Controlling the public debt in presidential systems: constitutional and legal restrictions in the US and Brazil

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Resumo:

Analisando o papel desempenhado pelas restrições legais no controle do endividamento público em dois países presidencialistas - Estados Unidos e Brasil, o trabalho mostra que tais regras não são suficientes para reduzir os déficits e a dívida pública. Para terem efetividade, elas dependem de certas condições políticas, como a coesão governamental.

Palavras- chave: Instituições políticas - coesão governamental - dívida pública

Abstract

Focusing on constitutional and legal restrictions over public indebtedness in two different presidential systems, the US and Brazil, this paper shows that they are not sufficient to reduce deficits or high levels of debt financing. To be enforced those restrictions depend on other institutional and political conditions such as government cohesion.

Key-words: Political Institutions - Government Cohesion - Public Debt

Classificação da ANPEC: AREA 1 - Metodologia, História e Economia Política

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Introduction:

Institution-oriented approaches have come to emphasize the role of institutions in social life. Many empirical studies driven by new institutionalism have shown the effects of institutions over behavior, preferences and strategies of actors in economic and political activities (North,1981; Powell and DiMaggio,1991; Weaver and Rockman, 1993). Without denying these findings, the present paper stresses that some institutional arrangements such as constitutional or legal budgetary restrictions, have limited effects. Since they impose immediate and visible losses over relevant actors while their expected benefits are long-term, diffuse and uncertain, they are hardly enforced. To be enforced they depend on political and other institutional conditions.

According to Weaver and Rockman (1993)although institutions affect government capabilities, their effects are contingent and mediated by other institutional and non institutional factors. Thus, instead of speaking about the sufficiency of certain institutional arrangements, it is more appropriate to speak about opportunities and risks for any given capability which vary over time and across areas of public policy. In fiscal policy, as in other areas, the most important capabilities of government are loss imposing and priority setting.Many scholars have indicated that the parliamentary system, despite some difficulties, especially in multiparty coalition cabinets, offers more institutional advantages to enhance government capacities than the presidential ones (Linz & Stepan 1996; Weaver,& Rockman, 1993; Lever and Shelpse,1994). The existence of multiple veto points inhibits the ability to impose losses and to set and maintain consistent priorities under presidentialism. Therefore, building government capacities is a greater challenge faced by politicians in this latter system.

Assuming that constitutional or legal restrictions over public deficit and indebtedness are not sufficient to achieve desirable fiscal outcomes, the purpose of this study is to analyze the political conditions under which those restrictions can be enforced in presidential countries. The main question is: What are the political conditions necessary to achieve desirable fiscal outcomes in presidential systems during hard economic times (of recession or hyperinflation)? Or, using Weaver and Rockman' s terms, What kind of capability should governments have in order to set fiscal priorities and impose losses on concentrated interests? A possible answer to this question is government cohesion, as advanced by Schick (1993). In the paper I will borrow his argument, analyzing the cases of two different presidential systems: the US and Brazil.

How does one justify the comparison between these countries, considering their differences in levels of economic development and in their political systems? In general, in the comparative studies, the selection is based on similarities, such as OECD democracies, common post-authoritarian situations, etc. This is not the case here. Even though presidentialism, federal system and a public debt to curtail are common situations among the US and Brazil, this study will focus on the differences rather than on the similarities in their presidential and federal systems. Several studies have shown that formally common presidential and federal systems existing in these two countries actually work very differently. In Brazil, the legislative branch is much weaker and the federal model more centralized than in the US (Abranches,1988; Camargo, 1992). In contrast to the American model of full separation of powers, the Brazilian presidential system gives considerable legislative power (through provisional measures) to the president, who also controls a great part of budget resources (Mainwaring& Shugart,1997; Figueiredo e Limongi, 1997).

Working very differently in each country, these systems have produced different situations of government cohesion over time (1) While the American system hardly presents government cohesion (especially in periods of divided government), the Brazilian presidential and federal systems have some devices which can induce more cohesiveness. Besides the legislative power of the president, the more centralized federal system which, for example, concentrates the control of public indebtedness in the Senate, can also work in the same direction (2).

Government cohesion is defined in this paper as the capacity of the president to set clear priorities, to have the main part of his agenda approved by Congress and to implement his policies. In the Brazilian presidential system, the government cohesion also includes the capacity of the president of having the provisional measures not disapproved by Congress.

What are the conditions necessary for government cohesion? If institutional arrangements (such as parliamentarism or presidentialism, electoral rules, partisan fidelity, etc.) do matter, the level of cohesiveness of a government also varies according to contingent political factors. In the US, it depends on the frequency of non divided party control of the legislative and executive branches (Cox and McCubbins,1992; Schick,1993; Endersby and Towle, 1997) (3). In Brazil, it depends on the capacity of the president to build enduring coalitions among several parties in Congress, negotiating ministerial positions and other political resources (Abranches, 1988; Amorin, 1994; Loureiro and Abrucio, 1999). Sometimes circumstances can also induce elite cohesion, such as the threat of victory on the part of the opposition candidate (a former unionist leader) in the 1994 Brazilian presidential campaign. In addition, to set clear priorities, consensus around some basic ideas is required as well as the presence of a competent and internally coherent bureaucracy (4). The scheme below can help to make the relationship between the variables clearer:

Institutional framework						
Contingent political factors		government		enforcement		desirable
Consensus around ideas	—>	cohesion	——>	of	—>	fiscal
Bureaucratic coordination				restrictions		outcomes

1.Comparing fiscal outcomes in two different parliamentary systems, Schick (1993) has also pointed out : "If Sweden and the Netherlands have taken different fiscal paths, it is at least partly because beneath the surface similarity of their cabinet governments, one country has been much more politically cohesive than the other" (p.188).
2 It is useful to remember that the American system was built not to be efficient, but to prevent tyranny; on the contrary, the Brazilian presidentialism still maintains considerable authoritarian features.
3 Even though they are affected by electoral rules, I assume that divided or unified governments in the US are contingent political situations since they can occur under the same institutional arrangement.
4. In the context of this paper which stresses mainly the relationships between executive and legislative branches, these requirements were not taken into account.

Cohesiveness is a crucial capacity which enables government to achieve desirable fiscal outcomes under adverse conditions. In the US, the absence of this capacity, due to divided governments, explains the high levels of deficit in the federal government, during the hard times of the 1980s and 1990s, as many authors have shown (5). In state governments, the increase of debt levels, in the same period, even under constitutional restrictions, was also due to mechanisms of power fragmentation (Briffault, 1996).

On the contrary, the current Brazilian situation can be seen as an example which reinforces the argument that even under recession, governments with a certain level of cohesion are able to present some significant achievements in fiscal policy. If hyperinflation was the price paid for the absence of government cohesion ("ungovernability") during the first ten years of democratic governments (Sallum Jr. & Kugelmas, 1993), the monetary stabilization in 1994 was possible due to a new situation of elite cohesion (Abrucio e Costa, 1999). Recently, the severe fiscal adjustment imposed by economic difficulties has been possible due to the great effort on the part of the Cardoso government to maintain the cohesion among their allies. (Couto and Abrucio, 1999; Loureiro and Abrucio, 1999). Table I in the appendix compares these different situations between the two countries over time.

As regard to the empirical data used to analyze the American case, they were collected mainly in bibliographies and refer to federal and state restrictions over budgetary deficits and public indebtedness, during the 1980s and 1990s. In the Brazilian case, the study focuses especially on the political and institutional action of the Senate. According to the Constitution of 1988, the Senate has the exclusive power to control all financial activities on the part of federal, state and local governments. It authorizes credit contracts in the internal or external market, establishes limits over indebtedness, etc. The Senate has also been playing a singificant role in the Cardoso government cohesion. Besides supporting his administration politically, it has establised new fiscal institutions which improve the control of public debts and contribute to fiscal adjustement, central issue in the governmental agenda. The analysis refers to the period of great deterioration of public finances, since the implementation of the economic stabilization policies (the Real Plan), in 1994. The main sources of data used in this part are documents and reports from the Brazilian Senate and other governmental agencies. Some material published in newspapers was collected. Interviews with senators, their aides and with civil servants from the Central Bank and the Ministry of Finance were also included.

It is relevant to mention that the effects of the public deficit over the economy are a controversial issue among different schools of economics. Budget preferences also vary among politicians, according to their ideological values and the political culture predominant in each country (Benavie, 1998). In contrast to American conservative politicians who endure zero deficit, the European Union governments, in the Mastricht Treaty, for example, considered investments (necessary to the economic development and expansion of the employment rates) as a legitimate reason for government borrowing. Even though they see the increasing deficits a threat, European leaders did not try to balance their

5. The current economic boom made possible what political and institutional conditions did not: not only a balanced budget, but surpluses. If desirable fiscal outcomes were generated even without government cohesion, and even without the enforcement of restrictions, the economic performance has saved politicians from hard choices only temporarily. When *fortuna* vanishes, *virtú* will be required.

budget. Thus, in a normative perspective, what is expected from the governments is a capacity to manage moderate deficits rather than insisting on zero deficits. Severe debt restrictions have been known to bring recession and unemployment, a process which forces the government into more deficits. (Evans, 1997:.12).

The paper is organized as follows: the first part analyzes the effects of constitutional restrictions on deficits and indebtedness and how other variables affected fiscal outcomes in the US. The second part examines the role of the Brazilian Senate in controlling the public indebtedness and in supporting the Cardoso administration. As ongoing research, this paper does not present conclusions. It finishes with some general considerations derived from the analysis in its present state.

1.The control of the public deficit and indebtedness in the United States.

1.1. Federal deficits in the 1980s and 1990s.

For most of the 1980s and of the 1990s, the federal budget deficit has been a major issue in the American political agenda (Wildavsky, 1988; White & Wildavisky, 1988; Brady & Volden, 1998; Benavie,1998; Evans,1997; Eastaugh,1994; Briffault,1996).

> "…(In) the late 1970s, congressional policy making has shifted from a policy regime where new programs — entitlements and others — were added and existing programs were expanded — to a policy regime where budgetary policy (focused on the deficit) encompasses and constraint all congressional policy" (Brady &Volden,1998).

For that reason, in the last decades, there were several attempts to impose a balanced budget. All failed. According to Schick (1993), during the 1980s, there was a " pattern that persisted throughout the decade. Steps were announced to reduce the deficit, and some were implemented. The president (and sometimes Congress as well) projected a declining deficit in the years ahead, but the actual deficit generally turned out much higher" (p.201).

In 1981, for example, when Jimmy Carter's original budget showed a $16 billion deficit, the reduction agreements negotiated by president and congressional leaders turned that deficit into a project of $16 billion surplus. Nevertheless, the actual deficit for that year was $74 billion.During the conservative Reagan administration, despite the cutbacks and the ideological atmosphere of “deficit hysteria” (Benavie, 1998), the attempts to balance the budget were not enforced either (6). The most significant example is the Balanced Budget and Emergency Deficit Control Act, also called the Gramm-Rudman-Hollings law, enacted in 1985. Although long, it is interesting to quote Schick's analysis about the fate of this law: it was circumvented by different mechanisms and has completely failed.

> "The legislation was a by-product of protracted stalemate between the two branches. What the president and Congress could not agree to do on their own would be done through the automatic sequester process. At least this was the script writ into law, though it did not quite work out as planned. Although the sequester was automatic,

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6. As an example of "deficit hysteria" and the manipulation of public opinion around this subject by conservative politicians, one can mention the National Debt Clock on 6th Avenue in New York. The big panel shows the incessant growth of the governmental debt every second.

> hardly anything else about the process was. The cutbacks could be averted(...); the targets could be changed; false savings could substitute for real ones; spending could be loaded onto the previous year (...)In an era of extended budget conflict, the two branches managed to agree principally on one thing: <u>that it is better to lie about the budget than to take the bitter medicine of deficit reduction</u> "(p.207) (Emphasis mine).

In 1990, the president and Congress negotiated a much larger deficit-reduction package to alter the Gramm-Rudman-Hollings law (7). It shifted the emphasis from controlling the deficit to controlling expenditure levels and revenue legislation. But again, this agreement had a number of loopholes and exceptions. Increases in the deficit or in spending due to economic conditions, emergencies and technical reestimates were empt from the new control (Schick, 1993: 208). Like the others, this agreement also failed.

Despite all legal attempts to control and balance the budget, the federal deficits increased enormously, jumping from 79 billion dollars in 1981 to 290 billion in 1992. Until 1995 the public debt in the US represented 70% of the GDP. Only after this period and due to the economic recuperation, the deficit was reduced to the level of 50% ($3.6 trillion of a $7.2 trillion GDP) (Briffault, 1996).

1.2. **Constitutional limitations in state governments: how they have been circumvented.**

As the states and local governments can not print money, they need to borrow since their expenditures are larger than their revenues. Otherwise they can not govern and provide public goods and services to citizens. In other words, the sub national governments in the US issue bonds when taxes and federal transfers or grants are not sufficient to maintain their programs and policies. For the investors, the incentives to buy governmental bonds come from tax exemptions.

Unlike the federal government, most states are constitutionally prohibited from using deficit finance (8). Some constitutions bar state debt outright (as in Indiana and West Virginia). Others impose different levels of limitation. For example, in the Arizona Constitution the aggregate amount of state debt shall never exceed the sum of $350.000 dollars and the Georgia Constitution limits debt services to 10% of the revenue receipts ; in Nevada the debt limits are 2% of the state assets. Most commonly, debts may not be incurred without the approval of a majority of state voters in a referendum, or a supermajority vote in the legislature or both (Briffault, 1996: 43-75).

The existence of these limitations in the state constitutions and that state debts are small (less than 7% of GDP in the beginning of the 90s) comparing to the federal debt (around 70% of GDP in the same period) helped to cause the idea that the state governments have balanced budget. They are examples to be followed by federal government (Briffault, 1996).

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7. Schick has mentioned several situations in which this law was circumvented. He said, for example, that the original Gramm-Rudman-Hollings law set the maximum deficit for the 1988 fiscal year at $108 billion; in 1987, Congress reset the target to be $144 billion. The revised deficits target for the 1988-91 fiscal year totaled $228 billion more than the original targets (p.207).

8 In general, state governments can issue bonds without limitations in case of war, invasion, etc. They do not need authorizations to borrow funds to defend the state. The money should be exclusively used for this purpose.

Contrary to this belief — widespread mostly among conservative politicians — several studies have shown that the states use legal mechanisms to avoid the constitutional restrictions. Through these proceedings they actually borrow funds which are not considered as debt in the judiciary point of view.

> ”The history of debt restrictions has been a chronicle of state fiscal ingenuity in developing new instruments for borrowing while persuading courts that these instruments do not create debt in the constitutional sense”(Briffault,1996:45).

One important mechanism for circumventing constitutional restrictions is the creation of enterprises which operate out of the budget. They are called off-budget entreprises (OBEs). These corporations are set up by law in any state or municipality through simple procedures. For that reason, there are thousands of them all over the American territory. Pennsylvania, for example, has more than 2.500 OBEs. Operating in different areas such as the construction of bridges, roads, airports, etc., they raise funds issuing revenue bonds. As they do not rely on taxes to pay for these loans, but only on the earned tolls, the revenue bonds, and other kinds of non-guaranteed bonds, are not seen as debt. Consequently, their funds are not subjected to constitutional restrictions or budgetary constraints nor submitted to elected politicians control. (Bennett & DiLorenzo, 1982) (9).

The OBEs and hence the revenues bonds have increased in the American financial market since the 1970s when state and local governments had their tax and expenditure power constrained by the movements called "tax revolts". In the federal government, off-budget activities also increased during the 1980s as a reaction against the pressures to balance the budget. Between 1974 and 1996, the percentage of revues bonds in the financial market jumped from 44% to 65% (10). What is striking is that the expansion of off-budget activities is closely related to the limitations on taxes and on debts. The more fiscal restrictions, requiring a balanced budget, the more the off-budget enterprises increase. Although referring to the 1970s fiscal crisis, these words are very impressive:

> "Between 1972 and 1976, the proportion of nonguaranteed debt increased, on average, 5.6 percentage points in 'nonlimitation' states compared with 18 percentage points in 'tax-limitation'states. So even though tax and expenditure limits may have reduced the growth of on-budget local expenditures, billions of dollars of debt and expenditures were placed off-budget through the OBE device" (Bennet & Di Lorenzo, 1982: 17)(11).

It is interesting to mention that the Council of State Government, an important state interest group, developed special kind of knowledge, training consultants to teach their clienteles how to circumvent the legal restrictions on debt. These kinds of skills are advertise as "new technologies" to enlarge the public services offered to the citizens by more "flexible" administrations(Bennett and DiLorenzo, 1982)

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9. There are two kinds of bonds in the United States: r*evenue bonds* and the *general obligation* bonds (G. O .bonds).The latter are guaranteed by taxes and included in the budget.
10. The sources of these data are: The Bond Buyer; Securities Data Company, Newark, NJ, Municipal New Issues Database, quoted by Ferreira,(1998:42).
11. More recently, other authors have also demonstrated that legal restrictions affect only the guaranteed debt but not the total (Nice, 1991).

These legal "magics" or "legerdemain", as Briffault calls them, explain the growth of state debts, even under constitutional restrictions. According to the Book of States, 1994-95, published by the Council of State Governments, the state debts jumped from 21.6 billion in 1962 to 372 billion dollars in 1992**.** If in 1949 they represented 1.5% of GDP, this percentage was 6.2% in 1992(Briffault, 1996). Hence, the constitutional restrictions were not effective incentives to control the public deficit. The main reason for that can be explained as followed: State constitutions generally do not penalize governors or legislators who fail to balance the budget.12

Besides being inefficient, the constitutional limitations on public indebtedness also have negative consequences for public finances and for democratic order. According to Briffault these consequences are:)a).Increase of borrowing costs, as far as interest rates for the non-guaranteed debts are higher; b) Strengthening the executive branch relative to the state legislative; c) debt restrictions can generate eventual imbalances instead of a balanced budget, as far as the state governments often borrow money from those public authorities created to avoid the legal constraints; d)reinforcement of the judiciary power, as far as the judges are becoming active actors in the fiscal policies.

1.3. Political conditions and the role of the market

If constitutional and legal restrictions are not effective or sufficient to control deficits and to limit debts, it is necessary to consider some political conditions and also the role of the market

Several studies have stressed the role of political factors in generating different fiscal outcomes. In the US the most striking aspect has been the divided government. Many authors argued that the recent history of divided government at the federal level has contributed to the growth of deficits (Cox & Mc Cubbins,1991; Brady & Volden,1998). Schick (1993) has stated, for example, that:

> " While divided government has radiated to many areas of national policy, in none has the effect been more pronounced or protracted than the budget. Divided government clearly can reduce elite cohesion and increase the likelihood that mutual vetoes will lead to stalemate, exacerbating difficulties in priority setting that are inherent in the separation of powers....(It) unquestionably has impaired the capacity of the United States to deal effectively with budget deficits in the 1980s."(op.cit, p.190-191)

Other studies have shown that divided and unified governments also affect the state budget policies and hence their debt burdens (Alt & Lowry,1994). Partisan control of governments and their ideological differences affect fiscal outcomes as well. These political factors work as a kind of filter through which constitutional restrictions are processed.

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12 Several studies also concluded that other constitutional devices or budgetary controls such as the line-item veto rule, recission veto and legal limits on accrued debt, do not have independent significant impact over the state expenditures as well (Abrahams and Dougan, 1986; Endersby and Towle, 1997).

"States in which one party controls both governorship and the lower house in the legislature are more likely to respond quickly to unexpected deficits than their divided-government counterparts are"(Poterba, 1994: 818).

"Unified governments in states that are not permitted to carry a deficit over into the next fiscal year react quickly to income shocks so that there is little deviation in the time path of surpluses or deficits. (...) The parties have different goals and react differently to changes in permanent expected levels of income, in ways affected by federal aid and the business cycle"(Alt & Lowry, 1994:812). (13)

Financial market rules are also another mechanism for restricting debts. Besides being an instrument for financing public expenditures, the bonds also work as an instrument to control public indebtedness. Governments in need of loans should present a sound financial situation to get money from the market. Otherwise they do not have credit as happened to New York City during its fiscal crisis in the 1970s (Shefter, 1985).

"If a state borrows too much money, financiers may simply refuse to lend more. States and local governments risk bankruptcies that the national government can avoid simply by printing additional dollars". (Peterson, 1995.p.3).

In the US, this mechanism is extremely important to control public debt once the bond market became wide and very diversified. There are more than 58 thousand governments which can issue bonds. At the end of 1997 there were around 1.5 million bonds on the market, representing U$1.37 trillion dollars. Since the 1970s, the municipal bonds market in the US has experienced considerable changes such as the fluctuation of interest rates, the volatility of bonds and the increase of the number of investors who are now best informed. After the 1980s, banks and insurance companies were no longer the main buyers of these bonds. Private investors represent nowadays more than 70%. (Ferreira, 1998; Zipf, 1995). The expansion of bond markets brought together governmental regulations which have established norms to protect investors. The Securities and Exchange Commission (SEC), enacted in 1934 by Securities Exchange Act, controls the bond market through the Antitrust law and several other laws. In 1975, for example, with the *default* of New York City bonds, the American Congress enacted the Securities Act Amendments which allowed the punishment of dealers for bad behavior. It created the Municipal Securities Rulemaking Board (MSRB) to supervise and regulate the municipal bonds and Congress imposed the separation of fiscal responsability authority into several agencies (Shefter,1985). Security companies that establish systems for classifying the risks of different state bonds are also a crucial instrument to control public indebtedness in the US (Zipf, 1995).

In sum, this set of information indicates that the absence of government cohesion may be a plausible explanation for the difficulty in obtaining desirable fiscal outcomes in the US. Divided government (which reinforces the fragmentation of power, inherent in the system of full separation of powers) is viewed as responsible for federal deficits and for the high level of national debt during hard economic times. In the state governments, divided government and ideological partisan differences also play an important role in fiscal

13 Even taking into account arguments from authors who say "divided we govern" (Mayhem,1991) it is also important to stress that the budgetary politics is strongly affect by divided governments (Brady & Volden, 1998).

outcomes. Other political factors contribute to the debt increase as well: the strengthening of the executive branch with the creation of quasi-autonomous agencies; the reinforcement of judiciary power which has had great discretion to review debt schemes; the absence of political power to punish the governments which fail to enforce constitutional budgetary restrictions, etc.

2. Debt restrictions in Brazil: institutional and political dimensions

2.1. The macro conditions of legal restrictions

The total amount of public debt in Brazil (including federal, state, local governments and public enterprises) reached 35.8% of GDP at the beginning of 1998. At that moment, the public sector spent around 4% of the GDP to pay for interests. After the crisis at the end of 1998, this percentage jumped to 7.2%. Between January and August of 1998, Brazilian government (all levels included) paid more than 40 billion dollars as interest (14).

The public deficit is considered the most important problem in the country nowadays. If its causes derived from structural factors and the model of intergovernmental relationship existing in the country (Sallum, Jr. 1996; Affonso, 1989; Abrucio e Costa, 1998), its present deterioration is due to the increase of interest rates triggered by Central Bank since the implementation of monetary stabilization policies. The increase of the interest rate (currently the highest in the world) adopted by Brazilian policy makers has been an instrument to attract foreign money necessary to sustain the exchange rate — the anchor of the stabilization policy. The consequences of that have been harmful not only for individuals and enterprises but mainly for governments which finance their expenditures through indebtedness. Between 1990 and 1995, the debts of Brazilian states rose 150%, mostly due to the increase of interest rates. According to data from governmental agencies, they accumulated a debt of 97 billion dollars, at the end of 1997. Out of 27 states, 22 owe more than they levy in one fiscal year. (Folha de São Paulo,11/1/1998. P. A-6). Besides interest rates, personnel payment is the other important source of state deficit(15).

However, the pattern of intergovernmental relationships existing in Brazil has made the solution to this problem very difficult. On the one hand, since the constitution of 1998, the states have had autonomy to tax, to set their administrative organizations, to adjust the wages of their personnel and to decide what to do with considerable part of federal transfers (Tavares, 1998) On the other hand, there is no fiscal responsibility among the state and local governments. They borrow without conditions of repayment, knowing that eventually the federal government will do it. Since 1988, there have been seven debt agreements between states and the federal government. The majority of them were not enforced by the

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14. According to data from Fundação Instituto de Pesquisas Econômicas and others published by O Estado de São Paulo, 21.11.98. p.B2.

15 Only 5 out of 26 states spend less than the legal limit of 60% of their revenue in payrolls. Some of them spend around 100%. Even with the reduction of the number of civil servants, the payrolls increase due to some automatic benefits provided by the Constitution of 1998 (Beltrão, Abrucio e Loureiro, 1998).

states. Only two obeyed the terms of negotiations. The worst is that the states which did not honor their agreements were not punished at all (Werneck,1998). (16)

Even in the federal government — which is more pressured by international agencies, by the media and entrepreneurial areas and where there is a more consolidated consensus about the necessity of the fiscal adjustment — the process of controlling the public indebtedness is very hard and presents many moments of regression, especially in electoral periods.

Conflicts between states and federal government have often occurred. For example, in January 1999 the state of Minas Gerais declared the moratorium of its debt to the federal government. Even though the total amount of this debt was not large, the situation caused a serious national crisis which pushed the Central Bank to devalue the currency.

During the last decades, the state governments could circumvent their fiscal problems through two main mechanisms: a) the so-called "inflationary" tax which allowed governments to extract revenue generated by the re-adjustment of civil servants' wages in lower levels than the inflation rate and by the floating of creditors' payments; b) by borrowing from state banks. As they appointed the heads of these banks, the governors could borrow money without any limitations on the repayment of the loans. This kind of loans, actually, constituted an important way to finance the state governments in Brazil until recently.

Since 1994, the economic stabilization has caused considerable changes in intergovernmental relationships in Brazil (Abrucio,1998), strengthening the power of the federal government and reinforcing the authority of the Central Bank (Sola, Garman e Marques, 1997)(17). Consequently, state governments lost those alternative sources for financing their expenditures: the rate of inflation dropped and the majority of state banks were privatized or simply shut down.

Yet, the state governments still used another way to finance their expenditures: they issued bonds which were supposed to provide money to pay for judicial debts (the only possibility for indebtedness permitted by the new laws). The money, actually, was used for other purposes such as the payment of payrolls, financing electoral campaigns, and so on. With the end of this practice, the privatization of public assets has been the last alternative available for financing indebted state governments.

2.2. Controlling the public indebtedness in Brazil: political and institutional action of the Senate

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16. A journalist has well summarized the prevalent ideas around this behavior:"There is a general understanding that the fiscal adjustment is a problem of federal government, more precisely, of Ministry of Finance; and that state governments spend money for the people's welfare. When there is no money , a solution will always be found". (Sardemberg, 1998)

17 Until recently, the political manipulation of state banks was tolerated by the Central Bank because the federal government, which controls the Central Bank, needed the support of governors and of state representatives in Congress to have its agenda passed. In 1994, for example, the federal government bought very risky (or "junk") bonds from the state banks in a total amount of 5 billion dollars to guarantee the support from some strategic governors for the presidential candidate Cardoso. (Abrucio e Costa, 1998:47).

Unlike in the U.S, the Brazilian Senate has the constitutional power to control the public indebtedness for all levels of government. It establishes debt limits and conditions under which federal, state, local governments and public enterprises borrow money in the internal and external financial market. To issue bonds or to contract any credit operation all governments and public enterprises need prior authorization from the Senate. Indeed, the most important part of the exclusive legislative action of the Brazilian Senate involves governmental debts. According to data collected in this house, between 1989 and 1998, around 80% of its resolutions involved debt authorizations or debt re-scheduling for federal, state, local governments and public enterprises.

The process of debt authorization works like this: after having the approval from its legislature, each government interested in issuing bonds should send a request to the Central Bank. The bank analyzes its technical conditions and sends a conclusive report to the Senate Economic Affairs Commission, recommending or rejecting authorization. Composed of 27 senators (representing different political parties, in their corresponding proportion on the floor), the Economic Affairs Commission has the central role in the decision making process. Its decisions have never been rejected by the floor.

In recent years, the Brazilian Congress has been establishing more restrictive laws, reducing the limits on public indebtedness. In 1993, a constitutional amendment prohibited all governments from issuing bonds until 1999, except for the re-scheduling of former debts and the payment of judicial debts. As mentioned, this later alternative was mostly exploited by several sub-national governments as an additional (and irregular) way of financing their activities. The irregularities were so big that the Senate set a Congressional Inquiry Commission to investigate them in November 1996. According to the report of the commission, the São Paulo City government, for example, issued 1.1 billion dollar bonds above the total amount actually used to pay judicial debts

What is most striking is that the governments were able to use this irregular procedure knowing the conniving behavior of the Senate and the Central Bank in face their fiscal irresponsibility. In 1995, for example, all requests for debt authorization passed through the Central Bank departments and were approved by the Senate as the Congressional Inquiry Commission report has mentioned.

Although nobody was punished by the irregularities pointed out by the Congressional Inquiry Commission, the scandal around over-issued bonds supposedly used to pay for judicial debts has produced an effect: the enactment of more restrictive laws to control public indebtedness. Since 1990, the Senate has enacted four resolutions referring to this subject. Each one has been more restrictive than the last. Among the new rules (Resolution number 78, enacted in July 1998), it is interesting to stress the following: 1) the Central Bank should not send to the Senate any request for debt authorization if the government runs a primary deficit (which means the difference between revenue and spending, excluding the interest payments); 2) no government can offer any kind of tax exemption and still be able to receive debt authorization from the Senate; 3) the Senate also extended the prohibition against issuing new bonds until the year of 2010, except for re-financing the principal of former debts; 4) state governments with former debts re-financed by the Union are prohibited from issuing new bonds; 5) other procedures were adopted to make information about financial conditions of the issuer available at a lower cost to the public.

Thus, the Brazilian Senate has created a set of rules which is extremely rigorous and commits itself to the control of public indebtedness (18)

Yet, the new rules have not generated the desirable effects. On the contrary, always arguing emergency or exceptional situations, the senators have continued approving requests for debt authorizations, even after the enactment of new laws. According to data presented in table I, the debt authorizations have been oscillating over the period selected, probably due to different factors. Apparently the Senate resolutions have not influenced significantly this movement. For example, the number of authorizations for state governments increased in 1997, even after the enactment of more restrictive laws(19). In 1998, this number declined for the states and municipal governments, but increased for the federal government and for public enterprises (20).

Table I - Evolution of the number of debt authorizations by the Brazilian Senate: 1989-1998(*)

Categories	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Federal Govern.	18	9	9	12	10	19	6	11	16	17
State Govern.	34	38	34	30	29	43	31	52	75	57
Local Govern.	14	15	13	25	68	16	9	20	16	9
Public Enterprises	12	2	4	1	6	2	2	8	2	10
Total	78	64	60	68	113	80	48	91	109	93

Source: Federal Senate

(*) These numbers refer to authorizations for debts contracted in foreign banks, international agencies and in the domestic market.

As a state representative, no senator rejects debt authorization for his state. Besides political interests, he can argue moral considerations such as the social welfare of the population, especially in the moments the states face such tremendous fiscal difficulties. If he is not able to do so as a member of the Economic Affairs Commission, he negotiates the votes of his colleagues through the logrolling mechanism.

How does one explain that the Senate enacts laws which it does not enforce? Is it not really committed to the fiscal adjustment? Or is it simply an example of irrational behavior?

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18. The prohibition against any bond from being issued for more than 10 years is an example. According to some specialists on fiscal policies, the controlled expansion of bond markets would be a better alternative for public financing in Brazil as it occurs in the US. It would provide additional resources for governments necessary to improve social programs and indispensable investments without increasing tax burdens(Ferreira, 1998).

19 Unfortunately, due to calculating difficulty data about the value in dollars of these debt authorizations could not be presented for the present.

20. Recently, other authorizations were also approved, as noticed by this newspaper::"In the midst of hard fiscal adjustments, under which the federal government cuts spending as much as possible, a big feast happened in the Senate.... The senators approved a resolution which transfers to the Union a debt of 3.3 billion dollars from São Paulo City government, contracted as questionable judicial debts (Veja, 7/14//1999,p.45.)

It is more precise to characterize Senate's behavior as ambivalent rather than as simply irrational. While the Senate does not apparently enforce its own restrictions over indebtedness, on the other hand there is much evidence of its commitment to fiscal adjustment, central issue in the governmental agenda of monetary stabilization. The most striking is the delegation of power to the Central Bank. Knowing their weakness of will to resist pressures coming from governors and other state representatives, the senators transferred to the Central Bank the capacity to decide about requests for debt financing, according to the article VII of the Resolution 78/98. They also established strict conditions, providing the bank officials with technical tools to reject a great part of those claims**.**

Examining debt authorizations after 1997, in a more detailed way, one observes that a significant number of them occurred as part of the debt negotiation process established between states and the federal government in the State Fiscal Adjustment Program. Through these negotiations, the Senate authorized the re-scheduling of former state debts with the following condition: states should privatize their enterprises and, in particular, state banks (21). In 1996 there were eight authorizations as part of this program; in 1997 the number jumped to twenty-four authorizations, representing 32% of the total debt authorizations for the states. In 1998, there were sixteen, corresponding to 28% of the total (22). Thus, if debt authorizations approved as part of these negotiation agreements are taken out of the total, we would observe some reduction: Instead of 75 authorizations, mentioned in table II, the number drops to 51 in 1997 and to 41 in 1998. In other words, the legal restrictions were enforced under specific political conditions: the bargaining between federal and state governments. This fact is significant, allowing us to analyze the Senate's behavior in a more comprehensive way.

While still being sensitive to pressures coming from the states and local governments (politically inevitable, considering the difficulties of their economic situations), the Senate has been working with the executive branch. It has constituted a pivotal support to the president, cooperating decisively with his policy of fiscal adjustment.

Indeed, since 1995, the Cardoso governmental party coalition in Congress has passed the majority of its agenda of state reform (23). In the Senate, in particular, the government majority is more striking: the five parties of the governmental coalition (PSDB, PFL, PMDB, PTB and PPR) have controlled more than 80% of the floor votes and approximately the same proportion of the votes in the commissions. Despite the absence of partisan fidelity and that government needs to bargain continually to maintain its allies, the

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21 .With the federalization of their debts, which passed to the control of the National Treausury Secretariat, state governments obtained considerable advantages: besides the rescheduling (around 30 years), the interest rates are lower (around 6% per year, while the Brazilian current rate is around 30%) and the annual limit for repayments was established around 13% of their net revenue.

22 . According to Base de Dados da Legislação Brasileira.

23 During the Cardoso first term (1995-1998), sixteen constitutional amendments were approved by Congress, most of them involving economic deregulation and fiscal issues. Another example of the cohesiveness of this government can be found in his capacity to reenact provisory measures: during his first term, Cardoso administration reenacted 405 provisional measures, while in the former ones, this number was much lower: 49 in the Franco government; 69 in the Collor government and 22 in the Sarney government. According to Couto &Abrucio (1999) the reenactment more than the enactment of provisional measures can be seen as evidence of the higher level of delegated power received by the Executive branch. It acts independently from negotiations in Congress: if not disapproved by the legislature, provisional measures are reenacted continually.

Congress has clearly supporting the Cardoso government agenda (Figueiredo e Limongi, 1997). Thus, even experiencing some defeats, this government could build a relatively lasting elite cohesion which has allowed it to successfully pass its political agenda of state reform (Almeida, 1999; Couto and Abrucio, 1999).

In the fiscal area, the most significant achievements have been the privatization of state banks and the re-scheduling of state debts. As indicated before, they constituted serious obstacles to fiscal adjustment in the country. Until 1998, out of thirty-three state banks existing in the country, ten were privatized, eleven were shut down, and six were reorganized, according to data provided by the Central Bank. As regard to the re-scheduling (or "federalization") of state debts, out of twenty-two indebted states, eleven had their debts re-scheduled in the same period.

The Ministry of Finance has been playing a crucial role in the Cardoso government cohesion. Besides its traditional importance, as in any contemporary state, especially in hard economic times, the Brazilian Ministry of Finance has had its power reinforced in the current administration. Stressing the fiscal adjustment logic, it has been able to control other ministries whose heads had been appointed as a result of partisan negotiations necessary to ensure congressional support (Loureiro & Abrucio, 1999). This control is performed by the power to release and withhold budgetary resources held by the National Treasury Secretariat (STN), a department of the Ministry of Finance (24). It determines the pace of the implementation of policies established by other ministries, according to the needs of fiscal adjustment. Moreover, the STN has a strategic role in the process of state debt re-scheduling. As a result of the federalization of state debts, the STN has centralized the public debt and, hence, all information about federal, state and local governments finances. The Ministry of Finance also exerts its coordination power in the Cardoso government in an informal but relevant way. This occurs through the appointment of a great number of professionals connected to its economic team, as high officials in other ministries, as reported by several interviewees (Loureiro & Abrucio, 1999).

Implementing the political agenda of fiscal adjustment, the Cardoso government was favored by the following institutional arragements: the provisional measures, the Senate resolutions and the judicial decisions. If the conditions for state banks privatization and for debt re-scheduling (including penalties for the recalcitrant) were set through provisional measures, the Senate resolutions also provided the executive with more tools to adjust state finances. Besides the delegation of power to the Central Bank, already mentioned, other rules established by the Senate - such as the limits to future indebtedness not superior to the annual net revenue — also gave the federal government better conditions for bargaining with the states.

Besides the Senate, the judicial branch has been also working with the executive branch, cooperating with its policy of fiscal adjustment. In cases of conflict between states and the federal government, the courts have decided in favor of the latter. They support their decisions on legal apparatus brought by provisional measures and Senate resolutions. The case of the moratorium of the State of Minas Gerais in January 1999 is

24. The National Treasury Secretariat (STN) is a relatively new governmental agency created in the 1980s, during a process of restructuration of public finances in Brazil. Controlling all budgetary information and its output, this agency has greatly contributed to the reinforcement of the power of the Ministry of Finance inside the government and hence its role in the bureaucratic coordination (Loureiro & Abrucio, 1999).

exemplary not only of a new sort of intergovernmental relationships in contemporary Brazil, but also of government cohesion: challenged by the governor of that state, the National Treasury Secretariat of Ministry of Finance blocked constitutional transfers, with the support of courts. The federal government received the approval of the media and public opinion as well(25). In other words, while in the past states behaved as a sort of sovereign debtor in face the federal government, in the present they have had incentives to repay their loans (Conklin,1998).

Without passing judgment over the social effects of fiscal adjustment(in terms of unemployment and poverty levels), some instances of achievements in this area can be indicated. According to the Central Bank, at the end of 1999 the federal government had a 29 billion dollar surplus, which represented 3.2% of GDP; in the state governments the surpluses were 3.5 billion dollars (0.3% of GDP). Yet, due to the high interest rates, the level of national debt was still higher than in the previous year: 517 billion dollars, corresponding to 47.7% of GDP.

In sum, if the legal framework provided by the provisional measures and by Senate resolutions was necessary to obtain the desirable fiscal performance, political conditions made it possible to turn Congress and the courts from a position of potential *veto* points to allies of the executive branch, at least in regards to fiscal adjustment (26).

3. Final considerations:

Despite many differences, the US has shared a common fiscal behavior with Brazil: "it is better to lie about the budget (and other fiscal rules) than to take the bitter medicine of deficit reduction". These countries have also shared the practice of inventing mechanisms to circumvent their constitutional and legal restrictions over deficit and debt. Of course it is not easy for elected politicians to vote for tax increases or benefit cutbacks; neither to limit financing possibilities necessary to provide public goods and services to their constituencies. Hard choices, however, are indispensable in hard times. Government cohesion is a condition for this.

As the American system of full separation of powers and multiple veto points does not facilitate government cohesion, deficits are the most frequent results of economic recession. In the Brazilian post-1994 political situation, the same institutional framework of presidentialism and federalism, working differently, has generated, also under recession, a different outcome: some fiscal surpluses. In its case, the constitutional or legal restrictions over debts have produced the desirable effects, through government cohesion. Thus, we can acknowledge that political contingencies generate situations in which costs inherent in debt

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25. The courts have also decided in favor of the executive branch in all suits brought by the opposition parties against the privatization of public enterprises (Almeida, 1999). On the other hand, one of the most important newspapers in the country approved the federal government action against the state of Minas Gerais, publishing an article entitled: "The federal government weapons against the scofflaws" (O Estado de São Paulo, 7/1/1999, p.A3).

26.In regard to the social security system, for example, the government proposal for a constitutional amendment was not passed in Congress and other measures in the same area were considered unconstitutional by the Supreme Court.

or deficit restrictions are transformed into political benefits such as a lasting monetary stabilization, the increase of foreign investments flows, etc.

Yet, the fact that those restrictions are not enforced does not matter in the US because, unlike Brazil until recently, there is no bailouts of the central government and the financial market controls the level of public indebtedness, especially in the subnational governments. Thus the present analysis allows us to distinguish two types of public debt control: a) the decentralized control, characterized by the American case; b) the political or authoritative control, characterized by the Brazilian case and other Latin American countries (Dillinger, Perry & Webb, 2000).

On the other hand, we also can ask why those restrictions are established, considering that the costs of their enforcement are higher than their potential and uncertain benefits?. A possible answer to that question can be borrowed from Calvert and Johnson's analysis about constitutional making. According to them, besides legitimating decisions, constitutions are also necessary to create patterns for future behavior (Calvert and Johnson, 1997: 29), Thus, deficit and debt restrictions could be interpreted as devices available for **future** circumstances which are unpredictable in advance. In other words, they should be understood not only by the outcomes they prescribe but also by the future political uses of the rules.

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