicians may nevertheless be tempted to withhold resources because the effects of these policies are not generally felt in the short-term. Thus at some "constitutional moment," politicians establish impediments to changing these policies by tying the hands of future political actors. This results in rigid policies, which are advantageous when this rigidity constrains opportunistic behavior but which comes at the cost of reducing the ability to adapt to unforeseen future contingencies.

In summary, Section 2 has discussed this paper's basic model of the Brazilian political system, which describes the policymaking process and yields hypotheses about the characteristics of the policies created. These hypotheses are based upon a mapping of the country's political institutions and take into account specific policy issues. The expected result is to find stable and adaptable macro policy accompanied by geographically based transfers and pork, with hard-wired polices as a constraint and other residual policies being put off until economic and political conditions allow them to be implemented without harming the top-priority macro policies. Section 4 provides examples of each of these policies as empirical evidence against which to test the model. Before that, however, Section 3 provides more detail on the political actors and political institutions so as to give more substance to the bare-bones description of the model in this section.

3. Political Institutions

This section provides an overview of Brazilian political institutions and how they affect the policymaking process. As suggested in Scartascini and Oliveira (2003), this can be done by describing 1) the key political actors, 2) the payoffs for political cooperation, 3) where and how frequently the political actors undertake their exchanges, and 4) the properties of the arenas in which exchanges take place. The section begins with an analysis of the way in which the 1988 Constitution established the current political institutions and how it has endogenously changed as an important mechanism for providing commitment for policy reform. Next it describes the powers of the President and of Congress and analyzes how their interaction generates policies and how the electoral and legislative rules influence the behavior of the President and members of Congress. Finally the section concludes with an examination of other political actors that shape the policymaking process in many different ways, constraining what the President can do.

3.1 The Constitution

The Constitution of 1988 established the rules of the current political game in Brazil. A Constituent Assembly convened in 1987 drafted the Constitution. The Constituent Assembly was set up by conferring special powers to the ordinary legislature rather than by holding new elections for the purpose of writing a new constitution. The new constitution reflects a number of principles long advocated by the opposition: decentralization, transparency, participation, social control and redistribution. These principles produced a significant transformation in the patterns of policymaking and implementation. In terms of fiscal and intergovernmental relations, the Constitution devolved administrative autonomy to sub-national governments and mandated a new redistribution of functional responsibilities. In addition, it mandated a new regime of tax assignments whereby the states and municipalities were given not only new tax powers but also managed to secure a larger share of federal tax revenues. The Constitution created new funds for states and *municipios* by mandating automatic transfers of federal money. It also mandated the decentralization of public policy in a great number of sectors ranging from health to education to environmental policy. Furthermore, the Constitution mandated multi-level participatory arrangements aimed at social control. They include an enhanced role for the *Tribunais de Contas* (Court of Accounts), the decentralization of the Judiciary branch and the creation of the *Ministério Público* (discussed in detail in the remainder of this section).

Although the new Constituent Assembly was characterized by the strong desire to break away from a long period of authoritarian rule, a number of institutional innovations represented an element of continuity. Although the new Constitution (by virtue of Article 2 of the provisional clauses) mandated a plebiscite on the regime and system of government that was set to take place in 1993, most of its features in fact presupposed a strong presidency. These include *inter alia* a number of prerogatives enjoyed by the Executive (i.e., the power to issue *medidas provisórias*—provisional measures, veto power, the power to initiate new legislation including constitutional amendments, the exclusive right to initiate new legislation in certain areas such as budget and administrative laws, and the prerogative to establish urgency time limits for voting procedures and bills).

Constitution can be seen as a pivotal moment in time, with important path-dependent developments. Because it was formulated during a unique historical juncture, it incorporated a vast array of political, social and corporatist demands that had been kept silent under centralized military rule. As a result, with 250 articles in the main text and an additional 75 provisional articles, the Constitution is unusually long and covers many very specific non-constitutional issues of policy. The decision to create such a wide-ranging and detailed constitution could be attributed to the lack of any sort of political trust and credibility at that time. Thus, writing a constitutional article was a 'safe' institutional method by which political players could undertake political transactions with some degree of certainty that their arrangements and agreements would be enforced. As a result the Constitution emerged with many policy issues hard-wired, meaning that changes would require constitutional amendments. It is highly significant that many subsequent reforms under Cardoso involved de-constitutionalizing certain issues, i.e., deleting articles from the Constitution and subsequently (but not always), legislating issues through ordinary laws. The initial high level of constitutionalization of public policy produced great rigidity in public policy in general. This did not preclude the Cardoso or Lula administrations from passing their reform programs, however.

The previous paragraphs help explain why the Constitution of 1988 is the most amended constitution in the country's history. Brazil's first constitution, passed in 1824, lasted 65 years and was amended once, whereas Brazil's second constitution, which established the republican form of government, lasted from 1891 to 1930 and again was amended only once. The Constitution of 1946 lasted 21 years and was amended 27 times. The military constitutions of 1967 and 1969 were amended 26 times in a period of 21 years. By contrast, the Constitution of 1988 has already been amended 37 times in 12 years. Between 1988 and February 2001, 2,424 constitutional amendments had been presented to Congress. Under President Lula da Silva, three new constitutional amendments have been passed. The yearly average amendment rate for the Constitution of 1988 through 2003 has reached 3.5. For the period from 1992 (when the first amendment was approved) to 2003, the average yearly rate of amendment is 4.4—an extremely high rate by any standard.

These rates are all the more significant because constitutional change requires approval in two rounds of voting in each house by an absolute majority of three-fifths. Other procedural requirements include the following: the Executive is not allowed to change the constitution by *medida provisória* nor can it resort to special urgency procedures through which it can unilaterally require a vote on a bill ahead of any other legislative proposals; and the vote has to proceed by roll call (thus increasing the political costs of approving unpopular proposals). The political transaction costs of securing legislative approval are therefore much higher for constitutional amendments than for ordinary legislation. Comparatively speaking, however, the requirements for approving constitutional amendments are not very strict; Brazil is in a cluster of countries whose constitutions are the most easily amended (Melo, 1998).

In addition to the procedural difficulties, it should be noted that constitutionalization and de-constitutionalization (i.e. inserting and deleting provisions from the constitution) are very distinct and asymmetrical political processes. For consitutionalization, collective action problems undermine the ability of the public to insert particularistic interests. For de-constitutionalization the opposite holds; withdrawing benefits and rent-seeking privileges from the constitution requires overcoming the resistance of organized and sectoral interests.[7] Reforms that de-constitutionalize issues generally lead to legislation regarding the issuing of a *medida provisória*.[8] In this climate, a lack of trust and opportunistic behavior have precluded some welfare-enhancing deals from taking place. The lack of trust arose because the Executive holds great agenda powers and decree authorities. Many members of Congress saw the deletion of articles from the constitution as a mechanism by which the Executive can unilaterally impose its preferences. In other words, some regard de-constitutionalization as the equivalent of giving a blank check to the Executive.

Many constitutional issues have a direct bearing on fiscal and financial stability, and therefore put the constitution in the center stage of the political game described earlier. These include, *inter alia,* the rules defining social security benefits; the provisions stipulating levels of pay and of hiring/dismissing personnel, the stipulation of areas not open to foreign ownership, rules defining tax and fiscal matters of sub-national governments, and Central Bank independence. Thus, this paper argues that the political game described herein is largely a "constitutional change game." Granting constitutional status to certain policy areas is an integral part of hard wiring. As discussed in Section 4, this was the strategy pursued in the areas of education and health. In these cases, hard wiring represented a strategy of pre-commitment on the part of the Executive and the legislators.

In this game, the Supreme Court plays the role of a veto power because of the institution of judicial review in the country. Two instruments can be used by players in the judicial review game: the *acão direta de inconstitucionalidade* (*ADIN*, a petition for nullifying a decision or legal norm because it is assumed to be unconstitutional) and the *ação declaratória de constitucionalidade* (a petition for the confirmation of constitutionality of a decision or legal norm).[9] Both are to be decided by the Supreme Court (Supremo Tribunal Federal). The first one can be initiated by the President; congressional parties; the Attorney-General; the secretariats (*mesas*) of the Senate, the Chamber of Deputies and of the state Legislative Assemblies; the

[7] It is hypothesized here that this may be the reason the drafters of the Constitution stipulated in its Provisional Clause 3, as a precommitment device, that an ad hoc constitutional review process, taking place under special rules in a number of joint Chamber/Senate sessions, should take place five years from the date of its enactment.
[8] Constitutional Amendment 7/95 prohibited the practice of using *medidas provisórias* for specifying the enabling legislation (*regulamentação*) for a constitutional article which had been amended as of 1995.
[9] The ADIN was created by the Constitution of 1988, whereas the *ação declatória de constitucinalidade* was created by Constitutional Amendment 3/93. The latter was a reaction to the large number of ADINs and consists of a pre-emptive move on the part of the Executive and its coalition in Congress.

governors; the Bar Association; trade unions; and professional bodies. The second one can be initiated by the President, the secretariats (*mesas*) of the Senate or Chamber of Deputies; and the Attorney General.

3.2 The Executive, Congress, Parties, Committees, Electoral Rules

Since re-democratization, and especially after the new Constitution of 1988, all elected presidents have been able to build reasonably stable post-electoral majority coalitions within Congress with a high level of governability by means of strong party discipline of the governing coalition (Figueiredo and Limongi, 1999; Pereira and Mueller, 2003). The only period without a stable majority coalition was from March 1990 to October 1992 under President Collor.[10] Although none of the elected presidents belonged to a party with a pre-electoral absolute majority of the seats, they have, nevertheless, been able to achieve congressional support by use of their extensive legislative and non-legislative powers.

Despite the presence of a decentralized electoral system and a fragmented party system, the optimal electoral strategy in the Brazilian legislature has not been concentrated in personal votes, but rather, the party vote in Congress (Figueiredo and Limongi, 1999; Pereira, 2000; Nicolau, 2000). At first glance, this assertion seems paradoxical, given the premise that legislators are subject to electoral incentives to behave individually. Indeed, Brazilian legislators vote according to their party leader's indication in order to accumulate greater benefits in the congressional arena and thus to strengthen their electoral probability of political survival in the local sphere (Pereira and Renno, 2003). This claim is also corroborated by Neto and Santos (2001), who argue "party discipline was above all a function of the President's legislative coalition-building strategies based on dispersion of patronage to parties."[11]

Scholars who analyze the Brazilian political system, especially its electoral rules and political parties, usually affirm that they provide significant obstacles for the Executive to approve its agenda, thus creating tremendous governance problems (Mainwaring and Scully, 1995; Mainwaring and Shugart, 1997; Haggard, 1995; Haggard and Kaufman, 1992; Ames, 1995a, 1995b, 2001). For these authors, the electoral rules offer strong incentives for candidates

[10] Collor preferred to work through *ad hoc* coalitions and, perhaps as a consequence of this political choice, he was subsequently impeached.

[11] In 12 consecutive elections (from 1950 to 1998) for the Brazilian Chamber of Deputies, the great majority of incumbents (on average 70 percent have decided to run for re-election and almost 70 percent of them have been successful, more than most other countries in Latin America (Morgenstern, 2002: 416).This suggests that it is incorrect to ignore static ambition as the main goal among Brazilian legislators.

to develop direct links with their constituency groups rather than mediating such relations through political parties. Additionally, this institutional context generates incentives that lead to a personalized vote, as opposed to voting for political parties, and to a high saliency of constituency pressures in incumbents' electoral calculus (Ames, 1995; Samuels, 2001).

By contrast, a second group of authors has strongly questioned this predominant view. Rather than stressing the decentralizing effect of electoral rules, they emphasize the institutional rules and structures that centralize the legislative process itself and the powers held by the Executive (Figueiredo and Limongi, 1999, 1997, 1995; Pereira and Mueller, 2000; Meneguello, 1998). These authors attempt to explain how institutional variables internal to the decision-making process (the distribution of power inside Congress) and the institutional legislative and non-legislative powers held by the President (decree and veto powers, right to introduce new legislation, permission to request urgency time-limit to certain bills, discretionary power on the budget appropriation, etc.) work as key determinants for legislators to behave according to the preferences of party leaders.

The Brazilian political system can be characterized neither as a purely decentralized nor as a purely concentrated system (Pereira and Mueller, 2002 and 2004). While some features such as electoral rules, a multiparty system, and federalism act towards decentralizing the political system, other features such as the internal rules of the decision-making process in Congress, the constitutional powers of the President, and his capacity to selectively distribute political and financial resources (most of them locally allocated), act towards centralizing it. In fact, the electoral rules provide incentives for politicians to behave individually, while the internal rules of Congress, the President's power to legislate, and the centralization of benefits by the President render legislator behavior extremely dependent on loyalty to the party and on presidential preferences. It is claimed that even a political system with incentives for opposing behaviors, like the Brazilian one, provides equilibrium and stability. However, in this case it is a very dynamic equilibrium that can change from one issue to another and it depends on the capacity of the President and his party leaders to offer appropriate incentives (political and economic benefits) that can ensure the best electoral returns to individual legislators. This combination of institutional rules is key to understanding how it is possible for weak political parties in the electoral arena to coexist with strong political parties inside Congress (Pereira and Mueller, 2003). Thus, a premise of this analysis is that there is no contradiction between party and individual behavior in the Brazilian political system at the same time. In fact, the former is one of the most important reasons to explain the latter. In other words, legislators behave according to the preferences of party leaders within Congress so as to have access to benefits that will increase their individual chance of surviving politically.

Party leaders hold important institutional prerogatives: the ability to appoint and substitute members of committees at any time; to add or withdraw proposals in the legislative agenda; to decide if a bill will have urgency procedure; to indicate the position of the party regarding a bill on the floor; and fundamentally, to negotiate with the Executive the demands of the members of his party. In other words, party leaders are the bridges that link individual legislators with the preferences of the Executive. This is why political parties are so strong within the legislative arena. It is not rational for legislators to act individually inside Congress just as it is not rational for the Executive to individually negotiate or bargain for support with each member of his coalition on every bill. The role of intermediary between the Executive and the individual legislators cements the fragile links between voters and representatives in the electoral sphere. Because the Brazilian political system works in the peculiar manner described above, one might observe a false contradiction between the "personal vote" and "party vote" approaches in the literature. But the two explanations are faces of the same coin. That is, neither the "personal vote" model nor the "party vote" model can be totally transferred to the Brazilian case, where the models are complementary.

The most striking proactive power (which enables presidents to legislate and to establish a new *status quo*) in the Brazilian Constitution is the ability of the President to legislate through provisional decrees (*medidas provisórias*). This institutional device allows the President to enact new legislation promptly and without congressional approval. Provisional decrees not only give the President the power to legislate, they also give him influence over the congressional agenda. If Congress fails to act on a provisional decree within 30 days, it automatically goes to the top of the legislative agenda, displacing issues that Congress may have been discussing. According to the Constitution, a provisional decree should only be used in specific situations, although in practice the Executive has made indiscriminate use of this device. Not only have a large number of provisional decrees been edited in past legislatures, but individual decrees have typically been re-edited a large number of times, since Congress rarely challenges them.[12] The Supreme Court tolerated this practice as long as presidents did not try to reintroduce any decree that Congress had specifically rejected. In Congress, serious disagreements over the extent of decree authority were not resolved until September 2001, when, via an accord with President Cardoso, Congress amended Article 62 so as to limit presidents to a single reissue of a lapsed decree. The amendment also reduced constitutional ambiguity by specifying a list of issue-areas in which the Executive may not resort to decrees. The partial rollback of presidential decree authority in late 2001 has altered the game of Executive-legislative relations, and new patterns have yet to emerge (Pereira, Renno and Power, 2005).

In terms of reactive power, the most common is the veto in the sense that it allows the President to defend the status quo by reacting to the legislature's attempt to change it. The most common is the *package veto* with which the President can reject the entire legislation sent by Congress. Besides allowing the President to veto entire bills, the Brazilian Constitution also allows *partial vetoes*. The President may promulgate the articles of the bill with which he agrees while, at the same time, vetoing and returning to Congress for reconsideration only the vetoed portions. The 1988 Constitution makes it relatively easy for Congress to override a Presidential veto given that it requires only an absolute majority of the joint chambers. Nevertheless the Brazilian Congress has seldom used its veto power. This suggests that a majority of members of Congress benefit from the status quo as compared to a counterfactual world of multiple parties facing a severe collective action problem in the legislative arena.

In addition to provisional decree and veto power, the Brazilian Constitution defines some policy areas where the Executive has exclusive power to initiate legislation. Only the President can introduce bills concerning budgetary and public administration matters, as well as bills in an array of other important policy areas. In terms of budgetary law, although the congressional majority has the right to amend bills that were introduced by the President, it can only do so if those amendments are compatible with the multi-year budget plan elaborated by the Executive as well with the law on budgetary guidelines. In addition, Congress may not authorize expenditures

[12] The overall rate of approval of Executive bills is high and rejections are rare, only 11 (2.4 percent of the total) in the 1995-98 legislature. The opposite is the case for legislative proposals. According to Figueiredo and Limongi (1997), "no provisional decree has been rejected since 1992…. Congress stopped considering the decrees and the Executive has reissued them successively."

that exceed the budgetary revenue. In practice these rules enable the President to preserve the status quo on budgetary matters simply by not initiating a bill.

The internal rules of the Chamber of Deputies give party leaders in the Steering Body *(Mesa Diretora)* and Board of Leaders (*Colégio de Líderes)* central roles in the legislative process and in the definition of the committee system. Roughly speaking, it is the prerogative of party leaders to appoint as well as substitute at any time a committee's members (Art. 10). There are no restrictions regarding how long a legislator can be a member of a committee. There may be some extent of self-selection to committee appointments, but there is evidence of significant interference by party leaders in the process of appointing and substituting committee members. There has typically existed an extensive turnover of legislators from one committee to the next. Legislators change committees frequently, not only between years but also within years. Additionally the Executive, through party leaders in Congress, stacks certain committees with loyal members.

Besides centralizing decision-making processes inside Congress and allocating huge powers of legislating to the Executive, the Brazilian political system also allows the President to control the distribution of political and financial resources. This provides colossal electoral consequences for those who have the chance to exploit them appropriately. In Brazil, it is the Executive that has exclusive power to initiate the annual budget. Although legislators have the right to propose individual amendments to the annual budget, it is the Executive who determines which amendment will really be appropriated, making the budget contingent on the amount of available resources in the national treasury. As shown in Pereira (2000), Pereira and Mueller (2002 and 2004), and Alston and Mueller (2003), the Brazilian President rewards those legislators who most vote for his interests by executing their individual amendments to the annual budget and, at the same time, punishes those who vote less frequently for his preferences. This is done by selectively executing their individual amendments (pork barrel policies). By controlling for other variables that may influence the Executive's decision to appropriate a given congressman's amendments, Pereira and Mueller tested whether voting behavior influences that choice.[13]

[13] Instrumental variable estimation was used because one would not only expect voting to affect the appropriation of the amendments, but also that a congressman that has had more amendments appropriated would, *ceteris paribus*, tend to vote more favorably with the Executive.

The variable $Appropriation_i$ is the percentage of all amendments proposed by a legislator and approved in Congress that the Executive actually appropriated. The first right-hand side variable is $Votes_i$, which measures the percentage of all votes by a congressman that coincided with the position of the Executive. A positive and significant coefficient for this variable would suggest that the Executive takes into consideration the legislator's voting behavior when deciding which amendments to appropriate. The variable $Seniority_i$ is the number of previous terms a congressman has served in Congress.[14] The final variable in the first equation is $Position_i$, a dummy equal to one if congressman *i* was ever the president or vice-president of a permanent or a special committee.[15] The second equation has $Votes_i$ as the left-hand side variable and the key explanatory variable is $Appropriation_i$. If its coefficient is positive and significant, one can conclude that the Executive can affect the voting behavior of the congressmen by strategically selecting which amendments to appropriate and which to shelve. In order to control for other determinants of voting behavior the following were included: $Position_i$, explained above, and $Concentration_i$, which measures the number of votes received by legislator *i* in the 1994 election in the municipality where the legislator got the most votes divided by the total number of votes for this legislator in all municipalities.[16] Finally the congressman's party affiliation was controlled through dummy variables for parties in the left and in the center, with the right-wing parties being the left-out category. The second equation was also run with an interaction term of $Appropriation_i$ and a dummy for members of the coalition. This allows for a test whether having marginal amendments appropriated affect coalition and opposition members differently.[17]

[14] It is included in the first equation so as to control for the effect that experience and a reputation may have in helping to secure the appropriation of one's amendments.
[15] The purpose of this variable is to control for the possibility that congressmen who have what it takes to hold special positions within the legislative hierarchy may also be better at getting their amendments appropriated.
[16] This variable captures the effect of the direct influence the electoral constituencies have on the legislators' pattern of voting inside Congress.
[17] A similar interaction term on votes in the first equation did not turn out statistically significant.

Table 1. Relationship between a Legislator's Support for the Executive and the Proportion of the Legislator's Amendments that are Appropriated (1995-1998)

	Dep. Variable: Appropriation	Dep. Variable: Votes	Dep. Variable: Votes
Constant	13.42***	43.43***	75.14***
	(3.19)	(2.76)	(4.51)
Appropriation		0.89***	0.80***
		(2.75)	(2.33)
Approp. x Coalition			-0.64***
			(-4.01)
Votes	0.328***		
	(6.62)		
Position	-0.559	1.55	2.71
	(-0.33)	(0.76)	(1.34)
Concentration		0.18**	0.05
		(2.25)	(0.63)
Left		-29.88***	-53.25***
		(-6.31)	(-7.44)
Center		-1.73	-1.23
		(-0.85)	(-0.63)
Seniority	0.038		
	(0.52)		
R^2	0.10	0.28	0.31
N	402	402	402

Instrumental variables estimation
t-stat. In parentheses; significance 1 percent ***, 5 percent**, 10 percent *

As shown in Table 1, the key results in the regressions are the positive and significant coefficients for the voting behavior variable and the amendment appropriation variable. These coefficients show that even when controlling for other variables that may affect the Executive's decision whether to appropriate a congressman's amendments, an increase in a legislator's voting loyalty increases the probability that her amendments will be appropriated. In the same manner, the higher the proportion of amendments that a legislator has had appropriated, the more she will vote with the Executive. The last column in Table 1 shows that this effect is larger on members of the opposition (0.80) than on members of the coalition (0.80 – 0.64 = 0.16). This result suggests that for coalition members, who already provide a high level of support, the gain in votes for the Executive from a marginal increase in the amendment share appropriated is smaller than the gain in votes that can be had from opposition members. In the third column, *Concentration* presents a positive and statistically significant coefficient in the voting behavior equation, which indicates that legislators, who received a more concentrated vote distribution in the previous election, exhibited a higher probability of voting according to presidential preferences. This result suggests that these legislators are more dependent on providing pork than those who have a more dispersed electorate. Note, however, that this effect disappears when the interaction term is added. As expected, the variable *Left* had a negative and significant coefficient, confirming that those legislators are more likely to vote against presidential preferences.[18]

The preceding arguments showed that the legislators who are most successful in delivering pork barrel politics present a pattern of party behavior inside Congress consistently favoring the preferences of the President. Nevertheless, to what extent has this legislative strategy been producing electoral returns? In order to answer this question Pereira and Rennó (2003a) ran a logistic regression, using as the dependent variable a dummy with the value of 1 for those legislators who ran for re-election and won and a value of 0 for those legislators who ran for election and lost. The key explanatory variable is the amount of money ("pork") in the budget from 1995 to 1998 that originated from the individual amendments of legislators. The model predicts a positive correlation between re-election and pork. Besides "*pork*," the model also takes into account the variable "*Nº amendments*," which represents the number of individual amendments approved by the legislature but not appropriated by the government. A negative coefficient for this variable is expected, indicating that for legislators, merely claiming credit for trying without delivering does not lead to recognition by their constituency; legislators have to conceive and deliver the pork. The model also estimates the effect of legislators' voting behavior within the Chamber on the likelihood of re-election. "*Votes*" indicates how many times each individual legislator voted with the President during the period from 1995 to 1998. This variable is a measure of presidential loyalty. Hence, it was expected that the more legislators vote for the President, the more they increase their probability of re-election, since the President has enjoyed consistent popular approval during his whole first term. Finally, another variable was added, "*Spends98*," which represents the total amount of money each legislator claims to have spent during his/her electoral campaign of 1998, as per his official declaration to the Electoral Court. It is widely believed that the larger the amount of money spent, the greater the probability of legislators' re-election.[19]

---

[18] Note that the Executive's core coalition is on the right.

[19] For a more sophisticated approach regarding the determinants of re-election in the Brazilian 1998 election, though with similar results, see Pereira and Renno, 2004; and Leoni, Pereira, and Renno, 2003. Pereira and Rennó (2003)

The key result in the logistic analysis is the coefficient on “Pork,” which is positive and significant (see Table 2). This means that, *ceteris paribus*, the greater the amount of individual legislator amendments appropriated by the president, the higher will be the probability of legislator’s re-election. The marginal effect of the variable *Pork* is equal to 26 percent. That is, if a legislator with other variables equal to the mean of the floor would have all individual amendments appropriated, he would have a 26 percent greater probability of being re-elected than if he did not have any amendments in the final expenditures on budget.

Another important finding was the negative coefficient on “*Nº amendments*.” This result indicates that the greater the number of individual amendments approved (but not appropriated) by the president, the lower is the probability that this legislator will be re-elected. In other words, claiming credit is not enough to increase the chances of being re-elected. The money has to be delivered. The marginal effect of having an individual amendment approved but not executed decreases the probability of re-election by 14 percent.

Table 2. Logistic Estimation of the Re-election of 1998

Dep. Variable: Re-election	Coefficients
Constant	.820
	(.1317)
Pork	1.123
	(.0225)**
Nº Amendments	-.075
	(.0339)**
Spends 98	$.208 \times 10^{-5}$
	(.0942)*
Votes	.218
	(.7510)

P-values in parentheses
Percentage of Prediction: 79%
Log likelihood: -129.2009
Number of Observations: 288

The authors’ previous results provide strong evidence that the strategy of following presidential preferences and the preferences of party leaders is a successful one. In short, the Brazilian electoral connection functions well. The regression also indicates that spending money

demonstrate that the same pattern can also be found in the 2002 legislative election. In other words, the results indicate that pork, all of the electoral variables and campaign expenditures are explanations of electoral success.

during electoral campaigning also improves the probability of re-election. An increase of 10,000 *real* in campaign expenditure, for a legislator with features equal to the mean of the floor, increases the probability of re-election by 5 percent.

An additional result in the regression was the impact of support for the president (*Votes*). Although the coefficient is positive, it is not significant. This suggests that there is no direct effect of a legislator's votes within the Chamber on his probability of being re-elected. The votes matter for the indirect effect they have through pork. Furthermore, the result suggests that constituencies do not directly constrain their representatives' behavior inside Congress but rather are more concerned with the capacity of their representatives to deliver pork. This leads to the inference that, in the electoral arena, the great majority of voters do not care about their representative's legislative behavior overall. Therefore, when legislators are deciding how they should vote on the floor they are less inclined to take into consideration their constituency's preference because it provides few benefits for their future political careers. Instead, their strategy is to access the benefits controlled by party leaders and by the Executive. Party leaders have a series of prerogatives that allow them to reward or punish legislators, such as determining committee positions. This is why political parties are so strong inside the Brazilian Congress, but at the same time, they are so weak on the electoral arena. Consequently, there is no contradiction between expecting legislators to vote according to the preferences of party leaders inside Congress and expecting them to behave personally in the electoral sphere by searching for pork barrel benefits.

3.3 Judiciary

Eleven judges comprise the Supreme Court. The President nominates people for life terms, though with compulsory retirement at 70, and the Senate confirms or denies nominations. The composition of the Court has changed very slowly over time; the current Court has a judge who was appointed in 1981. This means that each President typically has the chance to appoint only a small number of judges, which makes it difficult to appoint the median voter in most issues, thus limiting the influence of the Executive.[20]

[20] Cardoso appointed only three Supreme Court justices in eight years in power, while Lula has already appointed three in just six months because of a mandatory retirement age of 70. This has been a crucial point of consideration by the Lula government in its efforts to pass reform measures similar to those attempted by Cardoso, which the Supreme Court declared unconstitutional.

The Constitution of 1988 further enhanced the independence of the Judiciary by establishing that: 1) the Judiciary determines its own annual budget, and 2) the judicial courts appoint lower court judges. Both of these rights removed potential instruments of control over the Judiciary from other branches of government.[21] If the Supreme Court was truly independent, then it should be possible to observe occasions whereby it directly contradicted the interests of the Executive and Congress, and in fact, there have been a few high-profile cases in which the Court ruled against the Executive on issues that were of extreme importance to the Executive. These are issues over which there can be no doubt of the Executive's preferences and will to prevail, so that if the Judiciary were not truly independent, the Executive would have used its power to change the Court's decision. The best example of this was the attempt by the Cardoso government to tax retired workers. The Cardoso administration envisioned this as an important component of the solution to the fiscal crisis of the government. The Social Security system in Brazil was seen as one of the main sources of the country's large internal deficit. Taxing the transfers to retired workers proved highly controversial because it involved acquired rights and entitlements, and the Executive was only able to pass this measure through Congress with much effort (Alston and Mueller, 2003). The Supreme Court, however, declared the measure unconstitutional. This decision enraged the government and its supporters in Congress. Initially, Congress and the President threatened to deal with the Supreme Court's decision by changing the Constitution. The reversal of the pension reforms also prompted a return to the episodic debate on the need for external control of the Judiciary. This debate is revived every time a ruling by the Supreme Court or other parts of the Judiciary gets in the way of governmental policy.[22] Despite its threats to change the Constitution, the Cardoso government abandoned the idea. The Lula government has just passed the same pension-reform measure through Congress. Lula dealt with the potential challenge of the Supreme Court by making exceptions in the pension rules for the judicial branch and by counting on the support of the three members he had recently appointed.

There are several other cases that provide evidence of judicial independence. In 1997 the Court required the government to increase the wages of federal civil servants by 28.86 percent to

---

[21] According to Castro (1997a, p. 243), the Judiciary actively lobbied for these rights during the Constitutional Assembly in 1988.

[22] The case for external control is usually made by mixing arguments about the Judiciary's inefficiency (delays, corruption, impunity, high salaries, etc.) with arguments concerning the political need for control. For a debate about the issue of external control, see Konrad, Adenauer, and Stiftung (1999).

compensate for losses due to previous economic stabilization programs. This not only significantly increased the government's wage bill, but also demonstrated the Court's restraint on the discretion of policy makers. Another example is the role of the courts in land reform policy. The Cardoso government put land reform high on its lists of priorities, given the pressure provided by the MST (Landless Peasant Movement) and public opinion (Alston, Libecap and Mueller, 1999). Through its land reform agency, the government attempted to expropriate "unproductive" land, a discretionary judgment. Nevertheless, the courts often thwarted efforts to expedite the transfer of land from large landowners to landless peasants. Landowners contested expropriations through the courts, arguing either that their properties were not unproductive, or that the compensation offered by the government was too low. As argued by Alston, Libecap, and Mueller (1999), the Supreme Court often ruled against the government in these cases, not because it was biased on the issue of land reform, but because it viewed the cases legalistically and disapproved not of the expropriations themselves, but of the manner in which the government pursued it, violating property rights and due process. For a list and discussion of cases of Executive vs. Supreme Court confrontation involving administrations from 1988 to 1994, see Castro (1997a).

There is also evidence from a more systematically chosen sample of cases. Castro (1997b) analyzed 1,240 Supreme Court judgments in the first semester of 1997.[23] Castro classified the cases into three categories: 1) public interests moving against private interests; 2) private interests moving against public interest; and 3) others (both private versus private and public versus public). The Supreme Court ruled in favor of private interests in 75 percent of the cases when they were up against public interests (i.e. government interests). Castro interprets his evidence as "indicating clearly that the Supreme Court, even in its routine order of business, has ruled against the initiatives of the government" (Castro, 1997b, p. 153). It is important to note that most of the private victories had to do with tax issues. Still, in considering only public-policy issues (i.e., non-tax issues), the Court ruled in favor of the private interest in seven out of 31 cases. This evidence can be interpreted as supporting the assumption of an independent Supreme Court.

[23] In total the Supreme Court analyzed 7,855 cases in that year. The sample includes many different types of cases: fiscal and tax matters, procedural issues, penal cases, issues regarding monetary correction and payments, decisions of federal policy, electoral issues, amongst others.

Given the independence of the Supreme Court, what can be said about its preferences and how can it be expected to act? Mueller (2001) analyzed the existence of commitment mechanisms for the government in the privatization and regulatory process in Brazil. His working assumption was that the Court can be expected to act in a non-political and unbiased manner in concession contracts, ruling closely to the letter of the contracts.[24] The evidence is not yet in, but the current political debate over tariffs (see the discussion of regulation below), is clearly taking place "in the shadow of the courts."

More generally, the main problem cited by companies, individuals and judges themselves is the system's slowness (Pinheiro, 2000b). Courts at all levels, including the Supreme Court, are typically overloaded with cases, and decisions can take years. Companies often use this slowness strategically, taking actions that they know will be struck down in the distant future. For the government, this type of strategic behavior is even more appealing since the consequences of actions taken today may be left for future administrations. Governments have used the expected court delays successfully in tax legislation. If the courts rule against the government, it is future governments who have to rebate taxes. In short, court delays act as a quick and cheap emergency means of government financing.

Pinheiro (2000b) provides survey evidence from businessmen, judges and the general population that shows that the biggest complaint, after slowness, is the access of the poorest segments of the population to the courts. Predictability, on the other hand, is not seen as a problem. In labor law, for example, the decision always favors the employee. Though this is biased and often leads to injustice, at least employers know the outcome beforehand, which reduces the cost of litigation and provides incentives for labor legislation to be respected. If the Judiciary had no autonomy, one might certainly see a different picture. Moreover, if the Court were not independent, Congress and the Executive would not be continually debating judicial reform as a means of reigning in the Court.

3.4 Governors

Unlike the other actors discussed in this section, governors do not have an independent and constitutionally defined power that can *directly* counter Executive preferences. Governors are not

[24] This assumption does not mean that the Brazilian Judiciary functions well in other aspects. Indeed there is evidence that the overall judicial system has a negative impact on the economy. See Pinheiro (1997) and Pinheiro and Cabral (1998).

institutionally speaking veto players: their agreement is not necessary for approval of legislative proposals, nor do they hold powers to reverse legislative decisions. They can, however, have some indirect power over policy by their influence.

The Constitution does vest a number of policy domains (e.g., public safety) to the states, which also enjoy tax, fiscal and administrative autonomy.[25] The policy preferences of governors and the Executive may diverge in the political game described in the preceding section. Governors are not primarily concerned with fiscal stability at the national level and have a preference for higher federal public spending and geographically concentrated investments. Governors are also interested in more social transfers because these can be presented as state government's spending and local programs. The preferences of governors and the Executive clash over fiscal policy.

It is necessary to distinguish two phases in the discussion of the ways in which governors, and federalism at large, have constrained the Executive. The first phase was transitional, when the rules of the political game were not yet fully institutionalized. In this period, governors derived their power by virtue of the role they played in the democratic transition. The second phase dates from the Cardoso administration, when the new constitutional rules of the game were in place.

Governors have derived their powers from two sources. First, as previously mentioned, they enjoyed great political power in the 1980s because of the role they played in the democratic transition. In addition, while there is much dispute in the political science literature, governors tend to have some, albeit declining, influence over the behavior of Federal Deputies and Senators in Congress. The degree of influence they hold varies across areas, with governors playing a crucial role in issues with important local (i.e., state-wide) effects such as tax and regional infrastructure. Governors can also play an important role in the electoral career of legislators at the state level. Samuels (2003), for example, claims that congressional candidates tend to coordinate their campaigns around gubernatorial candidates and not presidential candidates. That is what he calls the "gubernatorial coat-tails effect," in which the race for governor shapes the race for federal deputy because Brazilian politicians do not obtain much of the electoral

[25] According to the Brazilian Constitution of 1988 (Article 25), the prerogatives of the states are residual; they have jurisdiction over those areas that are not conferred to the federal government or the municipalities.

resources they need from national parties or presidential candidates, but from state-level connections.

However, the broker's role attributed to governors and their control over their state's legislative delegations have been greatly exaggerated by the media and by the literature, especially during the Cardoso administration. It is true that governors can constrain the Executive in indirect ways, but they do not wield veto power in any federal arena. There is no evidence that state loyalties on the part of legislators undermine party lines or create trouble for the Executive (Cheibub, Figueiredo, and Limongi, 2002). The indirect ways in which governors influence policy formation range from inter-alia lobbying activities on specific issues affecting states, such as tax policy, to control over specific appointments in the federal bureaucracy. Governors can also resist the implementation of federal policy, such as when a number of state governors refused to privatize state-owned energy firms. These episodes are unusual and have become even more so because states have become less and less autonomous and dependent from the federal government.

Another source of the governors' power is the Brazilian Constitution, which vests the states with substantial tax powers. The states collect Brazil's version of the value-added tax (the ICMS), which represents the single most important tax in the country, accounting for one-third of the country's total tax revenue. The Constitution of 1988, in effect, mandated a gradual increase in the states and municipalities' share of all public sector income. In 1994, the states' share had increased by 5 percent and the municipalities' by 11 percent. The inter-governmental transfers from the federal government to the states increased significantly. The share of the FPE (the states' revenue share fund) generated from the income tax and from the tax on manufactured goods climbed from 14 percent to 21.5 percent.

The fiscal decentralization created by the Constitution of 1988 prompted the federal government to substantially raise taxation by raising the *contribuições sociais* (social security and related taxes), which are not shared by the states and municipalities. Furthermore, to bypass the rigidities of the federal budget, the federal government set up a special fund to be used discretionarily. The *Fundo Social de Emergência (FSE)*[26]—which was renamed several times to become the FEF and as of 2000, the *Desvinculação dos Recursos da União* (*DRU*)[27]—was

[26] Constitutional Amendment EC 1/96 and Constitutional Revisional Amendment ECR 1/94.
[27] Constitutional Amendment EC 27/2000.

created by allocating part of the revenue from the *IPI* (the tax on manufactured goods) and from the personal and corporate income tax, before they are distributed. As a result, this innovation represented a reduction in sub-national resources because these taxes are not shared with the states and municipalities.

In addition, the institutional source of a state's power also has to do with the state's prerogative to own banks and public enterprises. The state banks were created in the 1960s as part of the developmentalist strategies pursued by the military government. With the democratization of the country in the 1980s, the governors became more autonomous from the federal government and therefore were able to use the state banks for pork. This included granting subsidized loans to the private sector and more importantly, financing state government projects that are fiscally unsound. The state treasuries also issued bonds that were purchased by the banks. Thus, during the Sarney, Collor and Itamar administrations, the states operated under a 'soft budget constraint' because of their ability to undermine the Central Bank's supervision. In 1994, prior to the establishment of the privatization program (PROES), there were 35 state banks. In 2002, there were four small state banks.

In addition to the state banks, governors control a vast network of sources of pork, ranging from public-sector jobs to infrastructural programs and state-owned enterprises. In the latter, a pattern similar to what occurred in the banking sector can be observed. Most public utilities companies in energy were privatized, leaving governors without an important instrument of power. The resources controlled by the states are important assets that are instrumental to winning elections, and they are coveted by the federal government. In the large states, the administrative apparati are large machines that can be even larger than the federal government machine itself, as in São Paulo.

Due to fiscal problems facing the states following monetary stabilization, the federal government was able to impose the privatization of the banks and public enterprises, thereby dramatically undercutting the power of governors. With inflation under control, the state banks lost their principal source of revenue (i.e., the floating of financial assets), and a surge in interest rates caused a rapid deterioration of the states' fiscal situation. State debt reached a peak in 1997 (three years after the *Plan Real* was phased in) and represented a significant part of the GDP. The *Plan Real* was therefore an exogenous shock that undermined the ability of the states to resist the preferences of the Executive. The federal government implemented a program aimed at renegotiating the states' debts. It included debt swapping under favorable conditions, though it was linked to a number of conditionalities.[28] Prior to 1994, a number of incentives such as federal bailouts encouraged states to behave fiscally irresponsibly and indulge in opportunistic behavior.

In sum, while it is clear that federalism matters and that governors play an important role, throughout most of the last decade the Executive has been able to have its agenda implemented by recentralizing the political game. This includes passing legislation that adversely affected the state governors—as exemplified in the cases of the FSE, FEF and DRU—and initiating measures that have led to a political recentralization of the country (Melo, 2002).[29]

3.5 Public Prosecutors (Ministério Público)

This subsection describes the role of the *Ministério Público* (MP - public prosecutors) as political actors in the policymaking process. Although several countries have public prosecutors,[30] the MP plays a particularly important role in Brazil in shaping the outer features of public policy. This subsection describes how the political institutions give the MP the independence, legal instruments and resources that allow it to be an extremely active watchdog of the actions of the other political actors. Because the MP is already intensely motivated to protect society from the misconduct and/or oversight of the other political actors, this has made the MP a central figure in the process of making and implementing policy.[31]

The *Ministério Público* has existed in Brazil since 1609 (Macedo Jr., 1999), although its role and institutional organization have changed over time as different Constitutions have redefined its structure. As in most countries, one of its purposes is to prosecute, in the name of the State, those who commit crimes. However, in Brazil the MP has taken on an additional role that has led it to turn much of its attention to the process of public policymaking. These changes began in 1985 when a legal instrument known as the "public civil suit" (*ação civil pública*) was

[28] This was accomplished by the Programa de Recuperação Fiscal e Financeira (RFF) and through Law 9496 in 1997. A stock of debts corresponding to 11 percent of the Brazilian GDP was renegotiated (Mora, 2002).
[29] For a contrasting view that argues that resistance from the states and governors undermines much of Cardoso's reform efforts, see Samuels (2003).
[30] For a database on the organization of *Ministerios Públicos* in the Americas, see: Base de Datos Políticos de las Américas. 1998. "Designacion del Ministerio Publico." *Análisis comparativo de constituciones de los regímenes presidenciales*. Georgetown University y Organización de Estados Americanos.
http://www.georgetown.edu/pdba/Comp/Control/Publico/designacion.html. 15 de enero 2004.
[31] This more active role played by the MP is recent, as it began with changes introduced in the 1988 Constitution and has been evolving since. As such, there is very little academic work available on the MP, apart from the very legalistic and biased work done by its own members (frequently dissertations for Master's degrees.) Important exceptions are Arrantes (1999 and 2004).

created, through which the MP could take to court any person or entity doing harm to the environment, consumer rights, or the artistic, cultural, historical, tourist and landscape patrimony of the nation.[32] It was the 1988 Constitution, however, that amplified the scope of these public civil suits by stating that it is the institutional role of the *Ministério Público* to "promote civil inquiries and public civil suits for the protection of public and social patrimony, of the environment and of other diffuse and collective interests."[33] This apparently innocuous article has in effect allowed the MP to take under its jurisdiction the monitoring of all public policy, since practically any act of public policymaking can be construed to affect "diffuse and collective interests." What the Constitution did, in effect, was to stipulate that a series of social conflicts that previously would have been mediated only in the political arena could now also be brought into the judicial arena.

Clearly, the establishment of a new role for the MP in the Constitution would have been innocuous had it not been accompanied by other provisions that granted the MP the instruments necessary to carry out that role. But the Constitution did in fact provide them, in terms of independence, resources and legal instruments. Whereas before the Constitution the MP was part of the Executive power, the new charter made the MP autonomous, not only in terms of insulation from interference by the other powers but also in terms of budgets, which are fixed and automatic. The Executive's only prerogative is to choose the head of the federal MP from one of its members at the start of the term, being immovable thereafter.[34] This independence extends to the level of the individual prosecutors. They enter the profession by taking a public exam that is open to all citizens with the necessary qualifications, though the exams are difficult and vacancies often remain unfilled. The 1988 Constitution establishes that prosecutors cannot be fired, transferred or have their salaries reduced. In addition, each prosecutor is independent within the profession, being immune from internal pressure, as in effect there is only administrative and not functional hierarchy (Arantes, 1999: 90). Salaries are among the highest in the country for public sector jobs, and as a consequence they attract highly competent people.

[32] Public civil suits can be initiated by states, municipalities, public companies and even civil society. However in practice it is mostly the MP that takes the initiative. Other entities have preferred to invoke the MP rather than do so themselves.

[33] 1988 Constitution, Art. 129-III.

[34] There is a federal MP and state level MPs in each of the 26 states plus the Federal District. Prosecutors are known as *promotores* and *procuradores*. *Promotores*, the first stage of the career at the state level, act in specific municipalities. They can eventually be promoted to state *procuradores* by seniority and merit. At the federal level there are only *procuradores*. At the state level the head *procurador* is chosen by the governor from a list of three names voted on by all members of the state's MP.

In addition to resources, the MP possesses a set of powerful legal and judicial instruments. The first of these is the “Adjustment of Conduct” warrant, through which the MP can request that an individual, firm or governmental entity cease or change a certain behavior or be prosecuted. In practice this instrument has been a credible threat as it can result in significant costs even if the case is struck down in court. The MP also has the right to request free expert advice from police and other governmental organizations so as to investigate a given issue. It can also impose daily fines until certain types of behavior cease. And most importantly, it can take to court via public action suits those who harm collective and diffuse interests. In practice this has proven to be a tremendously effective instrument since the prosecutors are highly trained and know how to use the often tortuous Brazilian judicial system. Even though judges have the final word and often strike down public civil action suits, many of those being prosecuted find it better to negotiate.

Generous endowments of human and financial resources as well as an effective set of instruments are not enough to explain the new role taken by the MP. There remains the issue of motivation, that is, what this largely independent organization chooses to do with these endowments. In part, the separation of the MP from the Executive meant that the MP was no longer charged with being the Executive’s advocate, that is, with defending the Executive’s interest before the Judiciary. This role was ascribed to a new governmental entity (the Union’s General Advocacy), leaving the MP free to be the advocate of society, defending in particular many diffuse and collective interests. Interestingly, what evolved was a very particular pattern of preferences and motivations on the part of the (mostly young) prosecutors, who see themselves as playing a messianic role in society: defending the weak and defenseless (hyposufficient in their terminology). Importantly for the theme of this paper, these prosecutors see a large part of their role as defending society from the government, which they consider to be responsible—by omission and by commission—for many violations against diffuse and collective interests. For example, rather than simply prosecuting a polluter, they will prosecute the environmental agency for allowing the pollution to occur. The reasons for this zealotry are difficult to ascertain. It may be due to a self-selection process whereby individuals with that view of the world are more attracted to a job where they can “make a difference,” or it may be induced by an *esprit de corp* that induces most members to adopt a common vision. A survey by Arantes (1999) of 763 members of the MP shows that they see the social and political performance of the Executive and legislature, at all levels and among all political parties, as very poor. In addition, they see themselves as the most important institution responsible for defending, broadening and consolidating social rights.

Having described the evolution of the MP, it is useful to provide some examples of how it can and does affect policymaking at the federal and local level in Brazil. The first example involves the constitutional provision that a fixed proportion of the federal budget must be applied to health-related expenditures. This is a typical hard-wiring of policy as discussed in other sections of this paper. In late 2003, it was discovered that President Lula's budgetary proposal for 2004 included expenditures in sewage and anti-poverty programs in the R$35.8 billion that should be devoted to health, so that in effect only R$32.5 billion would reach the actual health system. The congressmen who represent health providers' interests in Congress quickly denounced this attempt to get around the constitutional limitation, even though presidential powers could probably have easily gotten the proposal approved. The Executive argued that sewage and anti-hunger expenditures were in effect closely related to health. However, when the head of the federal MP officially recommended that the budgetary proposal be revised, the President backed down and made the necessary changes. This is an example of the MP serving as a check on the President and constraining the policymaking process.

A second example is the implementation of educational policy through the creation of a fund to finance schools and improve teachers' wages. This fund (FUNDEF) was created by a Constitutional amendment in 1996 under the Cardoso administration and received earmarked resources from a series of other constitutional funds as well as fixed proportions from a series of tax revenue sources. The idea of the fund is that resources get credited directly to the bank accounts of each state and municipality as soon as the money is received by each of those sources, so that there are less hold-ups and delays. Furthermore the size of the transfer is proportional to the number of students enrolled, guaranteeing a minimum amount per student, thus giving incentives for schools to increase enrollment rates. The resources must be spent entirely in fundamental public education and at least 60 percent of the resources must go to teacher's wages. Once again this is an example of hard-wiring policy so as to avoid any volatility that might ensue and potentially seriously compromise the policy's effectiveness.

The idea of the fund is that there are gains to decentralizing this type of expenditure. However, the policy makers recognized at the same time the inherent difficulty involved monitoring the use of resources in such a decentralized system. In order to deal with this, the receipt of the funds is contingent on the creation of local councils composed of representatives from the state, teachers, parents and school employees. These councils are independent from the state and municipal governments and are in charge of exercising social control over the use of the transferred resources. Despite all the merits of decentralized participatory monitoring, it was clear that the councils alone could not sufficiently check the myriad forms of fraud and corruption that this kind of transfer traditionally fostered in Brazil. The Ministry of Education thus sought to involve the MP in the task of monitoring the program by signing an agreement of cooperation. The Ministry created a manual and special courses for prosecutors, describing the program and the main problem areas, such as fraud in school censuses, delaying wages, or not using at least 60 percent of the resources for wages, unrepresentative councils, use of resources for non-education related expenditures, etc. The MP would have monitored the program even without the agreement, since it views the constitutional guarantee of universal public education as an important diffuse and collective interest. However, by explicitly bringing the MP on board, the Executive facilitated that monitoring and improved the working of its educational policy. Whereas local councils and auditing offices can provide some check over improper use of resources, they lack the independence, resources, legal instruments and motivation that make the MP so much more effective in achieving this task. Although there is no systematic data on the MPs participation, a cursory examination of the web sites of the various state MPs shows quite a preponderance of FUNDEF-related cases. In the state of Bahia in 2203, for example, 92 of 415 counties were being investigated by the MP for misuse of FUNDEF resources. This example shows that other political actors use the MP to ensure the proper functioning of policy. The MP not only serves to ensure that the rules will be enforced, but it also serves to reinforce the Executive’s commitment that this hard-wired policy will be followed at the state and local levels. With the MP so closely involved, it becomes even more difficult for the Executive to skirt the constitutional constraints on educational expenditures should such a need arise.

These examples show that the MP has been playing an important role in the policymaking process in Brazil, not only by constraining other political actors, but also by reinforcing policies by serving as arbitrators, mediators, coordination mechanisms and notaries. By doing so, the MP has brought the judicial branch into political transactions. This judicialization of politics implies that the MP is an increasingly important political actor in the policymaking process. Its interference in the policymaking process has already aroused reactions from the other political actors. A law was proposed by the Executive in 2001 seeking to forbid prosecutors from releasing information on investigations before their conclusion, a strategy often adopted as a means to buttress their cases since newspapers and other media can be used as evidence in investigation and also to gain popular support. This law, informally known as the Gag Law, was dropped due to the reaction it caused in the press, where it was construed as arbitrary and equivalent to censorship. Nevertheless the dissatisfaction of many political actors with the active role played by the MP, which they see as overstepping its bounds, remains and it suggests that in the future there will be further clashes to determine more precisely what that role will be.

3.6 Regulatory Agencies

Since 1997 Brazil has created more than 10 regulatory agencies. Before the new agencies were created, the regulation of the sectors resided in specific ministries, or offices within the ministries. There are two reasons why regulatory agencies are of interest to this project. The first is because they are political actors with strong influence over the policymaking process in important sectors of the economy. Secondly, and more importantly, the decision to adopt regulatory agencies, the choice of how to design them, and the way in which that design has evolved over time provide important examples of political transactions that reveal much about the policymaking process in Brazil.

The switch to autonomous agencies represented a dramatic shift in the locus of power since their design provided them with considerable policymaking clout and a high degree of independence from the Executive and Congress. Congress and the Executive gave agencies jurisdiction over decisions that were important to other political actors, including in particular the power to set tariffs and the power to grant the concessions through which the right to provide a public service is conferred to the private sector. The insulation resulted from the appointment process of the directors of agencies and through hard-wiring budgetary resources. Most agencies in Brazil have rules that provide the directors with stability, so that they can only be removed under very exceptional circumstances, requiring corruption or malfeasance proved in a court of law. The President nominates directors and the Senate confirms nominations. The terms of directors are staggered and as a result policy is more stable.

Mueller and Pereira (2002) and Melo (2001) argue that the most important motivation for the creation of regulatory agencies in Brazil, as well as the main determinant for the specific regulatory design chosen in each sector, was the issue of credibility. Brazil has a long history of government opportunism: for example, debt payment moratoria, confiscation of savings, use of utility tariffs to control inflation, several price freezes, manipulation of economic variables, reneging of contracts, disrespect for intellectual property rights, and arbitrary rule changes. Because of this, the government during the late 1990s had to signal to the market that it would not act opportunistically once investors had undertaken their investments, especially in the electricity and telecommunications sectors, which are particularly prone to administrative expropriation (Levy and Spiller, 1996).

Getting this message through was important because the privatizations had the objective not only of attracting investment and bringing more efficiency to these sectors, but also of raising badly needed revenue for the State (Pinheiro, 2003). One way of doing this was to set the concessions in the form of contracts, since despite all its shortcomings the Brazilian Judiciary deals well with contract law. But the most important means by which the government signaled a credible commitment to not act opportunistically was by designing the agencies so as to give them a high degree of independence. By tying its hands in this way, the government assured competitive auctions for the concessions, which generally resulted in high premiums above the minimum prices. This is particularly true of the telecommunications and electricity sector. Mueller and Pereira (2002) modeled the determinants of the government’s choice of agency design and choice of regulators and showed that the *de facto* design of each agency varied systematically with the level of credibility cost inherent in each specific sector. For example, in those sectors where future investments were particularly important, such as electricity and telecommunications, the government gave more autonomy to the regulatory agencies than in those sectors where credibility was less crucial, such as health plans and food and drug regulation.

The reason that a credible commitment was needed in the first place is because situations are bound to arise in which the President will want to act opportunistically. Because this paper is concerned with how actors accomplish political transactions, it is interesting to look at cases where the government’s promise to not change the rules comes under strain. Regulation provides several such examples. One which has confronted both the Cardoso and the Lula administrations is the choice of the consumer price index used in the price-caps mechanism to set tariffs. In December 1999, a controversy arose when several branches of the government, especially the Finance Ministry, Central Bank and Presidency, expressed concern about the effect of utility service tariffs on inflation as the market started to realize that the particular index used in the price-cap formula, the IGPM calculated by Fundação Getúlio Vargas, was more than double that of the IPCA, the official index calculated by the Brazilian Census Bureau IBGE.[35] That is, while the official rate of inflation for 1999 was approximately 9 percent, the inflation measured by the IGPM was around 20 percent. This discrepancy was due to the different methodologies used to compile each of the indexes. The IGPM is a general price index that covers a wide basket of goods, including many tradables that were greatly affected by the large devaluation that occurred earlier that year. The IPCA, on the other hand, is a consumer price index, which was less affected by the devaluation, since a reduced aggregate demand kept the prices of many consumer goods in check.[36]

Under normal circumstances the different price indices do not differ very much so that at the time when the parties signed concession contracts, it would have been hard to predict that this situation would arise. The main concern then was to move forward with the sectoral reforms and the privatization program. But once the problem had arisen, the government realized the potential danger that the use of the IGPM represented to price stability in the country. When the time came for their yearly rate reviews, the concessionaires would have the contractual right to increase their rates by the 20 percent measured by the IGPM, while the rest of society lived with the official rate of 9 percent. This was not only a source of additional inflationary pressure, but also allowed the companies a higher level of profit than that preferred by the government. Most electric distribution companies, for example, had signed price-caps contracts with an X-factor of zero for the first five years. This was done at the time of privatization so as to make the companies more attractive to investors. However, these new developments led the government to start questioning whether it would not be in its interest to change the contracts so as safeguard against the problems noted above.

[35] In Brazil there are a large number of different organizations calculating inflation indices. In part this is to be expected in a country that has lived for nearly 30 years with a highly inflationary economy where contracts had to be indexed. In several instances in the past, the government manipulated the indexes over which it had control, so that a demand arose for "credible" indexes, such as the IGPM, which the government could not manipulate. This is the main reason for the use of the IGPM in the concession contracts.

[36] For an analysis of the behavior of the various price indexes in 1999, see Banco Central do Brasil. 2000. *Relatório da Inflação*, http://www.bcb.gov.br/htms/relinf/frmder.asp.

The controversy played out over the press and in official circles, with public officials and pundits debating the need to modify the contracts and the effect this would have on the country's credibility. At first members of the Ministry of Finance defended changing the index used in the contracts, but this idea was eventually dropped, as noted by the Minister of Communications: "If the government changes the index unilaterally, the harmed companies will take it to the Courts and will win" (Paul and Aguiar, 1999). Having been unable to address the problem by changing the contract, sectors of the government considered the possibility of doing so through the X-factor. The price-cap formula allows the regulator to determine that the tariff will rise at a rate below inflation by a factor of X percent every year, thereby forcing the company to share part of its efficiency gains with the consumers while still maintaining the incentive to reduce costs. The contracts specify periods in which the level of the X-factor will be reviewed. The idea is that the regulator will periodically have a chance to adjust the level of profit sharing by the company with consumers. As noted above, most concession contracts in the electricity distribution sector had adopted an X-factor of zero, with a rate review set for five years later, that is, in 2003 for most companies. Unable to change the index in the contracts, the second attempt was to anticipate the rate review and reduce prices by slapping a high X-factor (Rondino, 1999). The government believed that it could do so by using loopholes in the concession contracts (Bautzer, 1999). However, in the end the government decided to do nothing. The next company to come up for its rate review was the distribution company for the city of Rio de Janeiro, CERJ, which received the full rate increase of IGPM minus zero (Paul, 2000). The same happened as subsequent companies reached their date of review.

3.7 Bureaucracy

This section discusses the Brazilian bureaucracy as an important institutional constraint in the political game presented in this paper. It should be noted that the changes in bureaucratic structures following the enactment of the Constitution of 1988 exemplify policy outcomes that are stable and adaptable. This paper views the bureaucracy as an important institutional player and a political outcome that has been undergoing significant change in response to the changing economic and political environment. The bureaucracy is an institutional actor that constrains the Executive but at the same time is an integral part of the management of the government coalition.

Brazil has been discussed in the literature on comparative bureaucracy as a fairly successful case. During the so-called *Estado Novo* (1937-1945), Vargas implemented a significant administrative reform. It set up the Departamento Administrativo do Serviço Público (DASP, or Administrative Department for the Civil Service) in 1938 as the key administrative agency responsible for the competitive selection of federal personnel and for the rationalization of administrative practices and procedures. The DASP reforms led to the formation of a hybrid administrative structure in Brazil consisting of two levels. The first level consisted of the core developmentalist bureaucracies in agencies in state-owned enterprises, state-owned banks, and in planning, taxation and budgeting. The second level consisted of the administrative structures of the line ministries, particularly in the social sectors. Whereas the first level was insulated from competitive politics, the second level was part and parcel of patronage games and highly clientelistic arrangements (Nunes, 1997; Geddes, 1995). Examples of the first type of insulated bureaucracies in the 1950s include the National Bank for Economic Development (BNDES), the Bank for the Brazilian Northeast (BNB), the Bank of Brazil, the Brazilian Institute for Geography and Statistics (IBGE), the Northeast Development Agency (SUDENE), and the Ministry of Foreign Relations (Itamaraty).

Itamaraty has been a noticeable example of institution-building. It managed to professionalize its bureaucracy much earlier than the rest of the sectoral agencies on account of two developments. The first one is that lateral entry into the diplomatic career was severely restricted as a result of the introduction of public competitive examinations in 1918, and as the result of the establishment of the Instituto Rio Branco, the second oldest public diplomatic training institute in the world (Cheibub, 1985). The second development has been the increasing prevalence of meritocratic mechanisms for promotion since the 1940s. Drawing on an extensive data set on the careers of cohorts of top-rank Brazilian diplomats between the 1920s and 1980s (*ministros de primeira* and *segunda classe,* and *secretarios gerais*), Cheibub (1989) showed that, controlling for social background, profession, state/regional origin, profession of father, kinship ties to diplomats, among other factors, the score/rank in the admission exam and the academic record at the Instituto Rio Branco were the key determinants of promotion.

The second comprehensive administrative reform in Brazil was implemented by the military regime in 1967. Decree-law 200 created a new tier in the Brazilian administrative state consisting of the so-called public foundations and mixed capital public companies. The rapid economic expansion-cum-modernization of the country under the military was accompanied by a great expansion of the bureaucratic apparatus. This new tier was freed from the cumbersome procedures regulating the so-called *administração direta*, the ordinary public service. These included the free recruitment of personnel and some financial and budgetary autonomy.

In the 1980s, the Brazilian bureaucracy consisted of a vast hybrid structure encompassing a number of insulated *ilhas de excelência* as they came to be called (literally, islands of excellence), coupled with large sectors of non-professionalized staff. In addition to those cited above, the key insulated bureaucracies were the state development banks and state-owned enterprises in oil, petrochemicals, mining and energy sector (Petrobras, Vale do Rio Doce, Chesf, Itaipu, and Banco Central, among many others).

Schneider (1993) examined the career patterns of elite bureaucrats in Brazil in the 1970s and 1980s, compared with their counterparts in Mexico, France, US and Japan, and argues that Brazil and Mexico have a much higher circulation of elites within different agencies and ministries than do the other countries. Unlike Japan and France, this has produced more bureaucratic autonomy vis-à-vis interest groups and more loyalty to the various Presidents and their inner circles (Schneider, 1991). This circulation intensified during the transition to democracy in 1985. This is so because in the political game discussed in this report, the assignment of bureaucrat posts is a key element of Brazil's coalition presidentialism.

In this game, as noted before, the President allocates cabinet portfolios more or less according to the share of Congressional seats held by the coalition members. In order to obtain his preferences for fiscal stability, the President faces the dilemma of delegating bureaucratic discretion to coalition party members while reducing the associated agency losses. The institutional rules governing the bureaucracy have enabled presidents to successfully play this game. The President can resort to 18,000 political appointments (known as DAS posts), a considerable number of which are low-rank posts. The key high-rank posts (approximately 3,000) are filled by the DAS 4, 5 and 6 appointments representing less than 2 percent of federal public employees. Presidents have recruited personnel for these positions from within the civil service, from non-tenured but highly qualified professionals currently holding positions in the bureaucracy, from public universities, and from the private sector.

The President delegates less in the areas of taxation, budgeting, and planning in the Ministries of Finance and Planning. Top-rank bureaucrats in these ministries are typically appointed from a pool of career civil servants in the Central Bank, the Internal Revenue Service, and the Itamaraty, among other institutions, and less frequently from outside government. Unlike countries such as the United States or France, appointments are made across career lines (Loureiro and Abrucio, 1999). The President can then combine distinct criteria while making these appointments. These include personal loyalty and technical expertise. The latter is assured in these careers by extremely competitive entrance examinations and subsequent training in a number of civil service schools including the Escola de Administração Fazendária and Escola Nacional de Administração Pública.[37]

The rest of the ministries have a less endogenous source of recruitment, and ministerial posts are assigned on a partisan basis. Presidents have usually kept the prerogative of appointing the ministries' secretary-general—second in line to the minister himself, and in charge of managing the ministries' positions – as a mechanism for reducing agency losses. The Ministry of Finance, however, is a key institution in this regard. By controlling budget execution and the cash flow of government expenditures, presidential control over the Ministry is crucial (Loureiro and Abrucio, 1999).

Crucial factors that explain the ability of bureaucratic executives to ensure a reasonable level of technical expertise in the Brazilian federal bureaucracy include the following: 1) The widespread use of competitive entrance examinations in the areas of tax administration, budgeting, control, economic planning, accounting, central banking, social security, and legal positions within the Executive; and 2) favorable employment conditions in the public sector. These include tenure and reasonably competitive salaries. In the 1990s there occurred an erosion of public employees' real salaries, but they were raised significantly during the Cardoso administration.

The government also managed to change the civil service rules enshrined in the Constitution of 1988. The Constitution introduced important changes in the Brazilian administrative state. The extension of tenure to all state employees (formerly called CLT workers) through *Regime Juridico Unico* (the Unified Legal System RGU) created a rigid system of personnel that exacerbated state inefficiency. The RGU prohibited different pay levels for distinct performance levels by state employees. It established the principle of equal pay for

[37] Established in 1945 as a training department, ESAF was transformed in 1973 into a highly professionalized institution specialized in preparing entrance examinations and providing hundreds of training programs for civil servants in tax, finance and budgeting.

categories of functions at the state, municipality, and federal government levels. It also granted tenure and a secured 100 percent (in several cases up to 130 percent) replacement rate for civil-servant pensions. The 1988 Constitution also created or strengthened bureaucratic and time-consuming mechanisms for competitive biddings and personnel recruitment, thereby creating an incentive structure that encouraged inefficiency.

The administrative reform package was approved in 1998 and included revamping the RGU; setting up the legal foundations for social organizations and executive agencies—institutions with managerial autonomy and with social control mechanisms; establishing performance contracts within the public sector; and making tenure more flexible. A number of measures also boosted the attractiveness of public employment: the ratio between initial pay and top grade pay within specific civil-service career tracks was expanded significantly. The reform aimed at the low and middle ranks of the bureaucracy, where the pay is high, performance poor, and the fiscal costs very significant as a result of the sheer numbers involved.

Another important positive development under Cardoso was the extension of professionalization outside the core of the economic, planning, finance and infrastructure ministries. The ministries for the social sectors, particularly the Ministry of Health and Education, also underwent important changes. For the first time, the ministers, secretary general and key managers were economists and were much more qualified than their predecessors.[38] As a result, the political game described in this paper has been severely circumscribed by the core bureaucratic ministries.

Overall, the Brazilian bureaucracy ranks well in international comparisons of social control over public sector employees, accountability and perception of corruption. Brazil ranks significantly ahead of Argentina and Mexico in these three counts (Heredia and Gaetani, 2002). In Evans and Rauch (1999)'s Weberianess scale, Brazil's score is 7.6, which compares favorably with Argentina's 3.80, Uruguay's 4.5, and Chile's 5.0.[39] Arguably, considering that the data refer to the public sector as a whole, these indicators would be much better if the data referred only to the federal bureaucracy. Personnel expenditure as a percentage of public expenditure has been about 35-38 percent and is close to the Latin American average. As for public employment, it accounts for less than 8 percent of the economically active population, slightly below the Latin

[38] For the larger trends in Brazil and Latin America, see Loureiro (1997).
[39] The Weberianess scale is a simple measure of the degree to which these agencies employ meritocratic recruitment and offer predictable, rewarding long-term careers, with higher numbers indicating a more professional bureaucracy.

American average. The Executive's ability to politically manage the bureaucracy while at the same time securing its preferences for fiscal stability and social spending demonstrates that the bureaucracy is an enabling constraint that has been used, shaped and reformed.

4. Policy Outcomes

Having presented the main political actors in the Brazilian policymaking process and described how they relate to the general framework of this paper, this section now turns to an examination of the different types of policy outcomes. Rather than generating consistent policy outcomes, the political institutions in Brazil generate policies in three broad but distinct categories: 1) stable but adaptable, 2) volatile and unstable, and 3) rigid and hard-wired. Consistent with this paper's claims that the government has incentives and instruments to pursue sound fiscal and monetary policy, the first subsection below describes those policies and the recent Fiscal Responsibility Law. Then it examines the residual policies mentioned in the framework, including social and poverty policies as well as land reform, which tend to be volatile. Subsequently education and health policy is analyzed. These are all examples of policies that are hard-wired given the long lag that exists between spending and outcomes in these sectors, which may tempt policymakers to divert spending to other, less fundamental areas that have more immediate dividends.

4.1 Stable and Adaptable

Stable but adaptable means that, should outside conditions be stable, policy in these areas would be on cruise control. But exogenous events always happen and the government adapts to the events so as to minimize the damage to fiscal and monetary stability. The policies that best fit into this category relate to economic growth, inflation and unemployment. The following subsections first discuss why macroeconomic policy is considered to be generally stable and adaptable when economic performance has been so poor. The Fiscal Responsibility Law, which reigned in state government debt, is then examined.

4.1.1 Macroeconomic Policy and Economic Performance

The framework presented in this paper states that political institutions give the Executive incentives to be primarily concerned with macroeconomic policy. In addition, strong presidential powers give the Executive the means to pursue those policies, which and when combined with the incentives and checks by other political actors, result in stable and adaptable policy.

Meanwhile other policies, described in the next section, remain contingent on the success of macroeconomic policies to be executed.

The framework presents a rather positive picture of the Brazilian policymaking process, especially when compared to most other Latin American countries. Although there are clearly several problems with this policymaking process, all in all this paper claims that it provides reasonably good means for intertemporal political transaction to be realized. The result is a system of checks and balances where a strong president achieves high levels of governability positively constrained by several other political actors. These claims, however, may seem to many observers to clash with actual facts. An examination of real GDP growth rates shows economic growth has been less than spectacular: 0.7 percent on average for Brazil from 1990 to 1999, less than the average of 1.4 percent for Latin America as a whole. In addition, the public sector's debt, which is a key variable for gauging the sustainability of public policy, presents an evolution over time that is a serious cause for concern: since 1999 the Government Debt/GDP has been above 50 percent.

This paper does not claim that economic outcomes have been as positive as can be desired, but rather that the underlying policymaking process has some very positive characteristics. Clearly a functional policymaking process should lead on average to good economics outcomes, although the fundamental link between these two is not immediate since history (path-dependence) and other intervening factors may delay the effect of new political institutions on economic outcomes. The policymaking process portrayed here has evolved gradually over time and is still evolving. Many of the positive incentives tied to that policymaking process, which enable political transactions to be realized, have only been functioning for a relatively short period of time. To see this, note that the major process of institutional change that has lead to this system started in 1985 with re-democratization, and especially with the new Constitution of 1988. However, these changes did not come into effect immediately. Even after the promulgation of the Constitution, there was still a long period in which complementary laws were being created and voted on in Congress. More importantly a process of gradual changes has occurred, as analyzed in Section 3.1. Furthermore, in the first years after the Constitution, the political process underwent a convoluted period due to shocks not directly influenced by the new institutions.

Most of the important institutional changes only began in 1995, which is why most of this analysis focuses on the Cardoso and Lula administrations. It has been during the period since 1995 that many of the formal and informal rules that currently permeate Executive-Legislative relations (see section 3.2) were consolidated and became routine. In addition, several important reforms began to be implemented, representing not only important policy outcomes, but also altering the nature of the policymaking process by changing the political actors' incentives and constraints, that is shaping the political institutions themselves. The following changes have been among the most important: 1) administrative reform, which changed the rules governing civil servants (see Section 3.8 on the bureaucracy); 2) privatization and the creation of regulatory agencies in several sectors (see Section 3.7); 3) passage of the Fiscal Responsibility Law, which constrains political actors, especially governors (see Section 4.1.2); 4) the evolution of the role of the Ministério Público, which has become an important veto player (see Section 3.5). Yet to come are a reform of the Judiciary, already initiated by the Lula government, and a political reform, still on the drawing board.

The point here is that the evolution of the policymaking process in Brazil has been a gradual and ongoing transformation that is changing political institutions in important ways. This paper argues that these changes will lead to political institutions that will generally result in positive policy outcomes. That these positive outcomes have not yet fully materialized can be ascribed to three factors. First, the underlying institutions are young and are still evolving, and institutional change takes time to translate into effective outcomes. Pension reform, for example, initiated by Cardoso and completed by Lula, will play an important role in improving the government's fiscal accounts. But even these effects will only be realized in the future, since most changes apply to those who enter the system after the changes were made, with current rights and entitlements being "grandfathered." Secondly, Brazil, like most other Latin American countries, has had a convoluted recent history including coups, dictatorships, high inflation, failed economic plans, moratoria, etc., which have strong inertial elements, especially in the belief and confidence of the population and outside investors. Finally, it should be noted that recent years have been particularly troublesome for the world economy as a whole, and for emerging markets in particular, with several external shocks to different countries as the global financial system consolidates to a new, more integrated world order. In other words, the mediocre economic outcomes in Brazil in recent years are not caused by the current incentives and constraints on the political institutions that determine the policymaking process. On the contrary, this analysis sees the process as providing good conditions for intertemporal political transactions to be realized. If it is correct, more positive economic outcomes should eventually materialize.

4.1.2 Fiscal Responsibility Law (FRL)

Congress and the President enacted the FRL in 2000. The FRL represented the apex of a relatively successful set of measures to control the state governments' indebtedness.[40] The FRL illustrates the kinds of policy outcomes that reflect the Executive's ability to implement its policy preferences in the political game discussed in the previous sections. Furthermore, it reflects a learning process arising from a repeated game between the federal government and the states. As Braun and Tommasi (2004) point out, fiscal rules to be enforced require self-enforcement by the players (states) or an external enforcer with the power to ensure compliance. This paper argues that the Brazilian case approximates the second case and not the first. As discussed at length in this paper, the current depiction of the Brazilian political system as a federal structure in which governors wield vast powers is inaccurate. In fact, the circumstances that produced the status quo that favored the states were unprecedented and extraordinary: a Constituent Assembly in which the Executive played a minor role; the political conjuncture of the transition to democratic rule, in which fiscal decentralization and increased social spending were important banners; and the specific sequence through which the political transition (democratic elections) occurred first at the state level (1982) and subsequently at the national level, converting the governors into key political figures in the transition. However, unlike pre-1994 Argentina, the political survival of the President or of the Senators does not depend on sub-national institutions such as the Electoral College in provincial assemblies in which governors play a key role.[41] Because there was no constitutional basis for the power of governors, the Real Plan represented a shock that restored the President's preponderance. Among other things, it a) laid bare the states' fiscal imbalances; b) made it impossible for the states to resort to floating and other financial mechanisms to finance their fiscal deficits; and c) caused a further deterioration of the deficits because of the

[40] At the end of 2003, the states were producing a surplus of 9 percent of their net revenue and representing 1 percent of GDP (Afonso, 2004).

[41] Current views on fiscal rules fail to recognize these crucial differences and instead categorize Brazil and Argentina as examples of the same perverse fiscal federal game (Melo, 2004a). These contributions fail to recognize the great preponderance of the Executive in the fiscal game. For analyses of the Brazilian case along these lines, see Braun and Tommasi (2004), Webb (2004), and Rodden (2003).

sharp increase in interest rates. The Executive was able to impose its fiscal preferences because: a) it could offer BNDES advancements in exchange for fiscal reforms, including privatization of state banks and utilities; b) it had agenda powers and other legislative prerogatives to implement its agenda; an c) it was also helped by the approval of the re-election amendment, which strengthened not only the President vis-a-vis the governors, but also helped extend the governors' time horizons (19 governors ran for re-election), thus introducing some element of self-enforcement in the fiscal game.[42] In addition, due to the devastating impact of hyperinflation in the mid-1990s, the President's policies were viewed favorably by a great majority of the public, which became strongly inflation averse.

The sustainability of the current fiscal situation is therefore not dependent on the states' cooperation. Although the FRL could be reversed, there is some rigidity in it since a three-fifths majority of in two rounds of voting in the two chambers is required for a change in the law. The FRL specifies in great detail the fiscal rules governing public sector indebtedness, credit operations, and public account's reporting. The Law prohibits the federal government from financing sub-national governments, therefore eliminating the possibility of bailouts as well as any changes in the financial clauses of the existing debt-restructuring agreement. The FRL imposes debt ceilings for each level of government. The Executive branch proposes the ceilings and the Senate must approve. The Law stipulates that in the context of economic instability or drastic changes in monetary or exchange rate policy, the federal government can submit to the Senate a proposal for changing these limits.[43] Any excesses to the limits are to be eliminated within one year, otherwise new financing and voluntary transfers from the central government are prohibited. Other sanctions include withholding federal transfers by the federal government, denial of credit guarantees and banning of new debt (Nascimento and Debus, n.d.).[44] In addition, the FRL contains a golden-rule provision for capital spending (i.e., annual credit disbursement cannot exceed capital spending).

[42] Without the re-election amendment, incumbent governors would have an incentive to exacerbate the common pool problem by leaving the fiscal problem to future governors.
[43] The Law stipulates that changes in monetary or exchange rate policy affecting fiscal performance will trigger an extension in the time limit for debt adjustment. The conditions are: a) if the economy contracts by 1 percent or more over the last four quarters; b) if a state of siege is declared or a condition of national catastrophe is approved by Congress.
[44] In order to guarantee transparency in the implementation of the rules, a list of the sub-national governments that exceed the limit has to be published by the Treasury Secretariat (STN) on a monthly basis.

The Fiscal Responsibility Law also granted constitutional status to a number of existing rules and introduced new ones. These include the following: a) personnel expenditures (including pensions), capped at 50 percent of net revenues for the federal government and at 60 percent for sub-national governments; b) new, recurrent expenditure commitments require specification of their full funding for the year in which they become effective and for the two consecutive years; c) a prohibition of spending commitments that exceed one budgetary period during the last year of tenure of the executives at any level of government d) tax and fiscal exemptions and abatements have to be specified in the budget together along with the instruments to offset their impact on the budget for two consecutive years; and e) public financial institutions at all levels of government are not allowed to lend to their main shareholders.

It would be misleading to conclude that the impressive fiscal costs to the central government meant that the initiatives were in the interest of sub-national governments. Furthermore, the fact that most of the fiscal adjustment was generated by raising tax revenue rather than by significant cuts in expenditure does not mean that there has not been a radical change in the intergovernmental balance of power. The states had to privatize or close their banks; embark on a program of fiscal modernization; reduce the relative importance of payroll (for which governors were required at least to refrain from hiring more personnel); sell enterprises; as well as to adapt their pension regimes to the federal rules (in addition to being prohibited from creating new pension institutions or legislating in this area). In sum, the states lost significant degrees of autonomy. As Mora (2002) argues, the states have become more and more dependent on the federal government because voluntary (i.e., discretionary) transfers from the federal government have become essential for their fiscal survival.[45] This is so because the states' own revenues (tax and automatic constitutional transfers from the federal government) have been devoted to producing the surpluses required to honor the refinancing contracts. As Mora argues, the states' indebtedness and their subsequent loss of autonomy have highlighted the autonomy they enjoyed in the past, particularly that of the large states, which had the ability to issue public securities—precisely the kind of debt most sensitive to escalating inflation rates. Currently, the most vulnerable and dependent states are ironically the large and powerful Rio de Janeiro, Rio Grande do Sul and Minas Gerais. Many observers have praised the FRL because it

[45] The recent behavior of the governors of Minas Gerais and Rio de Janeiro toward Lula's government provides graphic evidence of this connection. The governing coalition appears to be trading political support for voluntary transfers.

laid the foundation for a new formidable system of rules for fiscal management. The IMF described the new fiscal institutions as follows:

> In the last few years Brazil has achieved a high degree of fiscal transparency, together with major improvements in the management of its public finances. This was done against the background of an international and domestic macroeconomic environment which has posed substantial challenges to the country's economic policymakers. The cornerstone of these achievements has been the enactment in May 2000 of the Fiscal Responsibility Law which sets out for all levels of government fiscal rules designed to ensure medium-term fiscal sustainability, and strict transparency requirements to underpin the effectiveness and credibility of such rules. Another pillar of the improved fiscal management has been the medium-term expenditure framework aimed at better aligning the allocation of budgetary resources over time to the government's priorities and regional development strategy. Also instrumental in promoting sustained fiscal adjustment of sub-national governments has been the firm enforcement by the federal government of the debt restructuring agreements with most states and many municipalities (IMF, 2001:1).

4.2 Volatile and Unstable Policy

This paper categorizes certain policies as being volatile and unstable. Policies are unstable because: 1) some have a strong ideological component and as such will oscillate with changes in the Executive branch in particular; and 2) some are residual in that the appropriations are determined so as to meet a budgetary target that does not upset the overarching goal of stable monetary and fiscal policy. The mechanism by which receipts and expenditures are balanced by the government throughout the budgetary year so as to achieve the target primary surplus is known as *contingenciamento*. What happens is that at the beginning of each fiscal year the government passes a decree impounding part of the discretionary expenditures in the budget, that is, those that are not hard-wired. As the year proceeds, these resources can be "unimpounded" if tax receipts are greater than expected and if hard-wired expenditure have not been greater than expected.

The size of the cuts are set for each ministry and it is then up to each minister—together together with the Executive, but without consulting Congress—to determine which programs and projects will be hit. Because these are necessarily in the "investment" part of the budget, which is the only part that is not hard-wired, these projects typically affect the policies that have been labeled volatile residual policies. They become volatile precisely because they undergo this process where they will be executed more fully in good years than in bad years. The following two subsections will discuss two sets of policies that fall into this category: land reform and poverty alleviation.

4.2.1 Land Reform Policies

Land reform is the prototypical social policy. It is perhaps the most ideologically charged policy issue in all of Latin America. In addition, it is the kind of issue where the economic benefits of well-conducted policy materialize only in the long run. That is, land reform has those characteristics that the framework presented here predicts will lead to volatile policy, with changes in emphasis, design and implementation coming about with each change in government. In Brazil, this is clearly a predominant characteristic of land reform policies. Since the 1960s every government has had a specific land reform program, although more than 40 years of effort have not managed to budge the indices of land ownership concentration.[46]

Each new administration has created a new land reform program with a different name and set ambitious targets of how many families it planned to settle. The Executive includes resources in his budget proposal to Congress and Congress typically adds amendments to increase expenditures. But at the beginning of each fiscal year, the Executive issues a decree that impounds (*contingenciamento*) part of the resources from several areas, so as to assure that the government's expenditures and receipts are compatible with the primary fiscal surplus target, as described in Section 4.1.1.[47] This impounding cannot touch the hard-wired items and so has to concentrate on that part of the budget that can be manipulated. The policies that are subject to this *contingenciamento* are the ones that tend to be volatile because they depend on meeting the primary surplus target.

The budget of 2001, for example, originally specified R$1.847 billion for land reform (Texeira, 2001). When the budget passed through Congress this amount was increased by 4.3 percent to R$1.927 billion. Part of this total was composed of hard-wired expenditures over which the Executive had no discretion and which it had to execute regardless of any contingency. However, R$1.013 billion remained discretionary. On February 7, 2001, President Cardoso

[46] The Gini index of land concentration in Brazil has increased from 0.827 in 1960 to 0.856 today.

[47] As noted previously, the impounding of resources may be later reverted if the fiscal situation evolves favorably. However, the decision is wholly up to the Executive, who uses this power strategically. Since a large part of the impounded resources represent individual budget amendments sponsored by congressmen, the Executive impounds and releases resources with one eye on the fiscal surplus and the other on congressional voting behavior.

issued a decree impounding 12.57 percent of all the non-hard-wired items in the total budget for that year. The contribution of land reform to this fiscal effort was a cut of R$113.9 million from the R$1.013 billion non-hard-wired resources in the budget for land reform, that is 11.2 percent of the total. The fraction impounded in the following years was 24.75 percent in 2002, 36.47 percent in 2003 and 5.98 percent in 2004.[48] Despite its historic identification with the cause of land reform, which had always been a major campaign issue, note that the Lula administration, cut expenditures on land reform to an even greater extent than had the Cardoso government. Lula's most recent cut produced one of the lowest budgets for land reform in the recent past. The cuts on land reform led to the government's target of 60,000 settled families falling short by 23,200—more than one third.[49] As predicted by this paper's model, the government cut expenditures on land reform, a residual ideological issue, despite its ideological preferences for greater spending on land reform. The rationale for the cut was to meet the fiscal imperatives of a particularly troublesome year (see Section 5.2). It is possible to conclude that land reform fits neatly in the category of volatile residual policies described in this framework. One can speculate that the volatility would be even greater were land reform not pushed so effectively by the MST. Other residual policies where the government is less constrained, such as anti-poverty policy, are even more prone to fluctuations than land reform.

4.2.2 Poverty Alleviation

Brazilian anti-poverty programs exemplify the kinds of policy areas that have exhibited highly unstable patterns in the last decade. According to the political game discussed earlier, they are residual policies.. There is ample evidence of instability in the period from 1988 up until the end of the Cardoso government. The evidence during Lula's reign is more mixed and hinges on the interpretation of the high visibility received by the flagship program *Fome Zero* (zero hunger).

The Brazilian Constitution stipulates a clear role for the state in terms of poverty alleviation. According to Article 23 of the Constitution, poverty alleviation is the joint mandate

---

[48] Budgetary data including that on impoundments comes from several technical notes of the *Consultoria de Orçamento e Fiscalização Financeira* of the House of Representatives, (http://www.camara.gov.br/internet/orcament/Principal/exibe.asp?idePai=16&cadeia=0@).

[49] Of the 36,800families settled in 2003, the government only settled 9,217 in new settlement projects. The remaining 75 percent of the families were settled in pre-existing projects created by the Cardoso government. To save expenditures, the Lula government settled many in the Amazon region where the cost of settling is lower but so too are success rates. The controversy over these numbers is typical of the war over statistics in the politics of land reform in Brazil. These events also exemplify how the use of the number of settled families as a measure of the government's effort for land reform is illusory. When necessary, the government can settle a greater number of families at a lower cost by reducing the "quality" of the settlement projects.

of the federal Government, the states and the municipal governments. In the 1980s there were two federal institutions aimed at reducing poverty: the *Legião Brasileira de Assistência* (LBA) and the *Centro Brasileiro para a Infância e Adolescência* (CEBIA). The LBA was in charge of a network of institutions for the elderly and children in poverty. The LBA operated through agreements with a number of philanthropic institutions, both private and public, which provided funding. Before the decentralization mandated by the Constitution, the LBA oversaw more than 7,000 agreements with municipalities and other institutions. Within the Ministry of Planning, the *Secretaria Especial de Ação Comunitária* implemented a myriad of highly politicized small programs of social assistance.[50] The Collor Administration (1990-92) transferred many of these programs to a newly created *Ministério do Bem Estar Social* and also closed a large number of programs. In the area of food and nutrition, the administration terminated the eight sub-programs that had existed in the 1980s and from which children and expectant mothers had benefited (Resende, 2000: 15).[51] At the same time, Collor phased out the *Programa de Alimentação do Trabalhador* (PAT), a food program for low-income workers.

Upon taking office, President Itamar Franco announced poverty alleviation as one of his top priorities. Following a large country-wide mobilization led by IBASE, one of Brazil's largest NGOs, the Franco administration made poverty a top-priority issue. Ipea, the Planning Ministry's economic think tank, prepared a "map of hunger." The announcement of the map and the publication of figures pointing to the existence of 32 million people living in extreme poverty led Franco to declare the country to be in a "state of social calamity." The next step was the announcement of a number of emergency measures and the setting up, in 1993, of the *Conselho Nacional de Segurança Alimentar* (CONSEA, the national council for food security), consisting of eight ministers and 21 representatives from civil society.

Under Cardoso, *Comunidade Solidária* became the main anti-poverty initiative. Set up in 1995, the initiative consisted of an intersectoral administrative structure that was directly linked to the Presidency. Although it was in charge of a small number of programs (including the *alfabetização solidária, capacitação solidária* and *Universidade solidária*), citizens viewed the *Comunidade Solidária* as an alternative to a World Bank-style social fund.[52] The programs

[50] These ranged from self-help housing programs to schemes for milk and food baskets distribution.
[51] Several institutions and ministries [including the *Instituto Nacional de Alimentação Nutrição* (INAN), the LBA, the Ministry of Education's special fund (FAE), and the Ministry of Planning] operated the programs.
[52] For the design of the government's strategy, see the discussion by its chief architect Vilmar Faria, in Faria (2002).

consisted of public and private partnerships and included volunteer groups. Overall, C*omunidade Solidária* functioned as coordination mechanism designed to take place on two levels: 1) it would encourage and facilitate the participation of civil society institutions in the formulation and implementation of social assistance programs; and 2) it would identify current social-spending programs that had a higher impact on poverty and channel resources to those programs. The identified programs received the "priority seal," which protected them from expenditure cuts.

The Lula administration initiated a reversal of Cardoso's anti-poverty programs, at least on paper. The Lula administration phased out *Comunidade Solidária* and launched a new anti-poverty program, under the auspices of the *Ministério Extraordinário para a Segurança Alimentar e Combate a Fome(MESA*, an ad-hoc ministry for food security). The *Fome Zero* program became the centerpiece of the new ministry. This program would also operate on the basis of geographical targeting. Those municipalities with the lowest HDI would be selected for priority implementation over time, and households with per capita incomes of less than half the minimum wage would receive a food bonus of R$ 50.[53]

Ten months after its announcement, the *Fome Zero* program was still not fully implemented. Lula reduced the resources earmarked for the program because of its fiscal targets.[54] It is interesting, however, that Lula protected *Fome Zero* when a drastic rescheduling (*contingenciamento*) of the federal budget occurred in 2003. But mounting criticism from several sectors including policy circles and NGOs regarding the program's *assistencialista* nature and technical flaws in the design of the bonus scheme prompted the government to phase it out. The government dismissed *Fome Zero* mentor José Graziano and created a new "superministry" for the social sectors, the *Ministério para o Desenvolvimento Social e Combate à Fome*. At the same time, the government decided to introduce a single card, the *cartão família,* which was to be used by families to receive the food benefit plus three other current conditional income transfer benefits. To receive the benefits, families must engage in a number of activities including vaccination and school attendance. In practice, the government discontinued its initiatives and promoted the merger of cash transfer programs created under Cardoso: the school attendance

---

[53] Equivalent to US$ 18. This bonus is operationalized via the *cartão alimentação*, a debit card that is to be used in registered shops and vendors.
[54] The budget law for 2003 contained R$ 1.8 billion for the *Fome Zero*, whereas the budget estimate for its full implementation was R$ 5.0 billion.

program (*bolsa escola*), food aid (*bolsa alimentação*), and the gas benefit. The idea of creating a single card was not new. It was developed much earlier in 2001, when the *Caixa Econômica Federal* (national savings bank) started working on the Cadastro Único, a unified registry of social programs(FAO, World Bank and IDB, 2002). By creating the card, the Lula government could present the achievements of *Fome Zero*—i.e., the number of families that received the card—in the same package with the figures for the much larger existing programs. The same applies to the funds allocated to the family card. The net result was that the political visibility of the modest resources allocated to the food benefit was reduced.

Prior to Lula's administration there was an attempt to hard wire funds for poverty alleviation during Cardoso's second term. Following the intense mobilization around poverty alleviation, a congressional special committee, set up in 1999, became an important platform for opposition politicians to criticize Cardoso's policies in general and his macroeconomic policy in particular. The poverty issue was highly politicized and led to several legislative proposals for hard-wiring anti-poverty funds. Conservative and opposition politicians fought fiercely for authorship of the proposals.[55] While acknowledging the gravity of the poverty situation, the Cardoso administration opposed the idea of a fund because it would imply "budget rigidity." Significantly, the committee was called the "Committee for the study of the structural and conjunctural causes of social inequality and for presenting legislative solutions to eradicate poverty and social marginalization and for the reduction of regional and social inequality." The title of the committee signaled its concerns not only with poverty as such but also with regional inequality. The Committee prepared a constitutional amendment creating a *Fundo de Combate à Pobreza* (Fund to Eradicate Poverty). The original proposal contained several sources of revenue for the fund, including bill that would tax individual wealth and assets that Cardoso had proposed when he was a senator. The proposal, which became Constitutional Amendment 31, was approved in a compromise. The main source of income would come from the existing tax on financial transactions (CPMF). This tax was introduced by "sunset legislation," a transitional clause in the constitution that was legally valid for two years. The government endorsed the Committee's proposal and accepted that an increase in the tax rate would be earmarked for the fund.[56] The Cardoso government approved the constitutional amendment and extended the time

[55] See National Congress (1999).
[56] Constitutional Amendment 12/1996 created the CPMF with a rate of 0.25 percent. The tax was earmarked for health care and was valid for only two years. Constitutional Amendment 21 extended the validity for three

for expiration of the tax by additional two years. Because the fund would last for 10 years, further extensions would be "locked in."

The *prima facie* attempt to introduce rigidity in the budget for the purposes of poverty alleviation can be understood as part of the logrolling between the Executive and Legislative branches. The Executive maintained fiscal stability by increasing taxes at the sub-national level and in return, Congress received some poverty-alleviation programs sheltered from discretionary Executive budget cuts.[57] This is consistent with the political game described in this paper. The Executive prefers hard wiring sub-national spending so as to allow for fiscal discretion at the national level.

4.3 Rigid or Hard-Wired Policy

This section provides examples of hard-wired policies. These are policies specified in the Constitution over which the Executive has no discretion. In 2003, approximately 94 percent of the expenditures in the budget were "rigid," i.e., they could not be changed. The largest portion of these expenditures included types of expenditures whose shares grew over time and whose amounts were most probably not foreseen at the time of hard-wiring. The best example is pensions, which now accounts for 33 percent of the budget. Other types of hard-wired expenditures occurred intentionally: they are the outcomes of the deals between the legislature and the Executive. They include transfers to states and municipalities (18 percent), social assistance (1 percent), Kandir Law (export tax breaks) (1 percent), subsidies (2 percent), the health system or SUS (7 percent), and other expenditures (11 percent). Only 6 percent of the expenditures were subject to being withheld by the Executive to reach fiscal targets. However, the total value, which is approximately R$20 billion, is still significant. There has been much debate over what powers the Constitution and the Fiscal Responsibility Law actually confer to the President in terms of discretion to execute the budget (Lima, 2004). There has also been much debate on whether and how hard-wired items should be "flexibilized." As the rigidities imposed in the past on current public expenditures become more constraining and impede efficient adjustment to current circumstances, the pressure for decoupling some expenditures has

---

additional years. The rate was raised to 0.38 in the first year and to 0.30 in the remaining two years, but the proceeds would be earmarked for social security. The Fund for Poverty Eradication guaranteed that the 0.38 percent rate was maintained. The fund created some rigidity because should the yearly proceeds collected not reach 4 billion *reais*, the national government was to provide the difference with general tax revenue.

[57] The amendment prohibits the *desvinculação* (withdrawal of earmarking) of the fund's resources.

increased. Also, as more expenditures become hard-wired, there are less resources left over for use as pork by the President for trades with Congress. The only mechanism that remains largely unaffected by these fiscal trends is the political allocation of bureaucratic agencies to members of the governing coalition. But as indicated before, the increasing professionalization of the line ministries of the social sectors (the largest bureaucracies of the state machinery) has also restricted to a certain extent job politics and political favoritism in the allocation of public contracts in these areas. This has created an incentive for the President to try to find creative ways to increase his leeway for determining expenditures, although he is constrained by the courts and the *Ministerio Publico* (see Section 3.5). It can be expected that these pressures will most probably lead to important changes in the rules in the coming years.

Hard-wired policies generally include those with little ideological content, and are perceived in society as entitlements. The two that best fit this description and that will be discussed in the next two subsections are education and health policies.

4.3.1 Health Policy

According to the model presented in this paper, health policy exemplifies the type of area in which there would be attempts to hard wire institutional innovations as a pre-commitment device to ensure that they are preserved. These policy innovations are viewed by the governing coalition as crucial, thereby requiring insulation from political logrolls. The key issue here for the Executive is guaranteeing resources for the sector.

The Constitution of 1988 created a unified budget for pensions, social assistance benefits and health care—the so-called social security budget. This was part of the demand for a universalistic social protection system advanced by the opposition during the military regime and an important sectoral banner during the Constituent Assembly. A diversified source of funding was set up. This institutional arrangement was viewed by the groups supporting the idea as a mechanism that would de-link contributions and access to the system, making it more democratic and redistributive. It was also with this purpose that the Constitution gave universal access to health care through the newly created Unified Health System (SUS). It also introduced generous social assistance benefits. The social security budget was made up of the CSLL, the contribution on net profits paid by corporations (Cofins), and the employers' and employees' payroll contributions.

The fusion of expenditures for health care and pensions in the same budget produced over time a dynamic that is highly detrimental to health care. This resulted from the fact that pensions are contractual disbursements and are not compressible. They are a flux of future commitments that finishes only with the death of the pensioners. By contrast, health expenditures are mostly current expenditures that are by definition vulnerable in the context of fiscal management. Over time, social security commitments crowded out health expenditures. It did not take long before this process became critical. This occurred because fiscal imbalances in the pension schemes were not very significant prior to the Constitution of 1988, and, more importantly, pensions were not indexed. This gradually resulted in a sharp reduction in the real values of pensions. By mandating that pensions were to keep their real value, the Constitution of 1988 prohibited this practice. In addition, it expanded dramatically the mass of workers under the civil service regime (Regime Jurídico Único, in which benefits are related to the average of last pay checks), upgraded rural non-contributory pensions and social benefits to the level of urban pensions, and finally set the lowest value of pensions at the minimum salary level. This produced a shock in the system and caused the crowding out of health expenditures shortly after its implementation.

This mechanism took place at the same time as the decentralization of health care. The starting point was the Lei Orgânica da Saúde (1990), which furnished the enabling legislation for constitutional provisions mandating decentralization. The decentralization was very significant: The municipalities were responsible for 9.6 percent of total spending in health care in 1985 (Arretche 2003: 1-2). This share reached 35 percent in 1996 and 43 percent in 2000. The change in terms of the source of resources for health care was equally impressive. It jumped from 9.3 percent in 1985 to 28 percent in 1996. In its turn, the federal Government's share declined from 73 percent to 53 percent in the same period (Arretche, 2003: 1-2).

The recurrent crisis in the health sector enhanced the visibility of health issues in the country. Brazil exhibits infant mortality rates that are far above countries with comparable levels of development, measured in terms of per capita income. Policy elites have increasingly been sensitive to the need to address health issues as a precondition for development. Many proposals were advanced for earmarking resources for the health sector. These were criticized by the finance and planning circles as a move backwards that would caused more fiscal rigidities in a context of rapidly declining degrees of liberty in the budget. The argument that more resources would be secured to the health sector was even used in negotiations leading to the Fundo Social de Emergência, which was created in 1994. The fund would consist essentially of “de-freezing” 20 percent of taxes and contributions, which could then be freely allocated by the Executive. By year 2000, the municipalities were responsible for 89 percent of basic care procedures, up from 65 percent in 1995.

The measures to secure financing for the health sector culminated in a proposal to create the CPMF, the provisional contribution on financial transactions. The CPMF was created by Constitutional Amendment 3 in 1993 and was a “sunset” provision that would be valid for only two years. In 1996, Constitutional Amendment 12 reinstated the CPMF and earmarked it for the health sector. Subsequently, in 2000, Constitutional Amendment 29 stipulated minimum values for investments in the health sector for the three tiers of government. For the federal government, the budget for 2000 is set at the 1999 level plus 5 percent. As for the period 2001-2004, the value of health expenditures is to be readjusted by the annual variation of the nominal GDP. Of these, 15 percent should be spent in the municipalities on basic health care, and distributed according to their population. In the case of the states, 12 percent of the revenue (after legal transfers to the municipalities) is to be spent in the health sector. In turn the municipalities are required to spend 15 percent of their budget on health care. The states and municipalities, which in 2000 had expenditures levels inferior to those stipulated, should reduce the difference at the rate of one-fifth per annum. Non-compliance would allow federal intervention in sub-national governments. The law stipulated that all transfers would be channeled to a fund and subject to auditing.

The initiatives aiming to hard-wire health care resources may be interpreted as attempts at controlling and securing sub-national spending in a context of rapid decentralization and consequently high uncertainty over outcomes in an increasingly salient issue for the Executive. It is significant that in the context of fiscal adjustment, voluntary health transfers, which are by far the largest of their kind in the country, have become crucial for the fiscal survival of sub-national governments. This made the control of sub-national spending all the more critical for the Central Executive.

4.3.2 Education Policy

Education policy is another area that illustrates the use of institutional innovations as a pre-commitment device to ensure that they are preserved. As in the case of health care, primary (*ensino fundamental*) and secondary education is viewed by the governing coalition as crucial thereby requiring insulation from political logrolls. Similarly, the key issue here for the Executive is guaranteeing that the resources earmarked for primary and secondary education are in fact applied by the sub-national governments in the sector and in specific ways. It is worth noting that primary and secondary education is not a functional competence of any specific level of government. Primary education is to be provided by the municipalities with the financial and technical assistance of the federal government and of the state (Article 30 of the Constitution). Constitutional Amendment 14 contains articles calling for priorities to be given by each level of government but does not mandate specialization of competence. This definition provides an incentive structure that discourages efficiency because it diffuses responsibility and accountability.

In the late 1980s and 1990s, the centrality of education to development became a recurrent issue in the public agenda. From business interests to social movements, there emerged a consensus that was reflected in the Executive’s preference for insulation of the educational sector. This was combined with the increasing need to enhance control mechanisms in the context of an accelerated program of decentralization. For example, in 1989 there was a Parliamentary Inquiry Commission on the Calmon amendment. The commission found that states spent less than 20 percent of the constitutionally required educational expenditures on teachers’ salaries. It was widely agreed that teachers’ exceedingly low pay and lack of training at the sub-national level was one of the main reasons for the low quality of education.

The furor over education finally resulted in the passage of Constitutional Amendment 14 in 1996 and the approval of the LDB (the complementary law of basic guidelines for education) in the same year. Constitutional Amendment 14 required that for 10 years, at least 60 percent of the 25 percent of the sub-national resources mandated for education was to be spent on the payment of teachers actively involved in classroom activities. The resources required for raising pay and training were to come from a specific Fund, the Fundo de Manutenção e Desenvolvimento do Ensino Fundamental e Valorização do Magistério (FUNDEF). The Fund consists of 15 percent of intergovernmental transfers from states to the municipalities (FPM) and of the state’s revenue from the ICMS. The resources from the Fund are distributed according to the number of enrollments at each level of government. The federal government was to play an equalization role. It should pay the difference between the resulting per capita spending in each municipality and a national minimum per capita level that is set in the annual budget law. It is interesting that this has become the Achilles' heel of the new arrangements. Consistent with their preferences for fiscal expansion at the local level, sub-national governments have pressured the government to raise the national universal per capita level. However, fiscal needs have led the national government to not readjust it. Interestingly, the current Lula administration has not increased its level for 2004, notwithstanding the intense criticism by the Workers' Party (PT) of inadequate funding by the Cardoso government. The federal government's desire is to control sub-national priorities and spending while keeping its own preferred federal fiscal targets as the ultimate adjustment variable.

The incentive structure led mayors to actively engage in attracting pupils because this would lead to more transfers from the fund. In addition, it encouraged decentralization from states to municipalities because there would be negative transfers in some municipalities if the educational services were provided by the states. The rationale for the education initiatives by the federal government is similar to those that underly the health care system: attempts to control and secure sub-national spending in a context of rapid decentralization and consequently high uncertainty over outcomes. Control by the federal government over sub-national spending is therefore critical to ensure that federal government meets its preferences.

5. Shocks and Recovery

The previous section described representative policies in each of the policy categories mentioned in this paper's framework of the policymaking process in Brazil. This section provides a further perspective on this process by analyzing two specific events where the system was hit by political and economic shocks. It describes the reaction of the players involved each of these events, shows how these were conditioned by the political institutions, and argues that the response conforms to that expected by this analysis' model of the Brazilian policymaking process. In general, the response to shocks is to manage spending and taxes in order to maintain a certain equilibrium. In a sense, fiscal and monetary policy is the equilibrating mechanism. The first shock to be examined is an economic one: the strong devaluation of the *real* in January 1999, which threatened to bring back inflation and forced important changes in macroeconomic policy. It is followed by an examination of a political shock: the election of President Lula, which also led to a devaluation of the *real*, but also to a drop in investment, a rise in country risk and general uncertainty. This section will describe how the government's successful reaction to each of these shocks conforms to the political institutions and incentives as described in the framework presented here, for example, by reducing the execution of the budget related to residual policies.

5.1 Recovering from a Monetary Shock: The Devaluation of 1999

In October of 1998 Fernando Henrique Cardoso was re-elected for a second term as President, without even the need for a second round run-off. This electoral triumph was based on the success of the Real plan in achieving monetary stability and increased incomes, as well as on a record of important structural reforms. Despite the apparent ease of the victory, the economic situation had been deteriorating in several ways in the months before the election. The exchange rate was recognizably overvalued, which led to large current account deficits that had been partly financed by strong inflows of foreign direct investment. This situation required high levels of real interest rates which, together with fiscal profligacy, led to a public sector deficit of approximately 8 percent of GDP. The government planned a gradual process whereby the currency would be devalued 7 to 8 percent per year, although in the wake of the Mexican, Asian and Russian crises, markets were not willing to wait and several speculative attacks had to be fended off. As pressure increased, it became clear that a devaluation would eventually arrive, though in the midst of several successful defenses of the currency, on the part of the Central Bank, it was not evident how soon it would be.[58]

In hindsight, the events of 1998 and 1999 can be interpreted as a clear case of electoral cycle behavior. Unsustainable exchange rates, and current-account and fiscal deficits were made to endure without collapse until the election, after which the government could take the harsh measures necessary to correct the situation. Sustaining the status quo in the midst of growing market distrust was not a trivial task. In part this was achieved by a loan of US$41.5 billion from the IMF and other institutions. Increased capital flight also made it necessary to sharply increase interest rates twice in 1998 and for the President to announce that harsh austerity measures were being elaborated, all of which may have reduced the margin in the electoral victory (*The Economist*, 1998).

The devaluation came on January 13, 1999 shortly after the official start of Cardoso's new term. The head of the Central Bank was replaced and the *real* was allowed to devalue by 8 percent. At the time, this created great uncertainty in international financial markets and fueled

[58] Most banks had already hedged themselves for the case of devaluation and many profited handsomely.

speculation as to the fate of the Brazilian economy and its impact on the financial global system and especially on other Latin American countries.[59]

At this point the government faced its most difficult test to date. Its main electoral trump, the *Real* Plan and monetary stability, were under severe threat. Specialists disagreed as to how big the pass-through from the exchange rate to prices would be, but the general expectation was that it would be large (McHale, 2000). The lax fiscal behavior of the previous years seemed to indicate that the government would not be able to institute the tax increases and spending cuts that were seen as being key to riding out the crisis. In particular, there were doubts as to its ability to co-opt or circumvent Congress and the state governors in the implementation of the unpopular measures that would be necessary, for as noted in *The Economist* (1998), "neither group has shown much enthusiasm for austerity in the past four years."

As it turned out, despite the general mistrust, the government's reaction was remarkably swift and effective. With the election out of the way and given the several instruments afforded by strong presidential powers, the government was able to take the necessary measures to control the situation and stem the crisis. The outcomes following the forced devaluation were described by Cardoso and Helwege (1999: 23) in the following terms:

> By any standard, Brazil has negotiated its way through the Real Crisis with extraordinary ease and speed. By May 1999, the *real* had risen to 1 US$:1.67, compared to a low of 1 US$:2.21 on March 31. Short-term interest rates had fallen from 45 percent in March to just 23 by May 25, and inflation, measured by the national consumer index, had declined from an annualized rate of 16 percent in March to 6 percent in April. Far from slipping into a deep recession, the Brazilian economy actually grew by 1 percent in the first quarter of 1999, and forecasts of a serious decline in output were being revised.

While some positive circumstances, such as low interest rates in the US and a record harvest, can be seen as contributing to this remarkable turn-around, the key causal factor was clearly the ability of the government to gain control of fiscal policy in a way that credibly signaled to the markets that it would do what had to be done in order to restore a sustainable

[59] An article in the *Economist* regarding the devaluation put it in the following terms: "At this point a single question haunts investors and policymakers alike. Will a Brazilian devaluation precipitate global financial meltdown? Scarcely three months ago, when markets were at their most jittery, that seemed a strong possibility. Whether it remains so depends on two other questions: Will Brazil be able to control this devaluation, to regain investor confidence and to continue with its economic reforms—or will it descend into Asian-style chaos? And will the rest of the world react calmly or in panic?" (*Economist*, 1999)

situation no matter how stringent those policies had to be. That the government was able to successfully pass this message and follow through with the promise is not trivial. It was only made possible by the strong presidential powers which political institutions afford the Executive. While some analysts ascribe the government's ability to pass crucial legislation in this period to an "(a)wareness of the risk of a grave collapse among even intransigent legislators and governors" (Cardoso and Helwege, 1999: 23) or the realization of the "urgency of Brazil's fiscal condition" (*The Economist*, 1998), closer examination shows that the Executive really had to resort to its powers in order to assure that the necessary policies got approved and instituted.

One example is the moratoria on Minas Gerais's debt with the federal government announced by the governor of the third-largest state in Brazil just a few days after the devaluation. Other states followed suit, announcing that they too had the intention of renegotiating their debts. This event created additional uncertainty at a time when the government's credibility was at its most vulnerable. The answer was the blocking of all Constitutional transfers from the federal government to the state, a measure that proved to be extremely effective in persuading the rebellious governors to get back in line. The ability to control these transfers to the states is an extremely powerful instrument held by the President and one that has been actively employed since the devaluation crisis to force the states and *municipios* to comply with the new fiscal effort. In fact, these events are part of the federal government's successful reform of sub-national fiscal policy, which culminated in the Fiscal Responsibility Law of 2000, as described in detail in Section 4.1.2. The point here is that once the exchange-rate anchor was gone and the election had been successfully won, making it no longer possible or necessary to persist with the unsustainable fiscal behavior of the first term, it became crucial for the government to make drastic changes that were achieved through the use of its strong presidential powers. If the Brazilian President had not had such leverage over sub-national entities, as was the case in Argentina, it would probably not have been possible to deal so effectively with the crisis.

Other examples of the government's use of its powers to assure a swift emergence from the crisis are the approval of important legislation such as pension reform (Alston and Mueller, 2003) and the renewal of a temporary tax (Melo, 2002). These were policies that were seen as crucial to the new fiscal effort and they had to be forcefully passed through Congress, which convened extraordinarily for the purpose in the weeks following the devaluation. The case of pension reform involved the imposition of a new tax on the benefits of retired civil servants, a law that was extremely unpopular and that had been rejected in Congress just a few months earlier.[60] As described by Alston and Mueller (2003), the severity of the situation led the government to employ all its legislative powers to assure that this time the proposal would not be defeated. This involved the intense use of patronage and granting of jobs in the federal structure, on a level even above the usual use of these instruments of persuasion.[61] As Melo (2004b) argues, the fact that the government did not embark on a radical pension reform should be understood not as a signal of Executive weakness but rather as an example of a cautious policy choice in a context of high uncertainty. Policy makers reached the conclusion that Brazil's extremely high implicit pension debt made the transition costs to such a system a highly risky move, and opted instead for a parametric reform.

More generally, since the devaluation crisis, the government has consistently set and reached tough primary surplus targets accorded with the IMF (see Sections 4.1.2 and 4.2). It has done so by employing all of its presidential powers, and in particular those which give it extreme control of drafting, approving and executing the budget, to turn Brazil from a country where fiscal deficits seemed to be endemic, to a country where an unsustainable path to collapse is no longer being followed, despite some lingering problems.

5.2 Recovering from a Political Shock: The Election of Lula

The model of the Brazilian policymaking process presented here asserts that the country's political institutions provide incentives for the President to prioritize macroeconomic stability over other policies. This implies that whatever an individual's set of preferences over policy issues before coming to power (which can be thought of as "ideology"), once in power the preferences that are acted upon are those shaped by the political institutions.[62] The President realizes that whatever his final objectives, achieving them requires first reaching a minimum

[60] Though the Supreme Court would go on to declare this taxing of pensions as unconstitutional at the end of 1999, the event nevertheless shows the government employing its powers to achieve its new fiscal objectives.
[61] Alston and Mueller (2003) analyze pension reform through a model similar to that presented in Appendix 1. The argument being made here is that in the wake of the devaluation, the government's utility function changed, making it more imperative that certain policies be approved. This is represented by a steepening of the government's utility curves in Figure 1 in the Appendix or an elongation of its indifference curves in Figure A2 in the Appendix, with the result that the final policy would be closer to the President's preferred point and more patronage would be employed in equilibrium.
[62] In the model presented in Figure A1 in the Appendix, the elliptical indifference curves postulated for the President are shaped by political institutions, such as electoral incentives. On the difference between the treatment of preferences in economic and political models, see Ordeshook (1986), Chapter 1.

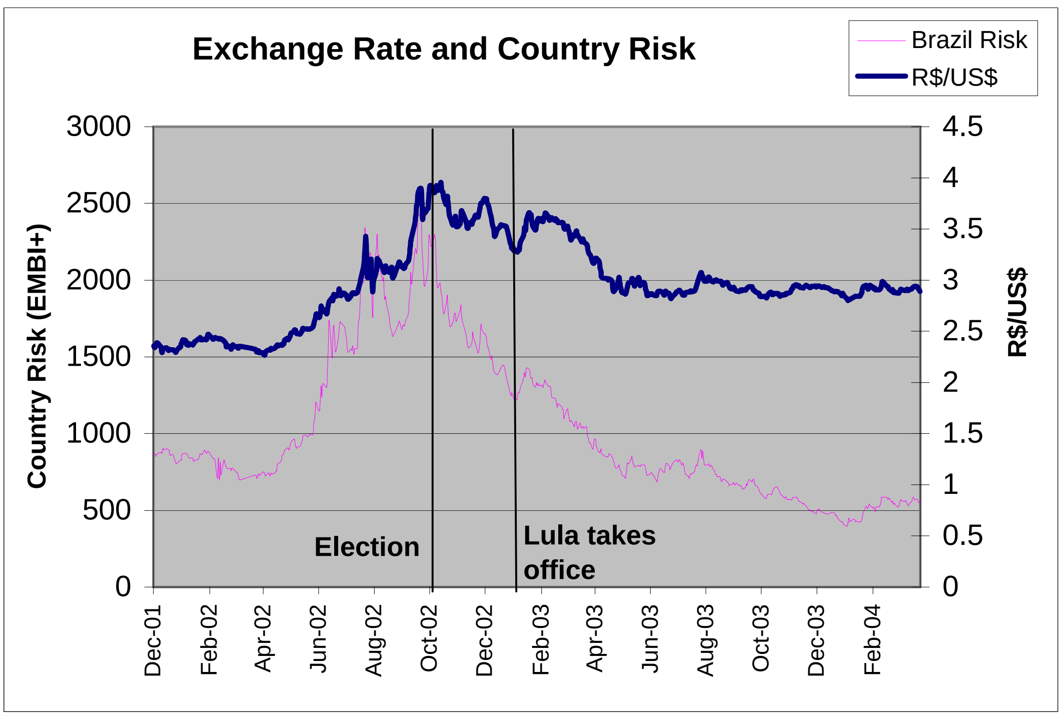
level of macroeconomic stability and credibility. A corollary that emerges from this model is that any President who comes to power will pursue a similar set of “sensible” macroeconomic policies, irrespective of his ideology.

This section explores the recent change in presidency from Cardoso to Lula in January 2003 as a test of this corollary and other implications of the Brazilian policymaking process. This event provides a natural experiment that yields insights into the policymaking process and policy features because of the markedly different political preferences held by each administration. Whereas previous transitions represented relatively smooth changes in the political positions held by the President (all on the center-right), the substitution of Cardoso with Lula was a clear and extreme shift from the right to the left, with Lula and his Workers’ Party (PT) having been some of the sternest critics of both Cardoso’s policy objectives and his means of reaching them. The change is illuminating because it holds constant all political institutions and the rules of the policymaking game, and varies greatly the preferences of some of the major players. This creates several situations where the nature of political institutions and their effect on the policymaking process, as well as the effect of that process on the features of policies, become much more salient. For example, it has been a big surprise to most observers that the Lula government has pursued many of the main reforms and other policies that were pursued by Cardoso. Particularly telling has been the decision to focus first on pension reform in basically identical terms as those undertaken by Cardoso as well as the observation of a strict rectitude in fiscal matters that more than surpasses the surplus agreed upon with the IMF. These choices represent extreme departures from everything that Lula and the PT have always preached and represented, and have created fissures in the party and the governing coalition, as well as antagonized many of the President’s most important supporting groups, such as unions and civil servants.

It is noteworthy that the test proposed for our model is a particularly tough one. To expect that a Lula/PT government would come to office after almost 20 years of radical opposition and make an about-face by adopting the very same policies it criticized for so long, is no trivial test. Whereas many Brazilian political parties are known to be fickle and lack a clear programmatic line, this is not the case with the Worker’s Party. Scholars, the public and the press had viewed the PT as the only true political party in Brazil, with a well-organized grass-roots base and a clear set of beliefs. Both the press and financial markets expected that Lula would bring about significant change in policies. Figure 1 shows the Emerging Market Bond Index

(EMBI+) for Brazil from December 2001 to February 2004, which provides a measure of country risk. The Lula effect is easily perceptible. As the election approached and the probability of his victory increased, country risk more than doubled. The index remained at stratospheric levels after the election and during the first months of the new President's term, but converged towards previous levels as the new government made clear commitments that its macroeconomic policies would continue along the lines of the previous government. A similar story is told by the exchange rate (also in Figure 1), which rose sharply several months before the election and only retreated to a new level at around 3 R$/US$ after the Lula government clearly signaled its intentions of maintaining stable monetary and fiscal policies.

Figure 1. Country Risk for Brazil during the 2002 Presidential Election



Source: Country Risk: EMBI, J.P. Morgan; Exchange rate: Banco Central do Brasil.

The "credibility shock," through which the Lula government sought to counter the markets' expectations, involved making clear commitments that macroeconomic policy would remain austere. The first signal was the appointment of Henrique Meirelles as head of the Central Bank, an appointment endorsed by Arminio Fraga, the former head of the Central Bank under Cardoso. On the fiscal side, the Lula government voluntarily raised the primary surplus target accorded with the IMF from 3.75 percent to 4.25 percent, quite an unexpected move for a party that customarily decried the IMF as responsible for many of the country's problems. In order to achieve this, Lula cut R$14.1 billion from the budget, affecting all areas of government, especially social programs. Further evidence of the new government's responsible fiscal stance was the increase of interest rates during the first months in office and cautious reductions thereafter, resisting severe pressure from allies and opposition, as well as business and the media to undertake bolder reductions. Once again, this responsible management of interest rates represented an unexpected change in posture for a party that had always been one of the main voices decrying the perverse effects of high interest rates on economic growth and unemployment.

Further evidence of the government's newfound zeal came when it chose pension reform as its first major policy objective in Congress. The previous government had managed to pass several changes to the pension system, but halted its attempts to complete the reform when the Supreme Court declared unconstitutional parts of the changes that were painstakingly pushed through Congress (Alston and Mueller, 2003; Melo, 2002). This issue was highly contentious as it involved the need to eliminate acquired rights and entitlements. In fact, the PT had been one of the main sources of opposition to the previous government's efforts at reforming the pension system. Nevertheless, once in power not only did the Lula government re-open pension reform, but did so along much the same lines as that of the previous government. The unpopular taxation of the pensions of retired workers, which had been barred by the Supreme Court, was reintroduced and passed in Congress.[63] The Lula government also undertook tax reform in 2003, though half-heartedly because the government was reluctant to introduce changes that could reduce its high levels of tax receipts.

According to the model of the Brazilian policymaking process presented here, the counterpart to sober macroeconomic policies in a context of political and economic shock is the reduction of expenditures on other types of policies. Here once again the behavior of Lula's government in 2003 fits squarely with this analysis. Besides its reputation for ethical integrity, the PT's main comparative advantage in the eyes of the electorate had always been its concern for social issues such as poverty and land reform. The PT had consistently argued that previous

[63] Lula appointed three new Supreme Court Justices in 2003, so the reforms have a greater chance of being considered constitutional by the Court.

governments had ruled for the rich and that a Lula government would make ending poverty a top priority. Once in power, Lula dismantled many of the previous government's highly successful social programs and substituted them with new programs with basically the same purpose.[64] With much fanfare and publicity Lula created new ministries (Ministry of Cities, Ministry of Assistance and Social Promotion, and Ministry of Food Security), new programs and new campaigns. Nearly a year and a half into the new President's term, most of these ministries and programs are in complete oblivion or have been merged.[65] Even the much-touted Zero Hunger Campaign, the centerpiece of the government's social program, has been slow to produce results despite massive popular support from individuals, celebrities and businesses voluntarily donating money and aid to the campaign. As expected by this paper's analysis, the main cause of this disappointing performance in the social area is the fact that many of the budget cuts necessary for achieving the fiscal surplus fell precisely in these areas. Among the ministries suffering the greatest cuts were those of National Integration (that is, regional policy) and land reform.

The Lula government not only pursued much the same policies as the previous government, but also did so using many of the same instruments. This is important because the basic premise of this analysis is that political institutions are crucial determinants of how politicians undertake political transactions. Since the political institutions remained basically unchanged, it can be expected that the new government would use the same means to engage in those transactions as the previous government, despite very different initial preferences (ideology). This provides another test of the model because the PT had always questioned the legitimacy and the morality of other governments' use of strong presidential powers. It first became apparent that the new government would follow old ways when it quickly forged a broad coalition in Congress that assured a majority of the seats and thus control over much of the legislative machinery. In order to achieve a comfortable majority, the government had to reach far across the spectrum to entice parties, making for strange bedfellows. The consolidation of the coalition came about when the large but amorphous PMDB joined the coalition after intense

[64] Shortly before the change in presidency, Cardoso won a prize organized by the United Nations as the world leader who most contributed to fighting poverty. One of his government's most important innovations was to distribute benefits directly to the beneficiaries through individual bank cards, thus getting around local politicians who traditionally hijacked most of benefits meant for recipients.

[65] One of the problems with the government's entire social strategy has been a lack of coordination of the various ministries working on these issues. Interestingly, Spiller, Stein and Tommasi (2003) indicate that in Argentina there existed the same tendency of each new government to alter social policy, as well as problems of lack of coordination. This suggests that there may be certain characteristics of political transactions over social policies that lead to unstable and poorly coordinated (balkanized) policies.

negotiation over cabinet positions and other key government jobs, a form of doing politics the PT always derided. This brought about bizarre situations unimaginable a few years ago, such as having ex-President Sarney (PMDB), an old enemy, now head of the Senate, become a key defender of the PT's interest in Congress. Although this is only to be expected from parties such as the PMDB, it sits awkwardly with the PT's reputation. Examples of other controversial political instruments that the new government wielded as dexterously as the previous one include: strategic use of congressmen's individual budget amendments as a currency to buy support (see Section 3.2); the strategic reshuffling of recalcitrant committee members to assure approval of its proposals; and a high degree of reliance on decree power, often considered an undemocratic form of policymaking. The payoff to adopting these institutional but less-than-noble means was clear: the government did not lose a single important vote in Congress in 2003.

The apparent contradiction of a Lula government resorting to similar ends and means as previous governments, though no surprise to scholars of political institutions, perplexed not only much of society, but also the opposition and many of the government's own allies. Whereas the opposition faced the dilemma of having the government espouse issues that they themselves defended, such as pension reform, many of the allies and in particular members of the PT itself were reluctant to vote for issues they had traditionally opposed. One of the government's main political problems has been to deal with friendly fire from within its coalition and from some of its traditional supporting groups, such as unions and civil servants. After much criticism, the Lula government expelled four radical members from the PT for voting disobedience as a sign of the party's determination and strength. Nevertheless, every time negative economic numbers surface, such as the lack of growth in 2003 (-0.22 percent), discontent from within the rank arises (for example from the vice-president and several ministers), and forces the President to reiterate his resolve to adhere to the current line of economic policy.

There exists in the country a notion that there is a "Plan B" waiting in the wings, which would be adopted if the costs of the current strategy get too large. That is, if economic growth, unemployment and living conditions fail to improve, especially as the new presidential election approaches in 2006, the government may feel inclined to resort to populist policies, relaxing fiscal policy and accepting higher levels of inflation. Lula, however, has repeatedly denied the possibility of this scenario. Instead he insists that as economic fundamentals and the government's credibility strengthen, and as economic and political shocks permit, the budget constraint will ease and allow greater social spending and economic growth. With the midterm elections for mayors to be held in Brazil in October 2005, a crucial test for the maintenance of the current macroeconomic policies is rapidly approaching. If candidates who gave support to the Lula's administration meet defeat, especially in the most important municipalities, the costs of maintaining stable macro and fiscal policies increase, though it is anticipated that Lula will stay the course despite the temptation to switch to populist appeals.

6. Conclusion

This paper has found that the driving force behind policies in Brazil is the strong set of powers given to the President by the Constitution of 1988. To have strong powers does not mean unbridled powers. Several institutions constrain and check the power of the President, in particular the legislature, the Judiciary, the public prosecutors, the auditing office, the state governors and the Constitution itself. The electorate of Brazil holds the President accountable for economic growth, inflation and unemployment. Because of the electoral connection, and perhaps because of reputational effects, presidents in Brazil have a strong incentive to pursue stable fiscal and monetary policies as their first priority. At least for the past 10 years and especially during Lula's administration, Executive power has been aimed at pushing policy towards macro orthodoxy. Although orthodoxy may not lead to short-term growth, international financial markets provide additional incentives for discipline, as deviations are instantly punished with unfavorable consequences that are readily recognized by the electorate. Achieving stable macro policies required constitutional amendments as well as considerable legislation. To attain their goals, the past administrations (Cardoso and Lula in particular) used their property rights to pork to trade for policy changes. The rationale for members of Congress to exchange votes on policy for pork is that the electorates reward or punish members of Congress based on the degree to which pork lands in their district. With the exception of the devaluation of 1999, macro policy has become more stable over time. Macro policies in Brazil can be characterized as "stable but adaptable."

The pursuit of macro orthodoxy comes at a cost; some policies in Brazil are "volatile and unstable." This analysis has found volatility and instability in policies that have an ideological component, such as land reform and poverty alleviation, or whose gains accrue at the Congressional district level, such as infrastructure projects. The volatility on ideological policies is no surprise and happens most when administrations change. For policies having a local rather than national impact, the volatility results from spending being based on the residual left in the budget after the President takes care of hard-wired and pork expenditures. The negative side of this is that many infrastructure projects (i.e., sanitation and local roads) have fallen into this residual category.

The Constitution of 1988 is a detailed political document rather than a set of principles. It has constrained and still constrains policymaking. Its biggest constraint comes from hard-wiring expenditures in certain policy areas, most importantly those in health and education. The constraints from the Constitution bind because the Judiciary has been relatively independent in ruling on issues of constitutionality. This has lead to a perception that the constitutional amendments will be permanent. Reinforcing the role of the Judiciary is the independent and increasingly powerful role played by the MP. Public prosecutors have been most active in enforcing social policies, such as legislation concerning education, health and the environment.

Despite the perception in the press, the power of governors to influence national policies was found to be relatively weak and becoming weaker. In large part this resulted from the enforcement of a law on fiscal responsibility. There is still a role played by the state and local political actors that affects economic performance. Considerable federal and state funds are diverted from public spending intended for public goods and infrastructure towards campaign finance. Future research will investigate the role of the courts and auditors' offices in allowing corruption (the misuse of public funds for private gain) to persist.

Overall, this paper has painted a relatively rosy picture of the policymaking process in Brazil. Importantly, pork was found to be a relatively cheap and effective means to ensure stable but adaptable macro policy. The actions to date of the Lula administration bolster this view. Of course there are deficiencies, most prominently in the inflexibility of health and education policies, the volatility of social programs and infrastructure investments, and the persistence of corruption. But social programs can only be advanced in a permanent fashion once the government ensures stable macro policy and the confidence of world capital markets. Brazil is currently in a relatively stable political equilibrium, but this equilibrium can be upset by a sufficiently large exogenous shock. A shock of sufficient magnitude could tip Brazil back to its former populist ways.

References

Afonso, A. 2004. "Fiscal Sustainability: The Unpleasant European Case." Money Macro and Finance (MMF) Research Group Conference 2004 57, Money Macro and Finance Research Group.

Alston, L., G. Libecap, and B. Mueller. 1997. "Violence and the Development of Property Rights to Land in the Brazilian Amazon." In: J.V.C. and J.N.D. Nye (editors). *Frontiers of the New Institutional Economics*. San Diego, United: Academic Press: 145-163.

----. 1999. *Titles, Conflict, and Land Use: The Development of Property Rights and Land Reform on the Brazilian Amazon Frontier*. Ann Arbor, United States: University of Michigan Press.

----. 1999. "A Model of Rural Conflict: Violence and Land Reform Policy in Brazil." *Environment and Development Economics* 4:1 35-160.

----. 2000. "Property Rights to Land and Land Reform: Legal Inconsistencies and The Sources of Violent Conflict in the Brazilian Amazon." *Journal of Environmental Economics and Management* 39:162-188.

----. 2003. "Interest Groups and Information: How Organized Interest can be Represented Without Providing Contributions or Votes." Brasilia, Brazil: Universidade de Brasília.

Alston, L. and B. Mueller. 2003. "Democratization and Exploiting the Gains from Trade: Executive and Legislative Exchange in Brazil." Under review at *The Journal of Law, Economics and Organization*.

Ames, B. 1995a. "Electoral Rules, Constituency Pressures, and Pork Barrel: Bases of Voting in the Brazilian Congress." *Journal of Politics* 57(2): 324-343.

----. 1995b. "Electoral strategy under open-list proportional representation." *American Journal of Political Science* 39(2): 406-433.

----. 2001. *The Deadlock of Democracy in Brazil.* Ann Arbor: University of Michigan Press.

Amorim Neto, O. 2002. "Presidential Cabinets, Electoral Cycles, and Coalition Discipline in Brazil." In: S. Morgenstern and B. Nacif (editors). *Legislative Politics in Latin America*. New York, United States: Cambridge University Press.

Amorim Neto, O. and F. Santos. 2001. "A Conexão Presidencial: Frações Pró e Antigoverno e Disciplina Partidária no Brasil." *Dados* 44 (2): 291-321.

Amorim Neto, O. and P. Tafner. 2002. "Governos de coalizão e mecanismos de alarme de incêndio no controle legislativo das medidas provisórias." *Dados* 45: 5-58.

Arantes, R.B. 1997. *Judiciário e Política no Brasil*. São Paulo: Sumaré Press.

----. 1999. "Direito e Política: O Ministério Público e a Defesa dos Direitos Coletivos." *Revista Brasileira de Ciências Sociais* 14(39).

----. 2004. *Ministério Público e Política no Brasil.* EDUC/PUC-SP.

Arretche, M. 2003. "Financiamento federal e gestão local de políticas sociais: o difícil equilíbrio entre regulação, responsabilidade e autonomia." *Ciência e Saúde Coletiva* 8(2): L 331-345.

Bacha, E. 1994. "O Fisco e a Inflação: uma Interpretação do Caso Brasileiro." *Revista de Economia Política* 14.

Banco Central do Brasil. 2000. *Relatório da Inflação*. http://www.bcb.gov.br/htms/relinf/frmder.asp.

Base de Datos Políticos de las Américas. 1998. Designación del Ministerio Público. *Análisis comparativo de constituciones de los regímenes presidenciales*. Georgetown University and Organization of American Status.
http://www.georgetown.edu/pdba/Comp/Control/Publico/designacion.html. 15 de enero 2004.

Bautzer, T. 1999. "Para Analistas Cláusulas Podem Permitir Alteração Contratual." *O Estado de São Paulo*. São Paulo: Dec. 3, A-10.

Braun, M., and M. Tommasi. "Fiscal Rules for Subnational Governments: Some Organizing Principles and Latin American Experiences." *Public Economics*, Economics Working Paper Archive at WUSTL.

Cadji, A.L. 2000. "Brazil's Landless Find their Voice." *NACLA Report on the Americas*. Mar-Apr: 30-35.

Cain, B., J. Ferejohn and M. Fiorina. 1987. *The Personal Vote: Constituency, Service and Electoral Independence*. Cambridge: Harvard University Press.

Cardoso, E. and A. Helwege. 1999. *Latin America's Economy*. Cambridge, United States: MIT Press.

Carvalho, E.S. 2003. "Ação Civil Pública: Instrumento para Implementação de Prestações Estatais Positivas." *Fundação Escola do Ministério Público do Rio de Janeiro.*

Castro, M.F. 1997a. "O Supremo Tribunal Federal e a Judicialização da Política."*Revista Brasileira de Ciências Sociais* 12(34): 147-155.

----. 1997b. "The courts, law, and democracy in Brazil." *International Social Science Journal* 152: 241-252.

Cheibub, Z. 1989. "A carreira diplomática no Brasil: o processo de burocratização do Itamaraty." *Revista de Administração Pública* 23(2): 97-128.

----. 1985. "Diplomacia e construção institucional: O Itamaraty em uma Perspectiva Histórica." *Dados, Revista de Ciências Sociais*, 28 (1): 113-128.

Cheibub, J.A., A. Figueiredo, and F. Limongi. 2002. "Presidential Agenda Power and Decision-Making in Presidential Regimes: Governors and Political Parties in the Brazilian Congress." Prepared for delivery at the Annual Meeting of the American Political Science Association, Boston, August 29-September 1.

Consultoria de Orçamento e Fiscalização Financeira—Brazil's House of Representatives, (http://www.camara.gov.br/internet/orcament/Principal/exibe.asp?idePai=16&cadeia=0@).

Cox, G. 1987. *The Efficient Secret: The Cabinet and the Development of Political Parties in Victorian England*. Cambridge, United Kingdom: Cambridge University Press.

Cox, G., and M. McCubbins. 1993. *Legislative Leviathan: Party Government in the House*. Berkeley: University of California Press.

Downs, A. 1957. *An Economic Theory of Democracy*. New York, United States: Wiley.

Estado de São Paulo. 2004. "Assentados Ignoram Lei e Vendem 40% dos lotes." April 18: A-4.

Evans, P. and J. Rauch. 1999. "Bureaucracy and Growth: A Cross-National Analysis of the effects of 'Weberian' State Structures on Economic Growth." *American Sociological Review* 64(4): 748-65.

FAO, World Bank and IDB. 2002. "BRAZIL: Projeto Fome Zero." *Report of the Joint FAO/IDB/WB/Transition Team Working Group.*

Faria, V. 2002. "Reformas institucionales y coordinación gubernamental en la política de protección social de Brasil." *Revista de la CEPA*, 77: 7-24.

Favetti, R.T. 2003. *Controle de Constitucionalidade e Política Fiscal*. Porto Alegre, Brazil: Sérgio Antônio Fabris Press.

Figueiredo, A. and F. Limongi. 1995. "Mudança Constitucional, Desempenho Legislativo e Consolidação Institucional."*Revista Brasileira de Ciências Sociais* 29: 175-200.

----. 1997a. "Presidential Power and Party Behavior in the Legislature." Paper presented at the Meeting of the Latin American Studies Association (LASA), Mexico. September.

----. 1997b. “O Congresso e as Medidas Provisórias: Abdicação ou Delegação?” *Novos Estudos CEBRAP* 47: 127-154.

----. 1999a. *Executivo e Legislativo na Nova Ordem Constitucional*. São Paulo, Brazil: Editora Fundação Getúlio Vargas

----. 1999b. *Executivo e Legislativo na Nova Ordem Constitucional*. São Paulo, Brazil: Editora Fundação Getúlio Vargas.

----. 1999c. “As Medidas Provisórias e o Papel do Congresso na Aprovação dos Planos Verão e Collor.” In: *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro, Brazil: Editora Fundação Getúlio Vargas.

----. 2000. “Presidential Power, Legislative Organization, and Party Behavior in Brazil.” *Comparative Politics* 32(2): 151-170

----. 2002. “Incentivos Eleitorais, Partidos e Política Orçamentária.” *Dados* 45(2): 303-344.

Geddes, B. 1990. “Building State Autonomy in Brazil (1930-1970).” *Comparative Politics* 22(2): 217-35.

Goldfajn, I. and E.R. Guardia. 2003. “Fiscal Rules and Debt Sustainability in Brazil.” *Banco Central do Brasil Technical Notes* 39.

Haggard, S. 1995. “The Reform of the State in Latin America.” Paper prepared for the Annual World Bank Conference on Development in Latin America and Caribbean, Rio de Janeiro.

Haggard, S. and R. Kaufman. 1992. *The Politics of Economic Adjustment: International Shocks, Distributive Conflicts and the State*. Princeton, United: Princeton University Press.

Haggard, S. and M. McCubbins. 2001. *Presidents, Parliaments, and Policy*. Cambridge, United States: Cambridge University Press.

Heredia, B., and F. Gaetani. 2002. “The Political Economy of Civil Service Reform in Brazil: The Cardoso Years.” Washington, DC, United States: Inter-American Development Bank.

INCRA. 1999. *Balanço da Reforma Agrária e da Agricultura Familiar*. Brasília, Brazil: INCRA.

International Monetary Fund. 2001. “Brazil: Report on Observance of Standards and Codes.” (Rosc)—Fiscal Transparency. IMF Country Report 01/217. Washington, DC, United States: International Monetary Fund.

Leoni, E., C. Pereira, and L. Renno. 2004. "Strategies for Surviving Politically: Choices of Career in the Brazilian Chamber of Deputies." *Journal of Latin American Studies* 36: 109-130.

Levy, B. and P. Spiller, editors. 1996. *Regulations, Institutions and Commitment: Comparative Studies of Telecommunications*. New York, United States: Cambridge University Press.

Loureiro, M.R. 1997. *Os Economistas no Governo.* Rio de Janeiro, Brazil: Editora da Fundação Getúlio Vargas.

Loureiro, M.R., and F. Abrucio. 1999. "Política e Burocracia no presidencialismo brasileiro: o papel do ministério da fazenda no primeiro governo Fernando Henrique Cardoso." *Revista Brasileira de Ciências Sociais* 14(41): 69-89

Lima, E.C.P. 2004. "Algumas observações sobre orçamento impositivo no Brasil." Brasilia, Brazil: Consultoria Legislativa da Camara dos Deputados. Mimeographed document..

Macedo Jr., R.P. 1999. "A Evolução Institucional do Ministério Público Brasileiro." In: A.A.M.C. Ferraz (editor). *Ministério Público: Instituição e Processo*. Second edition. Brasília, Brazil: IEDC-Atlas.

Mainwaring, S. 1999. *Rethinking Party Systems in the Third Wave of Democratization: The Case of Brazil*. Stanford, United States: Stanford University Press.

Mainwaring, S., and T. Scully. 1995. *Building Democratic Institutions: Party Systems in Latin America*. Stanford, United States: Stanford University Press.

Mainwaring S. and M. Shugart. 1997. *Presidentialism and Democracy in Latin America*. Cambridge, United States: Cambridge University Press.

Marconi, J. 2003. "Diagnostico do Serviço Civil do Governo federal do Brasil." Brasília, Brazil. Mimeographed document.

Martins, I.G. and G.F. Mendes. 1994. *Ação Declaratória de Constitucionalidade*. São Paulo, Brazil: Saraiva Press.

Martins, M.D. 2000. "The MST Challenge to Neoliberalism." *Latin American Perspectives* September.

Matos, C. 2004. "Regulando o Regulador." *CERME Working Paper* Brasília, Brazil: Universidade de Brasília.

Mayhew, D. 1974. *Congress: The Electoral Connection*. New Haven, United States: Yale University Press.

McHale, J. 2000. “Brazil in the 1997-1999 Financial Turmoil: Fourth Country Meeting of the NBER Project on Exchange Rate Crisis in Emerging Market Countries.” Cambridge, United States: National Bureau of Economic Research.

Melo, M.A. 2001. “A Política da Ação Regulatória: Responsibilização, Credibilidade e Delegação.” *Revista Brasileira de Ciências Sociais* 16(46): 55-69.

----. 2002. *Reformas Constitucionais no Brasil. Instituições Políticas e Processo Decisório*. Rio de Janeiro, Brazil: Revan.

----. 2003. “When Institutions Matters: the Politics of Administrative, Social Security and Tax Reform in Brazil.” In: B.R Schneider and B Heredia, editors. *Reinventing Leviathan: The Political Economy of Administrative Reform in Developing Countries*. Miami, United States: University of Miami/ North-South Center Press.

----. 2004a. “Explaining the Capacity to Tax and to Reform: The Divergent Paths of Argentina and Brazil.” Paper prepared for the Taxation and Development workshop, Danish Institute for Development Studies, Copenhagen, 14-15 June.

----. 2004b. “Institutional Choice and the International Diffusion of Policy Paradigms: Brazil and the Third Wave of Pension Reforms.” *International Political Science Review* 25(3): 320-341.

Meneguello, R. 1998. *Partidos e Governo no Brasil Contemporâneo (1985 – 1997)*. São Paulo, Brazil: Paz e Terra.

Mora, M. 2002. “Federalismo e Dívida Estadual no Brasil.” Texto para Discussão 866. Rio de Janeiro, Brazil: IPEA.

Morgenstern, S. 2002. “Conclusion: Explaining Legislative Politics in Latin America.” In: S. Morgenstern and B. Nacif, editors). *Legislatures and Democracy in Latin America*. New York, United States: Cambridge University Press.

Mueller, B. 1998. “The Economic Theory of Regulation: the Case of Agrarian Reform Legislation in Brazil.” *Revista Brasileira de Economia* 52(1): 83-110.

----. 2001. “Institutions for Commitment in the Brazilian Regulatory System.” *Quarterly Review of Economics and Finance* 41: 621-643.

Mueller, B., and C. Pereira. 2002. “Credibility and the Design of Regulatory Agencies in Brazil.” *Brazilian Journal of Political Economy* 22(3): 65-88.

Nascimento, E.R., and I. Debus. (n/d). *Lei Complementar 101: Entendendo a Lei de Responsabilidade Fiscal. 2º edição*. Brasília, Brazil: Tesouro Nacional.

Nascimento, E.R. (n/d). *Três Anos da Lei de Responsabilidade Fiscal*. Brasília, Brazil: Tesouro Nacional.

Nicolau, J. 2000. "Disciplina Partidária e Base Parlamentar na Câmara dos Deputados no Primeiro Governo Fernando Henrique Cardoso (1995-1998)." *Dados* 34(4): 1-23.

Norlin, K. 2003. "Political Corruption: Theory and Evidence from the Brazilian Experience." PhD Dissertation, University of Illinois at Champaign-Urbana.

Nunes, E. 1997. *A Gramática Política do Brasil*. Rio de Janeiro, Brazil: Jorge Zahar.

Ondetti, G. A. 1998. "The Exceptionalism of Land: Explaining Brazil's Surprising *Sem Terra* Movement." Presented at the meeting of the Latin American Studies Association, Chicago.

Ordeshook, P. 1986. *Game Theory and Political Theory*. Cambridge, United States: Cambridge University Press.

Paul, G., and I.D. Aguiar. 1999. "ANEEL e Ministro Divergem sobre Contratos com Concessionárias." *O Estado de São Paulo*. São Paulo: Dec. 2, B-7.

Paul, G. 2000. "ANEEL Autoriza Aumentos de 8,5% nas Tarifas de Energia da CERJ." *O Estado de São Paulo*. São Paulo: Jan. 5.

Pereira, C. 2000. "Why Have Brazilian Legislators Decided to Clean up their Sidewalks? The Influence of the Brazilian Political Institutions on the Process of State Reform." In: S. Nagel, editor. *Handbook of Global Political Policy*. New York, United States: Marcel Dekker, Inc.

Pereira, C. and B. Mueller. 2000. "Uma Teoria da Preponderância do Executivo: O Sistema de Comissões no Legislativo Brasileiro." *Revista Brasileira de Ciências Sociais* 15: 45-67.

----. 2002. "Comportamento Estratégico em Coalizões Presidencialistas: as Relações entre Executivo e Legislativo na Elaboração do Orçamento Brasileiro." *Dados* 45(2).

----. 2003. "The Cost of Governing: Strategic Behavior in Brazil's Budgetary Process." *Comparative Political Studies* 37(7): 781-815.

----. 2004. "The Cost of Governing: Strategic Behavior of the President and Legislators in Brazil's Budgetary Process." *Comparative Political Studies* 20(1): 1-32.

Pereira, C., and L. Renno. 2003. "Successful Re-election Strategies in Brazil: The Electoral Impact of Distinct Institutional Incentives." *Electoral Studies* 22: 425-448.

----. (mimeo 2003). “Avenues to Success: Electoral Strategy and Ambition in the Brazilian Chamber of Deputies.” Paper presented at the 2003 Meeting of the American Political Science Association, Philadelphia, August 28-31, 2003, and at the XXVII Annual Meeting at the ANPOCS, Caxambu, October 21-25, 2003.

Pereira, C., T. Power and L. Renno. 2005. “Under What Conditions do Presidents Resort to Decree Power? Theory and Evidence from the Brazilian Case.” *Journal of Politics* 67(1).

Pinheiro, A..C. 1997. *Judicial System Performance and Economic Development*. São Paulo, Brazil: Universidade de São Paulo.

Pinheiro, A.C. and C. Cabral. 1998a. “Mercado de Crédito no Brasil: O Papel do Judicário e de Outras Instituições.” *Ensaios BNDES* 87.

----. 1998b. “Mercado de Crédito no Brazil: O Papel do Judiciário e de Outras Instituições.” *Ensaios BNDES* 90.

Pinheiro, A.C. 2000a. *Judiciário e Economia no Brasil*. São Paulo: Sumaré Press.

Pinheiro, A.C. 2000b. “Economics and Justice: Concepts and Empirical Evidence.” Working Paper. *Ensaios*.

Pinheiro, A. C. 2001. “A Visão dos Juízes sobre as Relações entre o Judiciário e a Economia.” Presented at the seminar “Reforma do Judiciário.” São Paulo, Brazil: IDESP.

Pinheiro, A.C. 2003. “Regulatory Reform in Brazilian Infrastructure: Where do We Stand?” Texto para Discussão 964. Rio de Janeiro, Brazil: IPEA.

Resende, L.F. 2000. “Comunidade Solidária—Uma Alternativa aos Fundos Sociais.” Texto para Discussão 725. Brasília, Brazil: IPEA.

Rocha, C.A.A. 2003. “Especialização e Autonomia Funcional no Âmbito do Tribunal de Contas da União.” *Revista de Informação Legislativa* 40(157): 223-251.

Rondino, R. 1999. “Elétricas Reagem Contra Proposta de Mudanças no Índice de Reajuste.” *O Estado de São Paulo*. São Paulo: Dec.3, 1999, A-10.

Sadek, M.T. 2001. *Reforma do Judiciário*. São Paulo, Brazil: Fundação Konrad Adenauer.

Samuels, D. 2000. “Ambition and Competition: Explaining Legislative Turnover in Brazil.” *Legislative Studies Quarterl*y 25: 481-498.

----. 2003. *Ambition, Federalism and Legislative Politics in Brazil*. New York, United States: Cambridge University Press.

Santos, F. 2001. *O Poder Legislativo nos Estados: Diversidade e Convergência*. Rio de Janeiro, Brazil: FGV Press.

Santos, J. V. T. and W. Barp. 1998. "Conflitos Sociais Agrários." Brasília, Projeto de Cooperação Técnica MEPF-INCRA/FAO: 108.

Scartascini, C., and M. Oliveira. 2003. "Political Institutions, Policymaking Processes and Policy Outcomes: A Guide to Theoretical Modules and Possible Empirics." Washington, DC, United States: Inter-American Development Bank.

Schneider, B. R. 1991. *Politics within the State, Elite Bureaucrats and Industrial Policy in Authoritarian Brazil*. Pittsburgh, United States: University of Pittsburgh Press.

---. 1993. "The Career Connection: A Comparative Analysis of Bureaucratic Preferences and Insulation." *Comparative Politics* 25(3).

Shepsle, K. 1989. "Studying Institutions: Some Lessons from Rational Choice Approach." *Journal of Theoretical Politics* 1(2): 131-147.

Shepsle, K., and B. Weingast. 1981. "Structure-Induced Equilibrium and Legislative Choice." *Public Choice* 37: 503-519.

Speck, B.W. 2000. *Inovação e Rotina no Tribunal de Contas da União: o Papel da Instituição Superior de Controle Financeiro no Sistema Político-Administrativo do Brasil*. São Paulo, Brazil: Fundação Konrad Adenauer.

Spiller, P.T., E. Stein, and M. Tommasi. 2003. "Political Institutions, Policymaking Processes and Policy Outcomes: An Intertemporal Transactions Framework" Washington, DC, United States: Inter-American Development Bank.

Spiller, P.T. and M. Tommasi. 2003. "The Institutional Foundations of Public Policy: A Transactions Approach with Application to Argentina." *Journal of Law, Economics and Organization* 19(2).

Teixeira, G. 2001. "Governo Corta Mais Recursos da Agricultura e Reforma Agrária." Nota Técnica, Assessoria Técnica da Câmara dos Deputados.

The Economist. 1997. "Land Rights, Land Wrongs." 344: 30-32.

The Economist. 2004. "My Own Bit of Land." Jan. 8.

Viana, L. W. 2002. *A Democracia e os Três Poderes no Brasil*. Rio de Janeiro, Brazil: IUPERJ.

Webb, S. 2004. “Fiscal Responsibility Laws for Subnational Discipline: the Latin American Experience.” Policy Research Working Paper Series 3309. Washington, DC, United States: World Bank.

Weingast, B.R. and W.J. Marshall. 1988. “The Industrial Organization of Congress; or, Why Legislatures, Like Firms, Are Not Organized as Markets.” *Journal of Political Economy* 96(1): 163.

Appendix 1. A Model of Executive-Legislative Exchange

This description of the Brazilian policymaking process foresees three categories of policies: macroeconomic policies, pork, and residual policies. In order to show how these policies evolve as the result of the interaction of the political players under the extant political institutions, a model is presented here that captures the transactions between the President and his/her coalition in Congress over a single policy dimension. It is then expanded to include an additional policy dimension, thus capturing the trade-off between the macroeconomic and residual policy categories.

Suppose that the horizontal line in Figure A1 represents a single policy dimension, for example the level of surplus written into the budget. Let *P*, *K* and *O* be the preferred points for the President, governmental coalition and the opposition respectively. The highest utility is obtained at the preferred point and declines as the actual policy moves away from that point as represented by the diagonal lines. The President's utility is $U^P(-\beta|P-x|, C(R))$, where β is the preference intensity, *x* is the approved policy, *R* is the amount of patronage provided to the congressmen, and *C(R)* is the cost of that patronage. The utility function of coalition party *i* is $U_i^K(-\alpha_i|K_i - x|, V_i(R_i))$, where α_i is a parameter that measures the intensity of party *i*'s preferences regarding policy outcomes, R_i is the amount of patronage received, and $V_i(R_i)$ is a function that measures the value of the patronage to the party.[66] With policy at the status quo point, *SQ*, the coalition's utility is at point I and the President's at point II. This is a low utility for the President since the status quo is far from his preferred point. Given the strong presidential powers discussed earlier, it is assumed that the President has control over the agenda so he is able to choose which proposals get put to a vote. The President can improve on this situation by initiating a proposal to move policy to point x_0. Because the party's utility at this point, III, is the same as at the status quo, I, it will support the proposal.

With policy at x_0 the President is better off than at the status quo, an improvement in utility from II to IV. He doesn't have to be content with x_0, however, because he can use his control over patronage to try to move policy even closer to *P*. Suppose, for example, that the President tried to achieve a policy to the right of x_0, such as x_1. At this point the coalition would

[66] In order to simplify the analysis, assume that the coalition is composed of a single party and has a majority of the votes in Congress. For a more complete analysis where the coalition is composed on N parties, see Alston and Mueller (2003).

receive the utility represented by point VI, which is worse than III, the utility from policy x_0, so it would block the proposal. But by offering patronage, the President can compensate the party for the loss represented by the vertical distance from III to VI, thus convincing it to pass the proposal moving policy to x_1.

If the trade offered by the President were costless to him, then his utility would pass from point IV to point VII. However, providing patronage involves a series of costs represented by the function $C(R_i)$. Figure 1 incorporates the cost of providing patronage as a downward shift in the President's utility curve. The more patronage that the President needs to offer to the party for it to agree to pass the proposal, the greater will be the downward shift in the President's utility curve. The magnitudes of the utility loss to the President and the utility gain to the party from the provision of patronage are determined by the $C(R_i)$ and $V_i(R_i)$ functions, respectively. Opportunity for gains from trade exist as long as the utility gained from a more preferred policy by the President is greater than the utility lost from the patronage that he must provide the coalition to approve that policy.

Figure A1. Political Transactions in One Policy Dimension

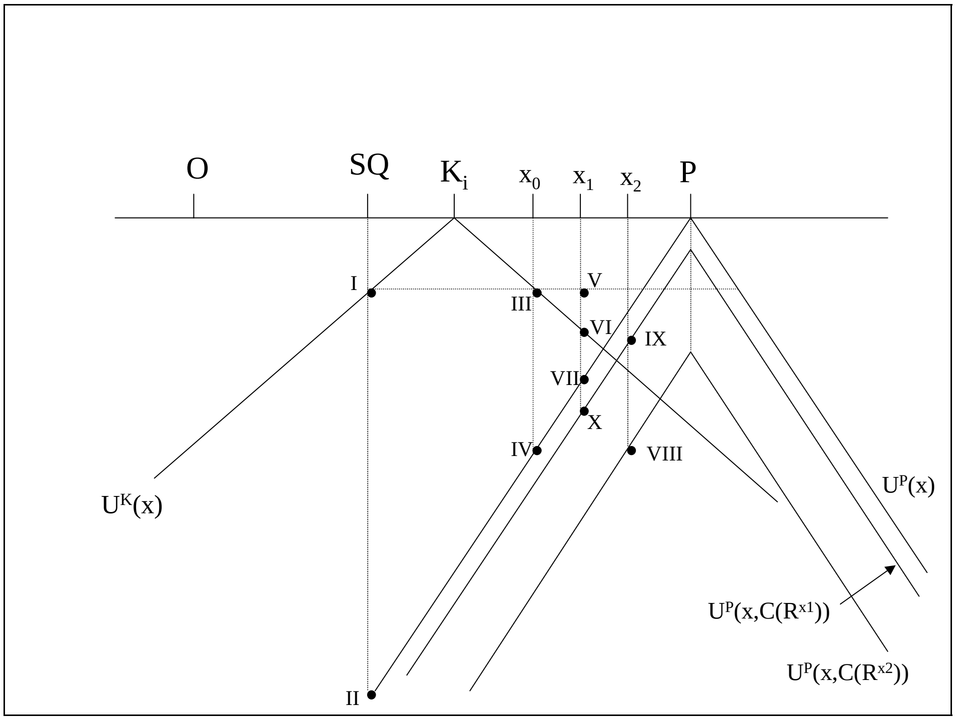


Figure A1 shows the effect of the cost of patronage on the President's utility. The middle utility curve for the President includes the cost of pulling the policy from x_0 to x_1, and the bottom utility curve includes the cost from x_0 to x_2. The total gain for the President from moving from x_0 to x_1 is the vertical distance from IV to VII, although this also entails the cost equivalent to the vertical distance from VII to X. Therefore, the net gain is the vertical distance from IV to X. Because this is positive, at least as far right as x_1 there are gains from trade to be realized. If the President opted instead to submit a proposal for policy x_2, then he would end up with utility at VIII, which is slightly worse than IV, the utility he would receive from policy x_0. Therefore the President would not propose the change from x_0 to x_2. The equilibrium policy would be a point x^* in between x_1 and x_2, where the marginal benefit of pulling the outcome towards P would equal the marginal cost of doing so.[67]

So far, the model has incorporated only two of the three policy categories described earlier: macroeconomic policies and pork, or patronage. In order to incorporate residual policies, an additional dimension to the diagram must be added. This is shown in Figure A2 where the horizontal axis measures macroeconomic policies and the vertical axis measures residual policies, for example expenditures in anti-poverty policies. Whereas in Figure 1 utility functions could be shown, in Figure A2 it is only possible to show the indifference curves that portray all the points that provide equivalent utilities to a given actor. An important element of this analysis is the assumed shape of the President's utility function. Assuming that the electoral connection is such that the President internalizes national goals, his/her indifference curves are drawn as ellipses, so that the trade-off between macroeconomic policies and residual policies is such that the former are given a preponderant weight.[68] In addition, there is a budget constraint so that resources used for residual policies cannot be simultaneously used by for macroeconomic policies.

---

[67] The President's problem is (assuming $K \le x_o \le P$):

$$\max_x \; -\beta(|P - x|) - C(R(x)) \text{ subject to } -\alpha(|K - x|) + V(R(x)) \ge -\alpha(|K - x_0|)$$

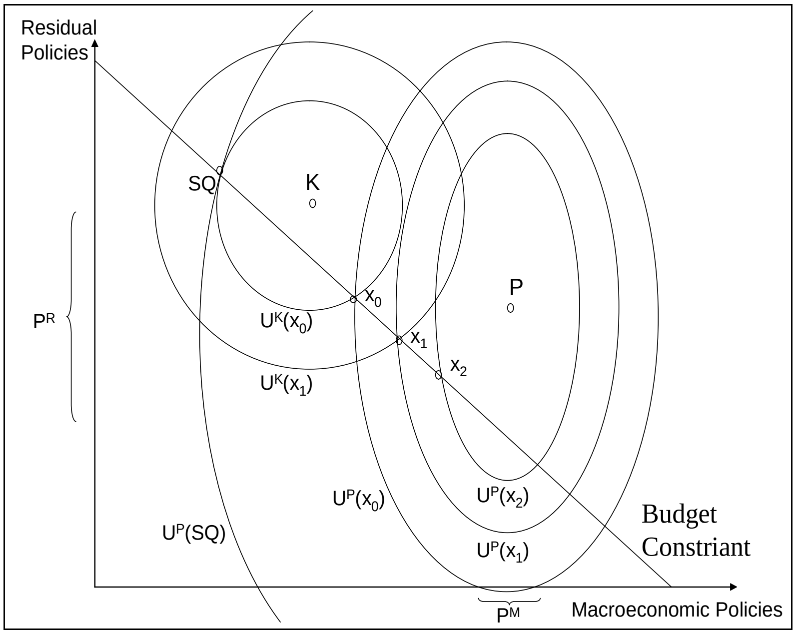
The constraint forces the President to compensate the coalition with patronage up to the point where it will be just as well off in terms of utility as it was at the status quo. It is assumed that $V_R>0$, $V_{RR}\le 0$, $C_R>0$ and $C_{RR}\ge 0$. Note that the President's choice variable is where he chooses to put the new policy x. The amount of patronage, $R(x)$, is set so as to satisfy the constraint at that point.

The first order condition is $\beta = C_R R_x$, where β is the marginal benefit to the President from moving the policy one unit closer to P, and $C_R R_x$ is the marginal cost. R_x measures how much extra patronage the President must give the coalition to move policy one unit closer to P, and C_R is the cost to the President of that marginal patronage.

[68] An example of a functional form with these properties is $U(x,y) = -[a_1(x_1 - y_1)^2 + a_2(x_2 - y_2)^2]^{1/2}$, where y_1 and y_2 are the coordinates of the agents's preferred point and a_1 and a_2 are issue weights that give the indifference curves the elliptical shape. It is assumed that $a_1 > a_2$ for the President.

The equilibrium policy can be derived similarly to the one-dimensional case. If policy is at the status quo point, the President can use his agenda power to propose x_0 which is indifferent to the coalition, but will increase the President's utility from $U^P(SQ)$ to $U^P(x_0)$. Once again the President can do better than x_0. If he proposes a policy even closer to *P* than x_0, yet still respecting the budget constraint, such as x_1, this will make the coalition worse off than at the status quo, so the coalition can be expected to block the change. However, the President can offer the coalition patronage to make up the difference between $U^K(x_1) - U^K(x_0)$ thus leaving the coalition just as well of as at x_0. This will only be of interest to the President while the marginal cost of this patronage is lower than the marginal benefit derived from moving the policy closer to *P*.

Figure A2. Political Transaction in Two Policy Dimensions



If the move from x_0 to x_1 leaves the President better off, after having compensated the coalition for losses bellow $U^K(SQ)$, then he may try to move policy even closer to *P*, still respecting the budget constraint, for example point x_2. If this move from x_1 to x_2 requires compensation to the coalition whose cost is greater than the utility gain to the President, then the equilibrium policies will be those represented by x_1. The greater the weight given by the President to macroeconomic policies, the more elongated will be his utility function and consequently the closer will be the equilibrium policy to his/her preferred level of macroeconomic policies. Clearly the shape of the utility function is given by the actors' preferences and cannot simply be asserted. What this paper argues is that the preferences are shaped by the political incentives that emanate from the political institutions, such as the electoral rules. The argument is that the incentives for the President in Brazil are for a primordial concern of macroeconomic over other policy so that the indifference curves are elongated as in Figure A2, which leads to an equilibrium outcome where horizontal moves are given more weight than vertical moves.

The model can also be used to portray the two different categories of residual polices discussed in the text; volatile and hard-wired. Some policies will tend to be hard-wired so as to prevent them from being traded-off against macroeconomic policies. Doing so implies fixing the level of residual policy at a pre-determined level. In this case the model collapses to the one-dimensional case of Figure 1, where the only choice is the level of macro policies and how much pork is necessary to achieve it. Those residual policies that are not hard-wired will tend to be volatile since they are dependant on budgetary conditions. When these conditions are favorable they are implemented, but are suspended when political or economic shocks endanger the macroeconomic policies. These policies tend to be volatile because they have a greater ideological component. This can be represented in Figure A2 by having political incentives such that any new President's utility function will tend to have its peak fairly rigidly in the P^M range (macroeconomic policy dimension) whereas there is more leeway in the P^R range (residual policy dimension). In this case each new President will follow similar macroeconomic policies but will change the non-hard-wired residual policies. Evidence that this representation conforms to facts of Brazilian politics is presented in the text.