Decentralizing Democracy

Spain and Brazil in Comparative Perspective

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Does decentralization of the state enhance democratic rule? Does democratization make decentralization more manageable? The key intervening variable governing decentralization with democratization is the coherence of the central state. Following a path-dependent logic, studies of democratization argue that an array of factors present in “political society,” that is, in the domain of political parties and parliamentary alliances, determines the coherence of the central state. The stronger political society is, and the greater the coherence of central authority is, then the more likely it will be that decentralization and democratization will reinforce each other. According to this argument, Spain’s well-developed political society played a key role in enhancing national authority by controlling the content and pace of state reform and regime change. In Brazil these factors were anemic or missing, thereby weakening the state in ways that allowed decentralization to endanger democracy.

The emphasis on political society in studies of democratization favors static factors that fail to account for the dynamic character of decentralization and democratization. The relationship between decentralization and democratization in Spain and Brazil was shaped by intergovernmental conflicts that were never fully under the control of either national states or political society. In both cases these conflicts challenged institutional arrangements in political society that studies of democratization credit with enhancing state cohesion. Efforts to resolve the conflicts in both countries depended upon ad hoc and transitory measures that were not imposed by a coherent national state. These dynamics challenged the Spanish central government’s ability to govern the expanding authorities of the regions, exacerbating emerging divisions within the ruling Socialist Party (Partido Socialista Obrera Español, PSOE). In Brazil runaway spending by the states was impeded by a partial reequilibration of authority and resources in the central state during Fernando Henrique Cardoso’s administration (1995–present).

Explanation of these dynamics requires a focus on the bargaining process among levels of government. This process is mediated by two factors: the open-endedness of institutions governing the distribution of intergovernmental authorities and resources and the political leverage wielded by central and subnational governments. Where federal institutions are open-ended, subnational governments are more likely
to assert their autonomy from the central government and employ fiscal resources for purposes they are relatively free to define, despite the coherence of parliamentary coalitions and partisan strengths. Subnational governments maintain their own interests in composing policy responses to local problems, even though their actions challenge the agenda of strong national parties, including those to which they are allied.

While federal institutions allowed more decentralization of policy authority and resources in Brazil, the parameters of intergovernmental prerogatives were also fluid in Spain. Over time, as local economic problems, particularly unemployment, became more compelling, the Spanish regions developed stronger incentives to expand their command over economic policies and European Union resources. This expansion produced sharper divisions within the ruling PSOE and threatened Spain’s participation in European monetary union by challenging the fiscal adjustment required by the 1992 Maastricht convergence criteria.

Yet, even when the institutions governing the distribution of intergovernmental authority and resources are open-ended, shifts in bargaining leverage may favor reequilibration of these powers and goods back to the central government. Changes in macroeconomic policy, economic performance, the assertion of international constraints, and the reform and regeneration of central regulatory bodies can produce new institutional constraints on subnational policy and raise the costs of violating these new rules.

Although the Brazilian states and cities acquired unprecedented authority over policymaking and fiscal resources during the 1980s and early 1990s, President Cardoso asserted presidential initiative through emergency reform legislation to bribe and threaten states into enacting fiscal reforms individually. His leverage was enhanced by his antiinflationary Real Plan in mid 1994, which dramatically raised the costs for states unwilling to enact cost-cutting measures and reschedule their debt with the federal government. More aggressive financial regulation by the country’s national monetary authorities, particularly the central bank and the National Monetary Council, and the continued nervousness of portfolio investors unwilling to invest in states eschewing reform weakened the political coordination of the states and shifted bargaining leverage to the president. By contrast, in Spain the availability of EU resources and continuing strong subnational alliances among regional party leaders, labor unions, and business accentuated the political leverage of the regions over the central government.

Analyses of political society have not been able to explain the evolution of decentralization with democratization in Spain and Brazil. They emphasize institutional “strength” without considering changing political and economic contexts, resulting shifts in intergovernmental bargaining leverage, and the open-endedness of federal institutions beyond the narrow domain of parliamentary politics.
The Limits of Analyses Based on Political Society: Spain and Brazil Compared

Much of the literature on democratization insists that the experiences of Spain and Brazil in decentralizing democracy were polar opposites. Juan Linz and Alfred Stepan argued that the sequencing of founding elections and decentralization during regime transitions enhance the coherence of the state and allow for a stable transition to democracy. According to them, the founding democratic election in Spain reinforced the coherence of the central state during an uncertain moment in the transition to the new regime when Spain’s national unity was challenged peacefully by Catalonian nationalists and violently by the Basque terrorist group, Basque Homeland and Freedom (Euskadi ta Askatasuna, ETA). Only after two crucial nationwide votes on political reform and a referendum on the national constitution in 1978 did the central state and the regions begin to negotiate on the decentralization of fiscal resources and authority. Had regional contests preceded these nationwide elections, subnational demands would have compromised the construction of a national democratic agenda.

By contrast, Brazil’s bureaucratic military regime initiated a process of liberalization in 1974 that unfolded in several important subnational elections for governor (1982), federal deputies and senators (1974, 1978, and 1982), and mayors (1982) before the first civilian president in twenty-one years was elected indirectly in 1985 by an electoral college. Before the first direct election of the president in 1989 other subnational elections were held for mayors in 1985, for congress and governors in 1986, and for the constituent assembly that guaranteed the decentralization of fiscal resources to states and municipalities. The timing of these events allowed Brazil’s governors and mayors to become the standard-bearers of the transition and to contest the devolution of state resources and authority before a democratically elected president could regulate decentralization from above. Following other scholars of Brazilian federalism, Linz and Stepan argue that decentralization with democracy in Brazil weakened the central state by fragmenting authority among these “barons of the federation.”

Democratic organizations and institutions emerged as effective instruments in governing decentralization in Spain. The organizational coherence and discipline of the Socialist Party (PSOE) under Felipe González was especially important. The PSOE won an absolute majority in the Spanish Cortes (parliament) over two terms (1982–89). Although it had to form a parliamentary alliance with the Catalonian nationalist party Convergència i Unió (CiU) in 1993 to retain a governing majority, it remained in power until 1996. The PSOE’s government was effective in mediating the numerous economic and political conflicts in the Spanish regions that might have threatened democracy.

In Brazil, by contrast, such coherent and stable party rule was completely missing. Electoral laws and particularism continued to erode party identity.
alliances for reform routinely fell apart as parties were unable to maintain a loyal following among either the voters or the political class. During the regime transition the dispensation of clientelistic rewards regulated pacts among leaders of the armed forces, civilian “notables” of the authoritarian period, and national and subnational leaders of the opposition to military rule. The governors and mayors were central figures among these traditional elites. National politicians required the political support of subnational elites to maintain power. Consequently, the distribution of clientelistic privileges to the states and cities became a key means of consolidating civilian rule, but it further fragmented parties in the national legislature.

Although electoral sequencing and the coherence and organizational strength of national parties produced clear contrasts in the experience of democratization and decentralization in Spain and Brazil, intergovernmental conflicts continued to mediate the process of political decentralization in both countries. These conflicts moved Spain from its pattern of mediated reform and kept Brazil’s new federalism from spiraling out of control. Democratization and decentralization evolved dialectically in both cases, allowing the Brazilian central state to reequilibrate its authority and forcing the Spanish central state to devolve more of its resources than national leaders would have preferred.

Spain: The Uneasy Road to the State of the Autonomies

While democratization in Spain is often considered to be the archetypal case of a pacted transition, based on building consensus among the political elite, the evolution of Spanish democratic institutions suggests that they were imbued with considerable open-endedness that allowed subnational governments to expand their authority and resources significantly during the 1980s and 1990s. The consensual elite settlements of the transition did not prevent decentralization from threatening the coherence of the PSOE, encouraging particularistic manipulation of fiscal resources, and fragmenting the central state’s control over spending.

From the beginning, the question of regional autonomy dominated the emergence of Spanish democracy. Indeed, the regional question overshadowed most of the major transitions in Spanish politics for more than 150 years. Three civil wars in the nineteenth century, the contested liberal Restoration (1875–1923), and the Second Republic (1931–1936) were all influenced by regionalism. During the dictatorship these sentiments were brutally suppressed by the Franquist embrace of Catholic unity and authoritarian centralism. During the transition the two most developed nationalities, the Basques and the Catalonians, once again forced Spaniards to revisit this historical problem.

Soon after Francisco Franco’s death in 1975 the Basques and the Catalonians called for a reinstatement of their statutes of political autonomy. These institutions had been abrogated by Franco in the 1930s. Lingering nationalist resentments in the
Basque Country and Catalonia and separatist violence by ETA threatened to derail Spain's delicate transition to democracy. At the same time, other regions began to assert their claims to autonomy, whether or not they had historical precedents. These regions feared that special concessions would be granted to the Basque Country and Catalonia, leaving them more dependent upon the central state. Thus, the political assertion of nationalist sentiments in two key regions initiated a wider debate concerning the structure of the state.\textsuperscript{14}

The transition to democracy provided the regions an opportunity to assert their claims when the new institutions of democracy were not yet established. Rightist and military interests viewed the generalization of the regional question as a means of diluting the nationalist claims of the Basques and Catalonians. At the same time, regionalist arguments had a certain resonance with leftists and other supporters of democracy who saw decentralization as a mechanism to reduce the power of a centralized authoritarian state.\textsuperscript{15}

The official response to these historical and political pressures during the transition was the creation of a system of autonomy encompassing all the regions. The parties of the emerging Spanish democracy, particularly Adolfo Suárez's centrist Union of the Democratic Center (UCD) and the PSOE, sought an institutional solution. The 1978 constitution guaranteed the regions “autonomy for the administration of their respective interests” (Article 137), and the controversial Title VIII authorized a negotiated route to autonomy based upon the development of statutes of autonomy for each region that would divide up responsibilities for taxation, shares of intergovernmental transfers, and corresponding spending duties. A new state structure known as the “state of the autonomies” emerged.

The system conceived by the 1978 constitution was meant to be flexible, to build the “state of the autonomies” gradually through a process of negotiation between the central state and the regions.\textsuperscript{16} But it was also designed to impose a coherent, national model for decentralizing resources and policy authority.\textsuperscript{17} Events, however, thoroughly confounded national elites and parties.

Different needs and political interests among the regions thwarted central state ambitions to generalize a model of autonomy that could be applied to all cases.\textsuperscript{18} Despite the constitution's stipulation that the national senate be transformed into a forum for the regions, like the Bundesrat for the German Länder, the minoritarian position of regional parties in the Cortes hamstrung their efforts to compel national parties to implement this constitutional provision. Without an overarching national forum on decentralization and in the face of widening calls by nonnationalist regions to be included in the new “state of the autonomies,” decentralization continued to evolve in Spain through intergovernmental conflict and periodic negotiation.\textsuperscript{19}

The negotiation of statutes of autonomy with each region in effect segmented the autonomy process. Different regions obtained distinct and sometimes “exclusive”
rights. Title VIII approached this problem by dividing the regions between those with an accelerated process and those with a more gradual process of building regional autonomy. The first (the Basque Country, Catalonia, Andalusia, and Galicia) were governed by Article 151, which established the “fast track” (via rápida) to autonomy. The Basque Country and Catalonia were placed in this accelerated process due to their nationalist demands for autonomy. Galicia and Andalusia were included due to their pressing economic crises. The governments of the Basque Country and Navarra were set apart from all other regions in that they could assert erstwhile “foral” rights that gave them the ability to tax and finance themselves in exchange for payment of an annual percentage (the cupo) to the national state. The second, which included all other regions, were governed by Article 143, which established a “slow track” (via lenta) to autonomy. The distinction had immediate effects on the authority of each region. It therefore became the focus of distributional struggles among regions classified within and between the two routes. Once each region became eligible to negotiate its particular statutes of autonomy, these differences came to the surface. They reinforced the heterogeneous nature of regional demands and reduced the relevance of the constitutional framework contained in Title VIII.

Even when national politicians attempted to regain control over the process, the regions proved effective in preserving the open-endedness of the “state of the autonomies.” In 1981 the UCD government commissioned a working group of judicial experts headed by the respected professor of law, Eduardo García de Enterría, to recommend the use of a single model for transferring authority to the regions. The group’s recommendations were published as the Project for an Organic Law for Harmonizing the Autonomy Process (Proyecto de Ley Orgánica de Armonización del Proceso Autonómico, LOAPA). The regional governments responded to LOAPA with bitter criticism, charging that the legal project was an attempt to “defraud” the statutes of autonomy. The confrontation was so sharp that Felipe González, then still the leader of the Socialist opposition, was compelled to observe that the tinkering with the regional statutes threatened to “ignite a second Civil War” and endangered the consolidation of democracy in Spain. Ultimately, most of LOAPA’s provisions were struck down as unconstitutional in August 1983 by the constitutional tribunal after the nationalist regions brought a case against the government.

Despite the Socialists’ sweeping electoral victory in October 1982 and their absolute majority in the Cortes, the PSOE was unable to impose anything similar to LOAPA. Instead, the “state of the autonomies” continued to evolve through distributive conflicts. These conflicts shaped the creation of a new composite system of fiscal rules that were institutionalized in the Ley Orgánica de Financiación de las Comunidades Autónomas (Organic Law of Financing for the Autonomous Communities, LOFCA).

LOFCA never escaped from the unremitting pressure of regional lobbies. The
continued bargaining over LOFCA and the ability to renegotiate each statute of autonomy after ten years intensified distributional conflicts that the Socialists would have preferred to avoid through the imposition of a unified, national system governing intergovernmental relations. Even when the Socialists declared an “end to the autonomy process” in late 1987, regional leaders defied the government’s call and continued to renegotiate the rules of the system. Embedded in all of these intergovernmental negotiations was González’s concern that further strengthening of regional autonomy would create an ever more confusing system of administrative responsibilities and resource control.

Notwithstanding differences between Article 143 and Article 151 regions, all the regional governments successfully gained increases in fiscal resources during the long evolution of the statutes of autonomy and LOFCA. Between 1984 and 1994 the Spanish regions increased their spending as a percentage of GDP from 4.8 to 10.9 percent. As a percentage of total public expenditures the regions increased their share from 11 to 20 percent, while the central state’s share fell from 78.9 percent to 68.2 percent during the same period. These aggregate numbers are deceptive, since many national and EU programs in infrastructure and industrial promotion were administered almost completely by the regions. In practice, therefore, the regions commanded a broader range of resources than those delegated to them by LOFCA.

While LOFCA succeeded in decentralizing fiscal resources, it failed to devolve taxation functions to the regions, thereby creating a distortion in “fiscal correspondence.” About 80 percent of the funding of subnational expenditures came in the way of fiscal transfers from the central state (more than 55 percent of these monies were already earmarked for social spending and education), while the regions collected 15 percent of their revenues in the form of taxes. The earmarking of national transfers became progressively less stringent after reforms of LOFCA in 1986 and 1992 increased the percentage of unearmarked transfers. But the regions’ limited taxation powers created strong incentives for regional politicians to lobby Madrid for resources without requiring them to finance part of their spending with their own taxes. Regional politicians received the credit for spending money, while Madrid suffered the calumny reserved for the tax collector.

At the same time, the constitution of 1978 and the statutes of autonomy granted the regions expansive authority to use nonearmarked transfers to “foment” industrial growth in their local economies. In all cases, the statutes of autonomy specified that the regional governments would have the authority to maintain their own public sectors. Accordingly, many regions launched an array of agencies and economic policies designed to promote industrial investment during the 1980s. Although the juridical parameters within which these subnational apparatuses operated were governed by the qualification that all policy must be “in accordance with the general, economic objectives of the central state,” these terms remained ambiguous enough to allow regional governments and their agencies to set their own priorities.
The open-endedness of the stipulated political economic rights of the regions allowed the regions to claim authority through their statutes of autonomy that were not specifically contained in the 1978 constitution. The regional governments effectively had the authority to develop their competencies in the area of industrial promotion and “reconversion” and even to expand them beyond the range the central state reserved for itself.

This expanded subnational authority over industrial policy partially thwarted the national government’s attempts to centralize authority over economic policy, particularly in an ambitious industrial restructuring program begun in 1983. Concentrating on efforts to improve productivity and slash labor costs in Spain’s most important public and private industrial sectors, the Socialists pursued a wide-ranging industrial “reconversion” policy, introduced in a white book (Libro Blanco) report in July 1983, delivered by then minister of industry Carlos Solchaga. Both the white book and its legislative successor, the Law of Reconversion and Reindustrialization (1984), targeted declining industrial sectors for subsidized credit and structural aid to ease the social costs of downsizing, but the long-term priority of restructuring policy was to reduce spending on the industrial sector. Firms in sectors such as steel, metallurgy, appliances, and textiles were targeted and downsized. Zones of urgent reindustrialization (ZURs) surrounding the most hard-pressed sectors were provided with preferential credit and subsidies and were the beneficiaries of funds for labor relocation, retraining, and unemployment support. From 1985 to 1993 these policies slashed 35 percent of the work force of the public sector. Spain’s public firms were later subdivided in 1992 into “profitable” and “nonprofitable” firms. Private buyers were found for the few that could be sold, and the national holding company was dissolved in July 1995.

In contrast to the process of negotiating consensual pacts among the state, business, and labor during the transition, the PSOE relied heavily upon the centralization of its authority to implement its industrial reconversion program. Using its strong parliamentary majority and its close relationship to the national Socialist unions led by the Unión General de Trabajadores (General Union of Workers, UGT), the PSOE could compel workers to tolerate the social dislocation caused by industrial downsizing.

In mid 1985 numerous frictions between the PSOE and UGT leadership led to a split. As a result of the PSOE’s embrace of membership in NATO, the downsizing of social security allotments, and the reluctance of national party leaders to negotiate a “second reconversion” after 1986, the UGT joined the Communist unions, Comisiones Obreras (Worker Commissions, CCOO) in their opposition to the reconversion. Yet even the party-union split did not threaten the Socialists’ industrial reconversion program or provoke a sustained national opposition to the program. By 1990 the government had achieved more than 90 percent of all anticipated job cuts. The government had also reduced severance payments but expanded spending on
retraining and "reindustrialization," subsidies to regional governments to find alternative employment for those left without a job. Smith suggests that these policies were designed primarily to mollify Spanish labor and proved successful, since the government was able to complete the industrial reconversion without serious disruptions. Bermeo and Durán credit the centralization of the PSOE for the same result. What both perspectives ignore is the role of the Spanish regions. With expanding authority and resources juridically devolved to them by the autonomy-building process, regional governments were in a strategic position to gain control over key aspects of industrial policy and the national budget. The national split between the Socialist party and the UGT only reinforced the closeness between UGT and PSOE leaders regionally and created new possibilities for political alliances in favor of the decentralization of additional resources. These relations had the effect of strengthening regional lobbies. Regional Socialist leaders who sought a more prominent role for themselves in the PSOE found ready allies within the UGT. Nicolás Redondo, the national leader of the UGT, publicly declared that he felt closer to Joaquín Leguina (regional president of the Community of Madrid) and Joan Lerma (head of the Generalitat of Valencia) than to Felipe González. The relationship served Redondo; he could gain influence within the PSOE in regions with strong Socialist support. Regional leaders such as Leguina and Lerma gained a natural ally in their campaign to combat the "political centralism" they perceived within the party and gain access to national policymaking. Similar challenges to the national Socialist administration emerged, albeit not surprisingly, in regions not under Socialist control, in Galicia, the Basque Country, and Catalonia. But the materialization of these intergovernmental cleavages between the central state and regional governments led by the PSOE suggests that decentralization empowered subnational interests to challenge consensual elite settlements within the PSOE's hierarchy.

By the end of the official period of reconversion in 1986 unions and business organizations increasingly allied themselves with regional governments to demand changes in national policy. They often called for an increase in compensatory measures, such as retraining and unemployment benefits. Faced with local economic crises, regional leaders often took up the demands of business and labor groups. Although Socialist economic technocrats such as Solchaga and his successors in the ministry of industry were initially concerned about decentralizing more resources for "reindustrialization" strategies run by the regional governments, national industrial reconversion moved in this direction in 1986. The sectoral programs initiated in 1984–86 were gradually phased out, while programs geared to retraining labor and promoting productivity and new technologies were decentralized to the regions. Although central state managers later argued that these decentralized policies were programmed "horizontal industrial policies," others admitted that
the regional governments and their labor and business allies were instrumental in lobbying Madrid for control of them.\textsuperscript{40}

Spain's admission to the European Community (EC) also produced opportunities for subnational lobbies. Under a 1985 policy the EC ruled that regional governments could invoke more active industrial policies than their national governments. Regional leaders saw this ruling as a strong incentive to press for new policy responsibilities and EC resources, particularly "cohesion funding" from the European Regional Development Fund (ERDF), the EC organization charged with redressing regional imbalances within the union.\textsuperscript{41} As these funds became available, the control regional governments exerted over expenditures expanded in degree and in kind. The autonomous communities administered approximately one-third of EC structural funds, while Madrid used the remaining two-thirds to cofinance programs in infrastructure and education already underway in the regions.\textsuperscript{42}

In areas such as the promotion of small and medium-sized firms and industrial employment, regional governments became more active as central state resources for these sectors declined.\textsuperscript{43} In terms of plans, projects, studies, laws, and the development of norms, the regions became much more active than Madrid in promoting industrial development.\textsuperscript{44} Even EC officials traveling through the Spanish regions claimed that the capacity of the EC to promote industrial development in Spain depended almost entirely on the capabilities of the regional governments.\textsuperscript{45}

As the decentralization of resources and authority proceeded and the central state's ability to maintain a coherent system of national control declined, substantial costs emerged on Spain's fiscal accounts. Although some regional industrial policies produced employment and new investment, they also created strong incentives for regional leaders to manipulate national resources for political purposes. With unemployment running at European highs of 20 percent nationally for much of the 1980s and early 1990s, regional leaders developed strong political interests in intervening in the market. To be sure, a centralized national system of regulation might have been more effective in determining the allocation of funds for particular projects, but decisions by the late 1980s were firmly in the hands of regional leaders with their own political agendas. Consequently, profligate economic policies implemented at the subnational level contradicted the national government's attempts to rein in unproductive public spending. These problems became more serious as Spain attempted to meet the Maastricht targets for monetary union during the 1990s.

One noteworthy example of the manipulation of subnational spending for political purposes was Andalusia. It became an active proponent of subnational industrial policies. Driven by labor union pressures to protect jobs threatened by divestment in the automobile sector, the Socialist regional government plunged millions into unviable industrial firms and bought many outright. For example, between May 1993 and August 1994 the Andalusian government invested more than $269 million of the regional budget to save thirteen unviable firms.\textsuperscript{46} This amount surpassed the total for
all of the region’s other industrial promotion programs in agriculture, industry, and services in 1993 and represented 83 percent of total industrial investment in Andalusia for the same year. Although this investment was economically inefficient, it was politically profitable for the Socialists. The PSOE, after losing their absolute majority in the regional assembly in June 1994, and despite sweeping victories by the opposition centrist Popular Party (PP) in most of Spain’s other regions, survived a challenge from the PP in 1995 and remained in power.

The national PSOE was not so successful. It lost its parliamentary majority in 1993 and was forced into an alliance with Jordi Pujol and the Catalonian Nationalists. The PSOE’s hierarchy could not resist the political necessity of manipulating decentralization for its own purposes. Using the distribution of spending on “reindustrialization” policies to forge its parliamentary alliance with the Catalonians, the PSOE granted Pujol an array of new resources and authority. Spending on projects in Catalonia jumped from an average of 12 percent in the 1991–94 period to 48 percent, while Madrid’s share fell from 62 to 34 percent. No other region’s share exceeded 4.5 percent, and most suffered declines.

These obvious regional inequalities in the distribution of spending for industrial promotion policies prompted a wave of national criticism of the Socialists and encouraged regional presidents to expand their spending initiatives in a “race to the bottom” competition. Elevated levels of spending requirements at the subnational level coupled with national fiscal restraints forced the Spanish regions to increase their debt to finance their economic policies. Total subnational debt grew expensively between 1984 and 1996 by twenty-eight times. By the mid 1990s subnational debt increased to 1 percent of the national GDP and 9.8 percent of the subnational GDP. Although the central state maintained a coordinating agency, the Council of Fiscal and Financial Policy (Concejo de Política Fiscal y Financiera, CPFF), to oversee subnational spending, regional debt levels continued to increase.

Even as the national government succeeded in cutting the civil service from 1,180,000 employees in 1982 to 900,000 in 1992, the regional civil service expanded by almost thirteen times (from 44,000 to 565,000), and the local civil service more than doubled (from 167,000 to 360,000) during the same period. In response to increased subnational spending, then Socialist minister of the economy Solchaga declared in 1992 that irresponsible regional governments threatened Spain’s compliance with the Maastricht targets for monetary convergence. At a time of fiscal restraint the Spanish central state appeared unable to temper the debt-financed spending of the regions.

Despite the sequencing of national elections and the strength of national parties, the evolution of the “state of the autonomies” was less controlled from above than expected. All attempts to establish a unitary national model for governing the “state of the autonomies”—LOAPA, LOFCA, and CPFF—failed. Instead, ad hoc arrangements reached through continuous lobbying and negotiation governed the process of decentralization.
Brazil: Reequilibration of Intergovernmental Authority

Political decentralization emerged as an offshoot of efforts to democratize Brazil, and it was itself an outcome of the redistribution of access to power at the heart of the transition to democracy. The two processes, however, were not mutually reinforcing. Political decentralization accelerated before a democratically elected executive and a national constitutional system could be constructed. Consequently, local politicians and their clientelistic political machines had an inordinate amount of influence over the content of democratic institutions and national policies. Forced by the need to make alliances with subnational politicians, the first civilian government of President José Sarney (1985–1990) played to this panoply of parochial interests to strengthen its own political position, thereby further fragmenting central political authority.

Ironically, the military government that had embraced authoritarian centralism initiated this most recent process of decentralization. The military decentralized fiscal resources to the states with the devolution of control of the Imposto sobre Circulação de Mercadorias (tax on the circulation of goods) in the tax reform of 1966–67. Intergovernmental revenue sharing was expanded in 1983 in the military’s Passos Porto amendment. Only with democratization, however, did subnational elites gain a new arena in which to use their expanded resources. The promilitary party, the Social Democratic Party (PDS), suffered a devastating defeat in the direct election of governors in 1982, and opposition governments took over the economically developed states of São Paulo, Rio de Janeiro, Minas Gerais, Espírito Santo, and Paraná. These elections produced a nationally prominent subnational elite that, before the direct election of the president, was popularly considered the standard bearer of the transition.

Subnational democratic leaders soon faced a paradox. The newly elected governors and mayors could not claim to be independent of the military government while they simultaneously continued to depend upon the same government for fiscal resources. Fiscal constraints prompted subnational politicians in 1983 and 1984 to expand their states’ control over the tax on the circulation of goods. The opposition governors and municipal and federal representatives mobilized support through broad subnational distributional and clientelistic networks.

When the constituent assembly convened in 1987 to draft a new constitution, regional interests dominated Brazilian political society. The constituent assembly itself became a forum for subnational interests, particularly on the subcommittees reviewing taxation and revenue sharing. These bancadas subnacionais succeeded in adopting constitutional rules that decentralized fiscal resources. The democratic constitution-making process lent these entitlements democratic legitimacy.

The constitution of 1988 made Brazilian federalism more fiscally decentralized. Significant fiscal authority shifted to subnational governments, especially munici-
palities. Federal tax revenue before revenue sharing fell from 70.4 percent in 1985 to 66.2 percent in 1990–94. State tax revenue increased from 27 to 29.1 percent, and municipal tax revenue increased from 2.6 to 4.7 percent in the same period. Subnational spending soon outpaced tax revenue, creating a gap between tax collection responsibilities and public spending. Although the federal government spent less than it collected in taxes between 1960 and 1994, this gap widened significantly following the adoption of the 1988 constitution.

The 1988 constitution gave the states reasons to spend by delegating to them areas of policy not within the jurisdiction of the national state. Open-ended devolution freed the states to spend on an array of “development” needs. Intergovernmental transfers, more than 90 percent of which were not earmarked by Brasilia, financed much of this spending. Even when funds were generically earmarked for health and education, the state governments maintained great discretion over their application.

The role of the federal government in social and economic policymaking eroded during the 1980s and 1990s under the weight of escalating debt and a stagnating economy. As federal responsibilities in health, education, and industrial policy declined, subnational commitments in these areas expanded. By the end of the 1990s subnational governments in Brazil accounted for 44 percent of all spending on health, 69 percent of all spending on education, and twice the federal government’s public investment.

While decentralization enhanced subnational policymaking capacity, other aspects of it weakened Brazil’s flimsy fiscal system. Control over state banks, including some development banks, pitted the governors against the national monetary authority, the central bank and the National Monetary Council (Conselho Monetário Nacional, CMN). The military’s 1966–67 tax reform authorized the governors to use the state banks to finance their growing subnational deficits. During the 1980s such financing threatened the liquidity of the banks and challenged the ability of the central bank and the CMN to regulate the financial system. As the fiscal condition of state governments worsened, the central bank was forced to bail out the states annually in response to the political pressure of governors and their economic secretaries on national politicians. Consequently, large subnational debts accumulated. By 1998 total state bank debt exceeded $96 billion, and total state debt “accounted for 8 of the 10 percentage point increase in domestic public debt from 1994 to 1997.”

More important, state elites had perverse incentives in the postconstitutional period to use their newly acquired resources to compete with each other to attract multinational investment. The 1988 constitution granted the states the authority to offer incentives on the circulation of goods tax, and many states did so in the 1990s to attract automotive firms, in a competition the Brazilian press labeled the “fiscal war.”
Decentralization might have ignited a far more extensive crisis had not a conjunction of factors shifted bargaining leverage over subnational spending back to federal authorities. First, the inauguration of the Real Plan in 1994 liberated President Fernando Henrique Cardoso from the “emergency agenda” of macroeconomic stabilization and raised the costs on states that failed to enact fiscal reforms. The Real Plan pressured the states by increasing interest costs on debt and eliminating inflation as a way to reduce civil service salaries. As payrolls expanded to over 70 percent of net revenues, the states and their banks began to falter financially. Cardoso took advantage of the leverage this situation accorded the federal government to press the governors to privatize their banks and utility companies and enact civil service reforms. While only nine of the thirty-four state banks have been privatized or slated for privatization, they include financial institutions in the four largest debtor states, São Paulo, Rio de Janeiro, Minas Gerais, and Rio Grande do Sul, which together account for 90 percent of all subnational debt. Additionally, numerous utility, public works, and transport companies have already been sold off, generating over $23.5 billion. State banks that remain public are now subject to more rigorous judicial and regulatory controls imposed by the CMN and the central bank. Privatization and centralized restrictions have raised governors’ costs in using these banks for subnational clientelism.

Cardoso’s position became even stronger with supportive federal legislation designed to coerce and cajole subnational governments into reducing bloated state and municipal payrolls. The most important legislation was the social emergency fund, later renamed the fiscal stabilization fund, one of the few achievements of the constitutional reform of 1993–94. Weakened by a prolonged congressional inquiry into corruption on the budgetary committees, the congress was in no position to oppose passage of the fiscal stabilization fund as part of a concerted effort of Itamar Franco’s government to reduce the public deficit. The fiscal stabilization fund empowered the president to retain control of twenty percent of fiscal transfers constitutionally earmarked for the states and cities.

New legislation such as the Camata Law, passed in 1995, and the Kandir Law, passed in 1996, expanded the executive’s powers over subnational spending. The Camata Law required the states to limit their payroll expenditures to 60 percent of net revenues or face losing federal transfer funds. The Kandir Law exempted exports from the tax on the circulation of goods, effectively reducing state revenues. The federal government has conditioned compensation to subnational governments on keeping their payments on rescheduled debt to Brasilia current and on continuing fiscal adjustments.

Cardoso employed his new sticks along with enticing carrots to induce state governments to enact reform. Under the Program to Support Restructuring and Fiscal Adjustment of the States, approved by the CMN in 1995, the federal government provided loans to accelerate privatization of state firms and reductions in the subna-
tional civil service. By rescheduling debt with favorable terms, including low interest rates and extended repayment periods of thirty years in some cases, Cardoso induced state governments to support reform. By mid 1999 the central government rescheduled the debt of twenty-four of twenty-seven state governments. Even opposition governors, such as Anthony Garotinho of Rio de Janeiro, complied. Garotinho granted the federal government the state’s royalties from petroleum exploration (10 percent of annual receipts in the sector) for thirty years to halve Rio’s debt with Brasilia. In all cases of debt rescheduling the federal government received stock in state government firms equivalent to 20 percent of total debt, giving Brasilia a mechanism to move privatizations forward. States agreeing to reschedule their debt were prohibited from emitting new debt notes, although agreements have not stopped capitalization of interest on continuing bond debt. While these actions have not created the hard budget constraints that analysts see as necessary to guarantee good fiscal management among the states, they mark a crucial turn against the unbridled spending of the 1980s. As an indicator of the adjustment effort, the growth of the subnational deficit slowed during the late 1990s. The nominal deficit for the states and cities fell from a high of 19.3 percent of the GDP in December 1994 to 2.3 percent of the GDP in February 1999.

Perhaps the most apparent turning-point in intergovernmental conflict between the central and subnational governments was the aftermath of the January 1999 devaluation crisis. In the midst of a prolonged capital flight sparked by the Russian financial debacle of August 1998, Itamar Franco, the new governor of Minas Gerais, declared a ninety day moratorium on the state’s debt payments to the federal government. Challenging the Kandir Law and the fiscal stabilization fund, Franco’s “fiscal revolt” triggered a financial panic that forced the central bank to float the Real. Cardoso’s response was swift. He froze federal transfers to Minas Gerais and Rio Grande do Sul, another state that flirted with fiscal revolt, tapped escrow monies belonging to the states to pay off past bills, and convinced foreign portfolio investors to stay away from these recalcitrant states. By individualizing their costs and using Minas Gerais especially as an example to other states, Cardoso disrupted cross-state coordination by the six opposition governors.

Attempts to organize all of the governors, first at a meeting at Granja do Torto (Brasilia) in February 1999 and then in Aracaju (Sergipe) in July 1999, highlighted the serious collective action problems faced by the states. While they all articulated common complaints about the fiscal stabilization fund and the Kandir Law, they disagreed over how to approach Cardoso. Few were willing to follow Franco, and others continued to favor the president’s fiscal reforms. Disagreements on related issues, such as the use of competing fiscal incentives to attract investors, posed impediments to a united subnational front.

Even armed with an extensive legislative apparatus and a divided opposition, Cardoso still faced severe constitutional constraints in limiting subnational spending.
The state governments retained the ability, protected by the 1988 constitution, to defend their authority and resources with legislation in the senate. Lasting reforms of the tax and pension systems and the civil service needed constitutional adjustments that are difficult to achieve since they require two three-fifths votes in both houses of congress. Furthermore, the senate remained beholden to the bancada subnacional to protect the states’ constitutional entitlements, particularly the right to roll over debt. All senators are bound by a “norm of universalism” to allow all states this right since any senator deciding to support reform would make his or her state vulnerable to the opposition of the collective.78

Nonetheless, the states have not been able to transform their strong collective interests in preserving constitutional entitlements within the institutions of the senate into a means to coordinate their actions in the broader partisan arena of party politics and intergovernmental relations. The events following the January 1999 crisis are strong proof of the emerging pattern. The patchwork of subnational economic policymaking is becoming more uniform in those areas of fiscal policy where the president has exerted leverage over the states (privatization, subnational debt, and state banks), but entrenched constitutional constraints preserve state spending prerogatives in other areas (civil service reform, pensions, and tax authority). Without progress on the latter, the ad hoc adjustments produced by shifts in leverage to federal authorities will not be sustainable.

Conclusions

The reequilibration of central state authority in Brazil and the growing difficulties with the “state of the autonomies” in Spain belie the argument that “strong” political societies can reinforce the cohesion of the state and thereby coordinate democratization with decentralization. According to this argument, two countries that were so different in the sequencing of decentralization with democracy and the strength of national political institutions should have had more diverse experiences. Yet both managed only an imprecise balance of intergovernmental authority based on ad hoc and transitory measures.

Political decentralization did not enhance any of the factors that are credited with facilitating the cohesion of the state and democratization in Spain. Building the “state of the autonomies” created open-ended institutional arrangements that allowed regional governments to expand their authority and control over resources. Decentralization also created preconditions for political alliances that threatened the coherence of the PSOE and encouraged the political manipulation of fiscal resources. Finally, decentralization increasingly fragmented the central state’s control over spending, allowing the regions to implement their own industrial policies in inefficient ways that augmented the public sector debt.
In Brazil open-ended federal institutions devolved significant policy authority and resources to the states. Devolution produced subnational spending patterns that threatened macroeconomic stability and fiscal management. Reequilibration was an unexpected outcome because of the weakness of political society, yet other contextual changes shifted leverage over subnational spending to federal authorities. The bargaining power of the Brazilian president expanded as the Real Plan increased the costs of rolling over state debt. The “fiscal war” divided subnational interests, eroded regional alliances formed during the 1980s, and strengthened the president when he successfully kept the states from coordinating their opposition to the fiscal stabilization fund and the Kandir and Camata laws. Such inducements as the rescheduling of subnational debt produced substantial costs for federal coffers but also reduced significantly the size of subnational debt and accelerated privatization of public firms previously under the governors’ clientelistic grip.

Democratization with decentralization in both Spain and Brazil evolved dialectically. Neither the initial political conditions of strong parties and properly sequenced founding elections nor the destabilizing effects of seemingly unbridled decentralization during the 1980s predicted the outcome of decentralized democracy in Spain and Brazil in the 1990s. Examination of the degree to which federal institutions delimit subnational authorities and changes in the bargaining leverage among levels of government hold the most promise in uncovering how democratization and decentralization affect each other.

NOTES

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1. Decentralization of the state is the devolution of resources and policy authority from the central state to subnational governments at the meso (provincial, region, or state) and/or local (municipal, council) levels. See Eliza Willis, Christopher da C. B. Garman, and Stephan Haggard, “The Politics of Decentralization in Latin America,” *Latin American Research Review*, 34 (1999), 8. Democratization is the establishment of institutions that guarantee competitive elections, representation, and citizenship to the members of civil society.


3. As finance minister under his predecessor, Itamar Franco, Cardoso designed the Real Plan and then campaigned for president in 1994 based on its success in reducing inflation.

18. Ibid., p. 176.
26. The “autonomous communities” received their financing from five sources stipulated by the constitution and later elaborated in LOFCA: taxes ceded by the central state in part or completely; autonomously administered regional taxes; fiscal transfers from the central state that are specified in the annual budget; all profits and capital produced by firms and agencies owned by the regional governments; and all financial operations administered by the regional governments.
31. Serrano Sanz, pp. 511–12; Pérez Díaz, pp. 54–55; Subirats Humet, p. 112.
37. Bermeo and García-Durán, pp. 118–120.
42. Rosell and Viladomiu, pp. 294–95.
44. Rosell and Viladomiu, p. 290.
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57. Abrúcio; Samuels and Abrúcio.


64. Twenty-four of the twenty-seven states own commercial and/or development banks.


70. The CMN limited new loans to the public sector, the sale of state bonds, and new foreign debt. The central bank intervened in state banks, enforced capital requirements, restructured administration, improved accounting systems, and slated some for privatization.


The fiscal stabilization fund is scheduled to be terminated in December 1999.

Of the three states that have not signed agreements, only the federal district has requested rescheduling. The other two, Tocantins and Amapá, have not requested federalization of their debt.


Indicadores DIESP (March-April 1999), 30. These numbers do not include accounts from contractors and suppliers in arrears.

See Garotinho's comments about the recent deal to use federal funds to place a Ford plant once promised to Rio Grande do Sul in Bahia. “You can say that Fernando Henrique is a lucky man. Before the Ford issue we might all be against his government. Now the Ford case has spoiled the relations among the governors.” Jornal do Brasil, July 14, 1999.