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**INTER-GOVERNMENTAL REVENUE TRANSFERS
IN BRAZILIAN MUNICIPAL FINANCE**

By

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All views, interpretations, recommendations, and conclusions expressed in this paper are those of the author, and not necessarily those of the Land Tenure Center or of the supporting or cooperating institutions.

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I. INTRODUCTION

Brazil is organized politically as a federal republic with three levels of government: federal, state, and local. The local government unit, the município, is the only form of public administration below the state level.² Municípios are typically composed of one principal city or town, plus an extensive rural area. Other, usually smaller, towns or villages may be found within municípios, but they do not enjoy separate or independent political status. Independent city government or lesser administrative districts, such as school or tax districts, do not exist in Brazil because they are neither recognized nor given means of finance by the constitution. All local government activities and prerogatives are therefore concentrated in and carried out by the município.

The Brazilian município, in comparison with local government in other countries, is not the strongest in terms of autonomy, organization, and powers, but neither is it the weakest. Some individual municípios are vigorous and dynamic; others are weak and ineffective, but the relative strength or weakness displayed by units of local government in Brazil is frequently a function of finances rather than a scarcity of statutory powers and prerogatives. All Brazilian municípios are patterned after the "strong mayor" type with an elected council, and they meet the three basic requirements for true local government: (1) operation within a restricted geographical area within a state, (2) local elections, and (3) some measure of autonomy, including the power to tax.³

¹ This is a condensation of the author's doctoral dissertation. The research was done while in Brazil during 1964 and 1965 in association with the Land Tenure Center, University of Wisconsin. Additional financial support was given by the Midwest Universities Consortium. The reader is referred to the original manuscript for more detailed narrative and statistical analysis.

² Diogo Lordello de Mello, A Moderna Administração Municipal (Rio de Janeiro, 1960), p. 7.

³ A.H. Marshall, Local Government in the Modern World (London, 1965), p. 1.

Historically speaking, Brazilian municípios have not fared well financially in comparison with local governments of other countries, as well as in comparison with higher levels of government in Brazil. Several reasons may be advanced for poor finances. First, the political status of local government was inferior to that of the state, provincial, or central government levels for the greater part of Brazilian history. Second, the specific tax powers allocated to local government were generally few in number and restricted to low productivity tax instruments. Lastly, the majority of municípios were and still are rural in character and located in the interior of the country, i.e., away from the developed coastal areas. Since most of rural Brazil suffers from chronic economic underdevelopment, income generation is low. As a result, rural local governments usually do not have a sufficiently large tax base from which to raise revenues for the simplest kinds of local government services.

Municipalities existed as early as 1549 in Bahia.⁴ The local governments of colonial Brazil were primarily urban rather than rural, and their administrative responsibilities and powers ended at the city limits. They did, however, exercise a limited number of purely local functions and had the power to raise revenues for those purposes.⁵ A few of the early local governments, including Maranhão, Bahia, Rio de Janeiro, and São Paulo, were in fact politically influential and for that reason were granted local powers equal to those enjoyed by Portuguese cities.⁶

Tax powers during the colonial period (1500 - 1822) were divided between the Portuguese crown and the municipalities.⁷

⁴ Antonio da Silva Corrêa, Impostos Municipaes (Rio de Janeiro, 1932), p. 33.

⁵ Antonio da Silva Corrêa, p. 35.

⁶ Alan K. Manchester, "The Rise of the Brazilian Aristocracy," Readings in Latin American History, ed., Lewis Hanke (New York, 1966), Vol. 1, p. 314.

⁷ An intermediate level of government did not exist during the colonial period. Most rural areas were under the administration of land grant holders who were responsible to the crown.

Royal trade monopolies and taxes on agricultural and gold production dominated the system. Municipal tax powers were restricted, largely by custom, to a few minor levies of low productivity. With the establishment of the Brazilian Empire (1822 - 1889) provincial governments were founded. All tax powers were then divided between the emperor and the provinces, and municipal government was placed under the control of the provincial legislatures. Whatever fiscal autonomy the municipalities may have enjoyed during the colonial period largely vanished under provincial control.

Local government was provided for under the new federal system after the abandonment of the monarchy, but the Constitution of 1891 maintained the municípios in virtually the same fiscal position that they held under the empire. The first republican constitution represented the first serious effort to resolve the problem of tax power allocation, but the division of powers set forth in that document was wholly between the federal and state levels of government.⁸ Local governments continued to be under the control of their respective states. It was not until 1934 that constitution law specifically recognized the municípios as semi-autonomous political units, and gave them exclusive tax powers independent of state control. Until that year, therefore, local governments had little or no power to decide their own affairs, or to raise revenues to defray local expenditures without express state permission and direction.

With the overthrow of the Vargas dictatorship in 1945, democracy was re-established and a new constitution written. The adoption of the Constitution of 1946 marked the beginning of a major new phase in Brazilian public finance in two respects: local government was treated with unprecedented generosity both politically and financially,⁹ and fiscal federalism was initiated. The later development is extremely important because it represents a significant change in the basic character of the tax system. Until 1946 constitutional law allocated tax instruments to levels of government with little concern for the income generating capacity of individual tax instruments. Tax powers continued to be allocated after 1946, but revenue sharing pro-

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Rubens Gomes de Sousa, "Sistema Tributário Federal," Revista de Direito Administrativo, Vol. 72, p. 3.

⁹ Allomar Baleeiro, Uma Introdução à Ciência das Finanças (Rio de Janeiro, 1964), 4^a ed., pp. 258-59.

visions in the new constitution required the federal and state levels of government to transfer portions of their tax receipts to local governments on a regular and recurring basis. This study seeks to investigate the role played by those inter-governmental revenue transfers in municipal finance, and it specifically hopes to answer two questions: first, what forms do the revenue sharing programs take, and what are some of their primary effects on the finance and structure of local government?

The basic division of tax powers in the Constitution of 1946, as amended, is as follows: the federal government has the exclusive right to income and consumption taxes, the rural land tax, customs duties, taxes on the transfer of funds abroad, and taxes on the consumption, production, and distribution of electric energy, petroleum products, and minerals. The states are permitted to tax sales and consignments, inheritances, and the export of goods produced within the state. Municipal tax powers include the urban land tax, buildings tax, a tax on the transfer of property between living persons, the industries and professions tax, license, and amusement taxes. All levels of government have the right to charge fees for services and levy a betterments tax.

The municipalities also receive specified portions of tax collections made by the federal and state governments as follows:

- A. Federal Transfers to Municipios
 - 1. 15% of income tax collections
 - 2. 10% of consumption tax collections
 - 3. 10% of electric energy tax collections
 - 4. 12% of the National Highway Fund (generated from the tax on petroleum products)
 - 5. 100% of the rural land tax
- B. State Transfers to Municipios
 - 1. 30% of the amount by which total state impost collections exceed the total of municipal incomes of any nature, excluding the export tax and capital municipios ¹⁰
 - 2. 40% of collections from any new state taxes.

All transfers are shared revenues rather than grants-in-aid or loans. A fixed portion of receipts from specific

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Henceforth the short term "31 per cent of excess revenues" will be substituted.

federal and state tax instruments is divided among all local governments annually.¹¹ Constitutional law provides the legal basis for all of the transfers and establishes the criteria for dividing shares among the municipios; therefore, neither legislative action nor appropriations are required to determine shares or make transfers.

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D.E. Riggert, "Federal Grants-in-Aid and Shared Revenues Briefly Defined," National Tax Journal, March, 1961, p. 105.

II. THE REVENUE TRANSFERS

The Income Tax Transfer

Article 15, Paragraph 4 of the Constitution of 1946 provides that "the Union shall grant to the municípios, with the exception of those of the state capitals, ten per cent of total collections from the... income tax, making the distribution in equal parts..."¹² Individual municipal transfers, called quotas, are determined simply by dividing the total share by the number of municípios in existence on December 31 of the preceeding year. All local governments therefore receive the same annual lump-sum amount since no effort is made to distribute transfers in proportion to population, land area, fiscal need, or any other criterion. Despite a substantial increase in the number of participating local governments, the values of annual quotas have tended to fluctuate upward over time because of rising income tax receipts and an increase in the basic share made available for transfers.

The transfer program went into effect in 1948, but as provided for by law, only five per cent of total income tax revenues was divided among municípios for that year.¹³ Between 1949 and 1961 ten per cent of income tax receipts should have been divided equally among the municípios. Late in 1961, Amendment #5 to the Constitution of 1946 further liberalized the income tax sharing program by increasing the share from ten to fifteen per cent of total receipts.¹⁴ Estimated annual quotas per município for the period 1948 through 1966 are shown in Table 1 below.

¹² Brasil, Constituição da República dos Estados Unidos do Brasil, 1946, (São Paulo, 1963), p. 10.

¹³ Brasil, "Ato das Disposições Constitucionais Transitórias, Art. 13, Para. 1," Constituição da República dos Estados Unidos do Brasil, 1946, pp. 95-6.

¹⁴ Brasil, "Emenda Constitucional #5," Constituição da República dos Estados Unidos do Brasil, 1946. p. 114.

Table 1. ESTIMATED INCOME TAX QUOTAS, Cr\$ 1,000
1948 - 1966

Year	Income Tax Share	Est. No. of Municípios (a)	Est. Quota per Município
1948	Cr\$ 209,749 (b)	1677	Cr\$ 125
1949	378,481	1682	284
1950	558,158	1873	298
1951	810,440	1873	433
1952	999,399	1873	534
1953	1,163,905	1929	603
1954	1,533,997	1935	739
1955	1,925,877	2351	819
1956	2,451,920	2388	1,027
1957	2,701,817	2397	1,127
1958	3,185,629	2447	1,302
1959	4,638,158	2610	1,777
1960	6,222,922	2742	2,269
1961	8,369,654	2833	2,954
1962	17,334,988 (c)	3062	5,720
1963	36,441,970	3554	10,254
1964	72,362,250	4234	17,090
1965	153,393,150	4113	37,294
1966	200,910,750	3956	50,531

(a) As end of preceeding year, capital municípios excluded.

(b) 5% for 1948.

(c) 15% beginning in 1962.

Source: Instituto Brasileiro de Geografia e Estatística, "Finanças Públicas," Anuário Estatístico do Brasil (Rio de Janeiro, 1949 - 1966).

The Consumption Tax Transfer

The sharing of consumption tax receipts with units of local government is of more recent origin. It was initiated after the passage of Constitutional Amendment #5 of 1961 which provided that ten per cent of annual consumption tax collections be divided equally among the municípios.¹⁵ The method employed

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Brasil, "Emenda Constitucional #5," p. 114.

to determine individual municipal quotas is similar to that used to establish income tax quotas: the total share is divided equally among existing units of local government.

The Brazilian consumption tax is similar to an excise tax that falls on a wide variety of goods. It is levied at varying rates on most consumer goods and on many kinds of producers' goods. The tax has been in use for many years and has been an excellent generator of revenues for the federal government. Most receipts originate from the sale of tobacco products, alcoholic beverages, textiles and clothing, fabricated metal products, and electric machinery and equipment. Although only ten per cent of consumption tax collections is made available for distribution among municípios in comparison with the present fifteen per cent from the income tax, consumption tax quotas have tended to be higher than income tax quotas, as shown in Table 2 below.

Table 2 CONSUMPTION AND INCOME TAX QUOTAS, 1962 - 1966
Cr\$ 1,000

Year	Consumption Tax Quota Per Município	Income tax Quota Per Município
1962	Cr\$ 6,670	Cr\$ 5,720
1963	11,482	10,254
1964	20,784	17,090
1965	31,765	37,294
1966	55,989	50,531

Source: Anuário Estatístico do Brasil, 1964 - 1967.

On the basis of experience from 1962 to 1966, municipal quotas from the consumption tax averaged one million more cruzeiros per annum than income tax quotas.

The Electric Energy Tax Transfer

Article 15, Paragraph III of the Constitution of 1946 gave the federal government exclusive power to tax the consumption of electric energy.¹⁶ It was not until 1955, however,

¹⁶ Brasil, Constituição da República dos Estados Unidos do Brasil, 1946, p. 9.

that federal authorities began to share revenues from this source with the municípios in an apparent effort to stimulate the construction of electric energy generation and distribution facilities by local governments. Ten per cent of electric energy tax collections is set aside for local governments, fifty per cent is transferred to the states, and forty per cent remains with federal agencies.¹⁷

Estimated ten per cent municipal share: for the years between 1955 and 1966 is shown in Table 3 below.

Table 3 ESTIMATED TEN PER CENT MUNICIPAL SHARE
OF ELECTRIC ENERGY TAX RECEIPTS
1955 - 1966, Cr\$ 1,000

Year	Municipal Share
1955	Cr\$ 84,351
1956	106,433
1957	119,665
1958	138,742
1959	148,513
1960	169,900
1961	191,400
1962	216,700
1963	1,193,700
1964	3,261,900
1965	9,713,700
1966	19,358,400

Source: Balanços Gerais da União, Ministério da Fazenda, 1956 - 1964, Anuário Estatístico do Brasil, 1962-1966.

Unlike the income and consumption tax transfers, the electric energy tax share set aside for distribution to local governments is not divided equally among them. Individual municipal quotas are determined on the basis of the following

criteria as set forth in Law #2.944 of November 8, 1956:¹⁸ fifty per cent of the quota is in proportion to municipal population, forty-five per cent in proportion to municipal electricity consumption, four per cent in proportion to municipal land area, and one per cent in proportion to the amount of electricity produced within the município. These criteria assure the largest quotas to municípios with large populations and the largest volume of electric energy consumption.

The law cited above also requires that any funds received by local governments from this source must be used for the production, transmission, and distribution of electric energy, and that municipal quotas will be deposited in and held by the National Development Bank until such time as local governments submit plans for expanding local electric service that meet the criteria established by the National Water and Electric Energy Council.¹⁹

The Petroleum Products Tax Transfer

The sharing of revenues from the tax on petroleum products has a longer history than any of the other transfers. Revenue sharing with states and local governments began in 1934, but it was not until 1947 that the municípios began to receive regular transfers directly from the National Highway Fund for independent spending on roads. In 1948, Law #302 provided that the National Highway Fund, the recipient of all revenues from taxes on petroleum products, be divided among the three levels of government in the following manner: forty per cent to the National Highway Department (federal), forty-eight per cent to the states, and twelve per cent to local government.²⁰

Law #1.749, passed in 1952, re-allocated petroleum products tax revenues in order to finance Petrobras, the Brazilian government's new petroleum enterprise.²¹ It

¹⁸ Brasil, "Lei #2.944 de 8 Novembro de 1956," Diário Oficial, 10 de Novembro de 1956.

¹⁹ "Impôsto Unico sôbre Energia Eléctrica," Revista Brasileira dos Municípios, Jul-Dez., 1956, pp. 249-50.

²⁰ G.A. da Silva, "Fondo Rodoviário Nacional," Revista de Finanças Públicas, Jan-Fev., 1953, p.9.

²¹ G.A. da Silva, p. 12.

reserved twenty-five per cent of tax revenues for Petrobras, leaving seventy-five per cent for the National Highway Fund, and subsequent division among the three levels of government in accordance with the criteria established in 1948. This law called for an eventual return of the twenty-five per cent portion to the National Highway Fund following the Petrobras investment program, and that promise became a reality following Presidential Decree #1.379-A of September 11, 1962. During the ten year period of revenue diversion, however, local governments were forced to sacrifice income that could have been used to improve the rural road system.²² Conjuntura Econômica reported, for example, that for 1959 alone the sacrifice was in the neighborhood of Cr\$ 3.8 billions.²³

Estimated twelve per cent municipal shares of the National Highway Fund for the years between 1948 and 1959 are shown in Table 4 below.

Table 4 ESTIMATED 12% MUNICIPAL SHARE OF NATIONAL HIGHWAY FUND 1948-1959, Cr\$ millions

Year	Municipal Share
1948	Cr\$ 129
1949	136
1950	164
1951	205
1952	247
1953	250
1954	361
1955	324
1956	357
1957	987
1958	1,189
1959	2,019

Source: Ministério da Fazenda.

²² Since, in terms of kilometers, municípios are responsible for maintaining about 80% of the road system, Petrobras refineries were built at the partial expense of local governments and the rural road system.

²³ "States and Municipalities - Their Share of the Union's Tax Revenues," Conjuntura Econômica, Intl. Ed., Dec. 1960, p. 47.

The municipal share of the National Highway Fund is not divided equally among local governments. At the present time two sets of criteria determine the distribution of annual quotas to individual municípios: one for tax receipts from the sale of petroleum products made from imported crude oil, and one for tax receipts from the sale of products made from domestic oil.²⁴ Quotas from that portion of the twelve per cent share derived from taxes on the sale of products made from imported crude oil are determined as follows: Twenty per cent in proportion to municipal land area, forty per cent in proportion to municipal population, and forty per cent in proportion to municipal consumption of petroleum products. Quotas from revenues derived from the sale of products made from domestically produced crude oil are determined in the following manner: eighteen per cent in proportion to municipal land area, thirty-six per cent in proportion to municipal consumption of petroleum products, thirty-six per cent in proportion to municipal population, and ten per cent in proportion to municipal production of crude oil.

Either set of criteria assures those municípios with the largest populations and the greatest consumption of petroleum products the largest quotas. The consumption criterion, moreover, is based upon the number of licensed motor vehicles in each município per annum.²⁵ Consequently, highly urbanized municípios with large populations and the greatest number of motor vehicles receive the largest quotas, while rural municípios receive relatively small quotas. In 1961, for example, the state of São Paulo had thirty-two per cent of all licensed motor vehicles. Guanabara (Rio de Janeiro) had fourteen per cent, and Rio Grande do Sul had eleven per cent.²⁶ These three states, then, which make up only seven per cent of the land area of the country, contained fifty-eight per cent of all licensed motor vehicles. Furthermore, most of the vehicles were licensed in the capital municípios.

²⁴ "Entrega das Quotas do Fundo Rodoviário Nacional," Revista de Finanças Públicas, Jul-Set., 1962, p. 49.

²⁵ "Entrega das Quotas do Fundo Rodoviário Nacional," p. 49.

²⁶ Transportes, Editôre Banas (Rio de Janeiro, 1962), p. 15.

With the return of the twenty-five per cent portion of revenues to the National Highway Fund in 1962, the value of the municipal share should have increased by approximately Cr\$ 9 billions. In addition, the 1964 decision of the Brazilian government to stop subsidizing the importation of crude oil should increase the municipal share even further. After the establishment of Petrobras in the 1950's all oil importation and refining operations were concentrated in its hands, while distribution of refined products continued to be carried out by private firms. Under these arrangements, however, Petrobras sold refined products to distributors at prices that did not cover all costs of production including import costs of crude oil, and the deficit was financed by the national treasury from general tax revenues.

The Department of Money and Credit issued Instruction #270 in 1964 prohibiting Petrobras from selling refined products at prices that did not cover all costs. This instruction, therefore, caused the real cost of petroleum products to be borne by the consumers of those products rather than the taxpaying public in general. The national government took this step primarily as a means of reducing its deficit, but the National Highway Fund and recipients of shares from it will realize substantial benefits in the form of increased shares and quotas. Since the removal of the subsidy on crude oil caused the retail price of gasoline and other refined products to increase substantially, and since gasoline is presumed to be price inelastic, the ad valorem tax on those products caused revenues to rise. Roberto Campos, the Minister of Economic Planning, recently stated that the receipts from this tax should increase by approximately Cr\$ 100 billions for 1965.²⁷ The municipal share should therefore rise by about Cr\$ 12 billions.

The Rural Land Tax Transfer

With the passage of Amendment 10 to the Constitution of 1946 in November, 1964, the power to tax rural land was transferred from the municípios to the federal government.²⁸

²⁷ "Fundo Rodoviário Nacional, Reforço de 100 Bilhões," Correio do Povo, Pôrto Alegre, 23 de Junho 1965.

²⁸ Brasil, Instituto Brasileiro de Reforma Agrária, "Emenda Constitucional 10," Estatuto da Terra, Departamento de Imprensa Nacional, (Brasília, 1965), pp. 5-6.

Although the local governments had only recently acquired the exclusive right to tax rural land late in 1961,²⁹ the transfer of this tax instrument to a central authority was deemed necessary for the implementation of Brazil's first national agrarian reform law known popularly as the Estatuto da Terra, or Land Statute.³⁰

The Agrarian Reform Law provides, among other things, that the rural land tax be used as a primary instrument of land reform. The removal of this tax instrument from municipal administrative control does not mean, however, that local governments will not continue to enjoy the exclusive use of virtually all revenues generated by it. Both the constitutional amendment and the Land Statute clearly state that although the federal government, through the Instituto de Reforma Agrária, (Agrarian Reform Institute), shall have exclusive administrative control for the purpose of setting uniform tax rates, making cadastres and assessments, and generally establishing common and uniform rules and regulations, the receipts will be granted back to municípios of origin less a small fee to cover costs incurred by the Agrarian Reform Institute. By reason of these changes, therefore, rural land tax revenues became the object of an inter-governmental revenue transfer between the federal and municipal levels.

A consideration of the land reform effects that might be produced by the rural land tax is beyond the scope of this study. Will, however, the transfer of rural land tax revenues from federal to municipal authorities compensate the latter for their loss of the exclusive right to tax rural land? Will the agrarian reform land tax improve, worsen, or have no substantial influence on municipal finance? At the present time it is impossible to answer these questions fully or with a high degree of confidence for two reasons: first, rural land tax collections by municípios,

²⁹ Brazil, "Emenda Constitucional 5," p. 114.

³⁰ Officially known as Law 4504 of November 30, 1964. Although former President João Goulart decreed a land reform program on March 13, 1964, it did not have congressional approval and was voided by the Revolution of March 31, 1964.

for the period when the tax was under their control, have never been published. Second, the earliest date for applying the agrarian reform land tax was January, 1966.³¹

Despite these and other difficulties associated with the computation of land tax revenues, an estimate of expected revenues per município for the state of Rio Grande do Sul was made on the basis of rates and minimum land values established by the Agrarian Reform Institute, and on a number of taxable hectares per município reported in the agricultural census of 1950. The results show that land tax revenues per hectare in Rio Grande do Sul should increase substantially in all tax zones. In the Campanha zone, for example, receipts per hectare should increase by approximately 233 per cent on the average. This area shows the smallest increase, however, because it was always taxed at relatively high rates owing to the existence of many very large livestock ranches. The highest percentage increase of 2,225% should occur in the Encosta Superior do Nordeste zone, an area of intensive fruit, grape, and tobacco production.

A comparison of rural land tax receipts per município for 1960³² with estimated collections under agrarian reform regulations for 150 units of local government in Rio Grande do Sul indicates the likelihood of substantial increases in revenues for all municípios. The mean increase amounted to 1,729 per cent, while the lowest amounted to 94 per cent, and the highest 15,244 per cent. The wide range in relative revenue increases testifies to the fact that assessed land values were very low in many municípios when the land tax was administered by either state or municipal authorities.

³¹ As a matter of fact since neither the cadastres nor administrative machinery were set-up in 1965, the federal government advised local governments to continue to collect the rural land tax in accordance with previous practices and methods until instructed otherwise. See E. Azevedo, "Imposto Territorial Rural: Arrecadação Neste Exercício," Folha de São Paulo, 25 de Julho de 1965.

³² Collected by the state.

By way of conclusion, one may tentatively state that on the basis of partial data for the state of Rio Grande do Sul, the rural land tax, as administered under the agrarian reform, appears to promise additional revenues for all units of local government with the exception of a few highly urbanized municípios. The increases result from the fact that the Agrarian Reform Institute established minimum land values for tax purposes substantially higher than any previous assessments. The influence of the agrarian reform land tax on municipal finance should be the object of further investigation, however, after the program has been in effect for some time, and on the basis of actual collections and transfers.

III. STATE-MUNICIPAL REVENUE TRANSFERS

Thirty Per Cent of Excess State Collections

The Constitution of 1946 also provides for two revenue transfers between the states and their local governments.³³ The most important of the two from the standpoint of actual money amounts transferred is contained in Article 20 of the constitution. It states that "when state impost collections, excluding the export tax, exceed the total of local incomes of any nature, except for the capital municípios, the state shall grant to the municípios thirty per cent of the annual excess collected."³⁴

This revenue sharing program differs from any of the federal transfers to local governments because it includes the aggregated receipts of several state taxes rather than the revenues generated by a specific tax instrument. All of the federal transfers emanate from revenues produced from individual tax instruments, such as the income tax, but not from the total of federal revenues. The state imposts currently subject to sharing are the inheritance tax and the sales and consignments tax. Prior to 1962, rural land tax revenues were also included. Regardless of whatever other forms of state aid or financial support the states may have extended to their municípios, they are required by law to make the thirty per cent of excess revenue transfers.

A reading of the basic law seems to indicate that this transfer should have provided substantial amounts of additional income to local governments, but that has not been the case. For various reasons some states never made transfers, and others made partial and intermittent payments. A survey made by the Brazilian Institute of Municipal Administration for the years between 1955 and 1959 indicated that the largest number of municípios ever to receive transfers occurred in 1959, but it only amounted to 34.5 per cent.³⁵

³³ Some states voluntarily shared revenues with local government before 1946. Since that practice was not uniform and since it appears to be of little financial consequence at the present time, it will not be discussed here.

³⁴ Brasil, Constituição da República dos Estados Unidos do Brasil, 1946, p. 12.

³⁵ Instituto Brasileiro de Administração Municipal, Municípios do Brasil, (Rio de Janeiro, 1960), p. 63.

The survey did not indicate whether those municípios receiving transfers actually received the full amount due them.

Statistical data for this transfer is practically non-existent, but it was possible to estimate the approximate aggregate amounts that should have been transferred to all municípios between 1948 and 1958, and to compare those estimates with total amounts the states reported to have budgeted for transfers in various years. The results are shown in Table 5 below.

Table 5 AMOUNTS BUDGETED BY STATES FOR 30% EXCESS REVENUE TRANSFER COMPARED TO ESTIMATED TRANSFERS 1948-1958, Cr\$ millions

Year	Budgeted Transfer	Estimated Transfer
1948	Cr\$ 0	Cr\$ nd
1949	0	nd
1950	0	2,583
1951	345	3,842
1952	467	4,186
1953	0	4,825
1954	853	6,729
1955	0	8,441
1956	1,357	11,057
1957	1,585	13,905
1958	0	17,984

Source: "Áreas de Incidência Tributária," Desenvolvimento e Conjuntura, Abr., 1960, p. 20, and Anuário Estatístico do Brasil, 1949-1959.

In general, the amounts budgeted for transfer have been far below amounts estimated on the basis of the constitutional criteria and published public finance data.

The Forty Per Cent of New State Tax Revenue Transfer

The second state-municipal revenue transfer has, for all practical purposes, been non-operative. Article 21 of the Constitution of 1946 allows the Union and the states to decree other new taxes in addition to those specifically provided for in that document. The law also requires, however, that forty per cent of any receipts generated from new state taxes be granted back to municípios of origin, and that twenty per cent be transferred to the federal treasury, leaving forty per cent for the state.³⁶

Although statistical data is not to be found for this second form of state-municipal revenue sharing, it would not appear to be an important source of local government income for two reasons: first, the state is required by law to sacrifice sixty per cent of any collections it might make from new tax instruments, but it must bear all administrative costs. Second, the constitution specifically states that in the event the federal government decrees a similar new tax, the federal tax will prevail, and the state version must be rescinded. As a result, the very provisions of Article 21 strongly discourage state initiative in the development of new tax instruments.

A few states successfully levied new taxes, but there is no evidence that the new revenues were shared with local governments.³⁷ Most states either did not attempt to innovate or were forced to withdraw new tax instruments when the Supreme Court declared them unconstitutional because they infringed upon the tax powers of other levels of government.³⁸ It seems reasonable to conclude, therefore, that the local governments never received significant amounts of income from this source.

³⁶ Brasil, Constituição da República dos Estados Unidos do Brasil, 1946, p. 12.

³⁷ Bahia, for example, levied a tax on business inventories. Amílcar de A. Falcão, Sistema Tributário Brasileiro, (Rio de Janeiro, 1965), p. 82.

³⁸ The São Paulo tax on transactions and the Minas Gerais "fee for economic recuperation" were both declared unconstitutional. Amílcar de A. Falcão, p. 99.

IV. THE FINANCIAL IMPACT OF SHARED REVENUES ON LOCAL GOVERNMENT

Several statistical tests were made to lend support to the statement made earlier to the effect that Brazilian local governments have been underfinanced. Use of the term "underfinanced" does not mean to imply that municipal income was inadequate in relation to any and all expenditures local officials might wish to undertake, but it means that most units of local government were not able to raise sufficient revenues from their own exclusive tax instruments to finance the most rudimentary kinds of local government services. Even if one considers the fact that the states frequently assumed some local services, most municípios were not able to finance the salaries of mayors, councilmen, and other local officials; build and maintain a seat of government and archives for public records; and to provide primary education and public health at adequate levels.

One test of municipal finance conditions involves the calculation of relative revenue shares for the three levels of government between 1910 and 1961. Throughout this period the federal and state levels combined accounted for ninety per cent of all Brazilian revenues, while the local governments collected the remaining ten per cent. Long-run secular trend estimates indicate that the federal relative share fell from about sixty per cent in 1910 to about forty-eight per cent in 1961, the state relative share rose from about twenty-nine per cent to forty-two per cent over the same time period, and the municipal share remained in the neighborhood of ten per cent for the fifty year period. The fall in the federal share was almost exactly offset by the rise in the state share. The municipal share, however, remained constant even though local governments received enlarged tax powers after 1934, and inter-governmental revenue shares after 1946.

The raw data used to calculate the relative shares reported money amounts received by each level of government after revenue transfers had been made. If, therefore, one subtracts the value of transfers from local government income before calculating the municipal share, it will be found that the share of total revenues going to municípios began to decline below ten per cent in 1943 and reached a low point of 6.6 per cent in 1959.³⁹

³⁹ "States and Municipalities - Their Share in the Union's Tax Revenues," p. 51.

The calculation of municipal relative shares before revenue transfers reveals some deterioration in the ability of local governments to raise revenues from local tax instruments. Additional evidence supporting this conclusion is provided by estimates of the income elasticities of representative federal and municipal taxes over the decade 1950-1960.⁴⁰ The coefficients of elasticity were calculated on the basis of the relative change in national income for Brazil and by state, and the relative increases in tax receipts for municipal and federal tax instruments. The results show that all municipal taxes were income inelastic in the aggregate, while all federal taxes were income elastic. The coefficient of elasticity for municipal taxes was 0.54, and for the four major federal tax instruments 1.42.

A coefficient of elasticity less than 1.0 means that the relative increase in tax collections was less than the relative increase in national income for the same period, and a coefficient of more than 1.0 means just the opposite. With respect to the local governments, a coefficient of 0.54 indicates that municipal tax collections increased only about half as much in relative terms as national income. As a result, municipal finance was weaker in 1960 than it was in 1950. If municipally administered taxes were the only source of local income, local governments would have received a smaller share of total revenue in 1960 than in 1950.

Poor local government finance is also influenced by the uneven pattern of regional economic development in Brazil. Many factors have been suggested as explanations for the fact that the southern coastal region from Rio de Janeiro south to Porto Alegre has experienced rapid and impressive economic growth while the rest of the country remained stagnant. It is not within the scope of this paper to analyze that phenomenon, but only to point out that there are two Brazils economically speaking.⁴¹ One is advanced and produces a surplus. It has modern and growing industry, technologically advanced agriculture, and relatively good means of transportation and communication. Its core is São Paulo and Guanabara with peripheral points of development in Minas

⁴⁰ H.M. Groves and C.H. Kahn, "The Stability of State and Local Tax Yields," American Economic Review, March, 1952, pp. 87-102; Melvin and Anne White, "Impact of Economic Fluctuations on Municipal Finance," National Tax Journal, March, 1954, pp. 17-39; Mabel Newcomer, "State and Local Financing in Relation to Economic Fluctuations," National Tax Journal, June, 1954, pp. 97-109.

⁴¹ J. Lambert, Os Dois Brasfl (Rio de Janeiro, 1965).

Gerais, Paraná, Santa Catarina, and Rio Grande do Sul. The other region, which embraces the larger geographic area of the country, including the Amazon region, the Northeast, and the western states of Mato Grosso and Goiás, is economically backward and functions at very low levels of income generation. It is isolated, has little or no modern industry, subsistence agriculture, and poor means of transportation and communication.⁴²

The existence of this economic dichotomy has important consequences for public finance at the local level. A few municípios in the relatively advanced areas of the country raise substantial amounts of revenues from the tax instruments reserved exclusively for local government. On the other hand, those municípios located in the economically stagnant and frontier regions, which make-up the majority of local governments, generate very low receipts from municipal tax instruments. Consequently, municipal income from local taxes is low in many areas primarily because of a low level of income generation, not because Brazilians have a greater propensity toward tax evasion, dishonesty or administrative laxness than the people of other countries.

An attempt was made to measure the relationship between community income generation and tax collections by calculating the portion of national income generated per state, and comparing those results with the portion of total municipal tax collections per state. The unevenness of economic development is revealed by the estimates which show, for example, that the Southern region of Brazil, composed of the states of São Paulo, Paraná, Santa Catarina, and Rio Grande do Sul, accounted for 51 per cent of national income in 1960. From a somewhat different viewpoint, the five leading income producing states, São Paulo, Guanabara, Minas Gerais, Rio Grande do Sul, and Paraná, generated 71 per cent of national income in 1960. If one compares the relative amount of national income generated per state in 1960 with the relative amount of municipal tax collections per state for the same year, it appears that those states with the highest portion of income generated also recorded the highest portion of municipal tax collections. For example, the state of São Paulo generated 32 per cent of national income, the highest in the nation,

⁴² Celso Furtado, A Pré-Revolução Brasileira (Rio de Janeiro, 1962) Roberto Campos, Economia, Planejamento, e Nacionalismo (Rio de Janeiro, 1963).

and its municípios collected 47 per cent of municipal tax revenues, also the highest in the nation. At the other end of the scale the municípios of low income states consistently generate the lowest portion of municipal tax receipts. Piauí, for example, generated 0.51 per cent of national income, and its local governments accounted for 0.47 per cent of municipal revenue from taxes. An estimate of the statistical correlation between the two sets of variables results in a coefficient of correlation of .98. Coefficients of correlation do not really explain the causative factors that might be involved in the inter-relation between the two variables, but at least regression and correlation analysis do not deny the hypothesis.

The statistical estimates therefore lead one to the following conclusion: The municípios of high income producing states manage to raise reasonably adequate amounts of revenue from their exclusive tax instruments because they have something to tax. In other words, they have a reasonably good tax base. There are, however, few high income producing states in relation to the enormous size of the country. Ten states, for example, generated less than two per cent each of national income, and none of them had municipal tax collections in excess of 1.34 per cent. As a result, the majority of local governments in rural and economically backward areas do not generate adequate tax receipts partly because local income generation is low; the local governments do not have an adequate tax base.

Finally, a division of municipal tax collections between amounts collected by the state capital municípios, and amounts collected by all other (non-capital) municípios reveals yet another dimension of municipal poverty in Brazil. Calculations for the period 1940 through 1962 indicate that non-capital municípios collected 42 per cent of municipal revenues annually, while capital municípios collected 58 per cent. Of 3,062 local governments, only 20 were state capitals in 1962 (excluding the Federal District, city of Rio de Janeiro, and four territorial capitals), and the state capital municípios contained only 13 per cent of state population of the average. If one uses the state of Minas Gerais as an example, the estimates imply that one município, the state capital of Belo Horizonte, with only 7 per cent of the state population, accounted for a little more than one-half of all municipal revenues for the state, while the other 717 local governments, containing 93 per cent of the state population, shared the remaining 42 per cent. On the average then, the non-capital municípios of Minas Gerais accounted for only about 0.06 per cent of total municipal tax revenues each.

The poor financial condition of non-capital municípios

is emphasized further if one takes special note of the role played by the município of São Paulo, and several of the other highly urbanized state capitals. In 1962, for example, the município of São Paulo, capital of the state bearing the same name, generated one-half of local tax revenues collected by capital municípios, and 23 per cent of all local government revenues. São Paulo plus four other state capitals, Pôrto Alegre, Recife, Belo Horizonte, and Salvador accounted for 36 per cent of all municipal tax collections. This analysis, therefore, suggests that the bulk of non-capital local governments, most of which are located in rural areas, account for a relatively small portion of municipal tax collections. Furthermore, these estimates overestimate non-capital tax collections by the amount of inter-governmental revenue transfers received. This occurs because the raw data series used reported total municipal income after transfers had been made. Capital municípios did not participate in the income tax transfer nor in the 30% of excess revenue transfers from the states throughout the entire period examined. Consequently, if inter-governmental revenue transfers were deducted from non-capital município income, and only those revenues resulting from local levies were considered, the portion of total revenues generated by non-capital municípios would be somewhat lower than the amounts estimated above.

What then was the effect of the revenue transfer programs on municipal finance? Did the sharing of federal and state tax revenues with local governments improve municipal finance materially? In general, the answer must be yes. As a matter of fact, one might go so far as to say that the revenue transfers were a fiscal lifesaver for many rural municípios. The benefits, however, were not as great as they might have been in the absence of several difficulties and side effects involving the proliferation of local governments, inflation, and administrative problems.

Given the scarcity of published statistical data, it is extremely difficult to measure the impact of the revenue sharing programs on municipal finance. One must therefore be satisfied with partial and incomplete evidence. It is possible, however, to demonstrate that revenue sharing has helped local government. The most recent year for which tax collections per município are available for all of Brazil is 1956. The data, as published in the Anuário Estatístico do Brasil, reveals that 1,400 local governments out of a total of 2,248 existing at the time raised less than Cr\$ 1,000,000 per local government per annum from locally administered taxes. For that same year the income tax transfer alone provided each local government with Cr\$ 1,027,000.

Consequently, 62 per cent of the municípios received more income from the income tax transfer than from their own local tax instruments. Moreover, if other transfers that were in effect at the time were added to the income tax quota, the number of local governments receiving more income from shared revenues than from local taxes would be greater still.

The financial impact of the revenue transfers may also be demonstrated by calculating the portion of shared revenues to total municipal income for various years. Such an estimate is provided in Table 6 below.

Table 6 SHARED REVENUES IN RELATION TO TOTAL MUNICIPAL INCOME
1941-1962, Cr\$ millions

Year	Total Municipal Income	Shared Revenues	Shared as % of Total
1941	Cr\$ 1,015	Cr\$ 56	6%
1947	2,245	83	4%
1952	6,708	1,104	16%
1957	22,848	4,995	22%
1961	62,025	15,928	26%
1962	94,292	21,284	23%

Source: Anuário Estatístico do Brasil, 1947 - 1963.

An examination of the table reveals that before the revenue sharing programs began (1941 and 1947), the portion of shared revenues to total municipal income was only six per cent and four per cent respectively. By 1952 most of the transfer programs were operative, and the shared revenue portion rose to sixteen per cent. By the late 1950's and early 1960's, revenue transfers accounted for approximately one-quarter of municipal portion of shared revenues to total municipal income. If it were possible to disaggregate the data and calculate the portion of shared revenues to total municipal income for each and every local government, the shared portion would undoubtedly account for a much larger portion of total income for many individual municípios. An analysis of 150 municípios in Rio Grande do Sul for 1960 reveals, for example, that the mean portion of shared to total income was 49 per cent, with individual municípios receiving from 14 per cent to 75 per cent of total income from shared revenues.

Although revenue transfers benefited local governments several factors prevented them from realizing maximum financial benefits. The primary factors include the fragmentation of local units of government, inflation, and various administrative problems, such as delays and the failure to make transfer payments.

The number of local governments increased steadily throughout the twentieth century. A total of 3,028 new municípios were formed between 1886 (roughly at the time the First Republic was founded) and 1963 without any increase in the land area of the country. During the twenty-three year period between 1940 and 1963 all states created a total of 2,146 new local governments. The number of municípios more than doubled. For every município that existed in 1940, approximately 2.4 existed in 1963. The five states permitting the largest number of new local governments were Minas Gerais with 430, São Paulo - 235, Paraná - 201, Bahia - 188, and Amazonas - 139. These five states accounted for 1,193 new municípios or 55 per cent of the increase.

Many factors may explain an increase in the number of local governments, such as population growth and social and economic development, but several Brazilian students of public administration feel that the revenue transfers, and in particular the income tax transfer, were the major cause of municipal proliferation. "In the space of a quarter century, that is from 1920 to 1945, 369 municípios were created. With the promulgation of the Constitution of 1946, whose spirit was frankly municipal, the dismemberment of municípios accelerated because in twelve years following 1945, 798 new municípios were created."⁴³ "We may say that up to 1945 the creation of new municípios was dictated by the force of economic and social development, but since 1946 the creating force has been determined by the constitution which sought to strengthen municipal finance, but appears to be provoking distortions by reason of the manner in which it is carried out."⁴⁴

Since the income tax share is divided equally among municípios, and not in proportion to population, land area,

⁴³ Esio F. Macedo, "A criação de Municípios e a Geografia Financeira," Revista de Finanças Públicas, Mar-Maio, 1959, p. 26.

⁴⁴ Esio F. Macedo, p. 24.

or fiscal need, the larger the total number of municipios, the smaller will be individual municipal quotas, assuming constant income tax collections. Even so, however, the state with 300 municipios would stand to receive larger aggregated quotas than a state with only 100 municipios. The quotas of course go to the local governments, not to state authorities; but the states may have viewed the federal transfer programs as an excuse for reducing their burden of financial aid to local governments, or as a means of attracting a larger portion of tax payments back to their political jurisdiction. The income tax transfer would have encouraged the creation of new municipios in both high and low income producing states as the states reacted to the income redistribution effects of that transfer. A low income producing state will benefit from more municipios because the more it has, the greater will be the sum of municipal quotas. A high income producing state will also tend to benefit from more municipios because the more it has, the smaller will be the negative income redistribution effects. In other words, assuming that high income producing states provide the bulk of income tax receipts, and the transfer tends to redistribute the income tax share in favor of low income producing states, the creation of additional units of local government in high income states will tend to cause a larger portion of income taxes paid to the federal government to flow back to its local governments.

Whatever the cause of municipal proliferation, it seems clear that the uncontrolled increase in the number of new local governments contributed materially to the erosion of the income tax transfer. Between 1949 and 1961, those years when a ten per cent share was divided among local governments, the number of municipios increased at a rate of about five per cent per annum. Given that rate of increase, and assuming that income tax receipts remained constant, the annual municipal quota would have fallen from Cr\$ 285 thousands in 1949 to about Cr\$ 168 thousands in 1961. But income tax receipts did not remain constant. They increased substantially over time, causing the value of the ten per cent share to rise at a rate of about twenty-seven per cent per year. Inasmuch as the share increased at a faster rate per year than the number of local governments, quotas actually rose in nominal terms by about twenty-two per cent per year.

In nominal money terms, then, the municipal quota rose from Cr\$ 285 thousands in 1949 to Cr\$ 2,954 thousands in 1961. If, however, the number of municipal governments had not increased after 1949, or had increased at an annual rate of less than five per cent, the municipal quota would have been larger in 1961 than it actually was. If no new municipios had been created, the 1961 quota would have been approximately Cr\$ 4,881 thousands, or about 65 per cent greater than it was.

Inflation also contributed to the erosion of the income tax transfer. The actual income tax quota increased approximately ten times in nominal money terms between 1949 and 1961, or from Cr\$ 285 thousands to Cr\$ 2,954 thousands. If the nominal quotas are deflated by an appropriate price index, however, it may be shown that the real impact of the income tax transfer was substantially less than that indicated by the nominal quotas. When nominal quotas are deflated by the national income accounts implicit deflator for Brazil, they rise from Cr\$ 285 thousands to only Cr\$ 364 thousands, or only 1.3 times. It is interesting to note that if the income tax share had remained at ten per cent for 1962, the real quota for that year would have amounted to only Cr\$ 312 thousands, the lowest real amount since 1952.

By 1961 the real value of the income tax quota was Cr\$ 364 thousands. If, however, inflation had not occurred, nor the number of municípios increased after 1949, the quota would have had a maximum value of Cr\$ 4,881 thousands. The difference between these two amounts is Cr\$ 4,417 thousands, and it is equivalent to the value of the quota eroded away by the combined effects of inflation and municipal proliferation. Of the difference, Cr\$ 2,590 thousands was eroded away by inflation (the 1961 nominal value of Cr\$ 2,954 thousands less the real 1961 quota of Cr\$ 364 thousands). Inflation thus accounted for about 57 per cent of total erosion. The portion of the difference attributable to municipal proliferation is Cr\$ 1,927 thousands, or the 1961 maximum possible quota of Cr\$ 4,881 thousands less the actual nominal quota of Cr\$ 2,954 thousands. Municipal proliferation, therefore, accounted for approximately 43 per cent of total income tax transfer erosion.

A final appraisal of the impact of inter-governmental revenue transfers on municipal finance must take into account the fact that transfers were sometimes delayed, sometimes partially made, and in some cases not made at all. With respect to federal transfers, the National Highway Fund has performed best. By 1959 better than 90 per cent of the local governments were receiving petroleum products tax transfers on a regular basis.⁴⁵ Previous mention was made of the fact that electric energy tax quotas are deposited in and held by the National Development Bank until such time as individual municípios submit plans for expanding local electric service

⁴⁵ Instituto Brasileiro de Administração Municipal, Municípios do Brasil, p. 63.

that meet criteria established by the National Water and Electric Energy Council. An article appearing in Conjuntura Econômica reported that many local governments have not received electric energy tax quotas. It stated that 'while the norms have been established for the division of this revenue, the nature of its application has in practice blocked its total utilization, principally that which touches the grants to states and municípios. It is sufficient to say that of a collection equal to Cr\$ 4.6 billions...less than Cr\$ 2 billions has been liberated up to 1960, even though...the national treasury has transferred almost all of the total to the National Development Bank.⁴⁶ One can only speculate as to why the National Development Bank did not release some municipal quotas, but the principal reason may rest upon the fact that many local governments do not have sufficient technical talent and other resources at their disposal with which to draw up the necessary plans and specifications required by law as a prerequisite for transferring the quotas.

The federal government also failed to carry out the income tax and consumption tax transfers to the letter of the law. Available evidence is sketchy and incomplete, but at least it is sufficient to show that the federal government did not always make full transfer payments on time. Two independent analyses of the income tax transfer reveal that between 1949 and 1955 only partial quota payments were made to local governments at the times provided for by law. The municípios eventually received the past due balances, but they often had to wait as long as five years.⁴⁷ By the time they received payment, however, inflation had seriously eroded the purchasing power of the past due quotas. The situation has continued to the present time. Specific information is not available from government sources, but numerous newspaper reports confirm the fact that municípios have not been receiving full quota payments on time. An article appearing in the newspaper Correio do Povo of Pôrto Alegre, for example, pointed out that income tax and consumption tax quotas had been paid irregularly to Rio Grande do Sul municípios since 1960, and that in August of 1964 the local governments had not yet

⁴⁶ "Impôsto sôbre o Consumo de Energia Eléctrica," P. 80.

⁴⁷ "Participação dos Municípios no Impôsto de Renda," Revista de Finanças Públicas, Set., 1955, pp. 14-17; D.R. da Silva, "O Município e o Impôsto de Renda," Revista Brasileira dos Municípios, Jan-Mar., 1954, pp. 15-21.

received full payment of the 1962 consumption tax quota.⁴⁸

The most serious evidence of non-payment is provided by the two state-municipal transfers. Mention has already been made of the fact that little or no income accrued to municípios from the 40 per cent of new state tax revenue transfer. In view of the fact, however, that most states made explicit provision for the 30 per cent of excess revenue transfer, one may legitimately ask why the states did not fulfill their promises or carry out provisions of the law.

State legislation typically called for a transfer of three per cent of excess revenue collections for the first year (1948) and for a gradual increase in transfers each year until they equalled 30 per cent by 1958. Some states, however, provided for more rapid implementation. São Paulo, for example, planned to transfer the full 30 per cent by 1952, Minas Gerais by 1954, and Rio Grande do Sul provided for an immediate full transfer.⁴⁹ Despite the legislative enactments, the states were generally unwilling or unable to comply with the modest goals they set for themselves.⁵⁰ As a matter of fact some states never made any transfers, and an estimate of performance by Rio Grande do Sul indicates that only half of planned transfers were made.⁵¹

Several reasons seem to explain poor state performance with respect to the 30% of excess revenue transfer. First, supplementary federal legislation gave the states ten years counted from 1948 in which to fully implement the transfer program.⁵² This concession to the states had the effect of putting the program on a voluntary basis until after 1958.

⁴⁸ "Assembleia Legislativa-Municípios," Correio do Povo, Porto Alegre, 12 de Agosto de 1954.

⁴⁹ "Leis e Regulamentos de Alguns Estados sobre o Pagamento de 30% sobre excesso de Arredação," Revista de Finanças Públicas, Set., 1952, pp. 38-40.

⁵⁰ One student of Brazilian municipal affairs claims that "the states refused to fulfill these obligations." C.L. Donald, "The Politics of Local Government Finance in Brazil," Inter-American Economic Affairs, Summer, 1959, p. 29.

⁵¹ Diogo Lordello de Mello claims that up to 1956 Amazonas, Para, Piauí, Paraíba, Alagoas, Minas Gerais and Goiás did not make transfers, and that other states made them on a reduced basis. "O Problema das Finanças Municipais no Brasil," Revista Brasileira dos Municípios, Jul-Dez., 1956, p. 211

⁵² Brasil, "Ato das Disposições Constitucionais Transitorias, Artigo 13, 2(III), "Constituição da República dos Estados Unidos do Brasil, 1946, p. 96.

It therefore contributed to reduced transfers, and in some cases no transfers at all. By 1959, the first year after the end of the ten year grace period, the portion of municípios receiving transfers by geographic region were as follows: South: 82.6%, North: 17.7%, Northeast: 14.3%, East: 8.4%, and Central-West: 3.9%. In all of Brazil only 34.5% of the municípios received state transfers in 1959.⁵³

A second reason relates to state interpretation of the words "local incomes" in Article 20 of the constitution. Constitutional language states that the excess revenue collections shall be calculated on the basis of "the total of local incomes of any nature," (o total das rendas locais de qualquer natureza). Municipal officials argued that it was the intent of the constitution to count only local tributary receipts, i.e., collections from locally administered taxes and fees, as the basis for making transfer calculations. The states, on the other hand, claimed that the word "renda" (income) is broader in scope than "tributary receipts", and they were legally correct in considering municipal incomes of any nature, and from any and all sources, including municipal taxes and fees, revenue transfers from the federal government, grants-in-aid, rent, interest income, gifts, proceeds from the sale of property, payments from autonomous government agencies, and grants from foreign aid programs.

A good deal of legal controversy took place over several years, and at least one student of Brazilian public finance claims that it was the intent of the constitution to limit the meaning of "local incomes" to revenues raised from locally administered taxes.⁵⁴ The content of these legal arguments need not be repeated here because they changed nothing. The states continued to use their interpretation, and as a result, the actual amounts transferred to local governments were minimized.

The manner in which the states administered their tax instruments provides a third reason. The states were frequently unable to determine precisely the excess of state impost collections over local incomes for individual municípios, and it was never clear whether transfers were to be made to the municípios where administrative collections were made, or to those whose residents actually paid the state taxes.

⁵³ Instituto Brasileiro de Administração Municipal, Municípios do Brasil, p. 63.

⁵⁴ Amilcar de A. Falcão, p. 70.

The states do not maintain tax collection offices in all municípios. It was not unusual for a tax office in one principal city to serve several municípios. This was especially true in rural areas which lacked commercial and industrial enterprises. Consequently, the state knew how much was collected for the region as a whole, but it could not readily determine how much was collected from individual municípios. Transfer inequities were bound to result from this situation. The municípios with state tax offices would tend to receive large transfers, while those without tax offices would receive virtually nothing.

The sales tax was by far the most important source of state revenue.⁵⁵ Therefore, the manner in which it was collected affected the transfers received by local governments. The sales tax was imposed on and paid by sellers, but the burden was easily shifted by buyers. If, then, consumers from neighboring municípios were in the habit of making major purchases in a regional commercial center, sales tax collections arising from these purchases would be reported as collected in the município with the commercial center, not in the município where those who bore the burden of the tax resided.

One must also consider the fact that many sellers maintained a main office in the state capital, usually the principal city in the state, and branches in other cities. If the sales taxes collected from branch sales were channeled back to the main office for payment to the state at that point, it would appear as if the taxes were actually collected in the capital município. To the extent that this may have occurred, it was of benefit to the state, but a disadvantage to local governments because the state capital municípios did not participate in the revenue sharing program.

Finally, the constitutionally directed state-municipal revenue sharing program conflicted with customary state-municipal relations. For the greater part of Brazilian history the local governments were not financially autonomous. They were subordinate to and financially dependent upon the states after 1889. Although the Constitutions of 1934 and 1946 gave local government a greater amount of local autonomy with respect to local elections, administration, and finances,⁵⁶ traditional fiscal and administrative relations between the states and their municípios did not change materially. There had

⁵⁵ Sales taxes accounted for 78% of total state impost revenue in 1960.

⁵⁶ F.B. da Rocha, "Incorporação, Subdivisão, e Dismembramento do Município," Revista Brasileira dos Municípios, Jan, 1950, p. 104.

never been, for example, a tradition of financing local projects or services through grants-in-aid from the states, and the new legal status of the municípios did not cause the states to devise such a system of supplementary local finance.⁵⁷ The states had always provided many local services to municípios in areas of primary and secondary education, public health, welfare, and security. Moreover, if local governments desired supplemental financing for capital investments, they appealed individually on a project by project basis to the state. State authorities, in turn, considered the merits of each case separately. If the state granted the request, it usually did so by making the capital investment itself, not by means of a loan or grant-in-aid.

These methods of providing state aid to local government have continued in use without significant modifications down to the present time for two fundamental reasons: first, because of a long tradition of centralized municipal administration at the state level, and second, because of a sincere and general belief that the majority of municipal officials have neither the experience nor the technical ability to administer grants-in-aid or public investment projects competently or efficiently.⁵⁸ The authors of the constitution appear to have directed the states to share tax revenues with their local governments without considering the pre-existing structure of state-municipal relations, but the directive does not seem to have altered previously established state-municipal relations to any significant degree. Available evidence does not permit one to conclude that the states cut back on traditional forms of aid to local governments in order to be able to make transfer payments. Actual behavior points to the opposite conclusion: the states more or less ignored the constitutional directive; they continued to extend traditional forms of aid and services to municípios at undiminished levels, and did so by minimizing 30 per cent of excess revenue transfers.

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Diogo Lordello de Mello, A Moderna Administração Municipal, p. 88.

58

Diogo Lordello de Mello, p. 74.

In conclusion, the combined forces of municipal proliferation, inflation, and several kinds of administrative problems served to reduce the financial impact of inter-governmental revenue transfers on local government. One measure of the reduced impact is provided by the pattern of revenue shares going to the three levels of government. It was demonstrated that the municipal share, calculated on the basis of locally raised revenues only, tended to decline after 1943, falling from a traditional ten per cent to approximately six per cent by 1959. Inclusion of the revenue transfers, however, tended to maintain the municipal share at ten per cent. Generally speaking, then, the transfers only permitted local government to maintain its traditional relative position in the structure of Brazilian public finance. The transfers did not increase the municipal relative share at the expense of the other levels of government. Although the transfer programs did not create a financial utopia for local government, it is reasonably clear that they did help municípios finance local services and maintain themselves as viable political units.

V. INCOME REDISTRIBUTION EFFECTS

The income tax and consumption tax transfers have measurable income redistribution effects. They tend to redistribute income from those states and municípios that generate high levels of income to those that do not. Earlier mention was made of the fact that there are wide disparities in the levels of economic development attained by the various states and regions of Brazil. Because of that situation a few states account for the bulk of national income. In 1960, for example, the four leading income producing states were São Paulo with 32 per cent of the total, Guanabara with 13 per cent, Minas Gerais with 10 per cent, and Rio Grande do Sul with 9 per cent. As a result, 20 per cent of the states (these four) produce approximately 64 per cent of national income, while the remaining seventeen states (80 per cent) produce 36 per cent of national income.

Since only a few states and municípios generate the bulk of national income, they also pay the largest portions of income and consumption tax collections. All municípios, however, receive equal annual quotas from revenues generated by those two taxes. Consequently, the income and consumption tax transfers function as a vehicle for redistributing income from the rich to the poor states.

The tables on the following two pages illustrate that phenomenon with respect to income tax collections and transfers by state for the years 1950, 1960, and 1963. Table 7 compares the portion of total income tax receipts collected per state with the portion of total municipal income tax quotas received per state. Only three states, São Paulo, Guanabara, and Rio Grande do Sul show tax payments proportionally greater than total quotas received by their municípios. These three states were also first, second, and fourth in terms of income generation. They accounted for one-half of national income and paid 80 per cent of income taxes in 1960. All other states on the table show total quota payments received proportionally greater than income tax payments.

Table 8 provides a slightly different view of the phenomenon. It shows total municipal income tax quotas received per state as a portion of total income taxes paid. A percentage figure of 100 indicates total municipal quotas equal to income tax payments. An entry of less than 100 indicates that total quotas were less than tax payments, and an entry of more than 100 means total quotas received were greater than income taxes paid. An inspection of the table reveals wide divergencies. São Paulo, for example, received total municipal quotas equal to only four per cent of taxes paid, whereas Piauí received

total quotas equal to 202 per cent of tax payments for 1960. Seven states, all in the Northeast and Central-West regions of extremely low income generation, consistently received total municipal quotas greater than the sum of income taxes paid over the thirteen year period examined.

Table 7 PER CENT OF INCOME TAX PAID AND PER CENT OF TOTAL QUOTAS RETURNED, BY STATE

State	1950		1960		1963	
	% Tax Paid	% Quota Returned	% Tax Paid	% Quota Returned	% Tax Paid	% Quota Returned
Amazonas	0.32	1.70	0.41	1.85	0.32	2.67
Para	0.71	3.25	0.83	2.29	0.44	2.44
Maranhão	0.27	3.79	0.17	3.28	0.13	3.43
Piauí	0.17	2.56	0.12	2.55	0.10	2.87
Ceará	0.56	4.16	0.59	5.32	0.58	4.27
Rio Grande do Norte	0.17	2.50	0.15	2.98	0.18	3.17
Paraíba	0.29	2.13	0.23	3.17	0.20	4.19
Pernambuco	2.64	4.75	1.60	3.68	1.21	3.40
Alagoas	0.35	1.92	0.22	2.00	0.17	2.11
Sergipe	0.21	2.18	0.13	2.22	0.13	1.74
Bahia	2.17	7.95	1.60	7.03	1.12	9.51
Minas Gerais	5.11	20.66	6.63	17.64	6.47	20.20
Espírito Santo	0.41	1.86	0.34	1.42	0.29	1.12
Rio de Janeiro	2.02	2.93	1.75	2.18	1.57	1.74
Guanabara (a)	34.41	--	30.29	--	26.91	0.02
São Paulo	39.64	19.64	42.18	18.34	46.91	14.20
Paraná	2.10	4.21	2.64	5.87	2.81	6.83
Santa Catarina	0.97	2.73	1.53	3.68	1.59	4.67
Rio Grande do Sul	6.89	4.85	7.12	5.43	7.03	4.44
Mato Grosso	0.20	1.81	0.21	2.29	0.18	1.80
Goiás	0.25	4.05	0.44	6.49	0.65	5.03
	99.86	99.63	99.18	99.71	98.99	99.85

(a) Former Federal District.

Source: Anuário Estatístico do Brasil, IBGE, 1951, p. 494; 1962, p. 338; 1964, p. 365.

Table 8 TOTAL INCOME TAX QUOTAS RETURNED AS A PER CENT OF INCOME TAX PAID BY STATE

State	1950	1960	1963
Amazonas	51.98%	44.99%	121.85%
Para	45.36	27.56	82.85
Maranhão	139.47	188.52	390.47
Piauí	149.92	202.26	397.47
Ceará	73.20	89.55	108.75
Rio Grande do Norte	141.61	188.40	255.72
Paraíba	75.06	137.77	301.64
Pernambuco	17.99	22.99	41.87
Alagoas	54.12	90.87	176.96
Sergipe	103.38	162.85	199.37
Bahia	36.55	43.79	126.60
Minas Gerais	40.41	26.59	46.81
Espírito Santo	45.57	41.72	56.56
Rio de Janeiro	14.52	12.43	16.60
Guanabara (a)	-	-	0.01
São Paulo	4.95	4.34	4.59
Paraná	20.01	22.18	36.49
Santa Catarina	27.80	23.96	44.03
Rio Grande do Sul	7.04	7.62	9.48
Mato Grosso	89.91	108.81	143.08
Goiás	161.99	145.58	115.83

(a) Former Federal District.

Source: Anuário Estatístico do Brasil, IBGE, 1951, p. 494; 1962, p. 338; 1964, p. 365.

Both estimates of the relation between tax payments and municipal quotas received, therefore, lead one to the conclusion that taxes collected in high income producing states are used to make transfer payments to municipios in low income producing states. Consequently, the income tax transfer played a dual role: it helped subsidize local governments, and it redistributed income.

VI. CONCLUSIONS

1946 was a turning point for municipal finance in Brazil, and it marked the beginning of a major new phase in Brazilian public finance. The Constitution of 1946 and its subsequent amendments not only gave local government more autonomy, independence, and exclusive tax powers than ever before, but it began an experiment in fiscal federalism. Before that date the constitutions made a rough division of revenues among the three levels of government by means of a specific allocation of tax instruments. After 1946 tax instruments continued to be allocated by statute, but the constitution also sought to make a more equitable division of revenues by having local government share in the tax revenues generated by the state and federal levels of government.

Municipal tax collections tended to be inelastic over time with reference to increases in national income. The local governments were unable to raise additional tax revenues from the instruments at hand at a rate equal to the growth in national income. Two factors contributed to this situation: Brazilian municípios did not have the same degree of freedom of action in fiscal matters that the local governments of some other countries might possess. The rigid "constitutional distribution system"⁵⁹ of tax powers prohibited them from using or devising taxes that were not specifically assigned to them by constitutional law. Second, the majority of tax instruments allocated to local government contained a built-in bias toward urban economic activities. The urban land tax, buildings tax, industries and professions tax, property transfer taxes, license, and amusement taxes do not function well in rural areas. The only clear advantage rural municípios had over urban municípios was in the form of the rural land tax, but it was not awarded to them until 1961. Consequently, a few highly urbanized municípios, most of them state capitals, did reasonably well with the tax instruments at their disposal because they had buildings, property transfers, businesses, professions, and amusements to tax. Numerous rural municípios did not have a sufficient volume of business, commercial, and professional activities, or a large enough urban real property tax base from which to raise revenues.

The revenue transfers have, therefore, been of considerable assistance to the great majority of local governments. The financial impact of individual transfers has varied because of the manner in which they were administered, methods used to determine quotas, and the pattern of collections for the tax

⁵⁹ Paul Hugon, "O Sistema Tributário do Brasil: O Problema da Distribuição," Digesto Econômico, Maio, 1949, p. 73.

source. In general, however, it seems clear that without revenue transfers local government would have grown weaker, and may have developed a form and structure different from that which exists today.

Brazilians point out that because of acute economic imbalances among regions, brought about by climatic conditions, unequal resource distribution, and a concentration of industry and diversified agriculture in the south of Brazil, private economic markets tend to redistribute income from the already low income generating North and Northeast to the high income generating South. The present equal lump sum method of making transfer payments tends to have an opposite income redistribution effect. As a result, the income tax and consumption tax transfers, as presently administered, tend to compensate the North and Northeast for income losses to the South. If the transfers were allocated on a per capita, or perhaps some other basis, the public sector would no longer cause a compensating income redistribution through the tax system. A per capita allocation would tend to reinforce the pattern of income redistribution emanating from the private sector.

If one assumes that the present equal lump sum criterion was purposely adopted in order to create income redistributions that tend to compensate the poor areas of the country for income drains to the rich areas, a per capita method of transfer allocation will probably not be acceptable to Brazilians. Whether a per capita system might become acceptable in the future would appear to depend on the attainment of a greater degree of equality in the pattern of inter-regional economic development and income generation.

The Brazilian system of inter-governmental revenue transfers for the support of local governments is somewhat unique in two respects: the bulk of transfers are received from federal sources, and this appears to represent a federal effort to by-pass the intermediate level of state government in order to assure the continued existence of effective, semi-autonomous units of local government. Second, the major portion of transfers are not tied to specific, federally determined spending goals, but may be spent at the discretion of local governments on the kinds of public services normally associated with local government. It might be more accurate to say, however, that the nurturing and cultivation of a system of local government is a primary national goal. Thus any transfers made to municípios are in fact tied to the attainment of that basic goal. The major transfer programs have been in operation for a relatively short period of time, about twenty years. Instead of viewing them as rigid and unalterable, the social scientist should treat them as an ongoing experiment

in the finance of local government within the framework of political democracy, mixed capitalism, and a social system that is rapidly breaking away from its traditional patterns of behavior.

In the final analysis, the economic effects of the transfer programs may be of secondary importance in comparison with the political effects, or the hoped for political effects. Prior to the 1930's Brazilian politics was generally controlled by a landed plutocracy. Between 1934 and 1945 political life and institutions were dominated by the dictatorship of Getulio Vargas. The Vargas dictatorship was humane, but it stifled political competition and the development of new political leaders who did not agree with the policies of the Vargas government. One of the great evils of a dictatorship, even though it may be benevolent, is the repression of political competition and the minimization of the number of alternative political ladders which may serve as a means for qualified young men and women to enter political life. Dictatorship, therefore, means political monopoly.

Brazil suffers today because of the political monopoly exercised by the Vargas regime. Had young men been able to enter politics freely at the state and local level during the 1930's and early 1940's, they would now have gone through twenty years of training, and many of them would be qualified to hold governorships, high level federal appointments and elected positions. But people with these qualities are actually in scarce supply today because the political and administrative talent that might have developed during the Vargas era, if differing and independent views had been allowed, has not materialized in sufficient quantity. Contrary to the popular view that there are too many politicians in Brazil, there is actually an insufficient supply of qualified politicians, and the situation will not be corrected until more people receive on-the-job training, so to speak, at local and state levels of government. The preservation of a system of local government, therefore, provides a competitive training ground for the development of public servants, and it offers multiple political ladders to those with political aspirations. The cost of subsidizing a system of local government may, therefore, be small in comparison with the hoped for political benefits that may accrue to the nation over the long run.