

The George Washington University
Institute of Brazilian Issues



Minerva Program
Fall 2013

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Taxation, public services and social control:
Analyzing USA experience to rethink the federative system in Brazil.

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Abstract

The Brazilian economy has grown very fast in the 2000's, despite an extremely negative international scenario. However, to continue this economic progress and increase the national welfare some specific reforms in federative issues are necessary. Solution to problems related to taxation and provision of public services are imperative for the country. The promotion of these complex reforms can only take place with a profound debate in the society. The social control is more than ever an important tool to make the country able to move forward towards social development.

Key words: taxation, public services, accountability, intergovernmental transfers.

0. Introduction

The objective of this paper is to start a discussion about issues related to the structure of the federalism in Brazil. Analyzing some experiences in USA we can think about possibilities to fix what is going wrong especially with the provision of public services, taxation and social control.

The idea here is not to take USA as a perfect model and import their way to deal with the institutions. We expect here to look at the good experiences that can be useful to rethink the institutional arrangement in Brazil, in order to make possible a development of the country in social, economic and political matters.

In the first chapter we will look at the social demands to increase the benefits to the population and how should the government conciliate this demands with the resistance to increase the tax burden. The focus is how to set an equation able to establish equilibrium between the increasing costs of public services, and an acceptable level of taxation.

Chapter two will describe some specific problem in the way that the Brazilian federation is structured nowadays. The main issues are about the mixed responsibilities between different levels of government, excessive intervention of federal government, barriers to the improvement of social control, and a breath analyze about the meanings of the protests occurred in Brazil in June, 2013.

Chapter three discuss some specific problems addressed by taxpayers in Brazil, such as the lack of transparency in the payments of sales taxes, how the regressive tax system penalize specially the poorest taxpayer and the problem of lack of information about costs of public services.

Chapter four brings the problem related to the high level of transferences of revenues between states in a way that affects the confidence of the taxpayers on the government and the consequent negative impact on the accountability and efficiency of the government. Finally, chapter five addresses some possible advantages that Brazil has in comparison to the USA, in purpose to show that the country can beneficiate for some historical conditions when seeking to became an economic developed nation.

1. The difficulty to achieve an optimal point in taxation and provision of services

Dealing with budgets is always a stressful issue. No matter in what institution, whether it is a government, an enterprise, a non-profit organization, or even a family, it is always hard to combine all the financial demands given the budget constraint. When these institutions are on the limit of the budget constraint, one single change in the market, such as inflation or a reduction in wages, can lead to a problematic situation - the decision to keep funding one service and, on the other hand, the alienation of the capacity to afford another service.

One alternative to the shortage of money would be the expansion of the budget constraint. In the case of public administrations, government might think about raising taxation in order to maintain the same level of public services as before. However, many times this is not possible for multiple reasons such as economic restrictions and pressure of political groups. The only way to reorganize the finance of the public administration would be enumerating the list of the government's priorities in order to decide what program would be affected with cuts.

Another possible situation is when the government receives higher taxes than was expected. This excess of revenues can be arbitrarily allocated in a policy that does not necessarily figure in the priorities of the population. In a hypothetical future moment of recession, the government will face the dilemma to cut or not the funding to this program.

It is crucial to find a point in the provision of public services that is adequate and sufficient for the needs of the society, without losing economic efficiency with an increasing tax burden.

The strategies in achieving this goal are influenced by the political biases. On one side, we have those who claim for a large government providing multiple services with strong policies focused on the poor population and redistribution of wealth. On the other side are those who argue that government involvement should be as minimal as possible, providing only the essential services to keep the society running.

The main concern in this paper is not to define the best direction but to clarify what issues should be on the table on the discussion of how the policymakers should act to lead Brazil to a better situation in the next decades. If society supports the idea of a large government, with

a high level of intervention in the individual rights, it is necessary to have in mind the consequences of the strategy on society. If society agrees to have a minimal government with lower taxes, it would be necessary to evaluate the potential impacts on the national welfare.

Nowadays, it is difficult to know in what direction the Brazilian society seeks to move. The country's constitution promulgated in 1988 defines an extended list of rights that should be guaranteed by the state to the citizens covering all the most important social demands, such as education, health care, social security, and so on. However, as we will see in the next chapter, the quality of this provision is quite low.

The pressure to increase the quality of public services conflicts with another pressure to reduce the tax burden in the country. As a result, Brazil stays in a middle position, where citizens have many rights, but almost none of them are fully satisfied. Summing up, we have two forces in opposed directions: the improvement in the many rights of citizens, and the reduction of the state given its intrinsic inefficiency.

1.1. Rights of citizens

The first step to decide in which direction the nation should move is to analyze what should be the extension of rights of citizens. The definition of citizenship in the Stanford Encyclopedia for Philosophy is:

“The concept of citizenship is composed of three main elements or dimensions (Cohen 1999; Kymlicka and Norman 2000; Carens 2000). The first is citizenship as legal status, defined by civil, political and social rights. Here, the citizen is the legal person free to act according to the law and having the right to claim the law's protection. It need not mean that the citizen takes part in the law's formulation, nor does it require that rights be uniform between citizens. The second considers citizens specifically as political agents, actively participating in a society's political institutions. The third refers to citizenship as membership in a political community that furnishes a distinct source of identity.”¹

¹ Source: Stanford Encyclopedia of Philosophy at <http://plato.stanford.edu/entries/citizenship/>, accessed in October 03, 2013.

This definition says that “*the citizen is the legal person free to act according to the law and having the right to claim the law's protection*”. Applying the theory to the Brazilian case, if the law determines that the population has the right to receive education, health care, housing, social security, the government has the obligation to sponsor all these programs. There is no way to make it, if there is not a huge structure of government working on the different issues.

Another interesting point is the second dimension of citizenship that takes citizens as “political agents, actively participating in a society’s political institutions”. In order to reformulate the government to meet the society’s needs, it is necessary that citizens take part in the political decisions. The citizens cannot be in a passive position; they need to guide the decisions of the government to achieve the interest of the society, which can go in the direction of a bigger or smaller government.

1.2. Rights of taxpayers

Taxpayers have the right to claim benefits and services in the proportion of the tax paid. If there is a huge tax burden, the population will accept nothing less than an excellent public service.

It is important to highlight that when we talk about taxpayers in Brazil we cannot restrict our views on the rich, but includes specially the medium class, and the lower classes. The reason for this is our extremely regressive tax system, a topic that we will see in a later chapter.

One important tool in the relation between taxpayers and government is the accountability. If the administration is transparent when showing the expenditures and benefits of the public policies, taxpayers feel more confident in the government, reducing fiscal sonnegation and less resistant to increases in the tax burden.

Nobody likes to pay taxes and the less tax paid, greater is the disposable income to buy whatever people want. There will always be a pressure in the government in order to reduce taxes, which would directly affect the provision of public services.

As a counterpoint to the growth of government, the Taxpayers Bill of Rights (TABOR) is an interesting movement in the USA that evokes the rights of taxpayers with severe restrictions

to the expansion of the government activity. The main statement is that the expansion of the expenditure cannot be greater than the inflation and the variation in the numbers of habitants. An increase in the tax revenue should be approved by referendum.

A famous case of the TABOR was implemented in the legislation of the State of Colorado in 1992. The excess of revenue, also known as “TABOR surplus”, should be returned to taxpayers, unless a referendum approves a destination to the sources. As a consequence more than US\$ 2 billion was returned to taxpayers². One consequence of the implementation of these rules was that after economic recession the government was not able to raise revenues to the pre-recession level. In 2005 the TABOR legislation in the state was modified losing the original essence.

Although the implementation of the legislation of the TABOR is an extreme way to deal with taxation and applied to specific cases, it helps to understand how Americans deal with the government expenditure. In the USA it seems like the individuals are more conscious about the implications of being a contributor. Once they are the ones that are financing the government they feel empowered to charge the government for results.

1.3. Setting revenues and expenditures in the same equation

Developing an equilibrated budget that reasonably respect the rights of property in taxation and assure the provision of the social demands is a real challenge. It also an historical concern present in ancient societies, as we can see in the quote attributed to Marcus Tullius Cicero, 55 BC:

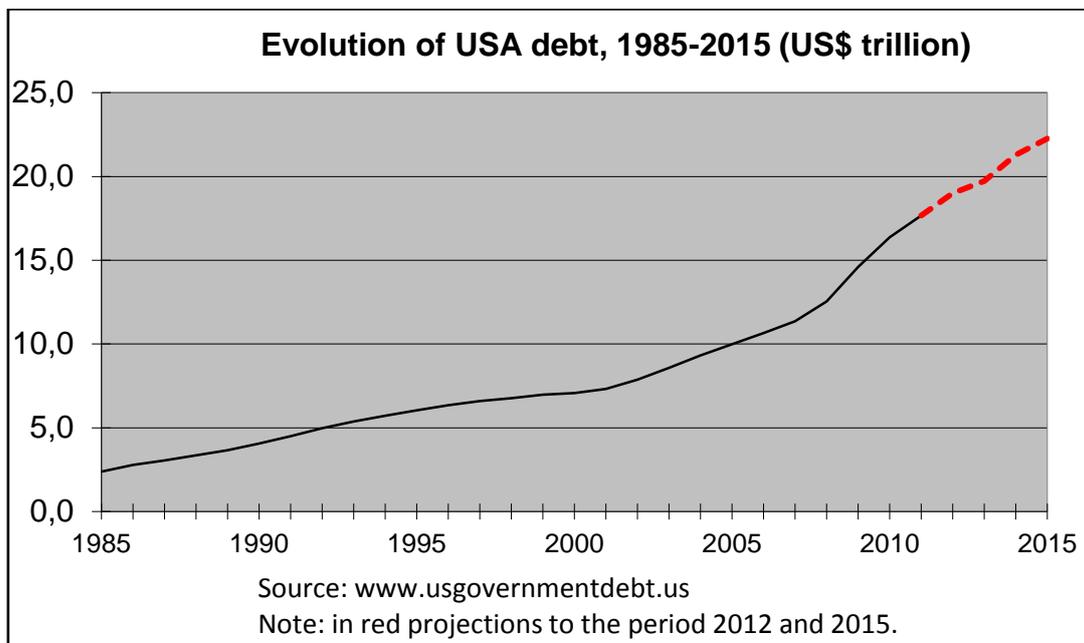
“The national budget must be balanced. The public debt must be reduced; the arrogance of the authorities must be moderated and controlled. Payments to foreign governments must be reduced, if the nation doesn't want to go bankrupt. People must again learn to work, instead of living on public assistance.”

In America, usually when the state or local administration plans to make a public policy the first think asked is: How much it will cost? The second and equally vital one: How the gov-

² Source: “Gallagher Amendment, adopted by Colorado voters in 1982” at http://www.colorado.gov/cs/Satellite/Treasury_v2/CBON/1251592160342, accessed in October 03, 2013.

ernment will pay for it? There are only two possible answers for the second question: it is possible to cut other expenses in a way that they do not affect the essential services, or the government will need to increase taxes.

However, this general assumption is not applied to the USA`s federal administration, which is the only level in the American government allowed to have unbalanced budget, causing many critics in the society. The possibility to raise the public debt to finance the government has been used for many decades, but with the financial crisis in 2008 and the efforts to minimize the impacts of recession the increase in the debt was especially greater. Projections demonstrate that in 2014 the debt of the country can achieve nothing less than US\$ 21 trillion, and the relation debt/GDP would be around 1.25³.



With the accelerated increasing debt there is also an increasing pressure on the government to reduce the fiscal deficit. This policy is not sustainable in the long term, and soon or later the country will need to make changes in the fiscal policy. The interesting point for our discussion here is to show how this whole scenario impacts the decisions policymakers take about expenditures.

Recently the president of the United States, Barack Obama, was hardly pressured to give up

³ Source: http://www.usgovernmentdebt.us/spending_chart_1985_2015USr_XXs1li111mcn_H0t, accessed in October 03, 2013.

the implementation of the Affordable Care Act majorly because of the financial impacts on the federal government. The act, also known as Obamacare, has the objective to expand the health care insurance plans, especially to the poor population, but a portion of the bill would be paid by the government.

Although, the expansion of the health protection is undoubtedly positive for a huge part of the population, there was a strong resistance to its implementation. By the third quarter of 2013 almost 29% of the Americans were supporting Obamacare, as 46% was against the act⁴. The main reason for this strong opposition was the high cost of the program.

As we can see in this example, a good policy cannot be measured only in terms of the benefits but also in terms of costs. Apparently in the USA taxpayers had better incorporated this relation, and there are many restrictions to the increase of expenditures. It is not surprising that the country has a relative small tax burden of 26.8% in 2005 (next table).

In the United States the provision of public services is inside an equation, which has costs on the other side. It's very clear in the recent discussion about the Obamacare program. It is not just a discussion about what is good or bad for the whole population, there is also an important questioning that is: who is going to pay for the act?

On the other hand, Brazil is experiencing a very different situation. With the promulgation of the Brazilian Constitution in 1988 a huge list of social rights was warranted to the citizens by the government. Although insuring rights cannot be seen as a bad thing, the problem is that the cost to provide all these services in a satisfactory level is extraordinary. Once the resources are limited, the only way to fund all these public policies would be strongly raising the tax burden.

⁴ Source: CNBC, 2013. "All-America Economic Survey".

Tax burden in countries OECD

	1970	1980	1990	2005
Sweden	37.5	46.1	51.9	51.1
Denmark	39.2	43.9	47.1	49.7
Norway	34.4	42.5	41.5	45.0
Finland	31.8	36.1	44.6	44.5
France	34.1	40.6	43.0	44.3
Austria	34.6	39.8	40.4	41.9
Italy	26.1	30.4	38.9	41.0
Netherlands	35.8	43.6	43.0	37.5
UK	37.0	35.2	36.8	37.2
New Zealand	26.3	31.8	37.6	36.6
OECD	28.2	32.0	34.2	35.9
Spain	16.3	23.1	33.2	35.8
Greece	22.4	24.2	29.3	35.0
Germany	29.8	34.6	32.9	34.7
Portugal	19.4	24.1	29.2	34.5
Canada	30.8	30.9	35.9	33.5
Brazil	26.0	24.5	28.8	32.9
Australia	22.2	27.4	29.3	30.8
Ireland	28.8	31.4	33.5	30.5
Switzerland	22.5	28.9	26.9	30.0
USA	27.7	27.0	26.7	26.8
Japan	20.0	25.1	30.0	26.4
South Korea	-	17.7	19.1	25.6
Mexico	-	16.2	17.3	19.8

Source: OECD (2008), UN (2007), IBGE (2007) e BNDES (2001), in Paes, Nelson "Carga Tributária Brasileira - Uma análise comparativa".

As long as it is easier to make promises about improving social rights than raising taxes, Brazilians got used to demanding social rights rather than analyzing the costs and ways of funding these expenses. With a tax burden of 32.9% (below the average of the OECD) and with urgent demand for infrastructure investment, Brazil faces a general bad quality in the provision of public services. Consequentially, a financial disorder heated many public institutions, in many cases accumulating huge amounts of debts.

1.4. The power of “consumer-voter”

About the issue of provision of public services especially on the local government, the classic article from Charles Tiebout, “A Pure Theory of Local Expenditures”, is an attempt to apply the market theory of economics in a model for the relation between taxpayers and government in the USA. It helps to understand the way how taxpayers in America deal with the expectations of public services on the local level and the costs related to it:

“The consumer-voter may be viewed as picking that community which best satisfies his preference pattern for public goods. This is a major difference between central and local provision of public goods. At the central level the preferences of the consumer-voter are given, and the government tries to adjust to the pattern of these preferences, whereas at the local level various governments have their revenue and expenditure patterns more or less set.” Given these revenue and expenditure patterns, the consumer-voter moves to that community whose local government best satisfies his set of preferences. The greater the number of communities and the greater the variance among them, the closer the consumer will come to fully realizing his preference position.”

Using this theoretical approach the citizens tends to evaluate the expenditure patterns of the places where they plan to live. It is possible to balance and compare how much they would pay in income taxes (in case of states) and property taxes (which rates can be very different among local governments) and what are the services that will be available for taxpayers and their families.

Some can say that the arguments of Tibout are not very strong, or could be applied only on the local level. But the important issue here is to show that in the USA there is a general sensation that the government is not an autonomous entity. The government is a reflex of the social demand and pressure. Taxpayers do not accept to have their money being spent in the wrong way.

Are there cases of corruption? Yes, but if the court declares somebody is guilty, this person probably will not escape from paying his dues on prison. If the government is not giving back to the population what is being collected on taxes, in an extreme situation people can even decide to move to another place.

2. Issues about the arrangement of the different levels of government in Brazil

The structure of government in Brazil changed many times since the independence of the country in 1822. Seven constitutions were originated in this period, with different forms of government such as monarchy and unitary state. The constitution promulgated in 1988 defined the country as a federative republic. However, the long period with monarchy still influences the centralized structure of the government. In the next sections we will discuss the main issues in the arrangement of the federation, and whenever possible compare with the United States of America to find ways to improve the structure of the government.

2.1. Same service, multiple governments

One big issue related with the quality of public services is that many times the provision of the same public services is made simultaneously by the different levels of government. It is quite common in Brazil to have the same local schools or hospitals maintained by federal, state and local government.

There are several problems related to this shared responsibilities between the levels of government. The first point is that when the program is made by the federal government, such as maintaining a federal school in any city of the country, it contributes to the inequality between regions in the country and even inside the same region. The federal government can easily raise funds to construct a school. By doing that the administration uses the taxes collected all over the country in benefit to a specific region. Even worst is that normally the students attended belong to the rich classes. But what happens is that apparently this is not a large concern to the population. It is strange that nobody complains if the federal government uses its astronomic budget to fund a policy that will attend a very specific part of the population, in a very inefficient way to solve the problems.

A second point is that when the federal or state government provides a service it will probably ignore the differences between each region. The service will be planned to be provided in the same way all over the country/state. A school located in the middle of an industrialized city like Sao Paulo should have the same structure and way to teach as rural city like Sorriso⁵

⁵ The city of Sorriso is one of the major producers of soy in Brazil, and has a population of 66.521 according to

in the State of Mato Grosso? Each region has its own peculiarities, and implementing an educational policy top-down will probably not present the best results. Brazil is the fifth biggest country of the world with continental dimensions. Ignoring the differences between the regions is also a way to miss the opportunity to develop the best things each one has.

The third point is the difficulty of management of services when it is not offered in the local level. Picking the example of the educational system of the State of Minas Gerais we can observe that in 2007 the administration had to manage nothing less than 122,146 professors of the basic education⁶. The number of students using the services in the year of 2013 was 2,182,586⁷. Managing these numbers of employees and students spread on a territory as big as France, with more than 800 cities do not seem to be an easy task. The result of this is that the managers of the states become far from the reality of the schools.

2.2. Federal government providing local services

The federal government, with its higher capacity of acquiring funds can make huge investments in specific activities, such as building a huge hospital, or an excellent university. At first look it seems to be great when the federal government makes this kind of effort. However, the outlays to do it are very high and the public benefited by this investment is very small compared to the Brazilian population. When we look in a deeper way to this situation we realize that the investment has a very low impact on the social welfare of the country, and on the other hand can be used only to help in the electoral intentions of the politician or to maintain high levels of inequalities.

One good example to examine is the Brazilian expenditure with college education. Brazilian federal law defines that the local government is responsible for the first part of the basic education. The states are responsible for providing high-school education, but there are still some basic schools, and universities maintained by state level. The federal level main responsibility

the Census of 2010 (Source: IBGE).

⁶ Source: MEC, 2007. "Censo do Professor" at

http://portal.mec.gov.br/index.php?option=com_content&view=article&id=13596&Itemid=975, accessed in October 10, 2013.

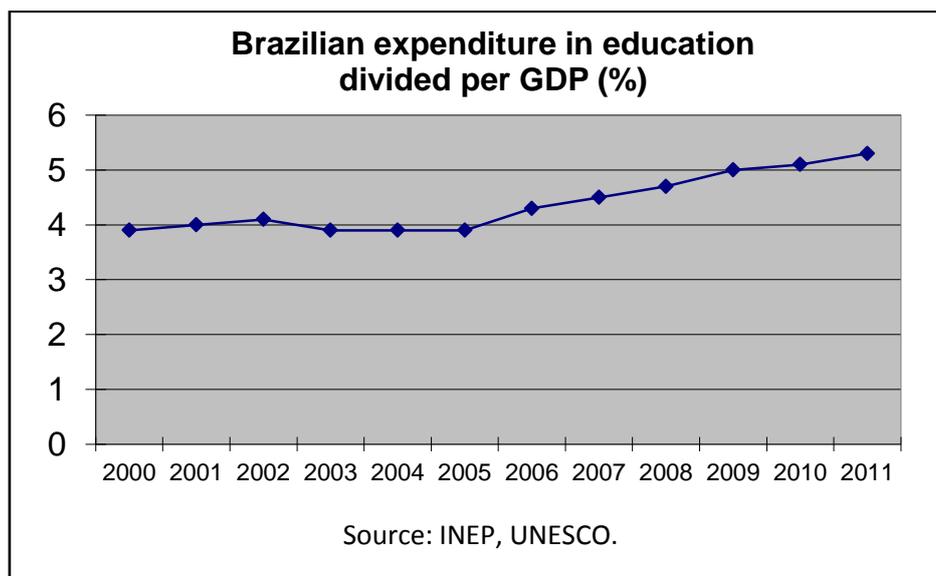
⁷ Source: "Matrículas da educação básica, estimativa da receita anual e coeficientes de distribuição dos recursos" at <http://www.fnde.gov.br/financiamento/fundeb/fundeb-consultas/matrículas-da-educação-básica,-estimativa-da-receita-anual-e-coeficientes-de-distribuição-dos-recursos>, accessed in October 10, 2013.

is to provide college education although there are some specific exceptions of basic and high-school education.

Important to note that people who uses the public education in Brazil is totally free from any type of charges with very specific exceptions. Also important to say that with the lack of investment specially in the public basic and high school in the past decades, those people who were able to afford private schools tends to make this option. The public university, are still considered good places to study, dividing the market with the private colleges.

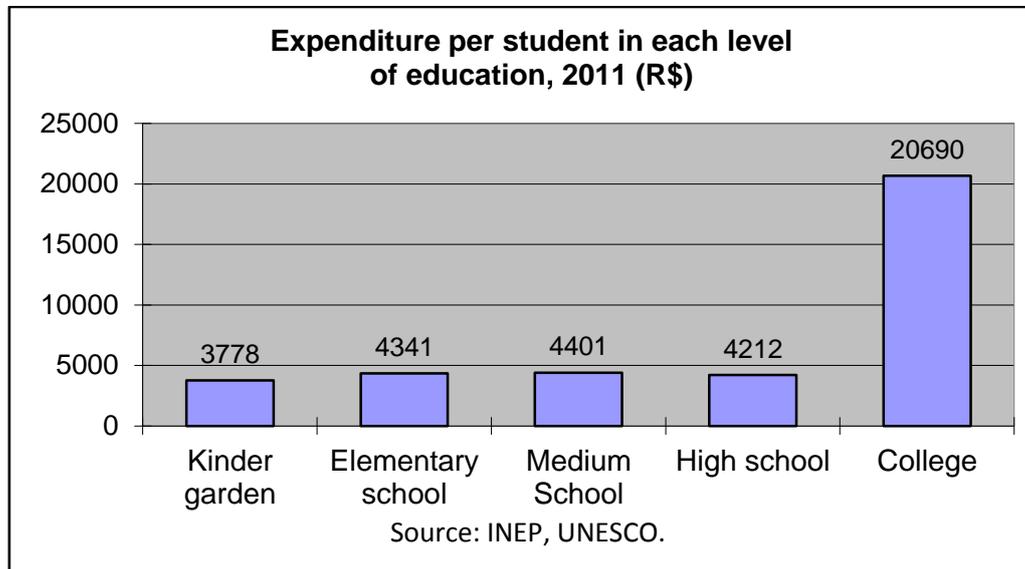
The general scenario is that, in the one hand, rich people pays for your children private schools, and after that they are able to pass in the selection for the public universities (in some cases these rich people choose some of the few options of good private colleges). On the other hand poor people study in the low-quality public schools; some of them do not even finish the high school. Those who are more persevering normally go to public college in the courses less attractive or pay to study in the private college, normally with a worst quality.

In 2011 the relation between expenditure in education and the Brazilian GDP reached the level of 5.3%⁸ and has been increasing in the last years. This percentage is very close to the medium observed by the countries of OCDE.



⁸ Source: Inep, Unesco.

So we can see that Brazil does not face a problem of amount of expenditure on education, but we have a problem about how this expenditure is being made. The next graphic shows the amount of money spent per student in dollar in the different level off education:



The graphic is very clear demonstrating the inequality in the distribution of resources in the different levels of education. It is not a coincidence that, as we have already said, normally poor people use the public education until the high school, provided by local and state government. The public college, used by the rich people, and normally provided by federal, and restrictively by states, receives huge amounts of money.

The important question this situation raise is: if the taxpayers know that a huge part of the amount paid in taxes in being used to afford good college education for a restrict number of students, they would maintain this expenditure? Would they prefer to redistribute the expenditure in the other levels of education, or even prefer to pay less tax reducing the expenditure in education?

Sometime is very clear that the federal government plays the role of local government on the provision of local services. Normally it happens because of the incapacity of the local government to make the policy by itself. A good example of that is the provision of money by the federal government to construct water pools in desert areas of the country. But the first question is: should not the cities be responsible for it? And if it the investment is very crucial for the city and it has no fund to do it is there any limit for federal intervention?

This high discretionary expenditure in the federal level causes lots of problems to the social control of the budget. As we will see in the next part of the paper, the provision of local services by the federal government makes more difficult to improve the accountability in the administration.

2.3. State and federal services and social control

At first people can say that when the different levels of government join together in the provision of the same public service it is good, and by doing this you have a hole net of services to attend the population. But the problem is that when the service is provided by state, and especially federal government, it becomes more difficult for the population to charge results from the managers, having a direct negative impact in the quality of the service.

Using the given example of the State of Minas Gerais, imagine that a class is not having mathematics lessons because there is no sufficient professor in the school, or the professor that was supposed to give the lesson decide not to go to the school very often. Imagine if this school is located in the interior of the state, hundreds miles away from the capital Belo Horizonte. The parents of the students want to complain about the service provided, and the first thing they will do is look for the principal of the school. The principal says that he is aware about the problem, but there is nothing he can do to higher another teacher, once he depends on the decisions made on the state level.

The second step for the student's parents would be going after the responsible manager of education in the state. But imagine the difficult to have a meeting with this guy or even how hard would be to be listened in a simple phone call. After some months the same school reports that is not only one missing professor, but dozens of them. The parents gave up trying to contact the responsible and decide to protest in the capital of the state. Imagine what huge efforts would be necessary to do just to make them being listened.

Unfortunately, this hypothetical story happens year by year in different parts of the country. The users of the service do not know how to reach the responsible of it. The result is the huge difficult to improve the quality, efficiency of the services.

2.4. Rethinking the distribution of obligations between levels of government

As we said a good way to improve the quality of the public service is to decentralize the responsibilities to state and, specially, local governments. When the service is provided by the local government it turns easier for the taxpayer to control the expenditures and see the results of the public policy. If he is not satisfied with the service he can go after or call the manager of the agency, or even the mayor of a city.

The best example to apply this idea is in the provision of basic education. There is no reason for the intervention of federal, or even the state level, if the service can perfectly be provided by municipalities. In general families enroll your children in schools located nearby your houses. So the local government can charge taxes to this family in order to maintain a good school in the same locality. In the United States the local government is responsible to provide the education until the high school, what seem to be working very well.

In fact, in the last decades Brazil is trying to make some modifications in the public education. The responsibility on the provision of basic education was decentralized to local government. State government is still responsible for maintaining high schools what seem to be a seriously problem for the public administration. There is no strong reason to maintain this service on state level since the students of one city will not need to go to other city to attend lessons. If the local government provide the service it can plan better the allocation of resources between each level of education, and even make rearrangements in the educational framework considering modifications in the characteristics of the populations such as age, gender, or even modifications in the local labor market.

The college formation needs to receive a different kind of approach. Once college students are able to move to other cities to attend lessons does not make any sense for cities to maintain universities, especially if the service is out of charges. In Brazil most part of the public universities are federal, and states are also an important provider of the service. Besides the problems of federal intervention associated with the increase of inequality described in section 2.2, the intervention of federal government in college services that could be provided by state level is normally justified as a national effort to develop the country. Private universities also have important part of the market.

As a counterpoint, in the United States of America college education is provided mainly by private universities, but many states maintain college education. Different than what happens in Brazil where the service is totally free, the students of state college need to pay for the service. Generally students whose families are from the state receive benefits paying less. The costs are high even for Americans standards of living, and a great part of the students' needs to make loans to afford the college. For example the Pennsylvania State University charges USD 28,664.00 for out-of-State tuition and USD 16,090.00 for in-State tuition⁹.

On the other side, some services are not well developed when provided by local government. The best example of it is public health. If you have huge inequalities in the quality of the service between cities, people who needs to use the health service can search another city with better hospitals. The cities with good hospitals are penalized receiving high numbers of patients from other cities crowding out the service to their own citizens. This is a very common reality in Brazil, at the point that is very common to hear that the best investment in health care is to buy ambulances, so the government can take the patients to another city.

In this case the better solution is to provide the service in the state level, in a way that the administration can organize the service considering as a whole different regions of the state for specific demands (neurosurgery, traumatology, and others), and spread as much as possible the basic health care, such as pediatricians, general practitioner, geriatricians.

Of course all the rearrangements of responsibilities exposed in this section should be on compass with redistribution of funds to cover the new expenditures in each level of government.

2.5. The distance between policymaker and citizens: lessons from the protests of June, 2013

During this year, on July, the world watched for the first time millions of Brazilians spontaneously organizing themselves to speak out against all kinds of problems in the country. For sure it was a remarkable moment of our history, and the consequences of it are still coming. However, in that situation of multiples social demand (price of public transportation, corruption, violence, education, health care, and so on) was very clear that people were having trou-

⁹ Sources: "The Princeton Review" at <http://www.princetonreview.com/PennStateUniversityPark.aspx>, accessed in October 13, 2013.

ble to identify whom should be blamed for each of the issues. All the politicians were being considered responsible for the many problems of the nation.

As a consequence a great number of executive chiefs on the three different levels observed their popularity score falling in subsequent surveys. In a few weeks majors, governor, and even the president were under a great pressure. After all, we can see that most of the questions raised on the protests are still waiting for answer because a good part of the population has no idea of who is the one that should be blamed about, or how to solve those problems.

The only thing that seems to be a consensus is that there is a crisis of representation in Brazilian democracy. This distance between the levels of governments making decisions and the citizens became a great barrier to development of the democracy. During the protests period, a survey revealed that 89% of the protestors do not feel represented by any of the political parties. Other important information is that 96% of those millions that went to the streets are not affiliated to any political parties¹⁰.

One possible reason for this distance between citizens and government is the low representation of the people in their government. Comparing data from Brazil and USA can be very useful to make us rethink about the way our federalism is organized nowadays. Despite all the economic differences between the two countries we should not lose in mind that both countries had important similarities in their constitution, beginning of European colonization, use of slavery labor force, date of independency (Brazilian independence occurred only 46 years after American's).

The table below shows recent data from the two countries about population, territory, numbers of states (including in both the respective capitals), and numbers of local governments.

¹⁰Source: IBOPE, 2013 at <http://www.ibope.com.br/pt-br/noticias/Paginas/89-dos-manifestantes-nao-se-sentem-representados-por-partidos.aspx>, accessed in November 2, 2013.

Population, Territory and the numbers of governments in Brazil and USA

Country	Population (A)	Territory (B)	States (C)	Local Government (D)	A / C	A / D	B / D
Brazil	201,032,714	8,515,767	27	5,570	7,445,656	36,092	1,529
USA	301,621,157	9,522,055	51	89,476	5,914,140	3,371	106

Source: Brazil's data: IBGE; USA data: B&K, 2011 and "Encyclopedia Britannica".

The first expressive difference is the numbers of local governments: USA has sixteen times more units of local governments than Brazil. We do not want here to deeply detail the structure of American federalism, but is important to point that in USA there are many different types of local levels, such as counties, municipalities, towns/townships, special districts, and school districts. Most of the times these governments overlap each other. The organization varies a lot along the states, but for a general comprehension for the reader we can say that in general there are three levels of local government: counties, which aggregate municipalities, which aggregate the other three forms of local government. As a consequence the number of people divided by the number of local government is 3371.

However, in Brazil we only have municipalities below the structure of the states. The relation of population per number of local government is 36,092 - much higher than that observed in USA. Even if we consider only the Americans municipalities the relation is still better with 15,474 habitants per municipality.

In addition, the elections in Brazil are restricted to choose the chief of the executive branch of each level, and representatives for the senate and the house. In USA normally the voter also decides other important positions of the administration especially in the local level, what contributes to raise the confidence of the population in your leaders.

We are not suggesting here that one model is better than the other, and we have not at least pointed up all the advantages and disadvantages of each structure. The fact is that numerically speaking is very clear that the administration in the local level in USA is more close to the population than it is Brazil, what can, in part, explain the sensation of misrepresentation in the second country.

Here we should stop to say that at this point Brazil and United States of America are reflecting your historic peculiarities The first always had strong political barriers to decentralize the

power all over the country, while the second is historically know for restrict any type of excessive centralization of power, and the flexibility inside the states to model the federation was undoubtedly determinant to achieve the actual arrangement:

“American local governments were not planned according to some grand design. Rather, they grew in response to a combination of citizen demand, interest-group pressure, and state government acquiescence. As a consequence, no rational system of local government exists. What does exist is a collection of autonomous, frequently overlapping jurisdictional units.”¹¹

Apparently the first step to bring the citizens to the political scenario is to make them feel as a part of the political decisions. A gradual process of decentralization, combined with mechanisms of social controls (public audiences, formal consults to the electorate), can bring important consequences to rethink the organization of the country on line with the wills of the people.

Once again we can look at the American experience to improve our democracy. Between the years 1990 and 2008, more than 700 referendums were promote by state and local government¹². More than 320 were ratified by the electors. The themes and complexity of the initiatives are quite different. Some examples of referendums occurred in 2010:

California	Proposal to legalize marijuana	Failed
Colorado	Proposal to reduce income tax rates, vehicle fees, and telephone taxes	Failed
Missouri	Proposal to require dog breeders to meet certain humane standards	Passed
Oregon	Proposal to increase the minimum sentences for repeat felony sex crimes and DUIs-Driving Under Influence	Passed

This exercise of direct democracy seems to be very efficient in the country if we consider that the participation on the elections is not mandatory we can consider the voter turnout quite expressively (61% in the presidential elections of 2010, tending to be less in the state and local elections). In Brazil, where the participation is mandatory, the voter turnout on presidential elections in 2010 was 81%¹³.

¹¹ Bowman, A. & Kearney, R. “State and Local Government: the essentials”, 2011.

¹² Bowman, A. & Kearney, R. “State and Local Government: the essentials”, 2011.

¹³ Source: Tribunal Superior Eleitoral, Brasil. “Estatísticas de Resultados - Quadro de comparecimento” at http://www.tse.jus.br/hotSites/estatistica2010/Est_resultados/quadro_comparecimento.html, October 25, 2013.

2.6. Comparison between Brazil and United States

The table below resumes the main differences in the framework of the countries in the provision of public services, showing how the responsibilities are generally divided between the levels of government, considering that there are specific exceptions to it:

Public Service	Brazil	USA
Elementary and Medium School	Local and State*	Local
High School	State	Local
College	State and Federal	State (with charges)
Health Services	Local, State and Federal	Local, State and Federal (do not provide services, only subsidize some citizens)
Police Department	State	Local
Fire Department	State	Local
Roads	State and Federal	State and Federal
National defense	Federal	Federal
Social Security**	Federal	Federal

*In 1996 was defined by law that state should prioress secondary education and local government primary education. The transition is still on course as many primary schools remain administrated by state government. On the other hand is not very common to have municipalities providing secondary education.

** Considering only the general system, excluding civil service and military service.

The general arrangements of both federations are similar in many ways but we can see that the Brazilian government has two specific challenges. The first is to maintain a greater structure of hospitals and emergencies once the country is compromised with the direct provision of health care, as the USA only pays part of the bill without the need to apply operational efforts for it. The second is the fact that in Brazil state and federal government provide free college education, expenditure that is much smaller in the US as the states usually charges fees for those who want the service.

It is also important to note that in US the division of the obligations in each level of government is clearer, in a way that is easier to verify the responsibilities of each level of the administration. In Brazil with education and health care, there are two or more levels involved in the provision.

In USA, those services provided directly to the citizens, such as education, tend to be situated mainly in the local level, corroborating the idea that people prefer to have the local government acting in their benefit, instead of the federal government. However, in Brazil there is still a strong dependency in the action of the central government.

3. Making the citizens conscious about taxation and the costs of public services

A very important point in the provision of public services is to talk about the impact of taxation on the taxpayers and the costs of the public service. As we just said the Constitution of Brazil have listed many rights to the population, but with the scarcity of funds and the low efficiency of the outlays, the country never reached a satisfactory level of implementation of social rights. On the other hand, people feels like paying too much tax without receiving back the correspondent service. The worst consequence is that, as we saw in the case of the educational system, the governments tend to be more effective to attend the demand of the high classes, and restrict the expenditure in favor of poor's people. In this chapter, we will talk about the main issues related to the floatation of the government.

3.1. The obscurity of payments in sales taxes

One of the most important principles about taxation is simplicity. When we look at the fiscal system in Brazil, we can see that this principle is not been taken in consideration. The possibility of multiple taxes been charged in the same operation - one using the other as base of calculation -, the difficult interpretation of the laws and rules, are examples of the problems in the national tax system.

When you buy an industrialized good such as a pen in any store, the consumer is paying at least two important taxes: the sales taxes to the state authority, and the taxes for industrialized products charged by the federal government in the phase of production. The rules associated with each of these taxes are quite complex and extensive. The rules of sales taxes in the State of Rio de Janeiro, is composed by nothing less than seventeen books. Additionally there other complementary rules such as the federal law, and agreements between states. If companies already have huge problems to understand and follow the rule, imagine how tuff would be the same task for the consumer that after all will be the one who will pay the final price.

Recently is increasing in the society a pressure for more transparency in the application of sales tax. However, as long as you have so many different rules for each type of product, even if the congress pass a law obligating the discrimination on the sales receipt of all the taxes charged, probably the implementation of the law would face serious operational limits. Anyway, this law would represent a huge step in order to make taxpayers conscious about the

taxes paid.

The USA experience to evidence in the chart the amount of taxes is a good way to show transparency to the taxpayers. The result is that taxpayers have the conscious of how much they are giving to the government, helping to increase the social control and accountability.

3.2. Regressivity of the fiscal system

When talking about Brazilian fiscal system, an important issue is the strong regressivity of it with multiple rates been charged simultaneously on the same product. When compared to other countries it is clear that our system has a strong participation of taxation on the consumption of products and services. On the other hand, a greater participation of income taxes makes possible a more progressive and fair system.

Tax burden in different economic sectors, 2008

Type of tax	Brazil	OECD		
		Maximum	Minimum	Average
Income	20.5	60.6 (A)	20.8 (E)	37.0
Payroll	24.1	43.8 (B)	2.0 (A)	25.3
Property	3.3	15.1 (C)	1.1 (B)	5.8
Sales tax	48.7	60.7 (D)	17.0 (F)	31.5
Financial operations	2.1	0.0	0.0	0.0
Others	1.3	5.3	0.0	0.9

Source: Receita Federal do Brasil, OECD.

Note: (A) Denmark (B) Czech Republic (C) Japan (D) Mexico (E) Slovakia (F) USA

Important to note that the United States of America is the country with less taxes in products and services (17% on average). Brazil is the one with less proportion of income taxes, the highest income tax in the country is 27.5%. In the United States the higher income tax charged for the federal government is 35%, but the states also charges additional income tax reducing the pressure on sales taxes. An extreme case is Denmark where the total income tax can achieve something around 57%. The immediate consequence of the Brazilian regressive structure is that poor people ends up paying relatively more taxes then the richest, as shown in the table below:

Days worked to pay taxes in different levels of income

Monthly Family Income	Days of work to pay taxes
Until 2 minimum wages	197
2 - 3	153
3 - 5	137
5 - 10	129
10 - 15	123
15 - 20	115
20 - 30	116
More than 30	106

Source: Instituto de Pesquisa Econômica Aplicada.

The only way to change this situation is to reform the tax system reducing the proportion of taxes on consumption, with a correspondent increase in income taxes. Of course, that would not be an easy task to approve the law and certainly would be strong conflicts of interests, making this type of reform almost a utopia.

3.3. Costs of public services

As was said in the beginning of this article, one of the political issues in Brazil is to see the government actions inside an equation within one-side revenues and in the other expenditures. The resources are limited and the social demands are extensive. At the revenue side, taxpayers already fell saturated with taxes, as they do not receive the correspondent payback in public services. On the other side, public services are seemed to be costly and inefficient.

The majority of the society blames the corrupted system for the bad quality of public services, but the fact is that corruption only explains part of the problem. Although we cannot measure how much the corruption costs in percentage of the budget, we can say that something is being done to minimize this problem. Mechanisms of transparency are being successfully applied in all levels of government, especially in federal and state level.

In many cases, it is possible to follow the budget execution, see government contracts, and values paid to suppliers. In some cases is even possible to see wages of public employees. One remarkable moment in our recent fight against corruption was the approval of the “Bill of Access to Information”¹⁴, in 2011, that assures to any citizen the right to request any type

¹⁴República Federativa do Brasil, Lei Federal número 12.527 de 2011.

of information to the government, with exception to private information for justified reasons.

One of the few options to measure the impact of this policies is the Corruption Perception Index, tool developed by the NGO International Transparency. According to this index, Brazil is having a slow decrease in corruption in the past six years:

2006	2007	2008	2009	2010	2011	2012
3.3	3.5	3.5	3.7	3.7	3.8	4.3

Source: International Transparency.

Note: Scores range from 0 (highly corrupt) to 10 (very clean).

The fact is that the fight against corruption will always be a concern in all the countries, and Brazil also needs to move on in other work fronts to increase the quality of the services. Other important issues related with human resources, bureaucracy, and target audience of the public policy should be in the table for discussion, but are always obfuscated with the strong speeches against corruption.

We cannot forget that with or without corruption the budget will always be short in relation to the social demands. Taxpayers should claim to have more opportunities to evaluate the priorities for the government action. What sometimes seems to be for free for citizens has strong costs perhaps. Even for those services that do not have satisfactory quality has strong costs behind (imagine the billions of dollars spent every year with education or health care).

In the other side, we also need to look at the public services that have a good quality, and we will look at the Brazilian public universities. Is it fair that the expenditure per student on college education is almost five times more than that on the basic school? Do the students of college have an idea of how expensive it is for government to maintain this whole structure? Would the rich people who join the public colleges accept to receive lower investments or even to pay a part of the tuition in order to promote a redistribution of welfare in the society? Would the whole society accept to pay more taxes to maintain the whole structure of college education?

A transparent government needs to walk in the direction of the costs of public services offered to the population. In an ideal scenario, people would be able to express their opinion

about where to invest more, or where it would be possible to cut expenditures. Unfortunately, this possibility is quite far from our reality, but is important to keep in mind that the accountability needs to go in this direction.

4. Issues related with the high percentage of transferences

One of the basic characteristics of a federative system is the financial cooperation between different regions of the country. Especially when you have substantial differences in the economic development in each portion of the nation it is quite reasonable to redistribute wealth around the territory to minimize social inequalities.

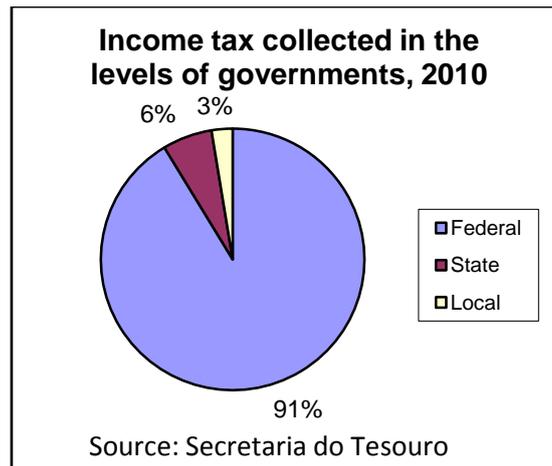
Normally the federal government is the one with the higher fiscal capacity, followed by the states and local government. To balance the equilibrium between this levels generally the federal government transfer to states a great part of its own revenue, doing so the central government tries to beneficiate more those states less developed with lower capacity of collect their own revenues. States also help local government`s finance with some type of aid.

However, the model of revenue redistribution between the regions has some structural problems, with serious consequences to the accountability, social control and even to the economic development of the country, as we will describe in the next sections.

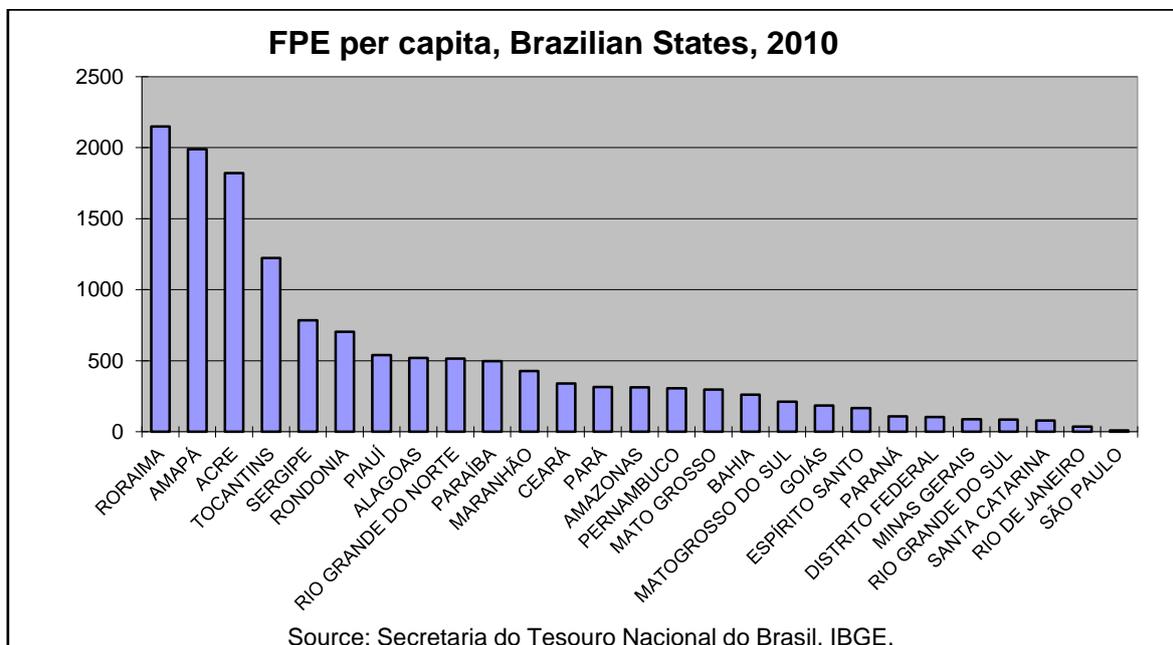
4.1. High level of redistribution of income tax

The income tax is probably the duty with higher resistance of the taxpayers in Brazil. It represents 22% of the revenues from taxes in all levels of government in 2010¹⁵. Only the federal government has the authority to charge this tax, but the Brazilian constitution authorizes that states and local government keep the sources paid by their own employees in the civil service.

¹⁵ Tesouro Nacional, "Estatísticas Governo Geral do Brasil", at http://www3.tesouro.fazenda.gov.br/hp/est_consol_geral.asp, accessed in September 25, 2013.



The constitution established that the 21.5% of the amount collected by the federal government should be transferred to states, and 23.5% to municipalities. The criterion of redistribution is quite arbitrary, although it is defined in federal law¹⁶. It was arranged to beneficiate the states considered more poor, in order to contribute in the social equilibrium of the country. This decision created a great distortion between the amounts redistributed between the states. The graphic below presents the value per capita received by state governments in 2010¹⁷.



¹⁶ The distribution of the grant is regulated by the Complementary Law 62/1989. The law was modified in 2013, in order to adjust the illegality pointed by the Brazilian Supreme Court, though the effective impact in the distribution is almost irrelevant.

¹⁷ Source: Tesouro Nacional, http://www3.tesouro.fazenda.gov.br/estados_municipios/download/CartilhaFPE.pdf, accessed in September 14, 2013.

In fact, it is comprehensive to have a redistributive police and it is quite common over the other federation in the world. The problem is that in Brazil these transferences are arranged in a way that can promote even more disequilibrium between regions, as we will see in the next sections.

4.2. Impacts of transferences in the efficiency and accountability

In a situation that taxpayers in the states with more developed economies pay huge taxes, but their states just receive back in revenues a minimum part of it, there is a tendency to reduce the confidence of the population in the government. A report from the World Bank¹⁸ summarizes the problem:

“[When countries] share the revenues from origin-based (production) taxes to the jurisdictions from which the revenues are collected, they break the desirable link between benefits and costs at the local level and hence reduce accountability and the efficiency of decentralization”.

An example is the State of Sao Paulo that received in transferences relative to income tax only the equivalent of 6% of all the taxes collected by employees of the private sector, as detailed in the table below:

¹⁸ Source: World Bank, “Decentralization Topics” at <http://www1.worldbank.org/publicsector/decentralization/what.htm>, accessed in September 14, 2013.

Transferences from FPE and payments in income tax, 2010

State	Transferences FPE (A)	Payments in income tax* (B)	A / B -1
AMAPÁ	1,331,502,176	20,683,052	6338%
TOCANTINS	1,693,645,793	29,332,125	5674%
ACRE	1,335,014,345	23,155,645	5665%
RORAIMA	968,070,765	22,183,317	4264%
MARANHÃO	2,816,837,340	90,151,759	3025%
PIAUI	1,686,387,310	78,841,734	2039%
RONDONIA	1,098,762,464	61,576,957	1684%
SERGIPE	1,621,568,286	93,159,672	1641%
PARÁ	2,385,152,784	151,538,540	1474%
ALAGOAS	1,623,441,442	107,382,585	1412%
PARAÍBA	1,868,824,962	140,613,466	1229%
RIO GRANDE DO NORTE	1,630,387,732	137,790,460	1083%
CEARÁ	2,863,158,943	284,715,196	906%
BAHIA	3,666,782,164	393,423,500	832%
AMAZONAS	1,088,928,392	123,742,701	780%
MATO GROSSO	900,637,126	149,203,711	504%
PERNAMBUCO	2,692,740,713	510,046,393	428%
MATOGROSSO DO SUL	519,800,967	180,278,558	188%
GOIÁS	1,109,494,090	427,560,758	159%
ESPÍRITO SANTO	585,361,449	244,881,254	139%
PARANÁ	1,125,142,753	826,863,367	36%
MINAS GERAIS	1,738,328,383	1,413,874,588	23%
SANTA CATARINA	499,430,389	458,575,475	9%
RIO GRANDE DO SUL	918,939,427	1,131,260,734	-19%
DISTRITO FEDERAL	269,344,315	459,432,231	-41%
RIO DE JANEIRO	596,171,124	2,829,252,443	-79%
SÃO PAULO	390,240,966	6,864,071,475	-94%

Source: Receita Federal do Brazil, Secretaria do Tesouro Nacional.

* Income tax paid by families, not included companies' payments.

The huge amounts of income tax paid, without a correspondent provision of public services reduces the confidence of the taxpayers on the managers of the government. Citizens pay their duties with the treasury and want to see what will be the benefits in response. If a great part of the revenue is redirected to different regions, the dissatisfaction between taxpayers tends to be greater.

If in one hand there are states receiving much less revenue relatively to the payments in income tax, on the other hand there are states receiving a huge amount of revenues collected outside their borders. With a weak taxation under their citizens it is possible to verify that the social control of government come to be less intense compared to states with a larger tax burden. In a situation like this, the population tends to be less concerned about the way that their government is spending money, what represents a huge impact to the principle of accountability.

*“Untied grants are provided by the national government to sub-national governments without conditions on how the money is to be spent. Untied grants can either be an arbitrary amount of money or set by a formula which, depending on institutional arrangements, may be subject to unilateral change. Given there are no attached conditions to their receipt, untied grants can be administratively simple to deliver. However, as it is more difficult for citizens to explicitly link paying a tax with untied grants, sub-national governments that receive untied grants may have diminished accountability to the public”.*¹⁹

As long as this transferences are not tied grants, the original intention to equalize the social conditions between the regions can be almost lost if the money is spent in a wrong way. On the limit would be better if the federal government decide to transfer revenues directly to the citizens:

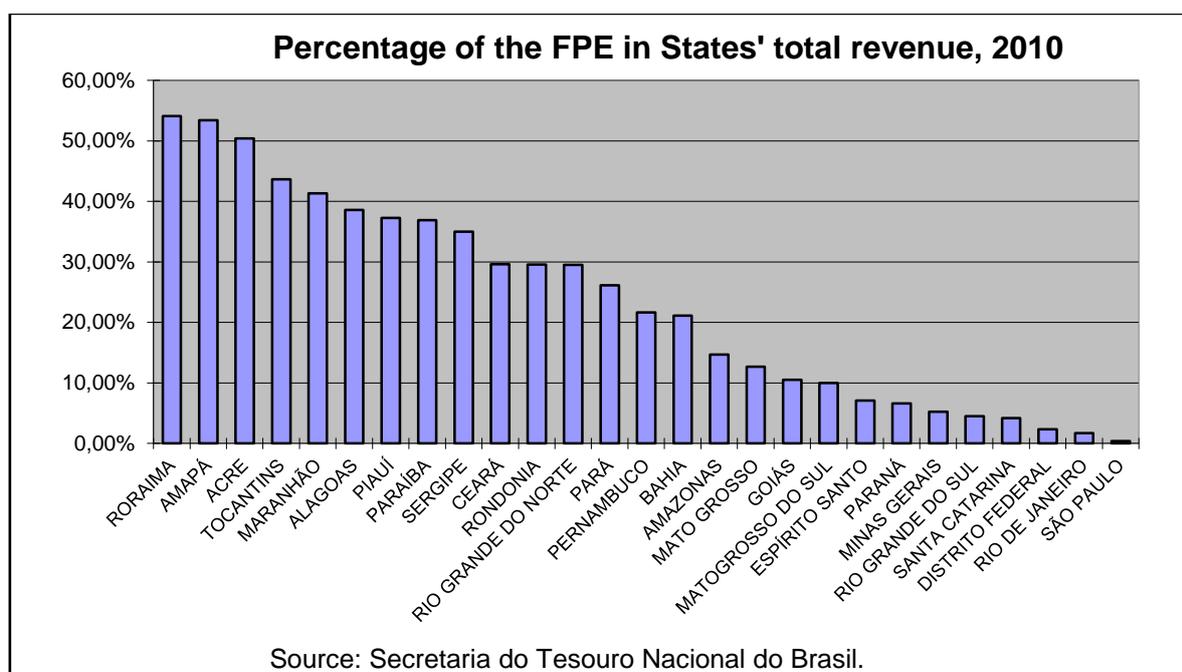
*“In some empirical studies, it has been observed that the portion of these grants retained for greater local spending tends to exceed local government’s own revenue relative to residents’ income; that is grant money tends to stick where it first lands. This is referred to as the “flypaper effect.” The implication is that for political, technical and bureaucratic reasons, grants to local governments tend to result in more local spending than if the same transfers were made directly to local residents”*²⁰.

¹⁹ Source: “Australia's Future Tax System Review”, 2009 at <http://www.taxreview.treasury.gov.au/content/Content.aspx?doc=html/home.htm>, accessed in November 10, 2013.

²⁰ Source: World Bank, “Decentralization Topics” at <http://www1.worldbank.org/publicsector/decentralization/what.htm>, accessed in November 10, 2013.

4.3. The risk of keeping states dependent on transferences

The disproportional redistribution of revenues between states makes some of them highly dependent of transferences. In some cases this revenues represents more than 50% of their Net Current Revenue²¹ as described in the table below.



This situation may discourage states to find ways to increase their own revenue charging their citizens, once there are available fund without the need to stress the taxpayers with taxation.

With increasing expenditures with bureaucracy and high salaries, without an efficient investment in strategic areas to develop a better economic environment, some states seem to be comfortable with this situation. Instead of improve the local taxation; they prefer to keep dependent from the transferences of taxes paid in other part of the country.

²¹Net Current Revenue, is a common indicator in Brazil to measure the disposable revenue of the states. It represents the total current revenues, excluding the transferences to municipalities and the contributions of employees from the civil service to the retirement funds.

5. Comparative advantages in Brazil's federative system

If in one hand the centralized formation of the Brazilian Republic affected until these days the autonomy of state and local government, on the other hand it also had developed comparative advantages in comparison with a country such as United States. In this section we will see how the centralized structure of government benefits the country making possible a faster implementation of rules in the dynamic globalized world and reducing costs for enterprises spread business in the country.

5.1. Faster implementation of new rules

In Brazil many issues as regulated by federal level, such as environment, civil law, criminal law, and others. In the US, for example, each state has the autonomy to legislate according to its own will. When a specific issue emerges on the national scenario the congress is unable to pass a general law, so it is necessary to wait the action of each state congress.

One good recent example to illustrate this is the regulation of the use of mobile phone while driving. In Brazil the National Law of Traffic concentrate the rules applied all over the country. In 1998 the law determined the prohibition to use mobile phones while driving solving this important social demand, and in a few months the new law could be applied in all states. However, in the United States the same law would need to be passed in each of the 51 states.

5.2. Lower cost of information for companies who wants to invest in different states

With a more centralized process of making laws, in Brazil in general terms the same law is applied all over the country, but as we just said, in the US each state has the autonomy to legislate according to its own will. Using the given example about the use of phones while driving, it would be possible to have 51 different legislations to each specific state, or even variations inside some states.

Of course, there is a general intersection between the laws but the variation can be quite important. In the state of Colorado, only novice drivers (those with less than 18 years old are banned to use cell phone, school bus drivers are allowed to use it, as well the other drivers. However, in Washington DC, all drivers are forbidden to use cell phones. The rules about text

messaging also vary among the states. An awkward but possible situation would be driving in a road speaking on the phone totally according to the law, but in a few miles be fined for infringing the law of another state.

The same problem can happen when you analyze commercial, industrial, or environmental legislation.

5.3. Less number of local governments reduces costs and increases returns in scale

Regardless the problems of a centralized structure of power, the fact that Brazil has almost 16 times less units of local government than USA can have positive consequences. The possibility to reduce the expenditure in the maintenance of the local administration could lead to a possibility to reallocate funds to other strategic areas such as investments. With a less fragmented local government Brazil is able to have increasing returns to scale in the provision of public services.

However, the reduction of these costs is also associated with the ability of the managers of the cities to administrate these larger localities. If they do not handle the challenge to organize services to a big territory, instead of reducing costs is it possible to have an even more inefficient government wasting public resources.

6. Conclusion

Considering the expressive growth rates of the national economy in the last years that led the country to the position of the sixth biggest economy in the world in 2012, Brazil is now able to perform important reforms to increase the welfare to the population.

Changes in the political structure are necessary to bring the population to the political decisions. Taxpayers are called to take part in the political scenario in order to influence the policymakers avoiding bad policies that can be approved in benefit to specific economic groups. The population must be aware of all the consequences and costs of public expenditures to avoid unnecessary government intervention and waste of resources.

The organization of the Brazilian Federation should also be discussed in the different segments of the society. The massive intervention of federal government should be restricted allowing the local government to embrace with flexibility the challenges to the local development. The rearrangement of functions between the different levels of government is crucial to promote the improvement in the quality of the public services, and the accountability in the administration.

A huge reform of the fiscal system is quite important to improve the economic environment, reduce bureaucracy and reduce social inequalities. Without these reforms the national economy will never be able to perform its huge potential.

The threats to accountability represented by the high level of transferences between the states are also very important to change the system of incentives in the country. Taxpayers in the more developed areas need to feel that the taxes paid are being reverted in the public services available. In the other side, poorer states need to have incentives to invest in their own productive system reducing the dependence on the federal transferences.

It is also clear that the country can use historical facts to take advantage in the global economy. The power of the federal government to implement new rules in a short period of time, and the possibility to have uniform rules all over the country can bring great benefits to the nation in comparison to others.

In conclusion, it is important to say that changes are necessary to take Brazil to a new standard of development. The country cannot wait too much to embrace structural changes, assuming the risk to become for a long period stuck in a system that perpetuates poverty and inequality. If Brazil always claimed to be the country of the future, none opportunity should be wasted.

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