



**Institute of Brazilian Issues
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REDUCTION OF INEQUALITIES

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1 - Introduction

1.1 Focuses on Tributary System

Brazil, in the condition of federative country, is constituted of three government levels that enjoy independence political, administrative and financial autonomy: the Union, twenty-six States and a Federal District¹ and little more than 5.500 Municipalities. However, that independence is shown fragile when we compared Brazil with other federal countries. The basic rule of the federalism is the union of several states, under the nation form, without they lose their autonomy out of the businesses of common interest. The survival of each autonomous unit, States or Municipalities, is measured by the capacity that they have to be organized politically and to generate revenues for their maintenance, providing the well being to the citizens that form the community.

In Brazil, in spite of many forms of generating new revenues, the main source of public revenue is still the collection of taxes. In relation to that revenue, each government level is entitled to institute the taxes that are attributed to them constitutionally and that belong to their private competence.

The Constitution of 1988 allowed Brazil to dispose of a reasonable tributary system and became free from incidences in cascade, as it happened before 1967, with the Tax of Sales and Consignments. In other words, the Constitution defined the attribution clearly of the tributary revenues to each sphere of the government, not having possibility of competence to overlap in relation to the taxes and to the social contributions.

¹ Federal District possesses an institutional structure similar to the one of States. Like this, the use of the term will always be including.

The current base of the Brazilian tributary system is the combination of the income tax (I.R.), tax on industrialized products (I.P.I.) and tax on circulation of goods and services (ICMS). These taxes represent the movement of the productive and financial section of the country. The first two serve as base for the Federal financial transfers made by the Federal Government for States and Municipalities. Already ICMS, that represents the largest source collection of States, serves as base for partition of FPM and FUNDEF. ICMS has also negotiated with the objective of capturing new productive opportunities for the area, when granting subsidies and fiscal incentives for new companies, to criterion of each Federation.

In spite of properly regulated distribution, the partition of the tributary revenue is an extremely controversial theme under any point of view and it has been generating conflicts among the benefited levels, such as the complexity and diversity of the interference that can happen starting from certain decisions. Would those transfers be the only form of increasing the regional development? Why in Brazil don't the autonomous units look to examples of other nations, for other options to diversify their revenues and stay in the hands of the Union?

2 – Federal financial transfers as regulators of the inequalities

2.1 - Analysis of the financial situation of the subnational² Governments

Being that Brazil is a country of vast territorial extension, the existence of financial, tributary and social inequalities has been accepted. However, this situation has been taking the country to true inequalities that the federal

² That expression understands the group formed by the administrations of the states and municipalities and it is thoroughly a concept used in the international literature about federalism.

government's action is working to minimize. As best we understand that situation, we will make an analysis of the public finances of the subnational Governments, in the best way to show the tributary reality of the states and Brazilian municipalities. The mechanism of transfers of intergovernmental revenues clearly demonstrates that a great part of the subnational Governments are dependent on the resources distributed by the Union, especially those states and municipalities located in poorer areas.

We will deepen that analysis now, starting to look those transfers not only as operations accomplished among different government levels, but trying to verify those same connections only for the optics subnational Governments. For that, we will analyze the formation of the Fund of Participation, because, no matter how much they are composed of federal taxes, the Union collects them in the several units federative. Like this, it will be possible to verify not only the states receivers of transfers, but also the donors. In practice, segmenting step by step the Federal Government's action, we can see how the transfer of resources are processed among the Brazilian states.

The data demonstrated below in the table allows us to confront two important indexes for the subnational Governments: the first, we will call L.A. It consists of the Level of Autonomy, comparing the greetings of transfer of resources with the governments' own collection. That is, denominating the received revenues of " R " and the own revenues of " P ", the index is calculated in the following way: $L.A. = \frac{R}{P+R}$. The possible indexes should be between -1 and +1, and -1 indicate a government whose available revenue is totally composed by transfers and, to the opposite +1, indicate a revenue just formed by the state own collection. The

nearest of the positive number, the government will be with better condition of sustaining in an autonomous way, starting from its own resources, without depending on receipt of transfers. The second index is D.L., or Dependence Level, comparing the resources that a government contributed to the Fund of Transfer with those that it received from him, in way to verify if a certain state "has being sustained" (positive values) or " being sustained " (negative values) for the others. For that, the table shows the column " donated " that consists of the volume of income tax (I.R.) and of tax on industrialized products (I.P.I.) (44 percent of I.R. and 54 percent of I.P.I.) that the Union collects in each state. Like this, denominating the resources that each state contributes to the transfer funds for the letter " D ", the index is defined like $D.L.=D-R / D+R$.

After analysis of the L.A., we verified that states belonging to the areas of the North and Northeast just present negative indexes. Among those, they stand out Acre, Amapá, Roraima and Tocantins that are therefore, the states most dependent on the federal transfers. The states of the Center-west, South and Southeast areas present only positive indexes, indicating a good autonomy of own collection. With relationship to D.L, only São Paulo, Rio de Janeiro, Federal District and, in smaller degree, Espírito Santo, have positive indexes, denoting that those states supply, in liquid way, the resources that they will form the transfer funds. All the other states are, in that sense, receivers of the transferred resources. However these data contain an inclination, due to the centralization of the payment of income tax of the firms (IRPJ) in the great taxpayers' head office and to the fact of Federal District to be the jurisdiction of the largest state's taxpayers.

LEVEL OF AUTONOMY (L.A.) AND LEVEL OF DEPENDENCE (D.L.)

STATE	Donated	Received	Own	P – R	P + R	L.A.	D – R	D + R	D.L.
	A	B	C	D=C-B	E=B+C	F=D/E	G=A-B	H=A+B	I=G/H
NORTH AREA	332.216	3.388.120	3.019.834	-369.536	6.406.705	-0,06	-3.055.904	3.720.336	-0,82
ACRE	9.258	390.407	63.401	-327.047	453.767	-0,72	-381.149	399.665	-0,95
AMAPÁ	9.889	376.152	65.912	-310.275	442.029	-0,70	-366.263	386.041	-0,95
AMAZONAS	157.741	416.105	1.341.588	925.066	1.757.276	0,53	-258.364	573.847	-0,45
PARÁ	108.525	983.928	922.639	-61.841	1.906.015	-0,03	-875.403	1.092.453	-0,80
RONDONIA	30.911	364.716	390.525	25.708	755.139	0,03	-333.805	395.626	-0,84
RORAIMA	6.965	272.099	60.505	-211.620	332.579	-0,64	-265.135	279.064	-0,95
TOCANTINS	8.927	584.713	175.264	-409.526	759.900	-0,54	-575.786	593.640	-0,97
NORTHEAST	1.385.373	8.989.434	8.969.995	-23.806	17.955.061	0,00	-7.604.061	10.374.807	-0,73
ALAGOAS	59.052	649.948	432.395	-217.771	1.082.125	-0,20	-590.896	709.000	-0,83
BAHIA	430.661	1.956.292	2.918.234	960.521	4.873.104	0,20	-1.525.631	2.386.953	-0,64
CEARÁ	230.606	1.275.324	1.430.507	154.561	2.705.210	0,06	-1.044.718	1.505.930	-0,69
MARANHÃO	61.756	1.160.653	476.489	-684.477	1.636.828	-0,42	-1.098.896	1.222.409	-0,90
PARAÍBA	92.549	812.479	543.015	-269.642	1.355.315	-0,20	-719.930	905.028	-0,80
PERNAMBUCO	326.801	1.230.662	1.883.371	651.654	3.112.978	0,21	-903.861	1.557.464	-0,58
PIAUI	62.892	684.355	337.767	-346.694	1.022.017	-0,34	-621.464	747.247	-0,83
R G DO NORTE	74.129	666.871	533.425	-133.715	1.200.028	-0,11	-592.743	741.000	-0,80
SERGIPE	46.926	552.849	414.792	-138.242	967.456	-0,14	-505.923	599.776	-0,84
CENTER WEST	1.614.443	1.504.105	4.729.524	3.458.574	6.466.785	0,53	110.337	3.118.548	0,04
DISTR. FEDERAL	1.286.081	98.236	1.359.142	1.131.945	1.328.417	0,85	1.187.845	1.384.317	0,86
GOIÁS	187.886	672.600	1.855.070	1.181.528	2.526.728	0,47	-484.714	860.486	-0,56
MATO GROSSO	84.300	437.324	1.048.149	610.470	1.485.118	0,41	-353.024	521.624	-0,68
MATO G DO SUL	56.176	295.946	831.173	534.631	1.126.522	0,47	-239.770	352.121	-0,68
SOUTHEAST	15.982.049	4.812.785	46.327.124	41.475.938	51.101.507	0,81	11.169.265	20.794.834	0,54
ESPIRITO SANTO	624.738	418.040	1.849.847	1.431.075	2.267.155	0,63	206.698	1.042.778	0,20
MINAS GERAIS	1.492.810	2.016.610	6.804.340	4.783.482	8.816.702	0,54	-523.801	3.509.420	-0,15
RIO DE JANEIRO	2.932.570	578.803	7.279.362	6.692.045	7.849.651	0,85	2.353.767	3.511.373	0,67
SÃO PAULO	10.931.932	1.799.331	30.393.674	28.569.337	32.167.998	0,89	9.132.601	12.731.263	0,72
SOUTH AREA	2.413.284	3.032.921	10.903.097	7.863.044	13.928.887	0,56	-619.637	5.446.205	-0,11
PARANÁ	832.220	1.137.990	3.691.590	2.550.349	4.826.329	0,53	-305.769	1.970.210	-0,16
R G DO SUL	1.123.933	1.210.576	4.777.472	3.564.453	5.985.604	0,60	-86.643	2.334.508	-0,04
STA CATARINA	457.131	684.356	2.434.035	1.748.242	3.116.953	0,56	-227.225	1.141.487	-0,20
TOTAL	21.727.365	21.727.365	74.131.579	52.404.214	95.858.944	0,55	0	43.454.730	0

Adapted from STN

Data refer to 1998

Starting from the demonstration above, it is also evident, the development inequalities and of wealth concentration in what we can call “two Brazils”. Then, the importance of the government action in the promotion of the scientific and technological development, investing decisively in the less favored areas, by establishment of rules where, in the future, the productive activities will be distributed, improving the work opportunities and income. By better distribution of investments in science and technology, the Federal Government will be altering the

direction of future inequalities of income. When favoring the areas less developed, giving them conditions of increasing the rhythm of their development and creating conditions to attract investments and productive initiatives, they are drawing the map of a more homogeneous nation, with more maintainable national objectives in the future times. Otherwise, if the public power concentrate their investments in the areas more developed, it will be weakening the federative pact, pushing the country for a confederate entity.

Unhappily one can see that Brazil is a country of continental dimensions, is extremely unequal. The North and Northeast, among the five areas, are those that present the worst social and economical indicative. Although more recent data exhibited more optimistic expectations with relation to the infant mortality and school frequency, the opening of new economical opportunities is still constituted in a challenge to be overcome. That because the country does not count with a national politics with focus on the regional development that aims to lessen the enormous existent moat among the areas more favored and the fewer developed economically. The inequalities among the South and Southeast areas and the North and Northeast areas are big and the aloofness large.

The government intervention is the most immediate form of promoting the movement of goods, capital and work, by the establishment and adoption of a national plan with focus on the regional development. If not configuring that politics, what would make possible the only opportunity of change for some, it becomes an easy way of larger concentration for other. The logic of the accumulation of the capital, in natural course, takes that concentration. It is the own natural force that acts to attract the new investments and of that it results the increase of the regional disparities today existent.

The fact is that most of the Brazilian states - except those already in franc development – do not have direct budget resources for execution of a politics of attraction of investments. It would fit, for the natural order of things, to the Union to elaborate and to place in practice a national plan with focus on the regional development, as more immediate and effective form of making possible the movement of goods, capital and work.

2.2 - Inequalities x Development x Tributary Competition

Being treated of a country with vast territory, it has been difficult for the Union to establish, short term, measures that minimize the regional inequalities in Brazil. The government action is fundamental to lessen the existent differences. Among those actions, the government has presented opportunities to increase the development rhythm, attracting investments and productive initiatives, for areas until then less favored of own revenues.

It happens that, no doubt, actions in that sense will trigger countless consequences, sometimes disastrous: if the Union converges development actions for certain area, fiscal incentives should surely be offered for the taxpayers that there will settle down, as form of compensating other costs (transportation of the production, for example). It enters in action the tributary competition.

Traditionally, the phenomenon of the tributary competition has been happening in federative countries above all in those where the subnational governments possess wide fiscal autonomy. The competitive process happens when a certain government, acting in way non-cooperative, it is used of that autonomy and it implements tributary measures that influence the other governments' economical and social results. According to Mintz and Tulkens

(1986), tributary competition exists when “a government's fiscal decisions affect the other governments' tributary revenues. Typically, by the alteration of their aliquots relatively to the aliquots of other areas, each government has the possibility to modify the size of their tributary base to the costs or their neighbors' benefit”. Like this, the tributary competition can be understood, basically, as an external problem.

This vision that the inefficiencies generated by the tributary competition came from external problems, several authors share it. In fact, the great problem of the federative environment competitive is that the states do not take in consideration, when they decide subjects of tributary politics, the consequences of their decisions on other States. To solve the problem, Wildasin (1989), basing on the theory of the external, suggests the existence of a intergovernmental system of subsidies, that will internal the external damages generated by the tributary competition, neutralizing their effects. However, once again, States would be hostages of the Union, which enters making up the situation with superficial solutions and without stanching the problem in its cause.

Recently, two factors collaborated for the worsening of the competitive phenomenon: the invigoration of the federalism and of the fiscal decentralization, starting from the political opening happened in several countries, and the intensification of the process of economical globalization, that has been expanding the border of the tributary competition for the international ambit. Like this, the tributary competition has been turned more and more intense inside of the federations, at the same time in that also starts to be present in the relation among countries. Being a phenomenon of importance, relevant for the public finances of several nations, the tributary competition became object of study of the economical theory starting from the second half of the century.

It is interesting to observe, still, that the modern approach of the tributary competition also studies their impacts on the public expenditures, passing the idea of a wider concept, which includes the fiscal competition. Wildasin (1988) besides, differently of the other competition models, he works with the hypothesis that the level of expenditures is the strategic variable and the revenues vary passively. Keen and Marchand (1997) show that competition among the areas does not just take at an inefficient level of expenditures, but also the inefficiency in its composition. In other words, the government privilege expenditures that affect the productive side of the economy (infrastructure), in detriment of expenditures with the consumption (parks, libraries or social services).

2.3 Brazilian tributary system

The current composition of the Brazilian tributary system is described below in the table, in which we underline those that are the base for the formation of the Federal financial transfers, at the federal government's level. The others are for terms a notion of the tax burden in Brazil:

CATEGORY	GOVERNMENT	TAX OR CONTRIBUTION
Trade external	Union	Tax about import Tax about export
<u>Patrimony and income</u>	<u>Union</u>	<u>Income tax – IR</u> Tax on the rural and territorial property – ITR
	States	Tax on property of Vehicles – IPVA Tax on transmission Causes Mortis and Donation – ITCD
	Municipalities	Predial tax and Urban Territorial – IPTU Tax on transmission alive Inter – ITBI
<u>Production and Circulation</u>	<u>Union</u>	<u>Tax on industrialized products – IPI</u> Tax about financial operations – IOF
	States	Tax on circulation of goods and services – ICMS
	Municipalities	Tax on services – ISS
Social contributions	Union	On the leaf of payments – INSS For the financing of social securities – COFINS For the program of social integration – PIS For the formation of the patrimony of the public server – PASEP About financial movement – CPMF On the net profit – CSLL
	States and municipalities	On wages for costing of your employees' precaution

One of the main existent problems in any federation concerns the distribution of the tributary bases between the governments and the subsequent partition of the tributary revenue. This is the reason the federation plays the fundamental role about the possibility of occurrence of tributary competition between several governments. The Brazilian practice of attribution of revenues, in spite of not being very distant of the theoretical recommendations, presents a serious distortion in what it plays to the taxation of the consumption. The peculiar characteristic of the Brazilian system, that distort the international pattern, is the

fact of two taxes imposed on consumption, of the type aggregate value, administered by levels different from government: IPI, that just happens by the manufacture goods, and ICMS, paid by the consumer of goods. Truly, the bases of those two taxes are similar, as well as their acute methods, what would allow a consolidation of the same ones in an only tribute, in a way to obtain a larger economical rationality and smaller administrative cost, as much for the public section as for the private. However, besides IPI and ICMS, they also apply the goods and service the ISS, COFINS and PIS/PASEP³. Like this, the consumption is taxed for the three spheres of government in a complex way, submitting, besides, to the taxation cascade, thwarting the Constitutional principles. Consequently, it resides in this point one of the largest federal problems and of tributary competition of Brazil.

2.4 - Distribution and impact of the national tax burden

Historically, the tax burden has been increasing. Of an inferior level to 20 percent of GDP in the beginning of the sixties, it passed an average of 25 percent in the seventies, because of the implemented reforms from the military government. Those reforms modernized the system, preparing it for the years of growth of the "Brazilian miracle" (1967-74). An average of 25 percent in the seventies, the tax burden of the country stayed stagnated during the eighties, the worst time of the economical crisis.

The collection of taxes in Brazil is quite sensitive to the acting of the economy, once there is great concentration of the tributes on sales in relation to

³ COFINS and PIS/PASEP, in spite of formally they place on the revenue of the companies, they are incorporated easily for the prices of the goods and services, burdening, ultimately, the final consumer. It is worth mentioning, besides, that those contributions have the undesirable characteristic of possessing incidence in cascade.

those that happen on the patrimony. Like this, the best results are obtained in the phase of full success of the plans of stabilization of the economy, above all when allies to inflationary control and economical growth. In 1998 the total of revenues collected by the three government levels added R\$269 billion⁴, corresponding to 30 percent of GDP. The Union participated with 69.34 percent of that amount, while States and Municipalities were responsible for 26.39 percent and 4.27 percent of the tax burden, respectively. This way, of course " Plano Real " contributed so that the collection reached the historical level, overcoming most of the developing countries.

TABLE III - DISTRIBUTION OF THE TAX BURDEN

percent

		1992	1993	1994	1995	1996	1997	1998
U	Total own collection	67.66	71.79	69.45	67.29	66.82	68.05	69.34
	Transfer for States	5.86	6.32	5.59	6.33	6.18	5.99	5.31
	Transfer for Municipalities	4.58	4.85	4.07	4.58	4.47	4.48	4.23
	REVENUE AVAILABLE	57.23	60.61	59.79	56.38	56.17	57.58	59.80
S	Total own collection	28.50	25.19	27.17	28.04	28.34	27.34	26.39
	Transfer for Municipalities	6.95	6.19	6.55	6.78	6.87	6.69	6.48
	Transfer of the Union	5.86	6.32	5.59	6.33	6.18	5.99	5.31
	REVENUE AVAILABLE	27.41	25.32	26.21	27.59	27.65	26.64	25.21
M	Total own collection	3.84	3.03	3.38	4.67	4.84	4.61	4.27
	Transfer of the Union	4.58	4.85	4.07	4.58	4.47	4.48	4.23
	Transfer of the States	6.95	6.19	6.55	6.78	6.87	6.69	6.48
	REVENUE AVAILABLE	15.36	14.07	14.00	16.03	16.18	15.78	14.99
TOTAL		100.00						

With relation to the distribution of the tax burden, it is verified in table III, that the Union is a donor of resources for all the federation, because it collected 69.34 percent of the liquid tax burden and it transferred almost 10 percent at the levels of subnational government. The states receive resources from the Union, but they also transfer resources to the Municipalities. They transfer a small part of their revenues for government's local levels. The Municipalities are, therefore, the great

⁴ Source: SRF/COGET

beneficiaries of the Brazilian system of Federal financial transfers. It is worth pointing out that, in function of the own mechanism of transfers, all the available collection of the Union originates from their own revenues. The states collect about 80 percent of their available revenues, while the Municipalities, this relation is of 28.49 percent only. It is important to point out that is a medium indicator, that is, we cannot generalize once there are Municipalities that possess their own collection in satisfactory levels. However, the great majority is dependent of the redistribute of the transfers for maintenance of costing and other basic activities.

3 – Formation of the base for partition

3.1 Origin of the Federal financial transfers

Besides the attribution of tributary competencies, the Constitution also establishes share rules and intergovernmental transfers of revenues, with the principal objective of correcting regional inequalities. Truly, Brazil, in function of their great territorial extension and regional diversity, possesses serious vertical and horizontal unbalances in their federalism. The system of transfers seeks to minimize those problems, adapting the readiness of revenues to the responsibilities of expenditures among the three government levels. It also redistributes resources of the jurisdictions more developed for those with less potential economical-tributary. There are basically two types of possible transfers: the constitutional ones, which are automatically accomplished after collection of the resources and the not constitutional, which depend on agreements or political will among governments. The Federal financial transfers can be classified in direct transfers (they redistribute part of the collection for certain government) or indirect

transfers (by the formation of special funds). However, independent of the type, the transfers always from the high government level to lower government level.

Table “I” shows the taxes that are transferred directly to States and Municipalities and their respective percentile of distribution. Table “II” presents the constitutional funds, from which the indirect transfers are composed by the collection the Tax on Industrialized Products - IPI and from Income Tax⁵ - IR.

TABLE I - DIRECT CONSTITUTIONAL TRANSFERS

GOVERNMENT DONOR	GOVERNMENT RECEIVING	TAX TRANSFERRED	PERCENTILE TRANSFERRED
Union	States and municipalities	Tax retained in the source by the state or local government	100%
Union	States and municipalities	Financial operations on the gold	30% 70%
Union	Municipalities	Territorial rural property	50%
States	Municipalities	Circulation of goods and services	25%
States	Municipalities	Property of vehicles	50%

Source: Federal constitution of 1988

TABLE II - INDIRECT CONSTITUTIONAL TRANSFERS (FUNDS)

TYPE OF FUNDS	FEDERAL TRIBUTE	
	IR(%)	IPI(%)
Participation of States and Federal District (F P E)	21.5	21.5
Participation of the Municipalities (F P M)	22.5	22.5
Compensation of the Exports (FPEX)	-	10.0
Financing of the North area (FNO)	0.6	0.6
Financing of the Northeast (FNE)	1.8	1.8
Financing of the Center-West area (FCO)	0.6	0.6
TOTAL	47.0	57.0

Source: Federal constitution of 1988

3.2 - Types of transfers

3.2.1 – Legal or constitutional transfers

Transfers represent the established funds in the Brazilian Constitution created by the government and that, generically, can be defined as the product of specific revenues that, for law, are linked to the accomplishment of certain objectives. All of them are characterized as funds of an accounting nature. This

⁵ The table II presents relative data to the federal financial transfers to States and Municipalities for the year of 1998.

means that their resources are distributed automatically to States and Municipalities in accordance with coefficients and established distribution rules that have been previously published. The revenues and expenditures should be foreseen in the budget and their execution, counted in a specific way. They are as follows:

FPE - Fund of Participation of States

FPM - Fund of Participation of the Municipalities

FUNDEF - Fund of Maintenance and Development of the Fundamental Teaching and of Valorization of the Teaching

ITR - Rural Territorial Tax

IOF-GOLD - Tax about financial operations with Gold

Other funds whose amount does not have a lot of importance.

In this paper, we will deal with the three first and more important funds.

3.2.2 - Volunteers Transfers

These represent the financial resources transferred by the Union for States, Federal District and Municipalities due to celebration of agreements, fittings or other similar instruments, the purpose of which is the accomplishment of infrastructure works and basic sanitation or services of common and coincident interest to the government's three spheres.

The portion transferred for each area depends on the administration exercised by the parliamentarians that represent their community, which falls within the ambit of the Camera of the Deputies and of the Federal Senate, which will define the priorities at national level.

3.3 - Attributions and Responsibility

Due to the fact that they are a polemical subject, the composition and distribution of all the funds are the object of rigorous control and inspection. Those tasks are exercised by the Federal Court of Accounts - TCU, an auxiliary organ of the Brazilian National Congress that, besides overseeing the correction of the values of funds redistributed by the Union to States and Municipalities, attempt to accomplish the legal periods for liberation of those resources. The Congress also oversees the Secretary of Internal Control of Treasury Department – Ciset. This Secretary controls the transfers in level of budget execution, verified if the resources of each source are being liberated appropriately.

To execute the control and inspection of transfers, there are periodic audits in the systems used in the ambit of Treasury Department, and the Bank of Brazil. Every ten days, the Secretary of National Treasury - STN, carries out examinations into the transfer.

3.4 - Agencies Involved in the Control and Distribution of the Resources:

The Secretary of the Federal Revenue – this body inspects the collection of the federal tributes; it supervises the transfer of resources from bank networks for the Central Bank. It also manages the system of classification of revenues and supplies the collection estimate of Income Tax and of Industrialized Products Tax;

SERPRO - makes the processing of the collection generated by the bank associate, for classification of the collected revenue.

Federal Court of Accounts - calculates and publishes the individual coefficients of participation, supervises the process of classification of the revenue and the delivery to the beneficiaries, in the form and periods legally established.

Secretary of National Treasury - calculates the due values to the participation fund and gives them to the Bank of Brazil S. A, for credit to the beneficiaries, publishes the amount given to the Fund and the values credited to each state and Municipalities, elaborates and publishes the estimates every ten days, monthly and an annual report of the behavior of the funds.

Bank of Brazil S A - calculates, with base in the coefficients published by TCU, the values given to each beneficiary, crediting them in opening specific bank accounts for that purpose.

4 - STATES PARTICIPATION FUND

4.1 - Composition

Of the total revenue of collection of the federal tributes, regarding the payment of Income Tax (I.R.) and Industrialized Products Tax (IPI), are deduced the fiscal incentives (FINOR, FINAM and FUNRES) and the restitution. Starting from the liquid value, 21.5 percent constitute resources destined to F P E - States Participation Fund

4.2 - Forms and distribution period

The quota of FPE destined for each State was established after meeting with all the State Secretaries of Finance. They defined individual coefficients, as enclosure of the Complementary Law number 62/89 December 28, 1989 (see table IV). To find the value of FPE due to each State, it is enough to multiply the total value for the individual coefficient.

TABLE IV - COEFFICIENTS OF PARTICIPATION OF THE STATES

STATES	COEFFICIENT (%)
Acre	3.4210
Alagoas	4.1601
Amapá	3.4120
Amazonas	2.7904
Bahia	9.3962
Ceará	7.3369
Distrito Federal	0.6902
Espírito Santo	1.5000
Goiás	2.8431
Maranhão	7.2182
Mato Grosso	2.3079
Mato Grosso do Sul	1.3320
Minas Gerais	4.4545
Pará	6.1120
Paraíba	4.7889
Paraná	2.8832
Pernambuco	6.9002
Piauí	4.3214
Rio de Janeiro	1.5277
Rio Grande do Norte	4.1779
Rio Grande do Sul	2.3548
Rondônia	2.8156
Roraima	2.4807
Santa Catarina	1.2798
São Paulo	1.0000
Sergipe	4.1553
Tocantins	4.3400
TOTAL	100.00

Complementary Law determines that of the total value of FPE, 85 percent are going to the states of the North, Northeast and Center-west areas and 15 percent for the states of the South and Southeast areas, with the composition

demonstrated to proceed: Northeast area	52.46%
North area	25.37%
Southeast area	8.48%
Center-west area	7.17%
South area	6.52%

The information on the Federal financial transfers are published by the Secretary of National Treasury - STN for the Federal Police stations of Control, located in the capitals, besides other available communication means in the government.

The value to be transferred is calculated automatically by the Bank of Brazil, with base in the information of the Secretary of National Treasury and the preset coefficients. As dictated above, these transfers happen every ten days, in decreasing values, due to the factors that are published by STN, during the month. In agreement with the Constitutional Amendment 14/96, of the total value of each liberation, 15 percent constitutes resources destined to FUNDEF, that we will see further on.

5 - MUNICIPALITIES PARTICIPATION FUND

5.1 - Composition

Of the total collection of the federal tributes, regarding the payment of Income Tax (I.R.) and of Industrialized Products Tax (I.P.I.), are deduced the fiscal incentives (FINOR, FINAM and FUNRES) and the restitution. Starting from the liquid value, 22.5 percent are destined to F P M - Municipalities Participation Fund. As an example of what happens with F P E, of that amount, 15 percent constitutes resources transferred for FUNDEF.

5.2 - Forms and distribution period

As it establishes the National Tributary Code, of the value destined to FPM, 10 percent are distributed among the capitals, 86.4 percent between the other municipalities and the remaining, 3.6 percent are distributed among the

municipalities of the city with more than 156,216 inhabitants, in agreement with the Decree Law of 1981.

As it happens with FPE, the resources of FPM are also distributed with base in coefficients. Those coefficients are defined through IBGE - Brazilian Institute of Geography and Statistics, the department responsible for the accomplishment of the demographic census, that makes the rising of the number of inhabitants of each municipalities and informs to TCU. With this information, TCU establishes the individual coefficient of participation of each municipality. The minimum coefficient, of 0.6 percent, is used for municipalities with up to 10,188 inhabitants; for the municipalities that are between 10,188 and 156,216 inhabitants, were defined 16 population groups, fitting to each one of them a different coefficient. For all the municipalities of the country with more than 156,216 inhabitants, the coefficient was fixed at 4.0 percent.

Two municipalities located in different states in the same population group, will have the same coefficient but they won't receive the same value of FPM because the percentile of participation for each state is different, depending on the area that is located in, as we will see:

Northeast area	35.22%
Southeast area	31.22%
South area	17.61%
North area	8.52%
Center-west area	7.43%

The coefficient of municipalities can be altered when its population changes, confirmed through data from IBGE. In this case, if there is alteration of the

population group of the municipalities, TCU is informed and proceeds to the reasonable alterations the following year, through normative decision.

When the coefficient of municipalities increases, the value of their financial quota also increases, while the individual quota of all the other municipalities of the same states decreases. This happens because that increase will be deducted of the financial quota of the other municipalities of the state. If the coefficient decreases, the other municipalities of the states will benefit, with the increased quota.

Having alteration of coefficients in many municipalities of the same state, the effects on the individual quota of each one will depend on the relation between the change of their own coefficient and that of the other Municipalities. In this case, it will even be able to have reduction of the individual quotas of municipalities that have elevated their coefficient.

5.3 - Creation of new Municipalities in the state

When that situation happens, the individual quota of FPM of the existent municipalities in the State decreases. This because the new municipality will also receive individual coefficients of participation that will be added to the existing ones for the distribution of FPM, destined to the State. As the participation of the State in the global quota of FPM stays the same and the number of participants increases, the individual quota of all decreases.

In the same way that happens with FPE, the quotas of FPM are also distributed every ten days, with base in the collection period of IR and of IPI, or be the collection from the 1st to the 10th, will be distributed in the 20th of the same month; from the 11th to the 20th, in the 30th of the same month; the collection of the

21st to the last day of the month, will be distributed in the 10th of the subsequent month.

6 - FUNDEF

6.1 Objectives

For several historical reasons, the offer of teaching in Brazil grew in a differentiated way in the twenty-seven units of the federation. In general, in the South and Southeast areas, the participation of the state networks became more unified, getting to review more than 90 percent of registrations in São Paulo and approximately 80 percent in Minas Gerais. The North and Northeast, felt the inverse phenomenon, falling to the municipal networks to assume larger responsibilities for the offer of the fundamental teaching, as is the case of Maranhão, where the municipalities answered for 68 percent of the registrations of this teaching level.

The effective Federal Constitution determined that a minimum of 25 percent of the tributary revenues of States and Municipalities, including the resources received by transfers among governments and of 18 percent of the federal taxes, must be applied to Education. However, in spite of that order it was well - known that wasted resources, often became diverted from Education for other purposes.

Besides, to the fact of the capacity of investment of States and Municipalities to depend on their collection capacity, over time great distortion appeared. In the areas with larger educational traditions, as the South and the Southeast, the states developed wider networks of school attendance, liberating the municipalities of a proportional investment to the growth of their collection capacity. To the opposite, in the areas less developed, in the North and Northeast,

the expansion of school attendance is more recent, promoted by the municipalities in a superior rate of growth of their collection capacity. As a result, it was observed that the richest municipalities left of spending their 25 percent in the fundamental teaching, at the same time, the poorest municipalities did not have enough resources to assure quality teaching and were forced to pay very low wages to the teachers, a factor of widespread discouragement.

This unequal picture of division of responsibilities with educational area generated serious distortion. In fact, it was verified frequently that the richest municipalities, located in the developed areas of the country, did not apply the 25 percent of their revenues in the obligatory fundamental teaching, destining most of these resources for the intermediate teaching and even for the higher education. They did not accomplish, therefore, the responsibility of assuring, in partnership with other States, the universality of Fundamental Teaching, base to prepare the students that need to have access to intermediate teaching and later, University.

The existent mechanisms previously for the distribution of the federal and state tributary revenues for states and municipalities and of part order of those revenues to the Education did not guarantee equality, for they were linked to non educational criteria, such as per capita income and total population. With some exceptions, the capacity of investment of states and municipalities were inversely proportional to the responsibilities of each one in the maintenance of the networks of fundamental teaching.

The creation of the Fund of Maintenance and Development of the Fundamental Teaching and of Valorization of the Teaching - FUNDEF, through the Constitutional Amendment 14/96 and their regulation for the Law 9.424 of 12/96, with their subsequent implementation, starting from January of 1998, constitute

one of the largest advances in search for a solution of the problems of public fundamental teaching of our Country; which is currently of that inequality caused by the perverse distribution of income. Since then, it started to invigorate the new systematic of redistribution of the resources destined to Fundamental Teaching.

With this initiative, the government answered to the commitment assumed with the Brazilian society of giving priority to the universality and improvement of the quality of obligatory teaching. The larger objective was to compel the process with the speed required by the social demands to reach in an incisive way in the correction of the bad distribution of resources, root of the existent inequalities.

The importance of that step is represented by the depth of the introduced changes and for the new criteria adopted for distribution of resources linked to education, as well as for reaching positive results medium term, that will be reflected in the educational indicators of the whole country, particularly in the municipalities and more lacking areas. The most important part of FUNDEF consists of a change in the structure of financing at fundamental teaching in the country to direct a portion of the resources for that teaching level. Additionally, it introduces new distribution and use criteria for corresponding resources, promoting the share of resources between State and Municipal Governments in agreement with the student number registered in each teaching network.

FUNDEF is an innovative example of social politics that articulates the three government levels and motivates the participation of society so that the following strategic objectives are reached:

- **To Promote social justice** - the focus is 32,4 million students of public schools of fundamental teaching and the largest beneficiaries of the new criterion of

distribution of resources are the states and municipalities of the poorer areas of the country;

- **To Promote a national politics of justness** - the resources linked to the obligatory teaching are redistributed between each State and their Municipalities in agreement with the number of students assisted in their networks. It is the responsibility of the Federal Government, to add value to the Fund whenever the annual minimum value is not reached by the student;
- **To promote effective decentralization** - the state and municipal network's teaching start's to come from proportional resources to their expenditures which motivates the State and Municipal networks to increase their offers of registration and offers conditions to maintain the children's presence in the schools;
- **To promote the improvement of the quality of education and valorization of public teaching** - the prior resources are destined for the improvement of remuneration levels, qualifications teachers and to the construction of quality public school.

6.2 Origin of the resources

The fund is composed basically for resources the States collect through ICMS, for original resources of sources already in existence and supplemented by the resources of the Union, constituted with 15 percent of the following portions:

- States Participation Fund - FPE
- Municipalities Participation Fund - FPM
- Tax on Circulation of Goods and Services - ICMS
- Tax on Industrialized Products, proportional to the exports – IPI Exp

- ICMS “desoneração” (Law 87/96)
- Supplemented by the Union, when the amount does not reach the minimum value for each student.

6.3 Distribution criteria

The distribution of the resources is made through the individual coefficient of participation established by the Ministry of Education and Culture - MEC, calculated with base in the number of students registered annually from the first to the eighth grades of fundamental teaching, in the registered schools of respective teaching networks. Additionally, it defines a minimum value, nationally, to be invested by student/year⁶. In the States or Municipalities what the per capita value is inferior to that minimum, the Union provides the difference. The Bank of Brazil S.A. credits the values automatically every month, in different dates, in agreement with its origin.

The criterion used by FUNDEF to redistribute these resources does not provoke revenue loss for States. To the opposite, the donations of the Union to the Fund, assures additional resources to States and Municipalities of the most lacking areas, guaranteeing that the minimum value for student/year defined nationally be reached without any transfer of resources from one State to another.

It is ended that, without an increase in the tax burden, this measured is favored by only the educational section, through the public network of Fundamental Teaching that today is responsible for the attendance of 32.4 million of students.

⁶ For the year of 1998 that value was of R\$315,00

6.4 Application of the resources

The resources of FUNDEF should be used exclusively in the maintenance and development of the fundamental teaching and, particularly, in the valorization of their teaching.

Of the total resources in the fund, 60 percent should be applied to the professionals' of the teaching remuneration for effective exercise of their activities in the respective teaching networks, however, the use of part of those resources in the teachers' training, should be allowed until the year 2001. The remaining 40 percent should be applied to the maintenance and development of the fundamental teaching as construction, extension, conclusion or reform of schools, teachers' training, acquisition of didactic material and of equipment, several services and payment of retired employees.

The institution of the fund and the application of their resources do not exempt States, the Federal District and Municipalities from the compulsory nature of applying, in the maintenance and development of teaching, in the form foreseen in Art. 212 of the Federal Constitution of 1988:

- At least 10 percent of the amount of original resources of ICMS, FPE, FPM, portions of IPI Export and ICMS “Desoneração”. Like this, the resources foreseen for the fund, added to the referred above, should guarantee the application of, at least 25 percent of these taxes and transfers in favor of the maintenance and development of teaching.
- At least 25 percent of the other taxes and transfers. About this resources not less than 60 percent should be applied in the maintenance and development of fundamental teaching.

In each state and in each Municipality FUNDEF should be supervised by a Council of Accompaniment and Social Control, with the attribution of supervising the fund and school census. In the ambit of the municipalities, the minimum composition of that advice is four members, representing:

- The Municipal Secretary of Education or equivalent Institute;
- The teachers and the school directors;
- The students' parents;
- The servers of the schools.

A fifth member, representing the Municipal Council of Education, is obligatory in the municipalities where this advice exists.

The state or municipal executive power is forced to give the advice of FUNDEF, all the data and information about the resources and their use, monthly. The Bank of Brazil, when required, supplies a bank account extract of FUNDEF to members of the commission, deputies, councilmen, public prosecution services and tribunals of the court. All the data should still be published by other available communication means.

6.5 Obtained results

With the new redistribution criterion of the resources and the guarantee of a significant portion of the fund for maintenance of teaching, important transformations happened. It was suggested that governments' resources has been moved from areas with larger financial capacity and a low participation level in school attendance toward the municipalities with inverse situations. After that, more than 2,700 municipalities obtained financial earning with FUNDEF in 1998,

and over 3,200 municipalities in 1999, according to data from the Department of Accompaniment of the Fund.

Another expressive change was the elevation of 6 percent in the registrations in agreement with the school census, between 1997 and 1998. Previously, the average of annual growth was about 3 percent. It was verified, at the same time, important modification in the state and municipal governments' participation in the attendance to the fundamental teaching. In 1997, the municipalities assisted 40.7 percent of the students and the states 59.3 percent. In 1999, participation was 49.4 and 50.6 percent, respectively.

With relationship to the remuneration of the teaching, between 1997 and 1998, an improvement salary average of 13 percent was verified for the professionals exercising in the state and municipal systems of the country according to the research of Fipe-USP. In the Northeast, those earnings reached 49 percent of the average of municipal networks.

During the first year of implementation, FUNDEF made important progresses in relation to the proposed objectives. However, it is important to point out that this is a preliminary evaluation, centered on their financial impacts, produced starting from the time where the accompaniment work that has been created by the Ministry of Education since the implementation of the Fund, with the collaboration of other Institutes of the Federal Government and of the state and municipal Secretaries of Education.

The effects of the new form of distribution of the Fund point to their different impacts, in agreement with the analyzed areas. The most expressive effects registered until then converges for the North and Northeast areas, where the municipalities had earned up to superior revenues of 10 percent in the following

proportion: 85 percent of the small ones, 94 percent of the medium ones and 78 percent of the great Municipalities.

The growth of the number of registrations in the Fundamental Teaching, from 1997 to 1998, was accompanied by an expressive increase in the number of teachers, above all of the municipal networks. Estimates done start from the result of research completed by sampling, points to openings of 50 thousand new vacancies in public teaching. To accompany this growth, it is calculated that about 20 thousand new positions in the section of administrative support in the school networks will be create.

7 - Results of the Federal financial transfers and its consequences

7.1 - Regional justness

The process of making the economic situation of the different areas in Brazil more egalitarian is dragging through the years. Since the seventies, the flags of the fiscal decentralization and of weakness are the central power occupied a prominent position in the idea of the march toward democracy in the country. In that aspect, we can consider the movement victorious, because since the beginning of the eighties, there was a strong increase of transfers of federal taxes in favor of the subnational governments. Since to approval at the new Constitution, the capacity of subnational governments to regulate the taxation in their own spheres was also strengthened and consolidated. In the case of States, the incidence of the tax was enlarged on sales taxes - ICMS that absorbed old federal taxes. The aliquots were also liberated, leaving each state to operate according to their interests and needs. At the same time, the transfers of that tax to the Municipalities were increased by 25 percent.

In fact, the Municipalities have always been the largest beneficiaries of the process of fiscal decentralization, whose available revenue (own collection plus transfers) increased sensibly since 1980. This is because besides they count with more distribution from the Union and States it has also been looking to improve their own collection significantly.

Like this, it is important to become clear in an appealing point in the analysis of the public finances in the country: the decentralization of revenue and its more uniform distribution, did not begin after the Constitution of 1988. The one that the Constituent Assembly promoted was the regulation and a proposal of better evaluation of the distribution process of federal resources.

Besides having just consolidated a tendency of the whole decade of eighty, the tributary system post-1988 only provoked an increase of the local governments' participation in the available revenue. The states maintained, until 1996, the same percentile that they had at that time of the constitutional alterations. Furthermore, the correct conclusion is that the new system consolidated and regulated a process that already happened long time ago. It benefited, in terms of available resources, just the Municipalities, in detriment mainly of the Union and also of States.

At the same time, the process of decentralization of the tributary revenues and of the tax power in Brazil was occurring another very important process, in equally intense rhythm, happened. This was the regional decentralization of the tributary revenues of the subnational governments. The governments of the less developed areas of the country earned more revenues than the more developed areas, above all when computed the resources of the state governments.

The process of regional decentralization already showed during the validity of the tributary system before to the constitutional alterations, largely certain for the

regular partition of revenues. After the reform of 1988, that process was intensified, above all in terms of the resources of the States. In this sense, the National Tributary System presents character innovation, once it promotes the transfer of coming resources of the tributary collection from the center-south-southeast to the north-northeast of the country. Nevertheless the justness at national level has been slow, such was the existent abyss.

7.2 - Federalism as Government form

Since their creation, after the proclamation of the republic in 1891, the Brazilian Federation was not born to assist a coalition “from bottom to top” but by decision “from top to bottom”, by the unfolding of a unitary State. Concerning the tributary system, such federation interested, above all, the developed provinces of the South and Southeast, especially São Paulo, which has concentration of export industries. Among other objectives, it intended to get more freedom to impose local taxes about on the exports. In compensation, it offered a larger representation in the Legislative Power to the less developed areas.

This way, the historical antecedents of the federalism in Brazil reveal, in the republican period, a cyclical tendency. Monitoring the moments of centralization and decentralization of the political regime, bigger and smaller participation by the state and local governments were registered in the collection and in the public expenditure. The experienced transformations for the Brazilian federation in the last thirty years are clear evidence in this sense. We can observe, starting from the reform promoted by the military government in the sixties, a deep centralization of tributary resources in the federal government's hands, that redistributed them through by regulated releases and agreements, which were all resultants of political negotiation.

The Federal Government implemented a model of governors and mayors' submission to the public politics. The model ignored the criteria of distribution of the resources and gave completely subjective information. This process served to enlarge the level of regional inequalities.

As the political system was transforming, it allowed a larger participation of local and regional leaderships in the division of the power. This allowed the governments to acquire more portions of public resources. The process culminated with the Constituent Assembly of 1988, which determined a wide partition of tributary resources in benefit of States and Municipalities.

To understand the context that has been processing the fiscal decentralization in Brazil, it is necessary to consider the deep political, economical and even cultural inequalities that have taking place. The poorest areas of the North and Northeast of the country present low development indicators to the average and, at the same time, it has upper political representation, in relative terms, to the richest areas, located in the south-southeast. This is a reflection of negotiations badly elaborated in a recent past.

7.2.1 -Autonomy

The chapters of the tributary system in the Federal Constitution, as well as the Complementary Laws that regulate them are clear and detailed regarding the competencies and responsibilities in the partition of the tributary revenues. However, each one of the three government levels lacks of more precision, establishing the distribution of the tasks among the involved spheres.

In synthesis, there is overlap of actions of some areas and lack in other and the Federal Government has not been getting to exercise its coordination function

satisfactorily, leaving that the subnational governments adopts politics autonomous. If the Federal Government or even some states, on one side, shrink their participation in the investments and programs of continuous duration, they do not transfer personal and goods for the States or Municipalities generating an increase not foreseen of joined public expenditures.

The indicators of the fiscal decentralization, measured for the indexes of participation of the subnational governments in revenue and in total expense, place Brazil among more developed federations. In the middle of the countries in development Brazil is, no doubt more progressed forward in terms of autonomy⁷. To prove this, we can review the table that measures the L.A. and D.L., in the subitem 1.2.1.

Simultaneously to the vertical decentralization in the division of the public resources, an important and intense horizontal decentralization of the revenue was observed. The concentration of the federal tributary collection in the areas more developed⁸ has as compensation an outline of partition of federal taxes in favor of subnational governments that benefits one of the areas basically less developed, beyond the largest participation of those areas in the division of the direct federal expenses in basic social actions.

7.2.2 -Brazilian and comparative model

The term "federalism" is usually associated to the development of American government's system. The constitutional principle on which the Federal State is

7 The index of participation of the subnational governments in the direct tributary collection does not have precedent in economy of similar load and it is leveled to the indicators of the more developed federations of the world as Canada, Australia, United States and Germany, overcoming the indexes of France and England.

8 It is important to mention the case of São Paulo, the state more developed of the federation, with per capita income of 70 Percent upper to the national average, where 22 percent of the population of the country live and are generated more than 37 percent of the national production. There 39 percent of all the state tributes are collected in the country and 46 percent of the federal tributes.

based is the plurality of power centers coordinated among them. To the federal government, that has the competence on the whole territory of the Federation, a minimum amount of powers be checked, indispensable to guarantee the political and economical unit. To the federated states, each one with competence on their own territory, the other powers are marked. This is the base of American federalism.

In agreement with the Constitution, the North American federalist system only consists of the national government and the 50 states. This way, the local governments (cities, counties, etc.) are just “beings” of the states of which they are a part, and each State is driven by their own constitution, which cannot be against the Federal Constitution. All the American states, except Nebraska, possess their own House and Senate.

In the American federalism system, the parties do not need to close subjects in national level. The existent diversities in each unit are evidenced in their legal systems and they work as a type of " laboratory ". If the programs or laws adopted by a state do not work properly, the problem is restricted to just that territory. But, if they work satisfactorily, they serve as example for the other states and also for the federal government.

In relation to the partition of the tributary revenues, the decentralization had beginning in the seventies, in the Governments of Nixon and Carter, together with the transfer of a larger responsibility of expenses for States and local Governments. In the Reagan government, the transfers were totally suspended, seeking to reduce the fiscal deficit. The states had therefore, to eliminate unnecessary expenses and to increase their collection. That philosophy, which

transferred more responsibilities to the States, reducing their dependence in relation to the government transfers, was known as " new federalism ".

To adjust the new reality, the states tried to increase their collection, charging tariffs, instead of taxes, considering that the taxpayer pays with more easiness when he gets to see the originating from benefit of that payment.

Brazilian federalism, in spite of having as model the North American, differs in several aspects. In the process of the formation of the country, the fundamental difference was that while the union of the colonies formed the American federation and, later, of the states, that already previously existed, in Brazil, the central government preceded the states.

The Brazilian federative system, whose economical border continues in frank expansion, is not still physically ended, independent of conflicts and conceptual subjects that subsist. The proof is that in the seventies two new states were created (Mato Grosso do Sul and Rondônia) and after the Constitution of 1988, three more (Amapá, Roraima and Tocantins), all in less developed areas.

The same Constitution, in the impulse of decentralizing, still elevated the Municipalities to the constitutional status of almost-members of the Brazilian federation and, at the same time, it facilitated the creation of about 1.5 thousand units in the whole country. Also inside of the subnational governments, Municipalities have a growing importance, having never reached a relative volume in the whole Brazilian history as high as recent. That government sphere isolated invests so much as the sum of the total formation of the federal government's capital plus the twenty-seven state governments.

Of the political point of view and in relation to the parliamentary composition, the Brazilian federative system also promotes a considerable redistribution of the

power. We can see clearly in the Federal Senate, similar to the North American model, with equal senators representation for each state, that to the whole gathers 43 percent of the Brazilian population and it has 74 percent of the chairs. That is especially important considering that the Brazilian Senate analyzes and vote all the Laws' project and constitutional amendments that go by the House of the Deputies and could veto them. Besides, it is responsible for the several leaders' approval in the government levels and fixation, as well as exceptional the margin of debts for the states and municipalities, which the House of Deputies does not have.

Be increased that, in the House of Deputies the representation is not proportional to the population of the states, because there is a limit of seventy parliamentary members for a state and a minimum of eight. Therefore, distortions are inevitable, being a less populous state from the North for example and having a larger delegation than a state of the Southeast/South area.

Those peculiarities in the representation of federalism units in the National Congress, fits another incoherent characteristic in the Brazilian political system: the Senate. According to constitutional attribution, they should control and limit the debts of the States and Municipalities; however, in practice it is a rarely adopted.

The great subject for the Brazilian federation becomes therefore: " how to reconcile the fiscal decentralization, larger or smaller, with the national and rational objectives of economical politics? " In Brazil, the answer tends to be more complex than in other countries due to a peculiarity: unlike other federations, as the North American, the Brazilian Union always acted as lender of last-resort of States and Municipalities in bankruptcy situation. This induces them therefore, to a more permissive fiscal behavior, with economical accommodation. However, there does not exist any possibility of a new centralization of the power in the hands of the

Union. First, it would not be feasible from political point of view. Second it would affect the social well being of a heterogeneous country. Finally this will be undesirable of the point of view of administrative efficiency. Besides, it does not fit to alter the regional distribution of the federal public resources of fiscal origin, because it would represent a setback in this procedure developed along decades.

7.3 - Fiscal incentives x Fiscal War

The area where the progresses have been more difficult is called fiscal war, whose implications are going beyond the fiscal dimension, because it has a likeness with the directions of the industrial politics and external trade. Measures those are indispensable to the firm retaking of the economical growth. It is good to evidence that the economical and financial opening of the Brazilian economy in the nineties, after at least six decades of introverted economical growth has been, in fact, a factor of complication of the federative relationships. In an open economy, the solidarity among the governments is smaller than the differences of interests and visions between the more and fewer developed areas in terms of commercial and industrial politics.

The "fiscal war" has been a cause and effect relationship, but the own denomination already means a pejorative term, harming the best understanding of the subject.

The drivers of this "war" act in search of an objective that is legitimate to them: to struggle for the well being of the population that lives in its territory. To guarantee the necessary ways for survival is to accomplish, in practice, a basic idea of ethical content and of unquestionable universal value. To attract investments using this methodology is, in some cases, the only way that have the

federation has of doing this, in its area; material accomplishments that, in another way, would not be rendered.

The absence of a national plan with focus on to the regional development is that makes to appear what is called fiscal war. The states then have sought alternatives to lessen the enormous existent moat among the areas less developed and those more prosperous ones. These last ones are in quite stable economical situation, favored by the tributary collection volume generated in function of its own development that there was implanted.

It is undeniable that the composition of the tax burden has a reflection on the competition process in Brazil. In fact, the state fiscal war does not happen by chance, because ICMS is the tax of larger importance in collection for States and consequently to the Country, almost representing the value of the whole Fiscal Budget of the Union. Like so, the financial importance of ICMS can be attributed to strong tributary competition existent among the States in the administration of that tax. Because the resources available grow, the possibility to attract productive factors by the concession of fiscal incentives for taxpayers also grows.

The practice of the concession of fiscal incentives is common in the world and was always exercised, with success, for the countries that intended to reduce the regional inequalities between their states and territories. It cannot, with the argument of condemning the fiscal war, impede the state governments, including those that knew to overcome their fiscal balances, from attracting new investments in their areas through fiscal incentives. Investment of high effects multipliers, capable of, in a short space of time, promotes a substantial change in the levels of income and employment.

8 - Conclusion

Undoubtedly the coming resources of the constitutional transfers have been of extreme importance in the national development and in the balance of the regional inequalities. However, for treating of compulsory transfers that generate revenues without larger effort, these resources have been limiting the actions of States and Municipalities in the search from new opportunities to develop new income and new work positions.

Just knowing the tax is the principal component of the tributary revenue and that this generates the constitutional transfers besides are not the only possibilities being gained. Many countries have been getting great progress concerning the creation of new revenues, equaled to the private organizations.

Would it be ideal for Brazil, to alter the tributary system, with implantation of Only Tax, where the subnational governments would administer their resources, without the federal government's interference? Probably not immediately, where the inequalities represent an estrangement among the developed states (South and Southeast areas), and other states of the country. In case that happened today, the rich areas would be richer and the poor ones would be poorer, rendering the theory of the "two Brazils". Like that, is justified the creation and maintenance of the constitutional transfers as government instrument that has reduced the existent regional differences.

If there were not a transfer of Federal Government resources, certainly the subnational governments would be in difficult situations. Though they would be creative and perhaps transform the existent opportunities into productive activities, with results that will make larger autonomy possible.

However, fact is that in Brazil, unlike other federative countries, the Federal Government is ready to help States and Municipalities, whenever they are in the presence of a financial crisis. Like Federal Government, all the Brazilian states are endowed with autonomy to create their taxes or to generate other revenue types that do not collide with interests of the Union.

To create new opportunities it is necessary, to offer fiscal incentives, infrastructure investments and actions to improve the equality of the labor, at the national level. All the countries that considered reducing the economic inequalities among their areas, rushed in to national politics with a focus on regional development. It happened like this in the United States, in the thirties, in Italy in the fifties, will before in Germany, in France and recently in the whole European Community.

In Brazil, if there is the inertia of subnational governments, on the other hand, the Federal government maintains under its administration the collection of two principal taxes of the country. Such procedure results in the compulsory partition of the revenue by the Union, in an attempt to reduce the inequalities. It has generated the accommodation of the states and become a vicious cycle.

For those reasons, and knowing the existent problems, the attempts of improvement of the federative system on the part of the federal government were concluded in conciliatory measures. In fact, the federal government's current politics, in relation to the subject federative, has been trying to tackle the most urgent problems, taking advantage of the system, although inside of a strategy of gradual and careful action. To illustrate we mentioned some of the actions developed lately by the government:

- To exclude the possibility of a new centralization of revenues, through proposed reform in the tributary system, correspondents to Congress in the intention:
 - To unify the national legislation of the tax of additional value
 - To block the growth of the fiscal war
 - To limit the negative effects of competitiveness
- The national debt, as well as the external, expired and do not pay the states and municipalities. It was consolidated and assumed by the Union that, in change: induced to the one wide sell out of companies to the governments, mainly in the areas of concession of public services as transport, telephony and electricity, besides to liquidate and sell to the private initiative most of the state banks.
- To decentralize the responsibilities, with the intention of taking the Union to assume the costs, as: in the educational section, to implant FUNDEF, whose difference for the states in the North and Northeast is complemented by the Federal Government until reaching the value of the national minimum regularly for students registered in fundamental teaching. In the section of health, to promote direct transfers for the municipalities, through per capita criteria, a side from other subsidies to finance preventive basic actions.
- To approve Complementary Law that instituted in 1996 a financial compensation regarding exemption of ICMS about the exports, since the taxation was eliminated by the states of the primary products exported.
- The Fiscal Responsibility Law was recently approved imposing maximum limits for debts and expenses with personnel in the public service, prohibiting new negotiations of state and municipal debts for the Federal government and

applying sanctions to the responsible for actions considered incompatible with the established guidelines or rules.

Then we can consider the Brazilian federation in a good development apprenticeship, though lacking some fittings with relationship to the fiscal decentralization, which reconciles the redistribution of the revenue with the division of expenditures. Besides, the tax burden between the greater and fewer developed states is still larger.

Although in a process still not finished, the Brazilian federation exhibits lines of stability, marked by the inheritance of the unitary state and for the moderate difference among the Brazilians, in language, race and religion terms. They still contributed to this situation, the contraction and decentralization' phases of the central power in relation to partition of the tributary revenues, as well as the Brazilian politicians' profile that has placed the situations in a quite friendly climate. Specifically in the case of the tributary and fiscal systems, the mechanisms to distribute revenues have been used to assist interests, regional divergences and contradictory, by the transfer of resources between the greater and less developed areas, and they were firm in a period of time that few other nations got to perpetuate without political or civil conflicts. It is not by chance that the federative ideals are always practiced, seeking to assist the located interests, with regional repercussions, always looking to consolidate Brazil as a federation strong, competitive and democratic, and more appropriate to world globalization.

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