

A Political Economy Analysis of Public Sector Management in the Brazilian States

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Introduction

This study was commissioned by the Brazil office of the UK Department for International Development (DFID) in response to the growing interest in policymaking process at subnational level in the Brazilian context, particularly among the Multilateral Development Banks (MDBs) which have been lending to states and municipalities in the last years. The main objective of the research is to contribute to our understanding of policy-making at the state level in the Brazilian federation. The focus of the research is on the determinants of the perceived wide variation in policy outcomes across the Brazilian states. Why some state are better capable to promote economic development while others stagnate? Why some states exhibit good capacity for policy coordination and adaptability whereas other states are characterized by policy inertia and predatory politics? Why some state governments are able to provide public goods such as a professionalized bureaucracy and adequate health and education services but other state governments tend to specialize in the provision of private goods such as public sector jobs and targeted transfers to specific clienteles? Why corruption is more prevalent in some states than in others? Why some states are more efficient in the provision of goods and service than others?.

This study does not offer answers to all of these questions, but to a selected subset of them. However, it provides a general analytical framework for addressing them and provides answers to a number of questions. Thus, its major contribution is both methodological as well as empirical. This is accomplished through in-depth case studies of a few states and by testing a number of general hypotheses regarding the determinants of good policy-making across the states.

The general objective of this study is to provide inputs about the policymaking process at the state level in Brazil with the purpose of understanding the factors affecting the performance of states' public administration. This will be done using a methodology that was previously used by the team to analyze the general policymaking process at the federal level in Brazil as well as a separate study focusing on the budgetary process. As detailed below, the study describes the general policymaking process within which the state level policymaking processes are couched. Subsequently the analysis turns to applying and adapting that framework at the state level, which involves some issues in common with the federal level analysis, but also some entirely new features. Special focus will be placed in exploring the variability in institutions and histories among states and the way these map into the diversity of outcomes, so as to be able to better understand the determinants of the policymaking processes and their impacts at the state level. That is, a major question that will be addressed is: If the macro state institutional endowments do not present enough variation to explain the different outcomes across states, what are the other institutional and political aspects that can account for these differences?

Recent literature on the political economy of reforms has emphasized that economic development outcomes are a function of the quality of the broader policy-making process in

a country.¹ This institutional focus may also explain why there is great variation in policy outcomes at the sub-national level. We understand the policy-making process (PMP) as involving the critical steps of discussion, negotiation, approval and implementation of policy proposals. Indeed, it has been increasingly recognized that policies' effectiveness depends on the manner that policies are discussed, approved and implemented. And this is true across policy areas. Thus this approach also rests on the assumption that it is necessary to look beyond the specific content of policies to the critical steps mentioned. We do not engage in the specifics of sectoral policies. The emphasis is put on the characteristics of the policy-making process and of policy outcomes. Thus we are concerned with the outer features of policies such as their adaptability, volatility or public-regardness. This requires an understanding of the role of key major political institutions such as the legislature, the executive branch, and the judiciary in the policy process and the incentive structure that actors in these institutions respond to when they interact. In the current governance literature a great deal of attention has been given to administrative capacities but much less is known about the functioning of these institutions.

The study adopts an institutional approach and is inspired by recent contributions by the new institutional economics. Central to this approach is the institutional framework that governs economic, political and social interactions. The main claim made in this literature is that good institutions help reducing transaction costs. Good institutions guarantee a stable framework for interactions over time thus affecting the social outcomes that arise from this interaction. The intertemporal transactions framework that informs the current research stress the ability of actors involved in making credible commitment mechanisms in their political transactions.

Central for the understanding of policy outcomes is the analysis of the key actors of the policy game and of the rules, formal and informal that govern their political interactions. The key actors in the implementation of policies include regulatory bodies and horizontal accountability institutions, such as the Tribunais de Contas and the Ministério Público (public prosecutors office), as well as specific actors within the executive's administrative machinery, including the planning, budgetary, tax, and sectoral bureaucracies in the social sectors. These processes have been studied with a focus on the national level in a number of research programs.² The authors of this research proposal are one of those that have contributed to the national level study of Brazil.³

¹ See Stein, E, Tommasi, M, Lora, E and M Payne eds. (2005) *Politics of Policies: Economic and Social Progress in Latin America*, IADB/Center David Rockefeller Center for Latin American Studies, Cambridge and Washington, DC.

² See the 13 case studies of Latin American countries in the contributions to the Research Network Project "Political Institutions, Policymaking Processes, and Policy Outcomes", IADB, (available at www.iadb.org/res/index/cfm?fuseaction=laresnetwork.studyview&st_id=82)

³ See Alston, L, Melo, Marcus, B Mueller and C Pereira (2006) *Political institutions, Policy-making processes and policy outcomes in Brazil*. IADB Research Department Monographs R 509. (co-author with Lee Alston and C Pereira). Research Network Working Paper # 509, Washington, Inter-American Development Bank. See also on related issues using the same methodology: Lee Alston, Marcus Melo, Bernardo Mueller and Carlos Pereira, "Who decides on public expenditures: the political economy of the budgetary process in Brazil," Washington, Inter-American Development Bank, Economic and Social Studies Series, RE1-05-006, 2005, 88 p. For the Brazilian case study of regulatory governance see Paulo Correa, Marcus Melo, Bernardo

Although a growing literature has contributed to a better understand of the process of discussing, approving, and implementing public policy and has illuminated the institutional determinants of the policy dynamics in many countries, virtually no studies have appeared on the dynamics at the sub-national level using the same approach.⁴ Much less is known regarding these processes at the sub-national level despite the increasing importance that states and provinces play in many federal states such as Brazil.

As indicated before, the general objective of this study is investigate the policy-making process at the state level in Brazil with the purpose of understanding the factors affecting the performance of states' public administration. The specific objective of the study is to provide inputs to inform ongoing processes of public sector modernization in which the Inter-American Development Bank (IADB) and the World Bank have been involved.⁵ They are also intended to provide guidance to future Bank operations in its initiatives at the sub-national level. Other specific objectives include a) providing recommendations for improving the results based management at the state level, including measures to establish a system of monitoring and evaluation for improving efficiency, effectiveness and transparency of programs and projects; and b) informing the debate on political reforms so as to improve the policymaking processes qualities in each particular state.

1. Research questions and methodology

In this study we will look at the states' public sector management process with the lenses provided by the political economy literature, specially through those developed for the IADB Research Network project "Political Institutions, Policymaking Processes, and Policy Outcomes" (PMP).⁶ We will attempt to explain some of the main characteristics of policies in the state level as the outcome of the state's policymaking process, and will trace back the institutional determinants (i.e. the structure of incentives of the main policy actors as provided by existing institutions) of that process. The study analyzes the states' public sector by presenting a thorough description of: (i) the key policymaking actors, their incentives, and their interaction; (ii) the degree of "institutionalization" of the states – i.e. how effective the institutional checks on the executive and other relevant political actors; (iii) the institutional capacity of sub-national governments.

Mueller and Carlos Pereira Assessing Regulatory Governance in Infrastructure Industries: Lessons from the Brazilian Experience. Washington, World Bank, PPIAF – World Bank, 2006.

⁴ Excellent recent work on Brazilian federalism illuminates part of this dynamics. Virtually no work has been done on the state judiciary, tribunais de contas or regulatory agencies, except those co-authored by the author of this proposal, see Samuels, D (2003) *Ambition, federalism and legislative politics in Brazil*, Cambridge University Press; Celina Souza and Dantas, P (2006) (eds) *Governo, políticas públicas e elites políticas nos estados brasileiros*, Rio de Janeiro: Revan, .

⁵ E.g. IDB Prodev, Pnage and Promoex and World Bank Ceara SWAp and Minas Gerais DPL

⁶ See the PMP analytical framework Spiller, Pablo & Tommasi, M. "The institutional foundations of public policy: a transactions approach with application to Argentina". IADB, 2003. Also Spiller, P and M Tommasi (2007) *The institutional foundations of public policy in Argentina*, Cambridge, Cambridge University Press.

The PMP study focuses on how policies get enacted, approved and implemented and draws on a transaction cost analytical framework to build explanations for understanding the policy process in Latin America. It goes beyond existing partial explanations which focus on single-factor causality to develop a general equilibrium approach which takes into account historical dynamics, country specificities, and different institutional contexts as they interact to shape policies and their consequences on development. The challenge in this proposed study of the PMP process at the sub-national level is to adapt this country level approach to account for the distinct policy dynamics in a federal state such as Brazil.

Broadly speaking, the Brazilian states exhibit great similarity with respect to their macro level institutional features which are established on state constitutions. These features include the following. Politicians, both at the legislative and executive branches, are elected every four years with the same electoral rules, proportional representation and open lists to the former and plurality with a runoff to the latter; legislators have no term-limit; Governors are allowed to run for re-election just once and are very powerful, equipped with several institutional tools to govern; the decision-making process within state legislatures is very centralized with a extremely weak and unprofessional committee system; in fact, legislative bodies are mostly reactive to executive dominance; the state courts are formally independent and sometimes work as an important constraint to the executive's preferences; every state possesses accountability institutions to deal specifically with the propriety of government expenditures (*Tribunais de Contas*).

Even with those great similarities in terms of their institutional endowments, the Brazilian twenty-seven sub-national unities are very distinct with regard to their economic and political outcomes. It is possible, on the one hand, to find states with a great level of social and economic development, and on the other, states that are extremely poor. *If the macro state institutional endowments do not present enough variation to explaining these different outcomes, what are the other institutional and political aspects that can account for these differences?*

Existing institutional theories predict greater policy rigidity (deadlock) in a policy space characterized by multiple veto players with significant ideological polarization or differences in players's preferences.⁷ It is assumed that the probability of policy change is reduced by the higher transaction costs and the existence of a smaller potential win-set to beat the *status quo*. Besides taking into account the number of veto points and the level of disagreement of their preferences, this comparative study intends to investigate the institutional conditions under which gains from trade can be extracted by the political players. In other words, we investigate the extent to which the players have the ability to develop inter-temporal political transactions. Our contention is that in order to understand the cost of policy change, it is necessary to examine at the sub-national level the institutions that may exist (or not) of realizing political transactions. Where institutions have arisen to enable such transactions, the cost of policy change will be lower (controlling for

⁷ See Haggard, S. & McCubbins, M. D. (eds.). (2001), *Presidents, parliaments, and policy*. Cambridge/New York, Cambridge University Press. Tsebelis, G. (2002), *Veto players: how political institutions work*. Nova York, Russel Sage Foundation/Princeton University Press

preferences). Where transaction costs are large and there are few means of circumventing or mitigating them, policy change will be lacking or limited. These costs are high when the number of veto players is large and there is no efficient commitment mechanism for cooperation.

This investigation adopts a transaction cost approach to understand the political actors' incentives to form and sustain inter temporal credible agreements. We focus on the resources available to facilitate political exchanges, the value of such currencies and the expected gains from the trade among Brazilian sub-national states. We claim that more capacity to build and coordinate majority coalitions and longer term horizons for politicians – with repeated interactions – have a decisive impact in lowering transaction costs and enabling political cooperation. Conversely, poor coalition management and restrictions on the types of currencies available decrease the value of accepted currencies and creates disincentives for political cooperation. We argue that the interaction of institutional features define the relative price of policy change in each particular institutional environment.

This research proposal recognizes that other economic aspects such as the stock of investment, level of economic integration with other state unities and with the international market, foreign investment, etc., play an important role on economic and political outcome. However, we would like to stress that other micro institutional aspects related to the state politics and policymaking play a key role in explaining different economic and political performance at the sub-national level in Brazil. We intend to operationalize variables such as political competition, electoral volatility, durability of the elite group in power, coalition management dimensions (size, heterogeneity and proportionality⁸), budgetary allocation, and level of professionalization and institutionalization of the state bureaucracy, among others. We claim that these variables have a decisive impact on the capacity of politicians to develop and sustain cooperation over time.

The time horizon of governors will also be tested. Governors with short political horizons – as opposed to hegemonic governors that control a state for several terms - will have few incentives to provide public goods and promote economic development. Hegemonic governors, in turn, will have incentives to promote economic development because they feel they will benefit privately from an expanding pool of resources in his state in

2. Plan of the Study

2.1. A General Framework for Understanding the Policy Making Process

In this section the framework that was used in the previous studies and will be applied to the state level policymaking process in Brazil will be described. Because policies are the result of a policymaking process composed of political transactions among a given set of actors, it is generally the case that the nature of that process will consistently imprint certain

⁸ See the discussion of Mesquita, B. B.; Smith, A.; Silversson, A. & Morrow, J. (2003), *The logic of political survival*. Cambridge, MIT Press.

features to whatever policies emerge over time. The precise details of the policies will vary with the issues being considered as well as with the current state of affairs, which is subject to all sorts of political and economic shocks. Nevertheless, as long as policy emerges from a process where the same actors interact under basically the same rules, whatever the issue of the day, those same characteristics will be manifest.⁹ The rules, in turn, are determined by the political institutions of the country. These institutions specify who are the actors involved in any given issue area, what are their preferences and their powers. They also establish the forums or arenas in which the transactions among these actors will play out. Examples of these forums are Congress, the courts, backrooms, the streets or the press. The nature of the interaction among these actors is also determined by political institutions. While some interactions may be one-shot games others will be repeated; some may be transparent while other may be concealed from the public view; some may involve multiple players while others may be more restricted; some exchanges may be simultaneous while others may be intertemporal. In addition, political institutions also determine the actors' ability engage in collective action and to provide credible commitments that assist cooperation, provide coordination and facilitate exchange.

The purpose is thus to map from political institutions to the nature of the policymaking process, taking into account the specificities of the issue area, so as to gain insight into the characteristics (or features) of the policy outcomes. These characteristics are thus the dependent variables that need to be explained. Examples of these are stability versus volatility, adaptability (or flexibility) versus rigidity, public-regardedness versus private regardedness. Ideally policy will be stable yet adaptable to economic and political shock and will have public good rather than private good qualities. Another characteristic is coordination and coherence of policy, such as across levels of government or different agencies. Yet another is to have investment-like qualities, where current costs are incurred that yield benefits only in the future. The purpose is thus not only to recognize the characteristics of policies, but more importantly to show how they map into the countries political institutions which in essence determine the nature of the policymaking process where political transactions take place.

2.2. Applying the Framework to the Policymaking Process in Brazil

In this section we will summarize the policymaking process that emerges from the use of the methodology described in the previous section to Brazil. This is essentially a summary of our first project using this framework (see footnote 1). It is important to have this description at the outset of the state level project because the policymaking process in the states is inseparably intertwined in the federal level policymaking process. The basic story is one where political institutions provide strong presidential powers to the Executive which is able to closely control the political agenda and to a great extent achieve his/her policy preferences. This does not mean that the Executive's powers are unchecked, as several other

⁹ Of course different issue areas have different characteristics so the features of policies will also be affected by those features and will vary across areas.

actors, such as Congress, the Judiciary and Public Prosecutors (*Ministério Público*) have constitutionally defined powers to constrain the President's actions in specific situations. The final picture that emerges is one where four categories of policy outcomes are delineated. The first consists of policies that are stable and adaptable to shocks. These are basically macroeconomic policies, such as fiscal and monetary policies, that is, those with a direct impact on stabilization and economic growth. The President, independent of personal ideological preferences, has electoral incentives to pursue these policies in an orthodox manner as he/she is seen by voters as responsible for outcomes in this area and is accordingly rewarded or punished. Similarly, global financial markets are quick to punish any deviant behavior in this area affecting exchange rates, country risk and investment flows. Whereas the electoral connection and financial markets assure that the President will want to prioritize stable and adaptable macro policies, strong presidential powers assure that he/she has the ability to do so.

The second category involves policies used by the President to provide patronage to other political actors in exchange for support in approving his agenda of reforms, that is, geographically concentrated transfers, or "pork." Political institutions in Brazil provide the President with several political 'currencies', such as jobs in the federal structure and budgetary transfers that can be used to 'purchase' support, especially within Congress, thus providing high levels of governability at low cost. Although there are undesirable aspects to this form of policymaking, there are also advantages of having effective means of realizing political transactions in a country with such dire need for reforms.

The third category includes policies that are hard-wired at some 'constitutional moment' and cannot be easily changed. These are policies such as education and health that typically have strong externalities for society but whose beneficial effects only mature in the long term so that politicians might be tempted to trade them off for policies with more immediate political returns. Making some policies rigid may be useful for achieving a credible commitment, but the lack of flexibility to adapt to shocks can also present a cost.

The final category consists of residual policies, which are only given priority when the objectives of the first category of policies (stable and adaptable macro policies) have been secured. These are policies that, similarly to the previous category, can be postponed with relatively few short term costs to the government, but over which no agreement for hardwiring was achieved. They also include policies that the government can credibly yet deceptively claim to be pursuing without actually having to detract resources from the first category of policies. Policies related to the environment, poverty, land reform, etc. are in this category. Note that they are frequently policies that have a strong ideological component. As a result of these characteristics these policies have a tendency to be volatile, oscillating according to political shocks, such as when a new president comes to office.

2.3. The Policymaking Process at the State Level in Brazil

Following the framework described in the previous sections the analysis of the state level policymaking process will require the specification of the main actors, their powers,

their preferences, their forums of interaction as well as the general rules of the game. This time however there is the twist that although there is common set of institutions that affect all states, each state is additionally subject to a set of idiosyncratic institutions and histories that lead to potentially different characteristics of the policymaking processes and consequently different feature of policy outcomes. Whereas this adds complexity to the analysis, it also provides important variability that can be used to identify the effects of different institutions ways that could not be done at the federal level. The following list specifies the most important actors and institutions that will be analyzed together with some indication of the most important issues related to each. In this section the analysis will be general for all states citing exceptions and variation where relevant. In the subsequent section a more detailed look at selected states will be undertaken.

i) Governors – What are their powers to initiate, promote and veto legislation? What are their additional legislative powers? Do they tend to have control of the policymaking agenda? Do they generally need to build coalitions? If so do they generally have the means to do so or are there important impediments? What political currencies do they possess to purchase support? What can be said about the Governor's preferences (i.e. local development vs. national goals such as low inflation or the environment)? What are their political career incentives and perspectives? To what extent are they constrained by the Fiscal Responsibility Law? Discussion of the governors' loss of power since 1988.

ii) Legislative assemblies – What is the dynamic of party politics in state legislative assemblies? When do state assemblies constrain state executives? What are the state legislator's incentives in the legislative and in the electoral arenas? What are their political career incentives and perspectives? What is the rate of turnover and what are its determinants? What are the roles and powers of regular and inquiry committees? Describe the decision-making process in state legislative assemblies.

iii) Judiciary – Are state judiciaries formally independent of the state executive? Are they independent *de facto*? When and how do state judiciaries constrain the state executives and legislative branches? How effective are state judiciaries? What are their major shortcomings (i.e. slowness, partiality, unpredictability, corruption, difficulty of access, etc.)

iv) Bureaucracies – How efficient are state bureaucracies? Do they receive ongoing training to adapt to changing circumstances? How are these circumstances determined by the states' political institutions? To what point are public sector jobs used as political currency? Can the bureaucracy act as a veto player, constraining opportunistic behavior or originating it?

v) State Accounting Tribunals (*Tribunais de Conta Estaduais*) – How effective are the TCE's at constraining corruption and assuring proper use of public resources? What are the politics of TCE creation, funding and choice of ministers? How are these choice affected by the level of political competition in the state? [Note that two of the authors in the team already have a study on this issue (Melo, Figueiredo e Pereira 2005).

vi) State Public Prosecutors (*Ministério Público Estadual*) – When and how do public prosecutors constrain the behavior of other actors, in particular the executive and executive agencies? How independent are the public prosecutors from the other branches? What are their motivation and preferences?

vii) Regulatory agencies – Practically all states already have at least one regulatory agency. What are the political determinants of agency design? Do the agencies constrain the state executives? Are the agencies effective in regulating their sectors and creating an investment friendly environment and also defending consumer interest? [Note that the authors have a published study of regulatory governance in all Brazilian regulatory agencies. (Correa, Pereira, Mueller and Melo, 2006)].

viii) Interest groups and elites – The states typically show great variability over the nature and composition of interest groups that affect the policymaking process as well as over the balance between these groups. Similarly the states have different levels of political competition, with some states possessing a stable governing elite which predictably remains in power over long stretches of time, while other states have great levels of turnover in power. The level of political competition is an important variable to understand the political behavior of the various parties and as such will be a major variable used to characterize the policymaking process.

ix) State level budgetary process – In the same way that the federal budgetary process was analyzed through a political transaction cost perspective in Alston, Melo, Mueller and Pereira 2006, this study will characterize the particularities of the state level budgetary process and its resulting policy outcome characteristics. In particular it is important to understand how expenditure decisions are made and whether the result is representative, sustainable and efficient. Special interest points are budgetary rigidities as commitment devices and the fiscal responsibility law.

x) Other actors and issues – What is the role of local councils in the policy making process? How are state-municipal government relations configured and how do they affect policy outcomes? What is the local role of federal deputies and senators? What is the impact of geographic specificities, such as being an Amazonian or costal or petroleum producing state?

2.4. Six Case Studies of State Level Policymaking Process

The previous section characterized the state level policymaking process in a general manner with some coverage of the variability among states. In this section six states will be analyzed in greater detail as case studies. The states that we intend to study are: Bahia, Pernambuco, São Paulo, Rio Grande do Sul, Roraima, Minas Gerais and Espírito Santo. The criteria used for the case selection are the following: regional distribution, balance between state per capita incomes, nature of political system (competitive versus hegemonic), level of

institutionalization (degree of independence and professionalism of bureaucracies, Judiciary, Ministério Público, Tribunais de Contas and regulatory agencies).

The key variables for the present study are the level of institutionalization and the level contestability in a state. By the former we mean essentially the robustness of checks and balances. High institutionalized political environments are typically states that have effective regulatory institutions, autonomous and independent courts of accounts, state assemblies with professional staff and active commissions, a functional bureaucracy, a proactive *Ministerio Publico* as well as other oversight and deliberative institutions such as councils. By contestability we mean political competition. Low or non-contestable environments are characterized by the control wielded by an state elite. Typically the elite does not alternate in power with contra elites and exercises some or a great deal of control over the media and over candidate selection at the state level.

Table 1 shows the possible combination from these variables and the likely outcomes. In the upper right cell, low contestability co-exists with low institutionalization. Because contestability is low, and political elites dominate the political space, the political elites may have long policy horizons. However, in these circumstances there are incentives for entrepreneurialism in the state and for the creation of a professionalized bureaucracy and fiscal austerity. Governors are encouraged to engage in initiatives that produce results in the long run. However because of low level of institutionalization there would also be incentives for elites to engage in private goods provision and to appropriate public resources for private use.

In the upper left cell, there is a combination of high contestability and low institutionalization. In this case there are strong incentives for the provision of private goods and corruption because elites have a short time horizon. Low level of institutionalization provides the ideal setting for predatory practices, particularly if the level of contestability is high. We expect low incentives for the supply of public goods and consequently poor developmental outcomes.

The bottom left cells represent cases of high institutionalization. High levels of institutionalization create incentives for the supply of public goods, but its interaction with levels of contestability may produce divergent outcomes. Low contestability may create incentives for clientelism, which is mitigated by strong checks on the executive. In turn, high levels of contestability may create policy volatility in case there is strong adversarial political tradition in the state. This is the case when good projects are discontinued because of preference polarization or predatory practices adopted by the elites to differentiate themselves from their adversaries.

Table 1

		Contestability	
		High	low
Institutionalization	low	Predatory political environments (politicians with short policy horizons) Ex. Rondônia	Patrimonialist entrepreneurial politics Ex. Bahia
	high	Governance-enhancing incentives (may produce policy volatility if preferences are polarized) Ex. RS	Governance-enhancing incentives Ex. Minas Gerais

I. Bahia – A low to middle income state which is characterized by traditional politics and a hegemonic regime (i.e. one characterized by lack of political competition), but which has undergone rapid transformation and has been witnessing the erosion of traditional clientelistic politics. A politicized but professionalized bureaucracy was instrumental in bringing about a robust process of economic and social modernization in the mid 1970s and mid 1980s, but this process appears to be exhausted. Modern TCs and regulatory agencies in a context of traditional political relations.

II. Pernambuco – A low to middle income state which is characterized by competitive politics and a declining economy which has been experience a process of economic resurgence. Independent judiciary and Ministerio Publico constrain to a large degree the executive's powers at the subnational level.

III. Rio Grande do Sul – A highly competitive state political system in a high income state with dynamic and competitive economic sectors, possessing a moderately professionalized bureaucracy and a highly independent judiciary, regulatory agency and TCE.

IV. Roraima – A former territory, the state is the quintessential rentier state captured by local political elites who control the judiciary, the bureaucracy and legislatures.

V. Minas Gerais – A successful traditional state characterized by high professionalism, independent judiciary and low competition politics. Large electorates make the state and its governors key actors in the national political game.

VI. Espírito Santo (to be considered) – Very low levels of institutionalization and professionalism and high levels of elite capture and corruption. The inclusion of Espírito Santo would offer the possibility of exploring the impact of low institutionalization outside the context of low level of economic modernization.

3. Historical and Political Context

3.1 Constitution and its framing impact

With the return to democracy in the 1980s the states have expanded their roles in the Brazilian federation. However, over the last two decades the states have lost political clout as well as economic importance as a result of a number of developments which we will summarize in this section. However the states still play key economic and policy-making roles in the Brazilian federation. They get some 27% of public revenue and collect directly about a quarter of total revenue – in fact, one of the few countries in the world where this happen. Social spending by the states is also very significant: it represents about a quarter of total spending. The states have jurisdiction over key issue areas such as public safety and play a important role in local economic development. The states are in charge of very large administrative machines, which account for a significant share of formal employment. Their performances affect directly the lives of ordinary citizens in several ways. Many services are in charge of the states, including vocational training, secondary education and secondary and tertiary health care. In addition, states are in charge of infrastructure programs in various areas including sanitation, roads and ports. Understanding policy-making at the state level is therefore a very important.

Several factors explain the decline of the state's political and fiscal clout. Governors had played the role of key power brokers during the transition to democracy. They acted as the guarantors of the new political order. Because they were elected directly in 1982, they enjoyed great legitimacy and thus could play this important role. In the 1990s Presidents reasserted their political importance not only because they were directly elected but also because there was a significant expansion of Presidents in all spheres of activity. This took place notwithstanding the sectoral decentralization in health care and education. The heyday of states' power was during the 1980s, particularly during the works of the Constituent Assembly of 1987-1988.

The Constitution mandated the expansion of the share of sub-national units in total revenue through new revenue-sharing rules and by granting new tax powers to the states. The fiscal implications of the Constitution were felt in the early 1990s, and the subsequent evolution of intergovernmental relations under Cardoso and Lula reflects the Federal government's reaction against this "exogenous shock". Since 1995 the balance between the center and the sub-national interests has changed dramatically.

3.2 Fiscal crisis and recentralization of the game

Since then there occurred a reversal of these decentralizing trends. Starting as early as 1993, Presidents introduced mechanism that reduced the fiscal autonomy of the states. These included several mechanisms for withholding constitutionally mandated transfers to the states (ex. FSE FEF, DRU). In addition, a new set of rules were imposed to curb the states fiscal autonomy. These included new strict rules for sub-national borrowing and ceilings for subnational spending. Central government's increasing control of subnational fiscal behavior culminated in the promulgation of the Fiscal Responsibility Law in 2000.

Thus the vision of a 'predatory federalism' (Abrucio 1998) – a weak federal executive that is unable to overcome the pressures from the periphery of the political system – describes the pattern of relations between the central governments and the states until the mid-1990s, but it is at odds with the picture of federalism under Cardoso (particularly Cardoso's second term of office) and Lula. There occurred an important transformation in the Brazilian federal structure, which was essentially a reaction against the fiscal shock produced by the Constitution of 1988. Brazilian Presidents have had since the mid-1990s a strong incentive to stabilize the economy and to pursue sound fiscal policies (Alston et al 2006). This was the result of two factors. The first is that the electorate became strongly inflation averse following the devastating effects of hyperinflation in everyday life in the 1980s and early 1990s.

The second factor is that citizens were not prepared to give electoral support to governments favoring unorthodox fiscal practices because of the failed heterodox experiments during the Sarney and Collor administrations – Planos Cruzado and Collor, respectively. Presidents had to reconcile their fiscal preferences with policies that would have impacts in their political survival. These included policy issues for which they would be blamed in case of failure. In addition to inflation, Presidents would be blamed for rising unemployment rates and for bad performance in increasingly salient issues such as poverty levels. Melo (forthcoming) refers to this as a process of 'federalization of credit claiming' for social citizenship improvements. Cardoso's and Lula's ability to reconcile these two imperatives explains part of their success.

The states' agenda in the mid-1990s were dominated by the issue of fiscal stabilization. To some extent this was an external agenda – the federal one – that was imposed onto the states. The ability of state executive's to pass this agenda varied across the states. Several factors which will be extensively discussed in the case studies influenced the governor's ability to pass this agenda. These factors include the size of the governor's majority, the level of institutionalization of a state and the level of contestability in the local electoral arena. In this study fiscal stability represents a public good and thus is key dependent variable.

4. Institutions, Players and Powers

This session intends to analyze the key political institutions, players and their powers at the sub-national level in Brazil. We draw extensively on pre-existing literature on “Positive Political Theory.” Most of the extant literature on effects of political institutions on policy outcomes, however, tends to focus on a single institutional dimension, and explores its impact on some policy outcome. Rather than looking at each actor or political institution in isolation we look at the relevant interaction of the institutions aiming at characterizing their role in the Policymaking process across Brazilian states. By doing so, we incorporate a broader range of players and embed them in models of strategic interactions. We see the constraints posed by other institutions as the foundational issue of players’ behavior. This “new separation of power approach” (De Figueiredo, Jabobi, and Weingast 2006) allows us to study interlinked phenomena occurring in multiple institutions. Thus, although we consider the executive branch as the key player in the policymaking process at the sub-national level in Brazil we do not see those Brazilian powerful governors as largely unconstrained. Our approach takes into account the effect of the executive’s need to pay strategic attention, for instance, to authority and preferences of legislative, judicial, regulatory agencies, public prosecutors, accounting organizations, etc. That is, in order to enhance their preferences governors have to anticipate as much as possible other payers’ reactions.

In order to be able to offer a comprehensive analysis of players’ interactions in such institutional environment we intend to address the following questions: Which are the key actors that participate in it? What powers and roles do these actors have? What preferences, incentives and capabilities do these actors bring to the table? What are the characteristics of the arenas in which they interact? How frequent are these interactions? What is the nature of the transactions they engage in? What are the available tradable currencies? Although we recognize that several of the above mentioned institutions interact with the executive at the same time in the policymaking process, for practical reasons will address these questions as if governors would play sub-games with each of those veto players.

4.1 Governors and Legislators

An interactive approach of political institutions is extremely useful to understand, on the one hand, why the legislative branch, both at the national as well as at the sub-national levels in Brazil does not legislate as it is expected from a typical law-maker in a separation of powers system. It works instead very similarly to a parliament whose most important job is not legislating at all but making and breaking governments (Laver and Shepsle, 1998). Although it does not choose or break the government, as it is the essence of a parliament in a parliamentary government, Brazilian legislative branches – especially at the sub-national level – basically work offering (or not, in the unusual cases of divided

governments¹⁰) governability majority power to the governor. On the other hand, this approach also helps to understand why the executive, contrary to other traditional presidential systems which is characterized for a more precise separation of powers, is the most important legislator in land holding an extensive array of formal legislative and informal non-legislative powers. This in turn, creates distinctive incentives for state legislators who must remain extremely loyal to governors' preferences if they want to have access to distributive benefits (pork, patronage, cabinet portfolio, etc.) which are under the discretion of governors and are important to legislators' electoral survival.

This unique combination of strong governors with extensive lawmaking and bargaining powers who live in equilibrium with reactive and unprofesionalized state legislatures is the dominant institutional feature of the policymaking process at the sub-national in Brazil. Governors in Brazil concentrate both negative and positive agenda powers. The former prevents proposals from being considered in the plenary (line and total vetoes) and the latter ensure that they will be considered (provisionary decree,¹¹ delegated law (*Lei Delegada*),¹² urgency procedures, exclusive powers to initiate certain legislation like budgetary, fiscal, and tax policies, etc.). As it is claimed by Cox (2006, 149) "distributing veto powers to more legislators imply a smaller (not larger) set of bills that all veto players can agree on, leading to frustration of various sorts and eventually to gridlock." Thus, the way Brazilian politicians found to decrease transaction and coordination costs in a fragmented institutional setting of proportional representation with open list electoral system was to delegate at length both veto power and proposal powers to the executive across all jurisdictions. Doring (1995) and Henning (1995) argue that increasing government's agenda power lowers the price of the more and complex bills, while leaving the price of non-conflictual bills unchanged. The literature that analyses the US Congress claims that it is perfectly rational to delegate authority to committees or to majority party leadership in order to overcome collective and coordination problems. In the case of Brazil, the choice was to delegate and to concentrate power and prerogatives to an agent even more central to the policymaking, the executive. By doing so, legislators gave up lawmaking powers but at the same time created a safer environment for their electoral bids, at least for the majority that gravitates and gives support for the executive.

When faced with the problem of how to set up the level of authority and legislative powers that will be delegated to the executive, state legislators wish to set things up so as to

¹⁰ Minority coalitions were built in very few states: in the Rio Grande do Sul in 1991-1994, when Alceu Colares was the governor and in 1999-2002 with the Governor Olivio Dutra. In SC the three last administrations also faced divided government: Pedro Ivo (1887-1990), Paulo Afonso (1995-1998) and Luis Henrique (2003-2006).

¹¹ In only four states governors are constitutionally allowed to use provisional decrees: Acre, Piaui, Santa Catarina and Tocantins). However, the use of this important device of setting the legislative agenda is more restricted by state legislators than the national counterpart. In Santa Catarina, for instance, ¼ of the provisional decrees were rejected by legislators. According to Tomio (2006), those rejections occurred regardless the size of the governing coalition. Likewise, the approval rate of provisional is also not correlated with the size of the coalition.

¹² The *Lei Delegada* transfers to the executive the capacity to legislate over certain issues without the necessity to submit projects to the legislative branch. Only few states (BA, PI, DF, MA, ES, RR, RS, and SP) do not allow the governor to use delegated law.

keep close control of the governor's behavior in order to be assured that policy outcomes would be consistent with their preferences. However, this control over the governor's powers and behavior is not free; it generates, for instance, governability costs that legislators must also consider. It may not interest legislators to live in a chaotic institutional environment where uncertainty for their own sake would prevail. Bigger control over governor legislative powers can also, for example, diminish legislators' 'free time' to do local politics with important consequences for the political life of legislators. Controlling too much powerful governors can decrease legislators' access to pork and perks under the discretion of a powerful executive, and so on and so forth. There is therefore an important trade-off between delegation and control of the governor's behavior that legislators face. In order to 'solve' or to moderate these apparently 'irreconcilable' conflicts, legislators have relied on institutional mechanisms and procedures concentrating powers at the executive's hands in order to enhance cooperation among government branches.

Strong executive and weak legislature is not a privilege feature of the Brazilian states. Cox and Morgenstern (2002), for instance, claim that Latin American legislatures have progressively become more reactive than proactive especially because legislators have delegated a huge amount of legislative powers to presidents. It seems that congressmen in this region have learned that by delegating several legislative and non legislative powers to the executive may lead to equilibrium and cooperation. Although less influential in policymaking, reactive legislatures, combined with very strong executives, have created the conditions for governability and electoral survival for the majority of legislators. But due to the information asymmetries inherent in this relationship, legislators run the risk that this discretion might be used to pursue outcomes that conflict with legislators' interests. This risk, however, is attenuated because legislators anticipate that powerful governors are in charge to zeal for the quality of public policies at the whole state. Failure in these areas cannot be credibly blamed on other political players such as state assembly or the Judiciary. Additionally, as the executive is the agenda setter the onus for potential governing mistakes is also under the executive's shoulders. If the executive faces a huge popularity loss with the electorate, for example, even legislators from governor's party or coalition will have the alternative to switch party and move to the opposition without credibility losses. The electoral connection for the state legislators, on the other hand, generally leads them to care more about redistributing gains to their constituents, e.g., geographical redistribution, which usually are under the control and discretion of the executive. Given the differences in preferences and the relative powers of each player, the legislative and executive branches can both benefit by exploiting the gains from trade (Alston et al 2006).

Politicians, both at the legislative and executive branches, are elected every four years with the same electoral rules, proportional representation and open lists to the former and plurality with a runoff to the latter; legislators have no term-limit; governors are allowed to run for re-election just once. Since the transition to democracy in 1985, and especially after the new constitution of 1988, most governors in Brazil have been able to build workable post-electoral alliances (Cox and Morgenstern, 2002) within state assemblies and have benefited from reasonable discipline within their governing coalitions. A puzzle here is how Brazilian governors, who are almost always minority governors, have

been able to build and maintain informal majority coalitions. The electoral rules (proportional representation and open list) do not provide incentives for a majority party inside Congress. Indeed, these rules encourage a post-electoral coalition-based system in which the government majority consists of several parties pledging support to the executive. In this context of coalition government, therefore, the key decision-makers are not committees (as it is in the US Congress), nor individual legislators, neither political parties, but the executive (Pereira and Mueller, 2004) that controls not only the legislative agenda but also several governing tools and tradable currencies (cabinets, jobs, pork, etc). In fact, both mechanisms - agenda control and coalition-management by allocating discretionary resources - seem to be extremely associated and interconnected (Pereira, Power and Raile 2007) structuring the equilibrium of the system.

In these flexible sub-national multiparty systems governors have to use an array of political tools to construct inter-party coalitions, to maintain them in working order over time, and to coax legislative support from these alliances. Although governors are basically equipped with the same institutional tools that help them to dominate the legislative-executive game all over the country, they have varied in how they used these tools to maintain their coalitions. Though also subject to the influence of electoral events, governors have recourse to a number of tools that can make their coalitions larger or smaller, more proportional or less proportional, more homogeneous or more heterogeneous, and even richer or poorer. In this informal coalition game the executive needs to rely on important intermediaries, party leaders, who usually work as brokers negotiating with the executive demands of the members of his/her party and vice-versa. In other words, party leaders are the bridges linking individual legislators and Executive's demands (Pereira and Mueller 2004).

The relationship between legislature and executive in the Brazilian presidential system is thus strategically rich and complex, especially at the sub-national level. On the one side of the coin, the executive has far-reaching powers to set and control the legislative agenda with considerable influence over the policy choice made by the assembly. On the other side of the coin, if the legislature cannot credibly threaten to break the government (as in the case of the parliamentarism), the powerful executive has to negotiate political support with his/her majority coalition within legislature in order to put forward his/her agenda. It looks like the parliamentary-style majority support coalition (Amorim Neto, Cox, and McCubbins 2004) very similar to parliamentary system, in which the executive has almost the monopoly of lawmaking.

Thus, the workings of the political institutions and policymaking (and the impact on policy outcomes) do not depend on single-factor explanations but rather on a multiplicity of factors, rules, and above all, on their interaction. We claim that, in the particular case of the Brazilian political system, the concentration of agenda power on the hands of the executive was an endogenous choice of politicians. In Brazil the executive has ordered along with the military support the closure of the Congress twice, in 1966 and in 1968. In the same way, the Brazilian Congress has taken actions to expel out presidents four times, 1955 (twice), 1964 and 1992. Those episodes of extreme conflicts between governing branches in addition to be severely traumatic for the sake of the country history, have also provided lots

of uncertainty and loss of credibility that Brazilian political system could be able to solve pacifically and democratically their inter-branch conflicts. Although it took a long time, it seems to us that legislators have finally learned with those previous traumatic authoritarian experiences and clearly have decided to make the executive the dominant player in the policymaking process in order to attenuate conflict and enhance cooperation in an institutional environment of multiparty system and proportional representation. On the one hand, proportional representation helps the majority of individual legislators to survive electorally, and on the other, a powerful president compensates the decentralized effect of the open list proportional representation system gluing and giving consistency to the same system. If governors cannot have electoral partisan powers (so common on majoritarian environments) they could at least rely on their agenda and bargaining powers and actions to manage their governing coalitions and to circumvent potential obstacles and accomplish governability, most of the times at low costs. This combination, in fact, tried to adapt the logic of separation of powers to the consensual models of representation and policymaking that prevail in multiparty parliamentary regimes (Colomer and Negretto, 2005).

By saying that the executive tends to predominate on the legislative game it does not mean that governors can do whatever they want in all regards. Tomio (2006), for instance, classifies the legislative process in three sub-games according to the issue-area. The first issue-game is played on the budgetary, financial, tax and administrative legislation in which the executive plays a proactive role where the institutional tools under governors' discretion help them to set the agenda according to their preferences; the second issue-game takes place on social policies (health, education, infrastructure, etc.) and it has a shared decision-making process between legislative and executive branches depending mostly on the size and consistence of the governor's coalition within the state assembly; the third sub-issue game refers to honorific and commemorative legislations which is dominated by logrolls between legislators. Therefore the great majority of the state legislative production on economic and administrative issues has an executive bias especially because legislators are not allowed to initiate new legislations on those specific matters but just to react from proposals initiated by governors. However, it is expected a more active role played by legislators on social and other minor issues.

4.2. Governors and Audit Institutions (Tribunais de Contas Estaduais)

The role of the courts of accounts – both at the federal, state and municipal level – in the Brazilian political system was greatly modified and expanded. The courts of accounts (hereafter called TCEs) were granted the power to issue fines to public officials both elected and non-elected. The TCEs are constitutionally defined as ancillary bodies of the legislature branch, with the purpose of examining the accounts of the three branches of government in terms of their compliance with the principles of the public administration (public morality, impartiality, publicity, efficiency) as well as the specific legal requirements for hiring of personnel, concessions of pensions, procurement, intergovernmental transfers, competitive public bidding and fiscal responsibility. As such

they have become more than just advisory bodies to the legislative branch for the oversight and monitoring of the use of public funds. Although the TCEs are not technically part of the judicial system, in practice they operate as quasi-independent judicial authorities. These institutions have a number of features typical of judicial bodies such as the right of reply, strict procedural rites, collegial decision-making, security of tenure of their board members, and civil service status for their employees. Not only do the board members enjoy tenure security but are also appointed until the official retirement age for public servants, currently 70 years old. (Speck 200; Speck 2002)

The first federal TCE was introduced in Brazil in 1890, while the first state counterpart was created in 1891, in the state of Piauí (Fernandes 2003, chapter 5). The dates of the creation of these institutions in the other states varied significantly, the last one of which was created in 1991, in the state (and former federal territory) of Roraima. The constitution of 1988 established new rules for the functioning of the TCEs which led to a certain institutional homogeneity among these institutions. Prior to the enactment of the constitution of 1988 (under both democratic and authoritarian rule), the executive had the prerogative of appointing all of the TCEs' board members. The new constitution set the number of board members at the federal court at nine members and at the state level (the TCEs) at seven. It also reduced the executive's power of appointment to only three members. The legislature would appoint the other four. The executive was responsible for appointing three members, one of whom was his personal choice - conditional on compliance with the requirements of morality, expertise and 10 years of relevant professional experience, as well as meeting the minimum age requirement of 35. The other two members had to be selected from, respectively, the TCEs' pool of professional senior auditors and public prosecutors (also conditional on the requirements cited). The states had to adapt to the new constitutional provisions but there was considerable ambiguity in the transitional rules.¹³ In some states, the governors (rather than the state legislative assembly) were able to continue to appoint replacements at will; in other cases they appointed auditors or public prosecutors. This was possible because the openings depended on the retirement or death of board members and the rule was ambiguous on the sequencing for the fulfilling of vacancies. More significantly, there were no senior auditors (*auditor substituto*) in eleven states. This was because either there was no legal statute for the creation of the position of senior auditor career track or because the position was vacant. In many cases the governors actively maintained the *status quo* so that they could continue the practice of appointing the two positions as they pleased.¹⁴ These senior auditors also have a right to a vote in the plenary in cases the full member cannot attend the judgment sessions.

Article 71 of the Federal constitution of 1988 defines the objectives and competencies of the courts of accounts. These included the preparation of three different types of reports: a) annual audit reports for all public bodies administrative units (*julgamento de contas*). The law requires that the TCEs have to produce at least one audit brief for every unit under its jurisdiction (*jurisdicionado*); b) annual reports on the global

¹³ For extensive treatment of all the court cases involving the implementation of the new rules, cf Fernandes (2003,582-622)

¹⁴ There were many judicial battles over this issue (Fernandes 2003, chapter 5).

accounts of the executive and legislative branches at the state or municipal level (*parecer prévio sobre contas do governo*). These could be reports recommending the approval (or approval with reservations) or, more significantly, the rejection of the public accountant's report (*parecer prévio pela rejeição de contas*). This recommendation is thus submitted to the State Assembly, which can endorse or reject it; c) audit briefs on the mandatory reports that state and municipal governments have to submit on the execution of the budget to be presented every four months (called *Relatório de Gestão Fiscal*) or two months (called *Relatório Resumido de Execução Orçamentária*). These are required by the fiscal responsibility law of 2000, and represent an important part of the TCEs' workload. In the case a problem was identified these reports work as a kind of early warning, a flashing red light, so to speak.

In order to produce these three different types of reports the TCEs could take on three different forms. First they work on the mandatory reports of accounts required by law that are submitted every year by the state and municipal governments (and by the legislative branches of these two levels of government). The TCEs have to complete their reports 60 days after the former have filled theirs. It is largely a routine work and reflects the statutory requirement for their presentation. The second form of action is based on the initiative of the auditors and the board. They are inspections or audits (*auditorias especiais*) that the auditors or board members initiate as a result of suspicion, evidence or information that they themselves gather about the municipalities or other administrative units. Actions in the third form are investigations which are prompted by denunciations or accusations by third-parties (*auditorias especiais por provocações de terceiros*). These are largely made by municipal councilors, opposition candidates, trade unions, and citizens.

It is a fact that TCEs all over the country presents a great level of variation in their organizational structures, institutional activism as well as in their audit performance. What are the factors that account for variations in the performance of auditing institutions? Why some TCEs are more pro-active than others, detect more irregularities and, where applicable, sanction misdeeds by politicians more effectively than others? Figueiredo, Melo, and Pereira (2006) investigated those questions with particular interest in finding out what factors influence the performance of the state courts of accounts (TCEs), especially focusing on their political and electoral motivations. Because the governors and legislatures appoint the members of the TCEs' boards, why would these members act against politicians' interests? They claim that elected officials may choose to bind their own hands (and in doing so, those of their potential successors) to more autonomous accounting institutions if they recognize that they have a high risk of being replaced by the opposition. Incumbents who face no credible electoral threats have fewer incentives to bind their own hands since they would prefer to keep their discretionary powers unchecked. These authors argue that one of the main rationales behind a greater activism and a court of accounts' propensity to sanction executives is the level of political uncertainty generated by the electoral competition among the state's elite groups.

In order to test these hypothesis, Figueiredo, Melo and Pereira (2006) applied several econometric model specifications to investigate: if organizational as well as political factors in fact have roles on the TCE's level of activity; the governor's choice to

appointing a senior auditor to a TCE; and the ‘propensity to reject or sanction’ a report of accounts submitted by governors, mayors and legislatures. Their findings suggest that Political factors have a significant effect on TCE’s performance when they control for what they call organizational variables. Indeed, the resources available to the TCEs are highly significant, but then so are the political environments in which they operate. In addition, political competition influences the likelihood that a governor appoints a senior auditor for the board. When auditors are members of the boards, the TCEs are more active and initiate more audits on the basis of suspicion (as opposed to routine audits). Similarly, the presence of a public prosecutor on the board significantly enhanced the likelihood that the reports of accounts of elected officials would be rejected (the highest penalty a TCE can inflict on a politician). Their findings also suggest that governors have an incentive to delegate authority to an independent court when they face the risk of losing elections. Finally, the tests show an inverse correlation between resources available to the TCEs and the propensity to inflict sanctions to elected politicians. Although they recognize that there is the possibility of a deterrence effect of better endowed institutions on the politicians’ incentives to commit offenses, they support instead the argument that there is also a “blind eye” effect by which governors buy the TCEs’ acquiescence by simply approving larger budgets for them. Therefore, the workings of accounting institution is better understood when the strategic interactions with other political players is highlighted.

4.3. Governors and Regulatory Agencies

To attract private investment, both federal and state level administrations delegated regulatory authority to relatively independent institutions. Between 1997 and 2005, federal regulators have been created in electricity (ANEEL); petroleum and gas (ANP); telecommunications (ANATEL); ground transportation (ANTT); water transportation (ANTAQ); and water (ANA) while 22 agencies were created in 19 of Brazil’s 27 states. Eighteen states set up multi-sector institutions, and São Paulo, Paraíba and Rio de Janeiro created two sector-specific agencies. Contrary to federal regulators were that created with very similar institutional designs, state regulators vary significantly in terms of the degree of autonomy they enjoy vis-à-vis the state governors. What does account for this difference in institutional design between state regulators?

The change to autonomous regulatory agencies has not been innocuous; it has represented a very important change in the organization of state governments, with a significant shift in the locus of power. Melo and Pereira (2006) argue that the main motivation behind this institutional change was the need of the current governments to tie the hands of the next state government administration. These authors model the process of institutional choice for the new independent regulatory agencies, focusing on the role played by electoral competition, vulnerability and uncertainty. They claim that the more stable the electoral political game, and consequently, the smaller the electoral risk for the elite group in power, the lesser the incentives Governors have to lock in administrative arrangements that reflect his/her preferences, since he/she would prefer to maintain

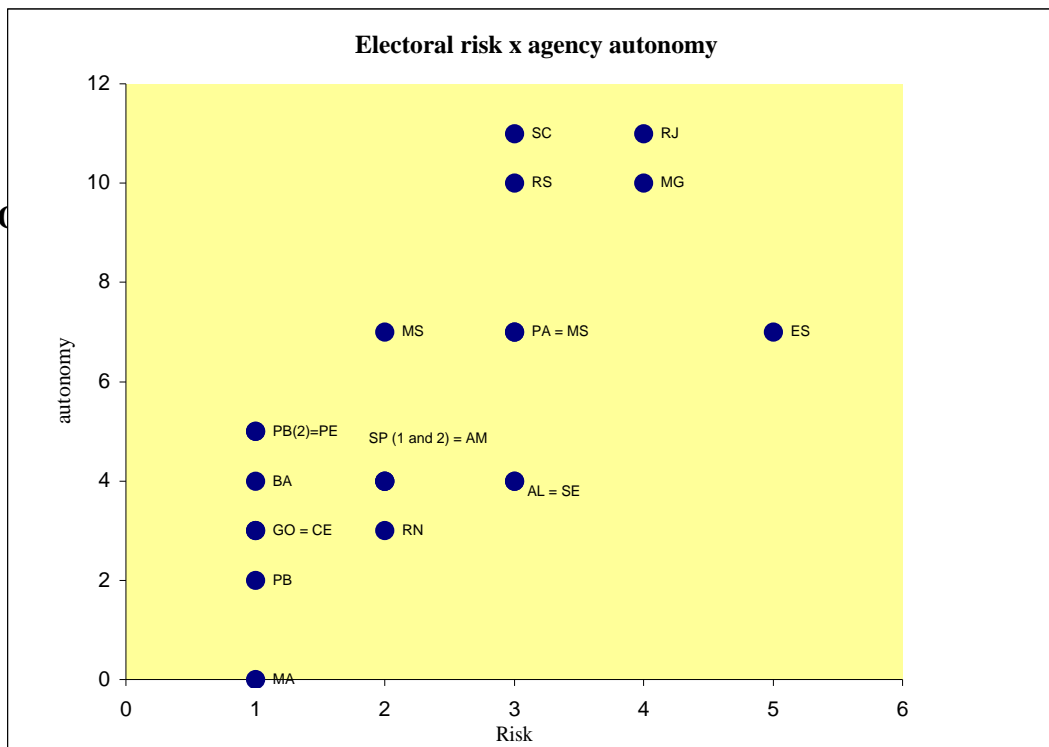
discretionary control. On the other hand, the greater the electoral competition among state elites and, consequently, the more electorally vulnerable the elite group in power, the higher the chances of the adoption of a more rigid and institutionalized institutional framework for public policy. Institutional forms therefore are conceptualized as strategies aimed at protecting the executive's policy preferences.

This hypothesis is based on the assumption that if politicians make a decision to run the risk that independent bureaucrats, once appointed by politicians, may engage in *ex post* opportunistic behavior it is because politicians can extract some sort of compensation from this institutional choice. In other words, by institutionalizing a policy with specific and precise rules and procedures, not only are the hands of the incumbent governing elite tied but so too are the hands of future incumbents. Newly elected governments, even with different ideological and/or administrative preferences, would be forced to keep implementing policies that they would reject if there were no rules designed to protect the *status quo*, thereby maintaining the preferences of the previous elite. The creation and the level of autonomy of regulatory agencies provide thus conditions to the enacting elite to preserve its preferences overtime independent of any constituents' pressures or monitoring.

Using an ordered logit model, Melo and Pereira (2006) tested the level of autonomy of state regulatory delegated by governors and find that the greater the uncertainty faced by the political elite in power, the greater the incentives for them to delegate powers to an independent agency in order to perpetuating their preferences in the upcoming administration. This prediction was confirmed in all model specifications. Precisely, the probability of regulatory agency autonomy decreases when the level of elite Turnover and electoral risk is small. While *Turnover* does increase the probability of regulatory institutionalization about 10.60%, electoral *Risk ex ante* is what really matters since it raises the probability of institutionalization about 50.89%. Thus, it is the fear of losing the upcoming election that plays a credible incentive for governors' decision and choice of how much power should be delegated to regulatory agencies.

In order to better visualize the spatial distribution of the relationship between electoral risk and the level of regulatory autonomy, they plot the states with their values for autonomy and risk (See Graph 1). The area located in the bottom left corner of the figure represents the states in which there are low risk and low autonomy. With the exception of Sao Paulo, it is interesting to note that they correspond to the states located in the Northeast of the country which are less developed and where political competition is generally feeble. On the other hand, in the top right corner of the figure, we can see a concentration of southeastern states, which are presumably more developed than the northeastern counterparts, and where electoral competition is usually stronger and regulatory discretion is higher.

Graph 1



These findings obtained by Melo and Pereira (2006) suggest that the more stable the electoral political game, and consequently, the smaller the electoral risk for the elite group in power, the fewer the incentives Governors have to lock in via administrative and organizational arrangements his/her preferences since he/she would prefer to maintain discretionary control. On the other hand, the greater the electoral competition among state elites and, consequently, the more electorally vulnerable the elite group in power, the higher the chances of the adoption of a more rigid and institutionalized institutional framework for public policy. Therefore, we claimed that autonomy enjoyed by IRAs could be interpreted as an intertemporal safeguard for the preferences of an enacting coalition.

5. Theoretical Framework and Empirical Tests.

5.1. Introduction

The central idea in this report is that political institutions are important determinants of the policies implemented in states. This chapter proposes a model of the policymaking process of the Brazilian states and then tests the implications of the model with state-level data for the period 1999 to 2006. The focus of the tests is on the role that the interaction

among political competition and institutionalization has on the characteristics of the policies that emerge in the states. The basic idea is that political competition has important effects on the choices made by governors and other political actors by determining how long they expect to be in power, what they can do while in power and at what costs. However, the impact of political competition on the characteristics of the policies varies with the level of institutionalization of the policy making game in each state, that is, the ‘rule of law.’ In principal political competition and institutionalization can be either complements or substitutes, that is, they can reinforce each other or work in opposite directions. The econometric tests will show in which cases these variables are complements and substitutes in the state policymaking processes.

The model presented here adapts that of Denzau and Munger (1986), which was developed to analyze congressmen in the US, to fit the circumstances of state governors in Brazil. The main differences are: (i) congressmen are legislators while governors are executive and thus have a more direct effect on which policies are adopted, (ii) we allow for the motive of using office not only to maximize votes, but also to obtain personal wealth, and (iii) the focus is not so much on who gets represented, unorganized constituency or interest groups, but rather on what determines the governor’s choice between pursuing public goods, private goods for specific groups or personal wealth.¹⁵

5.2 Theoretical Model

The governor of a state maximizes votes and money. Votes include both votes for the governor’s own reelection as well as votes for a successor, given the existence of term limits in Brazil. Money is desired both for its own sake and in order to purchase votes through electoral campaigns. The governor’s choice variables are E_u and E_r which are the amount of effort the governor and his staff allocate towards producing, respectively, public goods, P_u , such as public safety, health, education, etc., and private goods, P_r , that is goods that benefit specific small closed groups.¹⁶ There is a limited amount of effort available to the governor, \bar{E} , so that $E_u + E_r = \bar{E}$. In addition the governor chooses how much of the resources received from private groups are allocated to pursue reelection (or making a successor) and how much is pocketed for personal gain. Let α be a variable that measures the share of total resource received by the governor from private groups and through corruption (e.g. overinvoicing) that are used for electoral purposes, where $0 \leq \alpha \leq 1$.

The governor thus chooses E_u , E_r , and α so as to solve the following problem:

$$\text{Max}_{E_u, E_r, \alpha} U[V(P_u(E_u), P_r(E_r), \alpha R(P_r(E_r)), (1 - \alpha)R(P_r(E_r)))]$$

¹⁵ The focus on public goods, private goods and personal wealth has been adopted by other studies in the literature. For example, the ‘Selectorate Theory’ of Mesquita et al. (2003) ‘... emphasizes the circumstances under which leaders realize personal gain, promote public benefits and create special benefits for their political allies. The degree to which they choose to emphasize one form of benefit over another is shown to depend on the selection institutions under which they operate.’

¹⁶ In order to simplify the presentation only one private group is included. This can easily be generalized to allow for n groups as in Denzau and Munger (1986).

$$\begin{aligned} &\text{subject to} \\ &E_u + E_r = \bar{E} \text{ and } 0 \leq \alpha \leq 1. \end{aligned} \quad (1)$$

The objective function shows that the governor's utility is affected by both votes $V(\cdot)$ and by the share of resources that are pocketed $(1 - \alpha)R(P_r(E_r))$. Votes are influenced by the public goods provided by the governor P_u and through the private goods provided to the interest groups P_r . In addition votes can be obtained through electoral propaganda which is purchased using the resources R provided by the private groups. A fraction α of the resources is used for electoral purposes and remaining $(1 - \alpha)$ is appropriated by the governor.

The first order conditions that solve this problem are:¹⁷

$$\frac{\partial U}{\partial E_u} = U^V V^{P_u} P_u^{E_u} - \lambda = 0 \quad (2)$$

$$\frac{\partial U}{\partial E_r} = U^V [V^{P_r} P_r^{E_r} + V^R \alpha R^{P_r} P_r^{E_r}] + U^R (1 - \alpha) R^{P_r} P_r^{E_r} - \lambda = 0 \quad (3)$$

$$\frac{\partial U}{\partial \alpha} = U^V V^R R(P_r(E_r)) - U^R R(P_r(E_r)) \Rightarrow U^V V^R = U^R \quad (4)$$

Where λ is the Lagrange multiplier on the restriction $E_u + E_r = \bar{E}$.

Equations (2) and (3) together yield the following condition:

$$U^V V^{P_u} P_u^{E_u} = U^V V^{P_r} P_r^{E_r} + U^V V^R \alpha R^{P_r} P_r^{E_r} + U^R (1 - \alpha) R^{P_r} P_r^{E_r} = \lambda \quad (5)$$

This condition states that the marginal unit of effort will always be placed in that activity (public or private good) which yields the greatest electoral return to the governor, given α . The term on the left measures the gain from the marginal unit of effort on the public good, which comes through votes. The middle term measures the gain from the marginal unit of effort on the private good. This comes in three ways: (i) through the marginal votes generated by those policies (first part of this term); (ii) through the marginal votes purchased with resources obtained in exchange for effort for private goods; and (iii) through the marginal resources that the governor pockets due to the additional effort for private goods. In equilibrium the gain in utility to the politician from the marginal unit of effort must be the same for private and public goods and is equal to λ .

Similarly, condition (4) states that the decision whether to use resources for electoral or for personal purposes is taken so that the marginal real (R\$) goes to that purpose which generates most utility. Thus in equilibrium, the utility from the marginal real is the same whether it goes to finance the governor's campaign or his bank account.

¹⁷ Let superscripts denote derivatives.

The equilibrium values of the dependent variables E_u , E_r , and α depend on a series of parameters that affect the various functions in (2-5). These parameters capture the characteristics of each individual state's institutions, special circumstances and idiosyncrasies. Below, comparative static exercises will be presented that show how a change in each of these parameters affects each of the dependent variables. First, however, it is useful to consider each of the functions in the governor's maximization problem and spell out what are the kinds of things that the parameters in that function may capture. This list of parameters and their link to the characteristics of public policies that emerge in a state (public goods, private goods, corruption) will serve as a guide for the individual case studies. That is, these case studies will characterize their state's institutions, circumstances and other idiosyncrasies by presenting a picture of that state's political institutions and policymaking game that includes issues such as those listed below.

Functions:

i) Productivity of effort in producing public goods: $P_r^{Eu}(\cdot, \pi)$

where π is a parameter that makes this effort more or less productive. Examples of π are the governor's level of control of the state assembly, the quality of the bureaucracy and the level of political competition. A governor that faces a hostile state assembly, for example, may have a hard time passing legislation to provide more and better public goods. That is, she has low productivity of effort in producing public good. She will have to dedicate more effort to get the same amount of public good than an identical governor with a higher productivity of effort, such as a unified government.

ii) Productivity of effort in producing private good: $P_r^{Er}(\cdot, \omega)$

where ω is a parameter that makes this effort more or less productive. Examples of ω are the governor's level of control of the state assembly, the independence of the bureaucracy, the independence of the state auditor office (TCE), ownership of media by the politicians and the level of political competition. Suppose ω is a compliant TCE. This governor will have a higher productivity of effort in providing private goods than a governor similar in everything but a hostile TCE.

iii) The electoral response to public goods: $V^Pu(\cdot, \sigma)$

where σ is a parameter that increases or decreases this electoral response, such as voter education, income, control of the media, etc. In a state where voters are vary aware of the quality of public goods and correctly perceives the governor as responsible for the state of affairs (captured by a high σ), then an increase in the provision of public goods yields more votes than state similar in everything except for voters that are less aware (low σ).

iv) The electoral response to private goods: $V^{Pr}(\cdot, \xi)$

where ξ is a parameter that increases or decreases this electoral response, such as TCE independence, voter education, income, income distribution, control of the media, etc. The governor has an incentive to provide private goods to interest groups. However, the policies that transmit those private goods are perceived by the voters and affect the way they vote. Generally we would expect that policies that provide private goods reduce the votes received by the governor, though that need not necessarily be the case. In any case the

governor will take into account the voters' preferences regarding the policies aimed at private groups. This is how even unorganized groups are represented in policy (Denzau and Munger, 1986). The parameter ξ is anything that affects the voters' perception of the benefits provided by the governor to private groups. A culture of '*rouba mas faz*', for example, would imply a low ξ and mitigate the negative impact of private good provision on votes received by the governor.

v) The marginal utility of votes to the governor: $U^V(\cdot, \psi)$

where ψ is a parameter that increases or decreases the governor's marginal utility of votes, such as the existence of term limits, whether the governor is in the first or second term, the level of political competition. ψ can be, for example a measure of the governor's expected performance in the next election. A governor who has a strong lead in the polls and expects to win the next election easily (high ψ) will attach a smaller value to marginal votes, that is, lower U^V .

vi) The productivity of private policies in generating resources: $R^{Pr}(\cdot, \theta)$

where θ is a parameter that increases or decreases the contributions received by the governor in response for a marginal increase in the private good, the level of concentration of power among interest groups, elite hegemony, state income. If there is a high level of competition among private group to influence the governor (high θ), then the resources received in exchange for a given policy will be higher (higher R^{Pr}).

vii) The voters sensitivity to electoral campaigns: $V^R(\cdot, \tau)$

where τ is a parameter that measures how influential political campaigns are in the state (i.e. Denzau and Munger's (1986) continuum between rationally ignorant to 'civics class' voters). In states with more highly educated voters (higher τ) the same amount of resources used in the electoral campaign yield less votes (lower V^R).

viii) The marginal utility of money in the pocket rather in the campaign to the governor $U^M(\cdot, \beta)$

where β is a parameter that increases or decreases the utility of the marginal dollar to the governor, such as being a lame duck, existence of reelection, etc. If there is a high probability of being prosecuted even after leaving office (higher β), then the utility of money (U^M) will be lower.

Ideally we would like to do comparative statistics to determine how a change in each of these parameters affects each of the dependent variables E_u , E_r , and α , that is, to determine the signs of the following derivatives (where \cdot represents each of the parameters).

$$\frac{\partial E_u}{\partial \cdot} =, \leq \text{ or } \geq 0$$

$$\frac{\partial E_r}{\partial \cdot} =, \leq \text{ or } \geq 0$$

$$\frac{\partial \alpha}{\partial \cdot} =, \leq \text{ or } \geq 0$$

However, the expressions that emerge from this exercise are unwieldy, do not yield an unambiguous sign and are not amiable to useful interpretations about the channels that

push in either direction. The research strategy is thus for the case studies for individual states and the data collection for all states to use the model as a guide for which characteristics of the state's institutions to look for as well as which relationships to try to understand. The ultimate question is what determines the governor's choice between public goods, private goods and corruption. The model suggests focusing on the relationships i – viii described above (e.g. the governor's productivity of effort in producing public and private goods, the utility of votes to the incumbent, the productivity of private policies in generating votes, etc.) In doing so consider how each of the state's characteristics (called parameters above) affect those relationships. This will provide a characterization of each individual state's policy making processes that is interesting in itself and can also be compared with other states to draw conclusion of the general process.¹⁸

5.3. A Quantitative Measure of Institutionalization

Dependent Variables

The model presented above shows how the decision of governors between providing public goods, private goods and personal benefits is determined by a series of parameters related to political institutions as well as economic and social characteristics of the states. The discussion of the model showed the channels through which the parameters exerted their effect and gave concrete examples of the things these parameters represent. In this section we will test for the relationship between those parameters and governors' choices. The strategy is to estimate reduced form equations using panel data for all 27 Brazilian states for the two legislature of 1999-2002 and 2003 to 2006.¹⁹ The first challenge in pursuing this strategy is to obtain measures of the dependent variables. The most obvious way to capture the provision of public good, such as education, sanitation, health care, would be to use data on expenditures in these areas, which is readily available. However, these expenditures are often constrained by legislation, such as the Fiscal Responsibility Law, and might not really provide much information on the governor's choices. Instead we use an index of expenditure efficiency in the states developed by Ferreira Júnior (2006), which covers the period of 1995 to 2004. The index is a ratio of the part of total expenditure that is effectively spent in the final public good that is being provided (including debt) divided by the administrative and other intermediary costs involved in producing those services. States with a higher value of this index provide more public goods at a lower cost. This index partly captures the notion of private goods, as a low value of the index might reflect larger chunks of the state budget going to groups such as civil servants and construction companies rather than to the final service itself. We will test the determinants of both the variation of the index over a governor's term in office as well as

¹⁸ An obvious limitation of the model is that it does not explicitly consider the temporal aspects of a governor's choice, which are important given the temporal nature of politicians' time in office. In extensions to this project the model can be expanded to cover two periods with political institutions affecting the probability of remaining in office.

¹⁹ Earlier periods were not included due to the lack of data for several variables for those periods.

the average level of the index in each term.²⁰ The rationale behind using this variable to capture the notion of the governors' choice to provide public versus private good is that improving the index, that is the 'efficiency' of public expenditure is a difficult task for a governor, and one that will typically have upfront costs and benefits that are realized only in the long term. A governor will or will not be willing to incur in such costs depending on the level and type of political competition that he/she faces as well as on the level of institutionalization of the state. Governors that foresee longer expected periods in office will be more inclined to seek improvements in expenditure 'efficiency.' Similarly, governors in states that are more highly institutionalized and have more checks and balances (independent judiciary, public prosecutors, audit office, free press, vigilant society, etc.) may have less ability to refrain from investments in improving expenditure 'efficiency.' A second variable that will be used to capture public/private good provision is the expenditure by state governments on programs of voluntary exoneration. These are programs where civil servants, who have stability on the job guaranteed by law, voluntarily accept exoneration in exchange for a negotiated compensation. These types of programs were disseminated across Brazil in the 1990s as a means to reduce overstuffed public bureaucracies and weighed heavily on federal and state budgets. The use of this variable is justified because these programs have investment-like qualities, where the government pays the quitting civil servant an upfront compensation and receives only long term benefits as its salary and pension bill diminishes over time.

The second dependent variable that emerges from the model presents an even larger challenge to quantify, as data on corruption and illicit activity by politicians are generally not available. In order to provide a measure that proxies for the amount of personal benefit the governors and other politicians achieve from office, we use data from the Superior Electoral Tribunal that requires all candidates to political office to publicly declare their wealth. First we use data exclusively on state deputies and then a broader sample including politicians from other types of offices. The data is not without problems as a politician can always lie or underreport his/her holdings and also because there is not data for all politicians as some fail to report and other do not run for office at the end of their term so that they do not need to report their wealth again. Clearly this provides the potential for there to be a selection bias. Note, however, that our observations are at state level and not at individual level. We take the average wealth variation for all state deputies. Thus the final variable used does not contain a selection bias. It may not be a good proxy if the number of deputies sampled to create each state's observation is not representative, however there will be no selection bias as related to econometric estimation. In any case, we mitigate this problem by using the number of deputies that was used to create each state observation as a weight in the OLS regression and as a regressor in the panel regressions.

Table 2 summarizes the dependent variables we use and provides the sources.

²⁰ Unfortunately the variable is only available for the first two years of the 2003-2006 term, so it may not be capturing the full change that would occur across that period.

Table 2 – Dependent Variables

Num.	Name	Description	Source
1	Expenditure efficiency variation	The increase during the 4 year term of an index of expenditure efficiency that measures the ratio of final expenditures to ‘input’ or ‘means’ expenditures (e.g. administrative costs). Data for 1999-2002 and 2003-2004.	Ferreira Júnior, S. (2006).
2	Expenditure efficiency in levels.	Same index of expenditure efficiency as above, but in levels rather than variation over time. Average of the index for each four year period is used. Data for 1999-2002 and 2003-2004.	Ferreira Júnior, S. (2006).
3	Expenditures Voluntary Exoneration Program %	Percent of total expenditures that go to programs of voluntary exoneration. Average for the period of 2001-2004.	Ferreira Júnior, S. (2006) Table 13..
4	Wealth variation state assembly deputies	Percent variation of state assembly deputies’ declared wealth. Average for all deputies in the state for which there is information. Data for 1999-2002 and 2003-2006.	Rodrigues (2006) Políticos do Brasil.
5	Wealth variation of a sample of all politicians	Same as above, except that this variable includes politicians from all types of offices in addition to state deputies. Available only for 1999-2002.	Rodrigues (2006) Políticos do Brasil.

Explanatory Variables

As explanatory variables we need measures of the various different parameters that emerged from the model and were discussed above. Most of these variables capture different aspects of the level of political competition and fragmentation in each state. We use both number of effective parties as well as indices of electoral competition in the state assemblies. Another measure is the number of parties in the governor’s coalition, which affects the executive’s ability to pass his agenda through the legislature. Ideally we would like to have measures of whether each governor faced divided or unified government, however such data is not available for most states, especially as it can change across the same legislative term, according to the evolution of the political cycle. In compensation we do have the margin of victory of the current governor in the previous election (in the first round) which provides a measure of power and expectation of remaining in power. In the same vein we created a variable by multiplying a dummy for those governors that would go

on to win a new term in the next election and the margin by which they would win. This variable selects for those governors that had good expectations or remaining in power thus allowing us to test predictions concerning how a longer horizon affects policy choices. Another important variable that is tested is the amount of patronage received by the state's representatives in the House. The literature on Executive-Legislative relations at the federal level has shown that individual and collective amendments to the budget by the congressmen are approved or blocked by the President in reaction to the level of support provided by the legislators (Alston and Mueller, 2006; Pereira and Mueller, 2006). Being able to bring home these amendments is key for the electoral survival of the representatives and, since many of the amendments involve public works contracts, they potentially create opportunities for corruption that involve state and municipal level politicians such as governors, mayors and deputies (Samuels, 2002) .

In a similar manner we have data on electoral campaign expenditures, which the candidates have to declare to the Superior Electoral Courts after the election.²¹ The total spend in campaigns is summed for the state and divided by the GDP. The idea is that this variable measures certain aspects of political competition as the more that is invested should reflect a tighter race. The final explanatory variables are education and GDP per capita. The first is suggested in the model as parameter in the functions that measure the electoral response to public and private goods. The other, controls for a series of other variable that are related to the stage of development of the state and its level of income. The description of the explanatory variables and their sources are summarized in table 3. Descriptive statistics of all endogenous and explanatory variables are shown in table 4.

²¹ This is also a problematic variable as many do not declare, especially the losers, and there is always the potential for underreporting.

Table 3 – Explanatory Variables.

Num.	Name	Description	Source
1	Effective # of parties in House Representatives	Measure of political competition in the House of Representatives based on the number and size of parties. Data for 1999-2002 and 2003-2006.	Almanaque de Dados Eleitorais (Laboratório de Estudos Experimentais) http://www.ucam.edu.br/leex/
2	Effective # of parties in the State Assembly	Measure of political competition in the State Assembly based on the number and size of parties. Data 1999-2002 and 2003-2006.	Almanaque de Dados Eleitorais (Laboratório de Estudos Experimentais) http://www.ucam.edu.br/leex/
3	Index of Electoral competition House of Representatives	Measure of political competition in the House of Representatives based on the number of candidates per seat. Data for 1999-2002 and 2003-2006.	Almanaque de Dados Eleitorais (Laboratório de Estudos Experimentais) http://www.ucam.edu.br/leex/
4	Index of Electoral competition State Assembly	Measure of political competition in the State Assembly based on the number of candidates per seat. Data for 1999-2002 and 2003-2006.	Almanaque de Dados Eleitorais (Laboratório de Estudos Experimentais) http://www.ucam.edu.br/leex/
5	Nº of parties in Gov.'s coalition.	The number of parties in the governor's party coalition as registered at the Supreme Electoral Court. Data for 1999-2002 and 2003-2006.	Tribunal Superior Eleitoral www.tse.gov.br/internet/index.html
6	Margin of victory in gubernatorial election	Number of votes received by the first place in the gubernatorial election (first round) divided by the number of votes of the second place. Data for 1998 and 2002 elections.	IPEADATA http://www.ipeadata.gov.br/
7	Expected margin for reelected governors	Margin of victory in forthcoming gubernatorial election (see 6) times a dummy equal to 1 when the incumbent won that election. This variable captures the effect of governors who felt secure in office.	Constructed by authors.
8	Media ownership	Percent of all TV concessions in the state that are controlled by politicians.	Santos, S. S. e Capparelli. 2005.

	by politicians.	2004.	
9	Pork	Average value of individual and collective amendments executed across each legislature, divided by state GDP. Averages for 1999-2002 and 2003-2006.	http://www2.camara.gov.br/
10	Campaign expenditure	Sum of the value of campaign expenditures of federal deputies in the state as declared to the Electoral Court, divided by the state GDP. Data for 1999-2002 and 2003-2006.	Tribunal Superior Eleitoral www.tse.gov.br/internet/index.html
11	Substitute auditor at State Audit Office	Dummy equal to one if the State Audit Office has a substitute auditor. Data for 200?.	Melo and Pereira (2006).
12	Number of public prosecutors per 100,000 residents.	Total number of state public prosecutors divided by 100,000 residents. Data for 2003.	Sadek, M. T. e F.D. Lima. 2006. "Diagnóstico Ministério Público dos Estados."
13	Education	Percent of the population over 15 years of age that is illiterate.	IPEADATA http://www.ipeadata.gov.br/
14	GDP per capita	State Gross Domestic Product divided by total population.	IPEADATA http://www.ipeadata.gov.br/

Table 4 – Descriptive Statistics

Variable	Period	Obs.	Mean	Std. Dev.	Min.	Max.
GDP per capita	1999-2002	27	5.006	2.843	1.605	13.504
GDP per capita	2003-2006	27	5.171	2.696	1.728	12.406
Effective # of parties in the State Assembly	1999-2002	27	6.581	1.771	3.3	10.0
Effective # of parties in the State Assembly	2003-2006	27	8.026	2.034	5.2	12.5
Effective # of parties in the House of Represent.	1999-2002	27	4.656	1.393	2.5	7.4
Effective # of parties in the House of Represent.	2003-2006	27	5.359	1.652	3.2	9.5
Index of Electoral compet. House of Rep.	1999-2002	27	2.189	0.841	0.51	4.44

Index of Electoral compet. House of Rep.	2003-2006	27	3.284	1.085	0.72	5.69
Index of Electoral compet. State Assembly	1999-2002	27	3.909	2.158	1.58	11.92
Index of Electoral compet. State Assembly	2003-2006	27	4.684	2.283	1.82	12.1
Share of seats of top 3 parties State Assemb.	1999-2002	27	0.513	0.098	0.33	0.68
# of parties in Gov.'s coalition.	1999-2002	27	8.111	3.994	1	16
# of parties in Gov.'s coalition.	2003-2006	27	7.259	3.789	1	14
Margin of victory in gubernatorial election	1998	27	1.849	1.161	1.01	5.01
Margin of victory in gubernatorial election	2002	27	1.459	0.363	1.012	2.512
Expenditure efficiency variation	1999-2002	27	0.298	0.702	-0.48	2.83
Expenditure efficiency variation	2003-2004	27	-0.051	0.176	-0.601	0.22
Expenditure efficiency in levels.	1999-2002	27	2.682	1.226	1.37	7.453
Expenditure efficiency in levels.	2003-2004	27	1.997	0.473	1.065	3.15
Expenditures Voluntary Exoneration Program %	2001-2004	27	4.601	13.607	0	71.81
Education	1999-2006	27	14.819	9.640	4.672	34.160
Substitute auditor at State Audit Office	2003	27	0.519	0.509	0	1
Number of public prosecutors per 100k pop.	2006	27	4.809	1.203	3.17	8.79
N ⁰ state deputies in wealth var. variable	1999-2002	27	16.444	8.803	5	40
N ⁰ state deputies in wealth var. variable	2003-2006	27	18.363	9.987	7	49
Media ownership by politicians.	2005	27	0.42	0.231	0.08	1
Pork	1999-2002	27	52.630	107.454	1	534
Pork	2003-2004	27	9.704	19.062	0	78
Wealth variation state assembly deputies	1999-2002	27	2.052	1.890	0.29	7.14
Wealth variation state assembly deputies	2003-2006	27	2.602	1.791	0.28	7.78
Wealth variation of a	1999-2002	27	0.555	0.519	-0.247	1.474

sample of all politicians						
Campaign finance	1999-2002	27	0.099	0.168	0.001	0.705
Campaign finance	2003-2006	27	0.086	0.145	0.001	0.620
Checks & Balances index	1999-2006	27	0.519	0.147	0.175	0.889

5.4. Measuring Checks and Balances

Whereas there are several obvious and readily available variables for measuring political competition, it is not so easy to get a measure of institutionalization, a concept which is not even straightforward to define. It refers in part to the notion of ‘rule of law’ which captures ‘the extent to which agents have confidence in and abide by the rules of society’(Kaufman, Kray and Mastruzzi, 2003). But it involves also the existence of institutions that generate low political transaction costs that facilitate providing create credible commitments realizing political and economic exchanges. It involves as well as a set of checks and balances that provide constraints against opportunistic behavior and towards cooperation and public regardedness. In the remainder of this report we refer to this quality of ‘institutionalization’ simply as checks & balances, given that the term institutionalization is confusing in that political competition variables also measure factors related to institutions.

In order to create an index of checks & balances, we collected state-level data on seven variables that reflect the extent to which the more-or-less abstract factors just described are present in a state’s institutional matrix. The focus is on the existence, effectiveness and independence of several types of agencies and organizations that have important roles in the checks and balances at different levels of government. These variables are described in table 5, along with their sources. Because these variables all have different units, making comparison difficult, and also as a way to deal with outliers, we used the sum of the rank of all seven variables in each state and then normalized the final index to range from zero to one.²² Table 6 provides the values of the ranks of each state in each variable.²³

²² This method reduces the impact of extreme scores in any of the seven variables for a given state. Suppose one state has a very high score for one variable and average scores on all other six. It is possible that the impact of the extreme observation will be such as to make the state’s final score rank high on the list, even though it is only strong in one of the variables. Using ranks mitigates this effect.

²³ As with the creation of any index there are several different ways of proceeding, from the choice of input variables to the statistical treatment used to aggregate those variables into a single index. An alternative, also not immune to criticism, would be to realize a survey with experts in the literature of policymaking in Brazilian states, asking each to rank the states according to their perception of their level of institutionalization. This would be useful to compare with our results and may be done as an extension of this study.

Table 5 – Variables used to Create the Institutionalization Index

Num.	Name	Description	Source
1	Regulatory Agencies	Regulatory Governance Index. Measures governance of state and federal reg. agencies in Brazil based on survey data. States with no agency at the time of the studied were set at 0.53 (avg. of other states). Data for 2004/2005.	Correa, Melo, Mueller and Pereira (2006).
2	Judiciary	Index composed of two variables: i) an efficiency index calculated through nonparametric efficiency frontiers; ii) ratio of number of cases tried over cases opened (data for 2003). The simple average of both variables was used.	i) Swengberger, 2006, pg 79 ii) Ministério da Justiça. 2004. Diagnóstico do Poder Judiciário
3	Public Prosecutors	Index composed of three variables: i) Expenditures with public prosecutors per resident (2003); ii) Number of prosecutors per 100,000 residents (2003). iii) Number of staff per 100,000 residents (2003);	Sadek and Lima (2006).
4	Audit Office	An index of the level of activity in each state's Audit Office (TCE).	Melo and Pereira (2006).
5	National Justice Council (CNJ)	Number of procedures initiated in each state by the CNJ (agency that serves as a watchdog over the Judiciary) divided by state GDP (divided by 100,000). Data for 2006.	Corregedoria Nacional de Justiça. 2006
6	Media	Percent of all media concession in each state are not in the hands of politicians. ²⁴	Santos, S. S. e Capparelli. 2005
7	Public Defenders	Number of hearings per defender.	Ministério da Justiça. 2006. II Diagnóstico Defensoria Pública no Brasil.

²⁴ In this version of the study we cannot differentiate if the politicians owning the media are in government or in the opposition. We are however collecting data to allow this differentiation to be made, which will provide greater insight into the role of the media and of political competition.

Table 6 – Inputs in the Checks & Balances Index

Num	State	Regulatory Agencies	Judiciary	Public Prosecutors	Audit Office	CNJ	Media	Public Defenders
1	Acre	5	9	1	1	2	15	22
2	Alagoas	19	10	2	5	6	5	16
3	Amapá	6	2	4	22	12	10	12
4	Amazonas	21	8	3	13	13	13	24
5	Bahia	26	7	5	27	11	7	23
6	Ceará	4	18	6	21	9	9	6
7	Distrito Federal	7	23	7	26	3	24	9
8	Espírito Santo	8	12	8	18	16	25	13
9	Goiás	25	13	9	23	8	4	18
10	Maranhão	9	1	10	2	4	3	1
11	Mato Grosso	20	14	13	14	17	17	14
12	Mato Grosso do Sul	24	11	12	10	15	26	27
13	Minas Gerais	10	5	11	8	23	19	4
14	Pará	11	3	14	3	26	16	11
15	Paraíba	2	24	15	17	7	11	7
16	Paraná	13	26	18	7	25	14	19
17	Pernambuco	22	17	16	25	18	23	10
18	Piauí	12	19	17	4	1	8	2
19	Rio de Janeiro	27	15	19	16	19	20	3
20	Rio Grande Norte	1	25	20	11	21	2	26
21	Rio Grande Sul	23	22	23	24	24	27	25
22	Rondônia	14	21	21	6	20	18	5
23	Roraima	15	6	22	12	5	1	17
24	Santa Catarina	16	27	24	9	27	21	20
25	São Paulo	3	4	26	15	22	22	21
26	Sergipe	17	16	25	20	14	12	8
27	Tocantins	18	20	27	19	10	6	15

The final Checks & Balances index is shown in table 7 in order of highest to lowest. Overall the results are intuitive and fit reasonably well with common preconceived notions of which states have better institution. The bottom states are all state which our prior belief expected to find at the end of the list and Rio Grande do Sul at the top also seems to fit. As is inevitable there are always some surprises, such as Pernambuco in 3rd and Minas Gerais in 20th. Any supposed abnormality might be a result of poor data, poor design or of incorrect expectations. In any case, overall the index seems reasonable and will be used in the econometric tests both to estimate its direct effect on the dependent variables as well as its effect on the way political competition affects the dependent variables.

Table 7 – Checks and Balances Index

Num	State	Index
1	Rio Grande do Sul	0.89
2	Santa Catarina	0.76
3	Pernambuco	0.69
4	Mato Grosso do Sul	0.66
5	Paraná	0.65
6	Rio de Janeiro	0.63
7	Tocantins	0.61
8	São Paulo	0.60
9	Sergipe	0.59
10	Mato Grosso	0.58
11	Bahia	0.56
12	Rio Grande do Norte	0.56
13	Rondônia	0.56
14	Espírito Santo	0.53
15	Goiás	0.53
16	Distrito Federal	0.52
17	Amazonas	0.50
18	Pará	0.44
19	Paraíba	0.44
20	Minas Gerais	0.42
21	Roraima	0.41
22	Ceará	0.39
23	Amapá	0.36
24	Alagoas	0.33
25	Piauí	0.33
26	Acre	0.29
27	Maranhão	0.16
	Mean	0.52
	Std. Dev.	0.16

Estimation Results

The purpose of the estimation is to analyze how political and institutional environments affect the characteristics of the policies that emerge in the states. The dependent variables measure features related to the policy choices of the governors and the explanatory variables measure features related to political competition and checks & balances, both of which shape the incentives and restrictions that the governors face when making those choices. The estimations are thus reduced forms that capture the net effect of the parameters of the model on the dependent variables, without the pretension to estimate

a structural model that would include the relationship among the dependent variables. Wherever data was available we used a panel of the twenty-seven Brazilian states across two periods that cover two sets of four-year political terms, which is the basic time frame for governors. In these cases the estimation was done using random effects as some of the explanatory variables did not vary across the two periods or were not available for both periods. In some of the estimations data was not available for a panel and a simple cross-section was estimated by OLS.

Table 8 presents the results where the dependent variable captures the decision of the governor to seek his/her own benefit as opposed to that of the public as a whole or of private groups. We refrain from calling this a corruption equation as corruption may also be a means to provide private and even public benefit. Because seeking personal benefit is typically illicit there is no data available that measures this behavior directly. As a proxy we use the increase in personal wealth as declared by politicians to the Supreme Electoral Court before and after the four years in power. The estimation in column 1 uses data only on state deputies and column 2 uses data for a large set of politicians, including federal deputies, senators and mayors. Ideally we would have liked to try an estimation only with governors in the dependent variable, but there were many missing observations as several governors could not or did not choose to run for office after their gubernatorial term and thus did not have to declare their wealth. Our assumption in using state deputies and other politicians is that there is a high positive correlation between the increase in wealth of the governor and other politicians in any given state.²⁵

Because the sample is relatively small, and also because of potential multicollinearity among the explanatory variables, we chose specifications where most variables that had low levels of statistical significance were removed. In this section we discuss the results of these regressions and in the following section we extend the results to consider the interaction between political competition and institutionalization, which will shed more light on how to interpret the effect of political competition on the dependent variables.

Before examining the individual estimated coefficients, it is useful to look at the estimations as a whole to see what lesson is learnt. The main point to note is that political variables are able to explain a large part of the variation of the dependent variable. The R^2 and adjusted R^2 s are surprisingly high for cross-sections and panels with only two periods and few observations, especially if one considers the nature of the dependent variables, which capture the variation of wealth over time rather than the level of wealth. Our original set of variables included not only political, but also several other social and economic variables such as poverty, Human Development Indices, geographic variables, wealth

²⁵ As we discussed above there are other problems with the data. The first is that politicians may have an incentive to lie about their wealth, most probably to underreport. The second is that there is only data for a subset of all deputies and other politicians. As noted above, this does not lead to a selection bias as the values for all politicians for which there is data are aggregated and the level of observation is the state. This means that the proxy might not be a good approximation of what we are trying to measure, but there is no selection bias in the econometric sense for the estimation. Note also that to mitigate the problem the variable measuring the number of politicians whose data went into constructing the dependent variable in each state is added as a regressor in the panel estimations and as a weight in the OLS.

concentration, violence, natural resources, exports, etc. The estimations, for this and the other dependent variables (table 8) systematically showed a predominant effect of political variables over others, though we chose to keep GDP and education in several estimations even when not significant. This provides empirical support to the approach in this report that focuses on political and institutional determinants of policies.

Column (1) shows that the Checks & Balances index is positive and significant, indicating that those states with stronger rule of law (as measured by the quality of the judiciary, public prosecutors, audit offices, public defenders, media, regulatory agencies and the judicial watchdog) have lower levels of wealth increases for their state deputies. This result indicates that the institutional structure of the state is able to mitigate the use of power by politicians to pursue their own wealth. Ideally we would like to make this claim for the specific case of the state Governors, but due to the lack of data on their wealth variation, we can only presume that the same effect holds for them.²⁶

The effect of electoral competition within the state assembly has negative and statistically significant (1%) effect on the wealth variation of the deputies. This index measures the relative number of candidates per seat, indicating a virtuous effect of political competition in keeping corruption in check. Similarly, the greater the number of parties in the governor's coalition the lower the increase in state deputy wealth (significant at 5%). In principle it is not clear what we would expect of this variable. Having to attract and manage a more fragmented coalition might require that the governor concede more benefits to the deputies of the coalition. On the other hand, if the governor has a supermajority, then having more parties in the coalition might allow the governor to play off one party against the other and thus have to concede fewer benefits. Here again the case studies presented later in this report may offer some insight into the interpretation of this result.

The higher the number of effective parties for which the state has representatives in the National Congress, the greater will be the increase in wealth of the state deputies over the legislature, statistically significant at 1%. This is a case where more political competition or fragmentation leads to more personal benefit to politicians within the state. Our model does not inform what is the relationship between federal and state deputies, only that there appears to be a robust connection reflected in the data. In order to understand this result it would be necessary to analyze the relationship between the local politicians (state deputies and mayors) and the states' federal representatives. The key to understand this relationship is probably in the bringing of pork by the federal legislators to local specific areas in the state, which is crucial for strengthening popularity and reelection chances. This process is also an important source of corruption as the implementation of the projects involved allow for over-invoicing and kick-backs. One way to interpret our result is that in states where there are more parties bringing in the pork, state deputies are getting a larger share.

For those governors that would go on to win the next election, the higher their margin of future victory, the greater the wealth variation of the deputies. This variable was

²⁶ Note that this specification tests only for a direct effect of the Checks & Balances variable. Below we will test whether it has an indirect effect through its interaction with the political competition variables.

constructed to capture the effect of governors that had reason to feel safe in office. The positive and significant (10%) estimated coefficient shows that those governors with longer-term horizons allowed greater increase in personal wealth. This result is contrary to the notion of an end game giving incentives for opportunistic behavior. It may be that the explanation for this result is that governors that will be in power for a longer period are more powerful and better able to resist investigation and prosecution as they have privileges and immunities while in office, which leads them to more, rather than less, opportunistic behavior.²⁷ The regression also has a dummy for states where the Governor was a ‘lame duck’, due to term limits. This variable was positive but not significant.

The level of education was positive but not statistically different from zero. This variable is highly correlated with GDP per capita and other social and economic variables. In general these variable were not found to be as successful as the political and institutional variables. Finally, the variable which controls for the size of the sample of deputies in the dependent variable was negative but not statistically significant.

Table 8 – Determinants of Politicians Wealth Variation

	(1)	(2)
	State Deputies	State Deputies
	Wealth Variation	Wealth Variation
Checks & Balances index	-3.736* (-1.66)	-1.035** (-2.32)
Electoral competition State Assembly	-0.477*** (-2.81)	-0.095* (-1.70)
# effective parties House of Repres.	0.512*** (2.83)	
Electoral competition House of Represent.		0.135 (0.88)
# Parties in Coalition in State Assembly	-0.143** (-2.31)	
Expected margin for reelected governors	0.440* (1.87)	
Lame duck Governor	0.536 (1.23)	0.249 (1.39)

²⁷ A similar result was found by Melo, Figueiredo and Pereira (2006) using audit report data, in what they called the “corruption-enhancing role of reelection incentives”.

Pork		0.002** (2.40)
Education	0.634 (1.57)	-0.016 (-1.35)
N ⁰ state deputies in wealth var. variable	-0.050* (-1.81)	
Constant	1.54 (0.85)	1.164** (2.04)
Method	Panel: Random Eff.	OLS
	2 periods, 27 states	
Periods	1999-2002 2003-2006	1999-2002
Observations	54	27
R-squared (adjusted)	within: 0.50 between: 0.46 overall: 0.48	0.31 (0.10)

Notes: In parentheses, t-stats. *** indicates significant at 1%, ** at 5%, and * at 10%. OLS has robust std. errors and is weighted with the N^o of deputies in the wealth variable.

When we use as dependent variable the increase in wealth of a full set of politicians (available only for the 1999-2002 period) we find that the Checks & Balances index remains positive and significant and that electoral competition in the State Assembly continues to have a dampening effect on the increase of state deputy wealth. We no longer find an effect of competition in the National Congress, but the variable that measures the amount of pork brought home by federal deputies is positive and significant (5%). In states that receive more pork (relative to their GDP) there is a greater increase in the wealth of all politicians. Overall the results for this dependent variable are similar to those of the larger sample, though they are somewhat weaker.²⁸

Table 9 shows the results of the regressions for the variables that measure expenditure efficiency. The basic idea is that improving expenditures has the characteristics of a public good in the sense that it benefits the population at large, as well as having investment-like qualities in that such efforts typically have upfront costs and deferred benefits. A governor will only expend resources in pursuing such objectives if there are incentives for doing so. The rationale for the regressions, stemming from our theoretical model, is that the incentives and restrictions for pursuing effort in this direction have as key determinants political competition and checks and balances.

²⁸ In columns (4) and (5) the variable that measures the number of politicians in the dependent variable is used as a weight rather than a regressor.

In column 1 the dependent variable is the improvement in expenditure efficiency during the political term. Because some states may have already started off at a higher level of expenditure efficiency, thus having less room for improvement, we use the initial level of expenditure efficiency as a regressor, that is, its value in 1998 for the first term and for 2002 for the second term. The estimated coefficient for this variable is negative but not quite statistically significant.²⁹ Another control variable in this specification was the gini coefficient, which entered also a squared term to allow for a non-linear relationship. It was found that states with more concentrated wealth had lower levels of expenditure efficiency, though the effect gets smaller as concentration increases.

The index of checks & balances was found to have a positive and significant effect, which indicates that states that have better rule of law and constraining institutions tended to improve the quality of their expenditure over time. Although the regression does not provide information on the mechanisms behind this relationship, it suggests that in states where the judiciary, public prosecutors, audit office, public defenders and the press function better and are more independent from the executive, policy outcomes tend to have better characteristics.

In this specification we used indices of electoral competition in the state assembly (including a squared term) and in the House of Representatives in the National Congress. As was the case in the regressions in table 6, these variables had opposing effects. Electoral competition in the state assembly increases the growth in expenditure efficiency whereas competition for the House decreases it. It is noteworthy also that the direction of the effect is analogous to that in the previous regression (although the signs are switched since wealth variation is a negative variable while expenditure efficiency is a positive one). The robustness of these results for dependent variables of so different nature provides confidence in our argument.

Other political variables that were found to be significant were the number of effective parties and a dummy for 'lame duck' governors. The number of effective parties was found to have a negative impact on the variation in expenditure efficiency, perhaps due to the greater difficulty in passing legislation. Similarly, 'lame duck' governors tended to have lower levels of expenditure efficiency variation than did those who had a shot at a second term.

Columns 2 has the dependent variable the level of expenditure efficiency (average over the four years of the term) rather than variation. Results are basically similar to those in column 1. The checks & balances index is positive and significant and the results for the effect of electoral competition in the state assemblies and in the House show the local variable positively related to expenditure efficiency and the national variable negatively related. Political competition variables measuring the number of parties in the governors coalition and the margin of victory in the previous gubernatorial election were added to these regressions. They did not prove statistically significant at standard levels but nevertheless warrant a look at their relationship with the level of expenditure efficiency.³⁰

²⁹ For the second period we only had expenditure data for 2003 and 2004. The addition of 2005 and 2006 should strengthen the results as many effects may come into play towards the end of the term.

³⁰ In some specifications these variable did turn out to have significant estimated coefficients.

The greater the fragmentation of the governor's coalition in the assembly the greater the quality of public spending. This points to a virtuous effect of political competition. In the same manner, the negative sign in the margin of victory variable suggests that governors that feel safer in office feel less need to invest in improving expenditure efficiency. This is not an obvious conclusion as it could just as well be the case that governors with a longer horizon would have more incentive to pursue virtuous policies as they would benefit more from those policies themselves. The model and the regressions do not provide the means to sort out in more detail the effect of political competition. In the next section, however, we will investigate this issue in greater detail by analyzing the interaction between political competition and institutionalization.

Finally, in column 3 we use as dependent variable the percentage of total spending that states dedicated to voluntary exoneration programs, which we argued above have investment-like qualities due to the slow maturation of their benefits to the state's accounts. Because the data was only available in aggregate form (average over the 2001-2004 period) this equation was estimated by OLS. Once again the checks & balances index was found to be positive and significant. States with better checks & balances and rule of law were thus much more likely to pursue voluntary exoneration programs.

The electoral competition index for the state assembly was again found to be positive and significant at 1%, indicating virtuous consequences to political competition at the local level. On the other hand it was found that states with higher concentration of assembly seats in the hands of the two largest parties also had higher incidence of voluntary exoneration program, perhaps due to the greater ease at passing legislation. It was also found that states that receive greater shares of individual and collective amendments (divided by GDP) were more likely to dedicate resources to those programs. The statistical significance of this variable was very strong and accounts for a large share of the high R^2 for this regression. The reason for the strong relationship between these apparently disparate variables remains to be clarified. Finally, states with higher levels of education were found to be more likely to have voluntary exoneration programs, indicating governor's more inclined to pursue public goods.

Table 9 – Determinants of the Expenditure Efficiency

	(1) Expenditure Efficiency Variation	(2) Expenditure Efficiency (level)	(3) Voluntary Exoneration Program
Checks & Balances	1.230** (2.10)	1.441* (1.72)	18.728*** (2.67)
Initial level of Expendit. Efficiency	-0.090 (-1.41)		
Electoral competition House of Represent.	-0.158* (-1.70)	-0.389** (-2.73)	
Electoral competition State Assembly	0.570*** (2.99)	0.240*** (3.55)	3.298*** (3.54)

Electoral competition State Assembly squ.	-0.044 ^{***} (-2.88)		
Effective number parties State Assem.	-0.0810 ^{**} (-2.27)		
Party concentration in State Assembly			16.122 [*] (1.91)
Number of Parties in Gov.'s Coalition		0.037 (1.21)	
Margin of victory in gubernatorial election		-0.147 (1.08)	0.964 (1.25)
Lame duck Governor	-0.285 ^{**} (-1.98)		
Pork (per gdp)			0.077 ^{***} (4.55)
Gini	-151.21 ^{***} (2.53)	13.71 ^{***} (3.47)	
Gini squared	145.07 ^{***} (2.67)		
Education			0.287 ^{**} (2.32)
Constant	38.44 ^{**} (2.36)	-6.167 (-2.53)	-34.399 ^{***} (-3.53)
Regional dummies	Yes	No	No
Method	Panel: Random Eff 2 periods, 27 states	Panel: Random Eff 2 periods, 27 states	OLS 1 period, 27 states
Periods	1999-2002 2003-2004	1999-2002 2003-2004	1999-2002
Observations	54	54	27
R-squared (adjusted)	within: 0.28 between: 0.70 overall: 0.48	within: 0.19 between: 0.59 overall: 0.42	0.90 (0.87)

Notes: In parentheses, t-stats. *** indicates significant at 1%, ** at 5%, and * at 10%. Robust std. errors for OLS.

5.5. The Interaction of Political Competition and Institutionalization

The regressions in the previous section provide empirical content to the model of the state policymaking process presented earlier. That model predicted that political and institutional variables are key determinants of the characteristics of the policymaking process and the regressions provided evidence of the sign and magnitude of those relationships. Although the regression results are strong and robust, the evidence presented is not easy to interpret. It was found that political competition has virtuous effects in some cases, restricting wealth increase of politicians and increasing expenditure efficiency, but perverse effects in others. In addition, the checks & balance variable was significant in all of the regressions. In what follows we investigate the possible interaction between political

competition and checks & balances. This is based on the framework presented in chapter 2 that postulated that the characteristics of public policies are affected by where the policymaking environment stands in relation to the two dimensions political competition and checks & balances. This raises the possibility that the effect of checks & balances works indirectly by affecting the way political competition impacts policy choices. In principle both of these dimensions can be either complements or substitutes. Sorting out which is the case is important for us to understand our previous results.

The strategy that we will pursue in order to address these issues is to run the regressions again adding an interaction term between each political competition variable and the checks & balances index. The interaction term allows the impact of one the variables on the dependent variable to vary as the other interacted variable changes. That is, we can quantify and draw inferences from the varying effect of political competition on policy characteristics as the level of checks & balances changes. This will allow us to determine, for example, whether the effect of political competition on politicians' wealth variation gets more or less restrictive as we move from states with lower to higher levels of checks & balances. If we find that the effect of political competition gets stronger in more institutionalized states, then we can conclude that political competition and checks & balances are complements. If the effect of political competition gets smaller or even becomes statistically equal to zero, then we can conclude that both of these dimensions are substitutes.

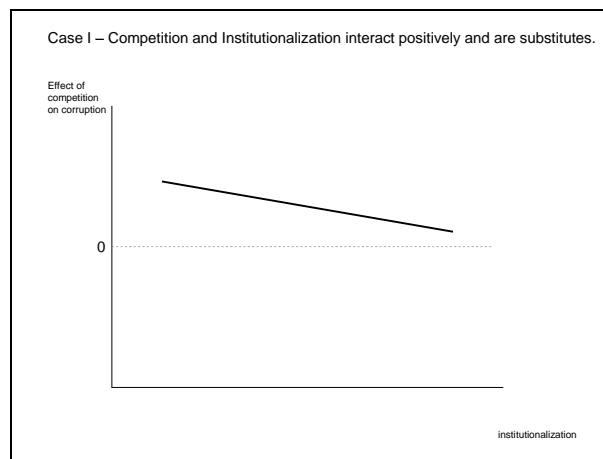
The use of interaction terms has become standard in the social science literature as they capture the fact, often encountered in real life applications, that the impact of one variable on another can depend on a third variable. However, the way in which interactive terms should be constructed and especially the way the results should be interpreted is not as simple as it might seem on the surface. Brambor, Clark and Golder (2006) have surveyed the top three political science journals from 1998 to 2002 and found that only 10% of the articles that use interactive terms do so correctly and interpret the results appropriately. Common errors are to use only the interactive term leaving out one or both of the separate variables and to use the standard errors directly from statistical package outputs for inferences, which leave out important terms from the formulas of those standard errors. These authors suggest a graphical method, which we will adopt below, that displays all the information from the interaction of the variables, including the information need for inference purposes.³¹

Before looking at the results of the interactions in our data, we need to describe how to interpret the graphs and how to make sense of the results. As we saw in the previous section, political competition variables can have a positive or a negative effect on the policy characteristic variable. If high competition leads to shorter horizons the governor might want to steal more while in office and might be less inclined to initiate policies with investment-like qualities. On the other hand, more competition might mean more veto points, which would lead to less corruption and more responsible policies. Graph 2 gives an

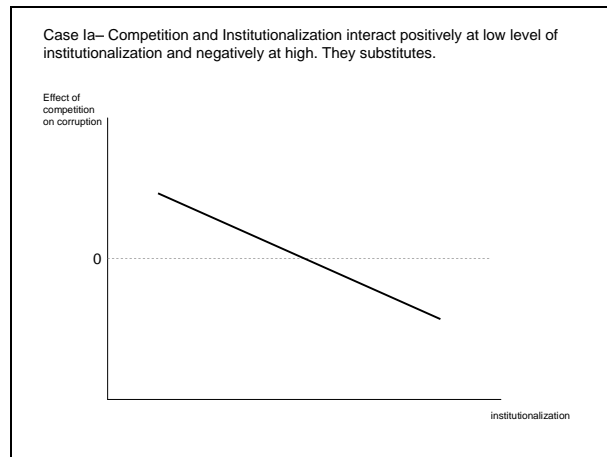
³¹ The computer code for creating these graphs in Stata 8.0 is available at <http://homepages.nyu.edu/~mrg217/interaction.html>.

example of the kind of result that can emerge. In the horizontal axis we plot the checks & balances variable so that states with lower levels are found in the left and those with higher levels are found more to the right. On the vertical axis is measured the effect of political competition on the policy characteristic variable, which in this example is the level of corruption. Note that in this setup the effect of political competition on corruption is no longer fixed, but rather it varies with the level of checks & balances, unless the line in the graph is found to be horizontal. In graph one the effect of competition on corruption is positive, however that impact decreases as checks & balances increases. In such cases we classify political competition and institutionalization as substitutes. Note that in actual applications we will be able to ascertain for each level of checks & balances if the coefficient of competition on the dependent variable is statistically significant at a given level of confidence, so it will often be the case that we find that coefficients different from zero in some levels of checks & balances but statistically equal to zero in other, indicating no relationship of competition with the dependent variable in those regions.

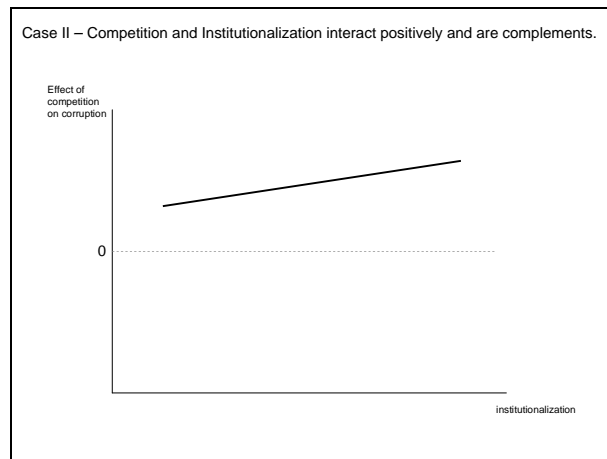
Graph 2 – Positive and substitute relationship between competition and checks & balances



Graph 3 presents a strong case that is similar to that in the previous graph, but where the substitution effect is so strong that political competition switches from having a positive to a negative effect on corruption as checks & balances grow. This would be a case where in states with poor institutions political competition enhances corruption but in states with good institutions competition reduces corruption.

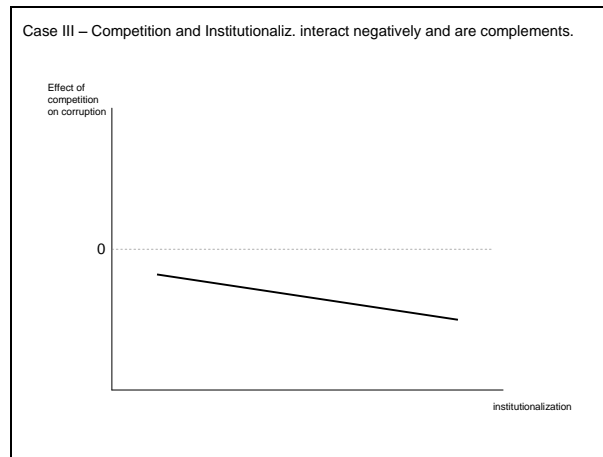
Graph 3 – Substitute relationship with sign switching from positive to negative

Case II in graph 4 shows an example where competition increases corruption, and checks & balances enhances the impact of competition on corruption. Finding such cases would contradict our expectations, given that we view checks & balances as increasing rule of law, facilitating cooperation and coordination, reducing transaction costs lubricating political exchanges.

Graph 4 –Positive and complementary relationship between competition and checks & balances

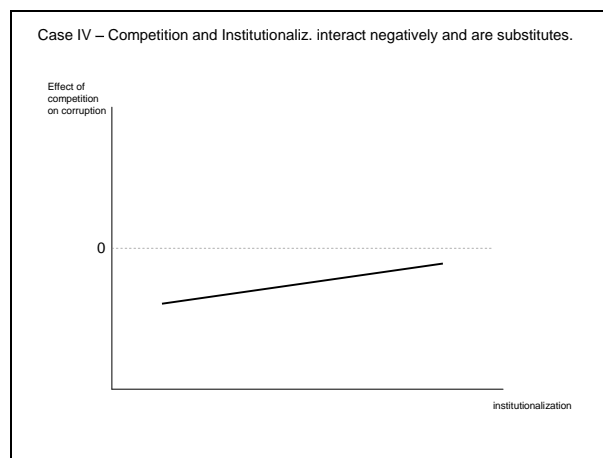
Case III in graph 5 shows the case where competition reduces corruption, and checks & balances enhance the impact of competition on corruption. This case does fit our expectations as it has checks & balances enhancing the virtuous effects of political competition.

Graph 5 –Negative and complementary relationship between competition and checks & balances



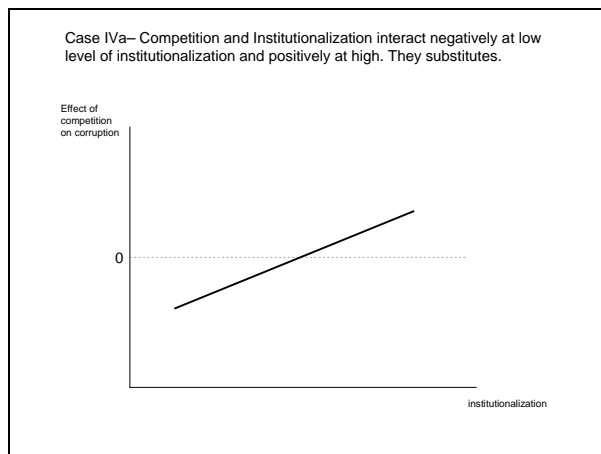
Graph 6 presents case IV, where competition reduces corruption, but checks & balances mitigates the impact of competition on corruption. Although this case seems at odds with our expectation of the virtuous effect of institutionalization, it may not be so if we consider that in states with good institutions competition may not be that necessary to prevent corruption as this is done by the institutions such as audit offices, free press, judiciary, etc. In such a situation political competition's effect on corruption would decrease as we move to the right in the graph.

Graph 6 – Negative and substitute relationship between competition and checks & balances



Finally, case IVa in graph 7 is an extreme case of the previous example. Here competition reduces corruption at low levels of checks & balances, but as checks & balances improve the impact of competition on corruption becomes positive. This should not be expected given our assumptions of the effects of institutionalization.

Graph 7 –Substitute relationship with sign switching from negative to positive



Having described how the results of the interaction models are displayed and how they can be classified and interpreted, we now turn to the actual results from our data. In order to save space we present only the graphs and not the regressions from which they emerge.³²

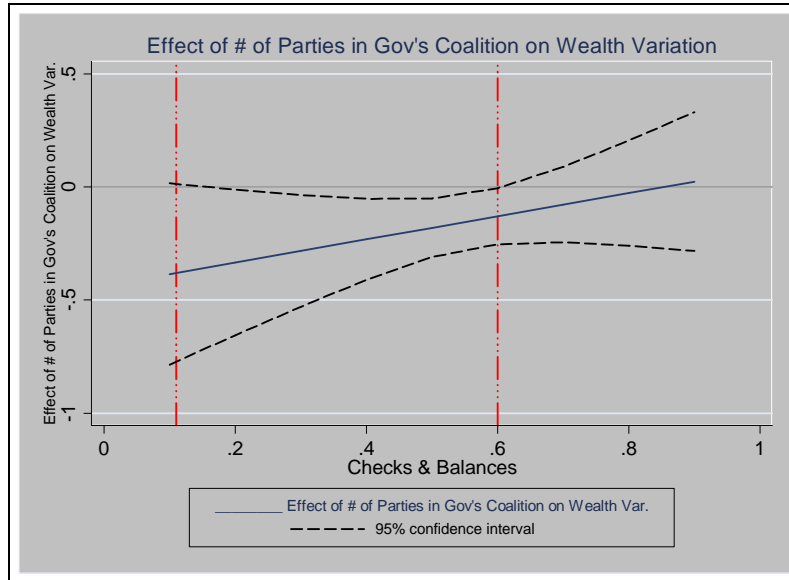
We will start the analysis with the interactions of political competition and checks & balances in the Wealth Variation (of state deputies) regressions in table 6. Each of the political competition variables was interacted with the institutionalization index in a separate regression, with all the other regressors maintained, and the effect is shown in the separate graphs below. The graphs show not only the effect of political competition on the dependent variable and how it varies over time, but also other important information for the interpretation of the results. The 95% confidence interval is shown throughout the range (see graph 8 for example). If this interval contains the value zero for the effect of competition on the dependent variable, then we infer that there is no statistical effect for that value of checks & balances. The graph helps the visualization of the range for which the estimated coefficients are statistically different from zero by bounding that range with the long-dash two-dot vertical (red) lines. The results are shown for the range of checks & balances from 0.1 to 0.9, which is approximately the range found in the data.

Graph 8, which show the interaction of the number of parties in the governor's coalition in the state assembly with institutionalization, regarding the wealth variation dependent variable, can thus be interpreted in the following manner: (i) the effect of the number of parties in the coalition on wealth variation is negative; (ii) this effect is only statistically significant for levels of checks & balances between 0.1 and 0.6, which includes 20 states in our sample (see table 7); (iii) as checks & balances increase, the impact of the

³² The regressions and data can be requested from the authors. Note also that presenting the regression outputs does not provide the correct standard errors given that the software does not calculate the correct formulas given the inclusion of an interaction term. The correct confidence intervals for inference purposes are shown in the graphs.

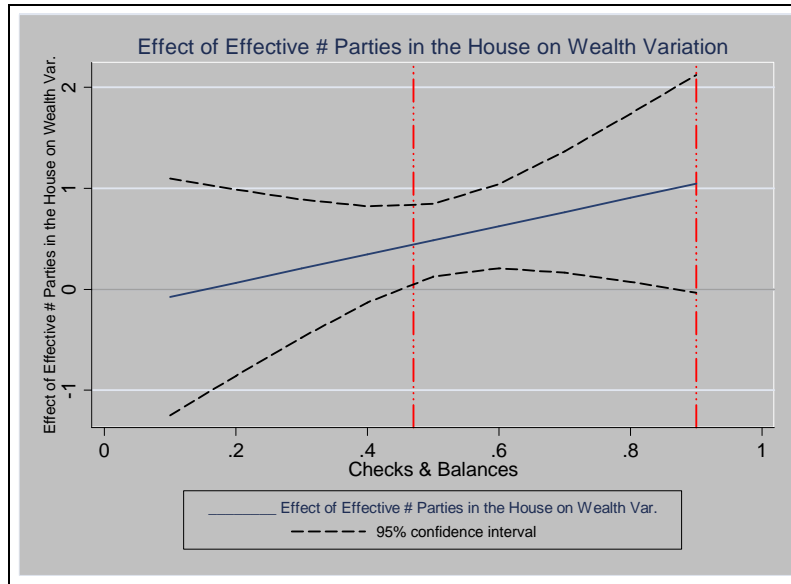
number of parties in the coalition on wealth variation gets weaker, so that we a case IV relationship (see graph 6) indicating that political competition and institutionalization are substitutes.

Graph 8 – Number of Parties in the Governor’s Coalition x C&B in Wealth Variation Equation



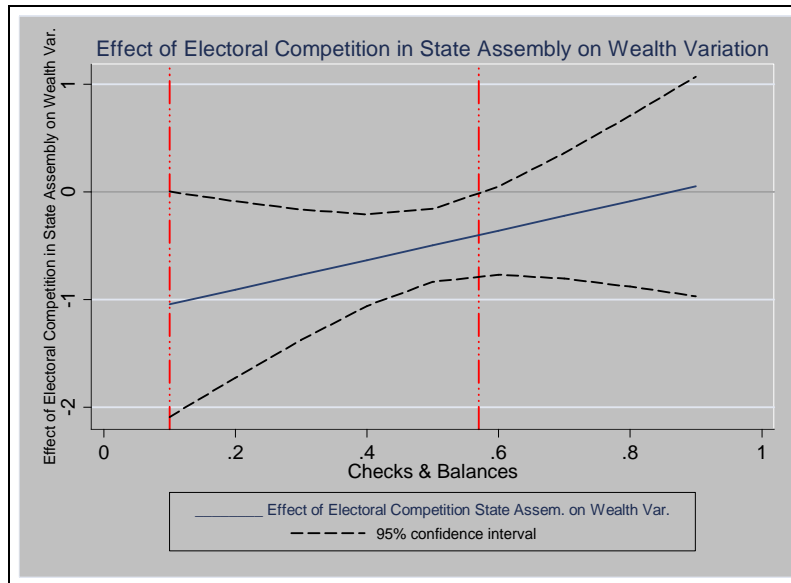
Graph 9 shows the effect of the interaction of the effective number of parties in the House of Representatives (National Congress) with checks & balances. The impact of this measure of political competition on wealth variation is positive. More competition implies greater opportunistic behavior by the state deputies and other politicians. This relationship is significant for states with checks & balances index greater than 0.48 (17 states). As checks & balances grow the impact of the number of effective parties becomes stronger. This fits with case II in graph 4 and is a result counter to our expectations. As we shall see this unexpected result emerges only when the political competition variable is related to the House of Representatives, posing a puzzle as to what it is about this area of a state’s political environment that has checks & balances increase a perverse effect (corruption) rather than reduce it as we would expect.

Graph 9 – Interaction of the Effective N^o of Parties in the House and C&B



Graph 10 shows that the effect of electoral competition in the state assembly on wealth variation is negative for states in the range of checks & balances below between 0.58 (18 states). As checks & balances increase, the virtuous effect of competition gets smaller, which fits case IV where competition and checks & balances are substitutes.

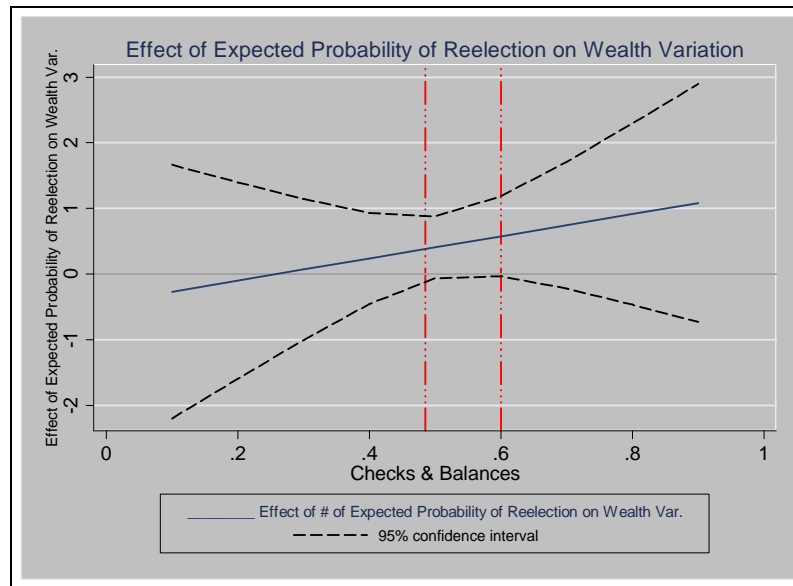
Graph 10 – Interaction of Electoral Competition in the State Assembly and C&B



Graph 11 shows the effect of having expectations of higher probability of reelection on Governor’s choices. This variable is different from zero for those governors that were effectively reelected and measures the size of their victory margins, so that higher levels

indicated that there the Governor perceived, even before the election, a higher probability of remaining in office. This variable is positively related to wealth variation and it becomes stronger as checks & balances increase. It is thus a case where less competition increases the level of wealth expansion, so the variables are substitutes. It is significant, however, only for a small range of the checks and balances variables.

Graph 11 – Interaction of Expected Governors with Long-Term Horizons and C&B



In this section we analyzed the interactions on political competition and checks & balances for the wealth variation of state deputies' regression (Table 8, column 1). The same analysis was done as well for the other regressions in Table 8 and Table 9. The graphs will not be shown for each regression due to space restriction. Nevertheless, the same basic result was found robustly throughout the analysis: political competition tends to reduce self-interested behavior by politicians and promote public goods. Additionally political competition and checks & balances are found to be substitutes in Brazilian states. The exception to this rule is found in cases where the political competition involves the House of Representatives (National Congress). In that case political competition increases self-interested behavior and reduces public goods, with the relationship between political competition and checks & balances being complementary.

5.6. Conclusions

This purpose of this chapter was to model and test the determinants of the characteristics of public polices at the state level in Brazil, in particular the decision by governors, who are the central policymakers, to pursue public goods, private goods or their own personal wealth. The main argument is that the key determinants of these decisions are

not ideologies, taste or personality, but rather the political institutions that determine the incentives and constraints faced by the governor in the pursuit of their own self-interest. The model in the first section showed the relationship of several parameters that measure those constraints and incentives with the governors' choice of policy characteristics. This provided the implications that were subsequently tested by regressing variables that sought to capture the nature of the choices made by governors in each state against those parameters. This exercise required finding suitable proxies for self-interested behavior by the governor (corruption) and providing private and/or public goods. We tried a variety of different such variables to check for the robustness of our results and extensions of this study should pursue further proxies. The main overall result of these exercises is that political institutions are major determinants of the governors' decisions, a result which should not come as a surprise but for which there is not a wealth of empirical evidence in the literature. The literature has focused mostly on explaining the policies themselves and not their characteristics. Researchers have typically used other policies as determinants of policy characteristics, such as explaining poor fiscal outcomes as being determined by the adoption of a certain type of tax rule or revenue distribution formula, rather than political institutions, which get at the motivation behind adopting a given rule or formula. The regressions showed robust results in the sense that variables measuring the same aspects of political competition lead to consistent results across different dependent variables. Additionally the level of explanation was remarkably high for the kind of regression and the nature of the dependent variable, so that even if it might not be perfectly clear how political institutions affect policy choice it is certainly clear that they have a large impact. Furthermore a robust direct effect of checks & balances on policy choices was found in all regressions, increasing the public regardness and constraining politicians' wealth increase.

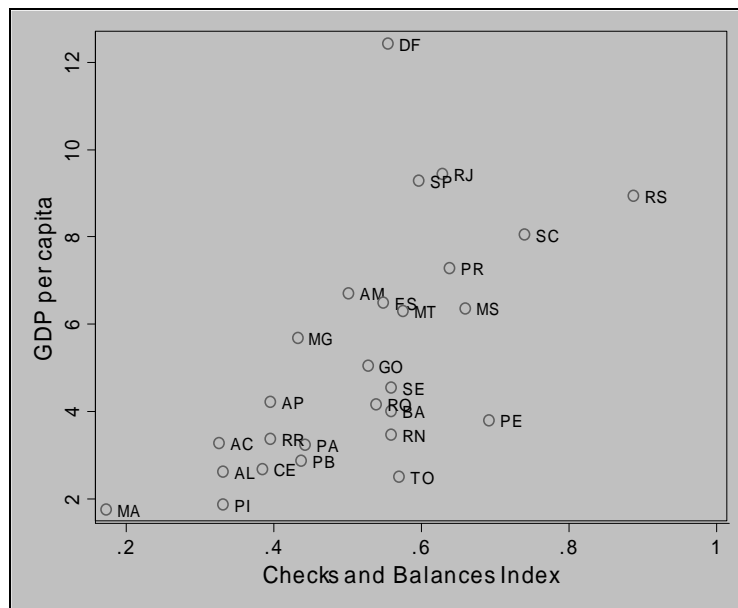
In order to further explore those relationships, the last section interacted the political competition variables with a check & balances index that measures the elusive notion of rule of law and low levels of transaction costs in political exchange in each state. We used a methodology that allowed a graphic appreciation of how the impact of political competition on the characteristics of the policies in a state is affected by checks & balances. This allowed us to analyze the relationship of each political competition variable with the checks & balance index and determine whether these different dimensions are substitute or complementary. The results showed that for most political competition variables there is a statistically significant interaction with the checks & balances index (for some subset of the sample). In general these dimensions proved to be substitutes, so that increased levels of checks & balances implied weaker effects of the political competition variables. The exception to this rule were variables involving the state in the National Congress, such as the effective number of parties in the House, electoral competition in the House and pork (which comes through the National Congress in the form of budget amendments by representatives and senators). These variables were found to be affected by checks & balances in a direction contrary to our expectations, so that increased competition led to less efficient public policy and greater wealth increase by politicians. In these cases a complementary relationship was found indicating that greater checks & balances intensified the effect of political competition. This poses the puzzle of what it is about political

competition in the House that makes its effects on policies exacerbated by checks & balances?

6. Case-study summaries

Graph 1 plots the Checks & Balances index against GDP per capita and shows that there is in fact a strong correlation between wealth and those institutions. The poorer states are indeed the ones where checks and balances are weaker, but there are outliers. Pernambuco and Tocantins, have higher than expected scores relative to their income level. Also, Rio Grande do Sul performs better in terms of checks and balances than predicted. Conversely, the Federal District is an outlier because despite its high income, its checks and balances' score is relatively low. Similarly, Rio de Janeiro and São Paulo have scores that are slightly lower than expected. In terms of the choice of case studies, our sample of case studies include cases of high scores in this dimension (Rio Grande do Sul, Pernambuco), average scores (Bahia, Espírito Santo) and low scores (Minas Gerais and Roraima). Minas Gerais is the only case that contradicts the findings in our case studies. Its lower overall score reflects the low score for “regulatory agency” – Minas Gerais is the only state (except Paraná) without a regulatory agency, which may be a signal of the statist preferences of its recent elites rather than institutional weakness. Other dimension lowering the scores is the “public defender”. As discussed below, Minas Gerais is characterized by a good interaction of institutionalization and policy choices. Cooperation among the elites in a political subsystem marked by non-polarization made it possible that public goods are provided.

Graph 12 – Checks & Balances x GDP per capita



6.1. Minas Gerais

Minas Gerais has reasonably established levels of institutionalization but low levels of political contestation. The combination could generate contradictory incentives for politicians in the policy-making process. In Minas Gerais, institutions are more consolidated than in other states and relatively more efficient. The legislative branch is reasonably professional, especially for the standards of most subnational legislatures around the world (Anastasia 2001). It is also quite proactive, hence dramatically different from other legislatures in Latin America, at the national or subnational level. The Public Prosecutors Office (Ministério Público) and the Accounting Tribunals (Tribunal de Contas do Estado) are independent, well staffed and well funded. Civil society is quite participative and has institutional venues to express its demands in both the legislative branch (Legislative Committee on Popular Participation) as well as the executive branch (experiments with the Participatory Budget in several municipalities, including the capital city of Belo Horizonte). Hence, the instruments of checks and balances and of accountability are in place and effective.

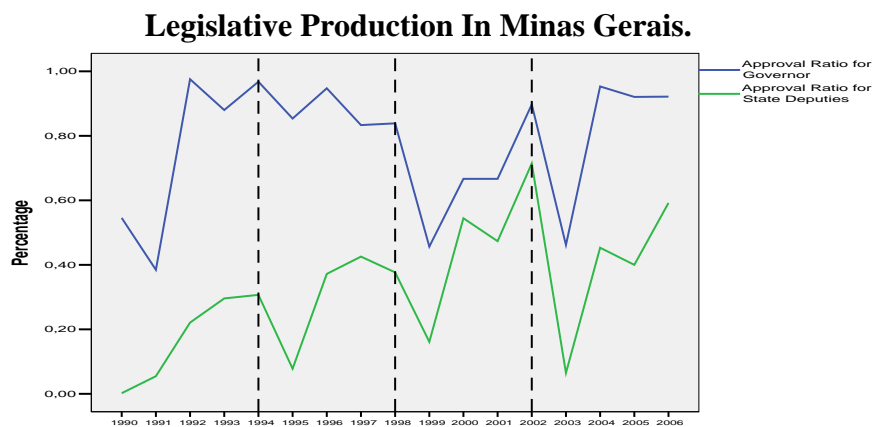
On the other hand, MG is not a state with harsh political contestation. Even though there have been changes in administrations over the past decades, there is a lot of continuity underneath the surface, with very little elite circulation in several key positions in the bureaucracy. The survival horizon of governors may appear short, but they do manage to maintain significant portions of their personnel in strategic positions once they are out of office. Hence, there isn't a very dramatic process of alternation in power between radically distinct political groups. For instance, Helio Garcia, the governor from 1991 to 1994 elected his successor, Eduardo Azeredo. Who later lost his reelection bid to Itamar Franco. Franco, however, was backed by several of Azeredo's allies and co-partisans. In 2002, Franco did not run for reelection and, instead, supported Aécio Neves, from the same party as Azeredo. Neves was elected and has been recently reelected in the 2006 elections: the first reelected governor in the state. Therefore, there is significant continuity of personnel and of political groups in power.

This continuity is, to a great extent, related to the style of doing politics in Minas Gerais. Political contestation is related to attitudinal and historical components of political styles in different states. Levels of political contestation in a state are related to more general social norms regarding the practice of politics. A political style is defined by the social norms that regulate political interaction (North 1990). Thus, the norms of interaction defined by the accepted and generalized pattern of political interaction, i.e. the political style of a region, affect the choice set politicians have. Mineiro politicians are risk averse and seek consensus. In MG, given the dominating conciliatory and conflict-averse attitude, there is a tendency of rallying around the governor to facilitate governance. This does not degenerate in collusion because of the relatively developed checks and balances institutions.

A second political style factor that contributes to conciliation in Minas Gerais is the strong sense of regionalism and belonging, that prevails in the state. There is a pride of

being from the state and for defending it. This factor strengthens even further the tendency to back Mineiro politicians and support them, especially when they have some national prominence. This is certainly the case of Aécio Neves, the current governor. Mr. Neves embodies Minas Gerais' hope of making the next President of the Republic.

The administrative reform proposed by Neves, is very interesting not just because of its content, but also due to the legislative mechanism through which it was implemented: Delegated Laws. These laws are an authorization given by the State Assembly for the governor to transform his proposals into law automatically, without the vote of the legislative branch. Therefore, when the Assembly approves governors' requests for having the power of passing Delegated Laws, it is a clear sign of the Assemblies goodwill towards the governor's proposals. But, the governors' requests for the use of Delegated Laws are restricted to certain topics and have a clearly defined period of validity. Since redemocratization in the 1980's, the MG State Assembly has approved three governor's requests for the permission of using Delegated Laws. The first one in 1989, when Governor Newton Cardoso asked for the permission to pass Delegated Laws to change civil service payment. The second request was in 2002, when Itamar Franco asked the State Assembly for Delegated Laws to be passed by the incoming governor, Aécio Neves, to implement his administrative reform. The third one was requested by Aécio Neves in 2006 to implement his new governing plan. All were approved, providing governors with an extraordinarily expedient and efficient way of implementing public policies. They all denote a very positive attitude of the State Assembly towards the governor. In fact the governors' approval rates for their proposals have been very high. (See figure below).



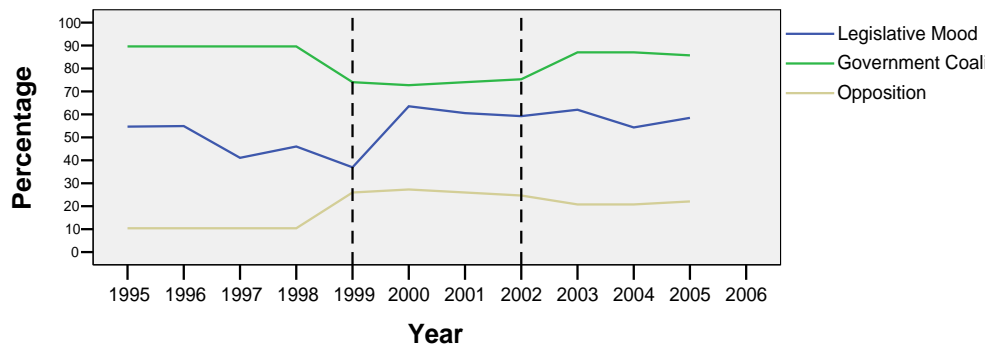
A clear puzzle emerges when we investigate governors' resources in Minas Gerais. MG is not an exception and like most Brazilian states after 2001 lost several of its key budgetary and financial resources due to the renegotiation of states' and municipalities' public debt with the Federal government, the privatization of state banks, and the Fiscal Responsibility Law. The influence of states in national politics and even in its dealings with municipalities after this period decreased abruptly. Hence, governors have very few resources in their hands to cope with transaction costs. Two of these resources are the execution of State Deputies' budgetary amendments and the allocation of jobs in the

bureaucracy. However, neither has been abundantly used for political negotiation in MG. Several governors had as their main campaign proposals and governmental programs administrative reforms to reduce personnel costs and very rarely are budgetary amendments funded by the executive branch. Hence, it is puzzling that any policy change is achieved given that the governor has reduced resources for negotiating. Are the policy changes then a result of preference congruence between actors involved in the policy-making preferences? Or, is it that the Mineiro political style induces cooperation? Or, have budgetary resources and patronage been used selectively by some governors?

How does the combination of medium to high institutionalization and low political contestation impact the policy-making process? and, what explains the success of governors in the policy-making process? (considering that the governors of MG, especially after 1998 and even more so after 2001, have relatively limited resources to negotiate with the State Assembly). The policy process and political reform has followed a steady progress in MG. Obviously, this success is not constant through all administrations. Itamar Franco was not as successful as his successor, Aécio Neves. What explains this variation?

The limited amount of data available, especially budgetary data regarding state deputies' individual budget amendments, limits our conclusions on the topic. It does seem, however, that budgetary amendments have been thoroughly used during the Neves administration, whereas they were fully vetoed during the Franco government. This is a possible explanation for one's success over the other. We discarded the increase in expenditures with personnel as a mechanism for covering transaction costs of the negotiation with the Assembly. It seems like the restructuring of public administration favored instead the improvement in the working conditions and stipends of civil servants hired through public contests.

Legislative Mood, Size of Governing Coalition and Opposition



Source: Felipe Nunes' dataset on roll call votes (2005).

Results indicate that Franco had a smaller coalition than his fellow governors, but that it was still quite large, and that there was an increase in the size of the opposition in his government. However, legislative mood, or the average of favorable votes to the governors' policy initiatives from all parties in the assembly, was quite high in the Franco Period. It dramatically increased in the first year and was kept relatively constant. In fact, most of the

time, Franco had higher levels of support than Aécio Neves. However, it must be clear that Franco had fewer legislations approved during this term than Aécio. This probably indicates that the few approved proposals were successful because of preference congruence between state deputies and Franco on the issue.

Still, overall levels of support in the Assembly and coalition size cannot single-handedly explain variation in legislative productivity, especially because neither is truly an independent explanation of legislative productivity. Coalition management depends on how jobs in the bureaucracy are distributed and also how much access allies have to the disbursement of monies through the state's annual budget. Unfortunately there is very little data available on either. However, we cannot discard that the allocation of state cabinet positions is an important negotiation mechanism between the executive and legislative branches. Secretariats are influential in the allocation of budget funds and in the distribution of important positions in the bureaucracy. Again, unfortunately, the data on how cabinet positions are allocated by party in the different administrations is not yet available and hinders our ability to conclude how influential this mechanism is.

Still, data for the current Aécio Neves cabinet, elected in 2006, does not indicate that such positions are used as negotiating tools with allies. 63% of the 19 state secretariats are occupied by technicians, not politicians. In addition, the remaining secretariats are occupied by members of only three parties, which are in the governor's coalition. Furthermore, members of the governor's party occupy 26% of the secretariats; leaving only 11% of them to other members of the coalition. Hence, the distribution of secretariats is concentrated on the closest allies and is not dominated by politicians. This further reduces the political use of cabinet positions.

On the other hand, several other explanations for the difficulties in executive-legislative relations over the entire period can be discarded. We found no evidence that the number of parties and the levels of renovation in the Assembly affected variation in legislative production by administration. The level of state deputies' support of governor-initiated legislative proposals has been equally high throughout the distinct administrations.

What then is behind Neves' greater legislative production and less incremental changes in public expenditures, including a dramatic reduction in deficit and a deep administrative reform? Certainly, relations between executive and legislative branches improved during Neves' administration. He started his government with a blank check written on his behalf by the previous legislature and governor, in the form of being permitted to use Delegated Laws. The style of Mineiro politics, which hinders conflict and stimulates conciliation, and which places state interests above partisan ones, cannot be discarded in affecting the policy-making process in the state. On top of that, Aécio Neves has a very important differential; he represents the states' most viable chance of making a President of Brazil. Aécio Neves' promising future turns him into an ally to cultivate and to support. Even if he can't reward allies immediately, he might in the future. This expectation itself may suffice to convince ally and foe alike to support his policy agenda. As the case described in Box 1 shows, these changes have been significant and have impacted outcomes of the policy-process.

In sum, we cannot explain the policy-making process in Minas Gerais considering only the budgetary and patronage resources governors have. We have also excluded other usual suspects, such as party fragmentation and legislative mood. We cannot yet exclude more subtle and intangible factors, such as political style and expectations about the future. By exclusion, these last factors appear to be very plausible explanations for the policy-making process in Minas Gerais.

Box 1

The Managerial Public Administration Reform of Minas Gerais

It is important to highlight upfront a very special mechanism of executive-legislative relations that enormously facilitates governors' abilities to implement reforms: Delegated Laws. These are special permissions given by the State Assembly, upon the governor's request, to create laws without normal processing in the legislative branch. Delegated Laws are regulations that the governor can approve directly, with limited participation of the legislative branch. They are, almost, an authorization to govern by decree. However, the period and the issues governors are allowed to pass as Delegated Laws are fixed by the Assembly and the Assembly can veto the proposed laws, albeit it has never happened (Fleury 2004). Therefore, it is the strongest sign that the Assembly supports the governor.

Even before Neves' government took office, the managerial public administration reform of Minas Gerais was being prepared. On November 12, 2002, Itamar Franco – the governor then – sent to the State Assembly a proposal that allowed the future governor, Neves, to elaborate Delegated Laws specifically to implement his proposed reform of the public administration structure of Minas Gerais. Hence, the public administration reform started with the support of the previous governor and the State Assembly, which gave the incoming governor special powers for a restricted period of time and for a very well delimited range of issues to implement reforms. The mentioned Delegated Laws should be allowed for the Governor's use until January 31st of 2003, that is, for the first month of the administration. According to the proposal sent by Governor Franco, the Delegated Laws should be limited to the four following subjects: a) Create, incorporate, transfer, extinguish and alter public bodies or Direct or Indirect Administration units, defining their basic administrative structure, competencies, objectives and names; b) Create, transform and extinguish government temporary positions and commissioned positions of the public bodies and entities mentioned in the paragraph above, and also alter their competencies and names, as well as define the rules for conscription and their values, considering the parameters of the current rules; c) Proceed the re-allocation of activities and programs in the Executive branch and move budget endowments stemming from the implementation of the reforms mentioned in the paragraphs above; and d) Alter the Indirect Administration Entities bonds. Only six amendments were added to Governor Franco's request for Delegated Laws favoring Aécio Neves. The Legislative Assembly approved the entire proposal, except for the moving of the budget endowments. From the 3rd to the 29th of January, the Neves administration published 63 Delegated Laws to implement the reform.

According to the government strategies, the reform had three main guidelines: Adjustment to the Reality; Planning; and, Innovation. These three guidelines aimed at creating a governmental structure that prioritized citizens' demands and needs. In what concerns the implementation of managerial public administration reforms, the Neves administration followed the recommendations of the World Bank. The reform started by implementing the Adjustment to the reality guideline, basically by extinguishing and merging several public units. The reform extinguished six Secretariats, 43 Superintendences in the Direct Administration and 16 Directories in the Indirect Administration, besides 388 other administrative units in the Direct and Indirect Administration. In addition, the government modernized several proceedings related to personnel expenses, like the creation of salary caps for the Executive branch personnel, which meant an economy of R\$ 9 million, and the centralization of the payroll, which resulted in an efficiency gain of R\$357 million. Another interesting action related to personnel expenses was developed. According to the government, data-crossing from the National Obituary System and the State System of Personnel showed that 2285 State civil servants were still earning salaries. The elimination of these payments resulted in R\$4 million recovered. Also in order to improve the services for the state government employees, the government reduced from 7 months to a day or two the time to schedule medical inspections and more expediently deciding if civil servants deserved benefits or should return to work.

All of these measures contradict the claim that the increase in expenditures with personnel was a mechanism for accommodating allies. It really seems that the increase was used instead, to improve salaries and working conditions of already hired civil servants in an effort to improve their performance. For instance, 128 state level civil service careers were restructured, benefiting 402,000 civil servants. The clear strategy was to improve the working conditions and stipends of civil servants, which could result in better quality response to public demands. This last move meant an annual increase in payments with personnel of R\$947 million (15.19%). Hence, the increase in expenditures with personnel is much more a consequence of increasing salaries of already hired personnel, all of which were hired through public contests (*concurso público*). It was much more a mechanism for improving state efficiency than for rewarding allies with new jobs.

Concerning other issues like the procurement system, the government saved more than R\$167 millions by adopting an electronic purchasing procedure, named *Pregão*. The electronic purchasing mechanism also increased the transparency of public price evaluations (*licitações*) and investment. Besides that, high control over general expenses was defined in order to facilitate the savings of the government.

The second stage focused on the Planning guideline, which was designed to coordinate and integrate planning and budgeting. By coordinating planning and budgeting, the Government was able to elaborate its vision of the future, its mission, and its objectives, and, by doing that, coordinate its programs and projects with a specific goal. By integrating planning and budgeting, the government was also able to integrate its planning activity with the government's financial flow. The state government defined 30 Structural Projects to be intensively managed and monitored. By defining several projects to be intensively monitored, the government intended to guarantee the outputs of the main public policies. Also, to ensure that the State Secretariats and the State public servants, as well as the Civil Society, would be aligned to the government's managerial strategy and intended results, several incentives and penalties were created in the third guideline of the Reform: innovation. The third guideline, innovation, was the one in which the shock strategy was implemented. The government speech was "do more and better with less" and "less with the State apparatus and more with the citizens". The shock strategy is related to the concentration of costs at a certain moment of time. So, instead of implementing a reform little by little, the main changes are implemented at once. By doing this, the costs are concentrated at a moment, but the results come faster. According to the government, that would only be possible if modifications were promoted in the administration of the government. Thus, the policy named "Management Shock" could be defined as the reengineering process started in the State of Minas Gerais in 2003, by the design of other three policies: Results Agreement, Individual Evaluation and Partnership Terms. By the policy named Results Agreement, every government body had the opportunity to gain autonomy and institutional development from the central Secretariat to design its own policies and to invest the economy it saved from general expenses with its development and with its civil functionaries.

The Individual Evaluation Policy was designed in order to align the civil public servants individually to the intended results of his/her Secretariat and, as a consequence, to the Government. In order to increase his/her salary and to have his/her career developed, the civil public functionary had to be well evaluated and the public body had to be saving money at general expenses. By aligning the civil servants individually to the intended results of the Secretariat where he/she worked, the government could ensure the alignment of every its functionaries with it. The Partnership Term was a strategy to provide the citizens with more public services by establishing partnerships with). Following the trends in the managerial public administration model, the Government of Minas Gerais tried to align itself around its political-administrative strategy and focus in results especially to guarantee the execution of priority projects and to have more coherency in the decision making process. So, to ensure that the government policies would all be implemented, the PMDI was mainly elaborated considering the Structural Projects. The portfolio of Structural Projects was, initially, composed by 30 projects that was considered a priority for the implementation of the reform and, so, needed an intensive administration by the public managers.

For the success of the Reform, besides making the management of the Structural Projects more feasible by implementing the logic of results management, the government also had to take into account the political environment. Once the Delegated Laws had guaranteed the restructuring of the State apparatus and of the legal framework required for the implementation of the Reform, the participation of the State Deputies in the approval of the budget cycle was required to guarantee that the public policies themselves – infra-structure, health, social assistance, education, public safety, etc – would be implemented. As was also the case of the reform of the Legislative Assembly of Minas Gerais the negotiation strategy adopted by the Executive branch

was also responsible to promote the political success of the Reform. Hence, the continued support of the State Assembly throughout the Neves administration was fundamental for the success of several of his plans. Neves, in fact, was extremely successful in building coalitions, even though he did not necessarily employ state budgetary funds for it.

According to the Government of Minas Gerais, the results of the Managerial Public Administration Reform could be aggregated in four different themes: Public Management; Infra-structure and Environment; Social Development; and, Economic Development. Concerning the Public Management theme, according to the State Secretariat of Finance, in 2004, the government reached the equilibrium of the public accountancy of the State. By the end of year 2006, the State saved approximately R\$564 million with the complete modernization of the buying process. The investment capacity of the State of Minas Gerais increased 394% since 2003, according to the Financial Administration System of the State of Minas Gerais. In terms of Infra-Structure and Environment, the government increased the percentage of highways considered well maintained by the Government of Minas Gerais– from 41,9% in 2004 to 60,4% in 2006. Between years 2001 and 2005, the percentage of the population attended by Licensed Treatment of Solid Wastes doubled – from 17,6% to 35,5% - and the expectation was to reach 62,5% until the end of 2006. According to the Secretariat of Planning and Management, the schooling age (5 and 6 years) reached 84,1% in 2004 – in 2002, the rate was 75,4%. In 2005, 102 thousand new vacancies were created. Hence, the decrease in investment indicated earlier did not have a negative impact in some educational indicators. It is likely that the money was investment in a more efficient fashion. Overall the state share in national exports rose from 10,4% in 2004 to 11,41% in 2006. The GDP grew 4,7%, twice the national rate. Minas Gerais was considered the easiest state to start business.

6.2. Rio Grande do Sul

The southernmost state of Rio Grande do Sul was the top score in the index of checks & balances. This outcome fits well with the general perception of this state and its population with strong European decent. Besides being one of the top four states in terms of income per capita, it holds the highest level of education and life expectancy in the country and stands among those states with the highest human development index (HDI). In addition the state played key roles throughout Brazilian political history, in particular in the mid twentieth century, having developed early on a strong institutional base from which the restructuring that followed the end of the military dictatorship could build upon. All of these factors together have resulted in a highly institutionalized state with strong checks & balances for Brazilian standards, and high levels of political competition. According to the framework that guides this report such characteristics are expected to produce an environment which fosters intertemporal transactions and governance enhancing incentives, leading to the prevalence of public good provision and economic development. The case study for the state of Rio Grande do Sul shows that these expectations are in fact realized, although the high levels of polarization that accompany the strong political competition also imply a certain degree of policy volatility.

The characterization of Rio Grande do Sul as a state where there are high levels of political competition is easily discerned in the data. From the 1940's to the mid-1960's no political party managed to win two successive elections for the governorship. The same pattern reemerged after the 1964-1985 military dictatorship and holds to the present day. In the past five elections (1990, 1994, 1998, 2002 and 2006) there has been a perfect alternance in power between parties or coalitions from the center-left with others of the

center-right, with very different political views and constituencies. In the past five elections four different parties have held power. Furthermore, political competition has not been limited to electoral competition. In several cases the governor has failed to build a majority in the state assembly, particularly when center-left parties were in power. In addition, even those governors that could count on a majority faced contestability from the legislators, for example in the form of high levels of rejected vetoes. Another example has been the general tendency for support within the state assembly to drop sharply as the term approach the next election, no doubt a consequence of the high levels of political competition. This has implied that any group in power in Rio Grande do Sul typically has the perception that there will be great contestability throughout the term and in the next election. This perception clearly has important effects on the governor's incentives. And given that the governor controls the agenda in the assembly and the policymaking process in general, it has important impacts on the types and characteristics of the policies that get proposed approved and implemented. Whether these incentives lead to short-term opportunistic behavior or induce public goods and good governance, is crucially dependent on the nature of rule of law and checks & balances within the state.

In this regard, there is similarly ample evidence that institutional arrangements in Rio Grande do Sul provide a series of checks & balances that enhance the virtuous rather than the perverse incentive that stem from the high levels of political competition. The high income and education levels contribute towards an environment in which a web of checks and balances composed of institutions and organizations such as the judiciary, public prosecutors (*Ministério Público*), auditors (*Tribunal de Contas Estadual*), the press, etc., are able to effectively establish constraints which hinder opportunistic behavior by politicians. The case study on Rio Grande do Sul stressed recent improvements in the structure and process of both public prosecutors and the general audit office in the state, involving not only significant increases in the quantity and quality of human resources but also in their scope of action, so that rather than simply acting reactively to potential misdeeds by other players, they have started to act preventively as well as evaluating the content and efficiency of policy rather than its mere adherence to the law. The upshot has been a large number of cases where these institutions effectively constrain the other players, such as the more than three thousand cases where the public prosecutors questioned the constitutionality of other players behavior from 1992 to 2005 (*Ações Diretas de Inconstitucionalidade*) and the numerous suits against governmental authorities, including 19 against the governor from 2003 to 2005. The picture that emerges is one where the rule of law is well established and where safeguards to investors and citizens against public and private abuse are present, which is captured in the state's top spot in the index of checks & balances.

The policymaking process that emerges from this arrangement of high political competition and well developed checks & balances is one where the governor controls the policy agenda and has the instruments to pursue those goals. Roll-call data for the past four terms show that every governor, even those without a majority in the assembly, have had high success rates in approving their projects, especially in the early years of each term. This has not resulted from a lack of involvement of the deputies, as an active committee

system and the high number of budgetary amendments and overturned vetoes attest, but rather to a set of institutional arrangements that provide incentives for intertemporal political transactions and policies that promote the public good more so than that of private interests. At the same time, however, the frequent turnover of power has also produced as a consequence a volatility of policy focus, as the center-left governments have concentrated in increasing the size of the state and state-led social policy, while the center-right governments have pursued policies focusing on fiscal adjustment and market-led development. The tendency for the state's seemingly persistent fragile public finances is both a consequence as well as a cause of the high levels of political turnover that result from the state's political institutions.

6.3. Roraima

Roraima ranked very low in checks and balances and intense (yet limited) inter-elite competition. In this scenario, there are few incentives to the production of public goods. Three important features of the local political system have important implications for the policy-making process. The state was a federal territory and was upgraded to the status of state only in 1988. This had several implications. First, there was no established political competition prior to 1988 except for the election for one federal deputy and for the mayor of Boa Vista. Thus no traditional political elite existed in the state. The key figure of the local political system before 1988 was the appointed governor, who under military rule was recruited to the Air Force (as opposed to Rondônia and Amapá whose governors came from the Army and the Navy, respectively). One of the two key political figures in the state has been a former Air Force Brigadier, Ottomar Pinto. Politics in the state over the last 18 years reflect the conflicts among a family-based political cartel.

Second, the preponderance of the executive was reinforced after the state was created due to the fact that the governor had the prerogative to appoint the members of the newly created checks and balances institutions, such as the *Tribunal de Contas* and the *Tribunal de Justiça*. This was so because these institutions were created simultaneously with the State Assembly and the latter did not approve the newly appointed members nor nominated itself some of its members as in the other states. The checks and balances institutions are controlled by governors who appoint relatives and political cronies to key positions in the state structure (the spouses of the three state governors, along with numerous daughters and nephews have held important elected posts. The local Tribunal de Justiça attempted to expel a judge who accepted the indictment of the Tribunal on the basis of nepotism. The only institutions that effectively hold checks on the executive are from outside of the state, particularly the *Ministério Público* Federal (MPF), the national media (the local elite has unparalleled control of the local media) and IBAMA, along with the local *Ministerio Publico do Trabalho*. Two governors have faced criminal charges – potentially leading to the loss of official positions – by the MPF.

Third, seven posts for the Chamber of Deputies along with three posts for the Senate when created when the state acquired the status of a state. The availability of these

positions encouraged politicians from other states to run for office. The barriers to entry were small. Low electoral coefficients and low cost elections provided key incentives to outsiders known locally as “*paraquedistas*”. Fourth, as a federal territory with very low population densities other than Boa Vista (which accounts for two thirds of the state population), the local economy is overwhelmingly dominated by the public sector, which is particularly concentrated in Boa Vista. Consequently the main political currency is public sector jobs and the level of professionalization of the bureaucracy is very low.

Box 2

The Scandal of the Locusts (*Gafanhotos*)

This scandal involved the diversion of public funds earmarked for personnel expenses to fictitious employees – who then eat the funds like locusts (hence the name of the scandal). The funds were then embezzled by several members of the local political elite. The scheme was operated by a private firm – *Norte Serviços de Pagamento* (NSAP) – in collusion with the state government during the period 1998-2002. The estimated amount of funds diverted were R\$ 500 million. Each month hundreds of “ghosts” showed up and formed a long line to get their pay checks. Irregularities in payroll have precedents in Roraima and are associated with the arrangements made during the upgrade process whereby the Federal Government would be responsible for personnel expenditures during a transition period. Diversion of funds and patronage positions have been documented at all levels, including the state assembly, which has the highest per capita expenditure of all Brazilian states. In the State Government it is also reflected in the extensive use of the *Tabela Especial*, which has been used for political appointments, thereby undermining public contests for governmental positions, which has been mostly restricted to the *Ministerio Publico*.

Sixth, the local party system is very fragmented and not institutionalized. In 2006, politicians from 15 different parties were elected for the 25 posts of the State Assembly. Inter-party migration is unparalleled in the state. Only five of the 25 state deputies has not changed parties during the last legislature. Coalition management is entirely dependent on distribution of patronage positions. Thus the overall result is a pattern of predatory hobbesianism.

6.4. Espírito Santo

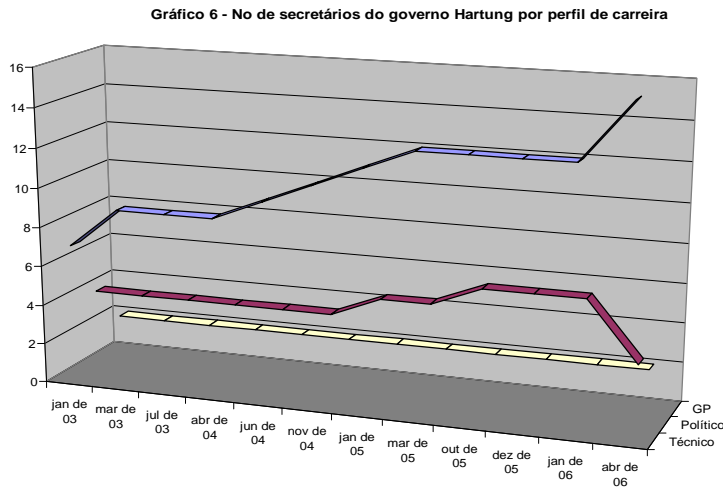
The state of Espírito Santo is a good example of high electoral competition among elite-groups and low level of institutionalization of its organizations of checks-and-balance. In fact, the Espírito Santo was ranked number fourteen in our checks-and-balance index. The policymaking process that emerges from this arrangement of high political competition and low institutionalization of checks-and-balance structures is a predatory state. The exception of this characterization in this political system could be attributed to the current administration of the governor Paulo Hartung (2003-2006), who was able to implement remarkable policy changes oriented to deliver public goods and to break up with several

criminal networks. As a consequence, the governor was reelected in the first round of the 2006 election with 77% of the valid votes. This change in the electoral trend might suggest that the Espírito Santo could face from now on a different environment, with smaller level of contestability and perhaps a better institutional framework, as a function of an external shock of electing and reelecting someone committed to a different policy agenda. However, as the Espírito Santo did not face any substantial institutional reform, the positive policy changes can be no sustainable at the long-run.

To what extent this policy changes can be attributed to some positive idiosyncratic features of the new governing elite that took power in 2002? Like any other Brazilian state, the Espírito Santo has the executive as its main political player who is both the agenda setter and the main veto power. Thus, if the electorate decides to vote for someone with different preferences in the future, most of the initiatives and achievements from the previous administration would be undermined since the new governor would have the necessary institutional instruments to change the status quo according to his/her new idiosyncratic preferences as well.

The economy of the Espírito Santo has experienced important transformations in the last twenty years. From an economy predominantly dependent from the coffee production until 1970s, the state faced an intense industrial modernization with the privatization of the Companhia Vale do Rio Doce (CVRD), Companhia Siderúrgica of Tubarão (CST), Aracruz Celulose, and a Samarco Mineração. This intense economic modernization took place in a society with low level of urbanization, a traditional and oligarchy political system, and low level of organization of the civil society. This combination led to a vigorous economic development combined with very slow social and political transformations.

Key to understanding the success of the Hartung's administration is the relationship the Governor developed with the state Assembly. Different from his predecessors, Buaiz and Ignacio, who were not able to build majority coalitions and had an adversarial relationship with the legislature, Hartung was able to attract the most important and influential political figures from different political parties to his government building a majority coalition. The only political party on the opposition was the PDT. Surprisingly, this ample and diverse majority coalition did not translate in a political cabinet (the presence of those coalition partners in the cabinet) because the majority of his state secretaries are considered bureaucrats and independents (see figure below).



Although Hartung did not allocate public jobs in the bureaucracy in order to obtain political support in the state legislature, he did not face a hard time with legislators to approve his agenda. Surprisingly, the Governor was able to build the majority with the support of PT after an agreement with the President Lula who agreed to renegotiate the state debts by given up the royalties of oil produced in the state. The monthly payments to the national treasure were used instead to pay salaries of public servants. As a consequence of this agreement, the governor Hartung became an ally of the PT offering state secretaries and supporting state legislators of this party to occupy the presidency of the state Assembly. Although the governor's candidate lost the election for the current president of the Assembly, Gratz, the Public Prosecutors suspended the term of five legislators accused to receiving bribes from Gratz to support his reelection. This corrupt scandal with large media coverage isolated the opposition and made the governor even stronger.

By the end of 2003 the governor Hartung made a new agreement with the federal government in order to have access once again to the oil royalties produced at the state. This was an extremely favorable deal because allowed the government to have a budget surplus which made it possible for the government to invest in public policies reducing and isolating thus potential opposition to his administration. The great majority of the legislative initiative of the state government was approved without further delays and full support from the legislature (see table below). Another aspect that can help to understand the success of this administration was the content of the legislative agenda extremely light, without constitutional reforms mostly based on normal legislation, which would not require a qualified majority. Comparing with the two previous administrations, Hartung presented more bills, approved 90% of them, and just 4% were rejected.

Bills	Buaiz	%	Ignacio	%	Hartung	%
Total	52	100	62	100	79	100
Approved	34	65	46	74	71	90
Rejected	3	6	0	0	3	4

Withdraw	13	25	6	10	4	5
Attached	1	2	0	0	0	0
Filed	1	2	6	10	1	1
W information	0	0	4	6	0	0
Vetoed	2	4	6	10	1	1
Override	0	0	3	5	0	0
Amendments	12	23	23	37	28	35

The extent to which those new policymaking capabilities and good governance mechanisms that have been implemented by this current administration will endure as a new path for the state is a function of the level of institutionalization of the checks-and-balance organizations.

6.5. Bahia

Bahia's political system has average institutionalization and low electoral contestability. In this case, the governor's time horizon is long, which might lead to the delivery of public goods to the electorate. This control, however, may degenerate to the production of private goods depending on the fragmentation or cohesion of legislative support. Bahia is a state in which the Executive and the Legislative have been, at least in the last decades, controlled by one party - the PFL - and by its main leader, Antônio Carlos Magalhães and in only two state elections the electorate supported a non-PFL candidate. In both occasions, this was made possible because opposition parties were able to put together a wide coalition but also because this coalition was able to name a credible candidate. This might induce to the assumption that Bahia's electoral politics is characterized by low contestability, given PFL's several victories. However, PFL's victories does not necessary imply the existence of low contestability, a point which deserves deeper analysis.

The control of one party throughout more than two decades has created, on the one hand, incentives for the delivery of two kinds of public goods – (i) economic modernization, meaning incentives and infrastructure to attract private and state companies, following decisions taken way back in the 1950s, and (ii) severe fiscal adjustment from the late 1990s onwards. On the other hand, improvements on social policies and on the social conditions of the population have lagged behind, placing Bahia's population as one of the poorest in Brazil.

Although it is true that in Bahia one party controlled by one leader with strong hands has been hegemonic throughout redemocratization, this party – the PFL - has the control of a captive number of votes, i.e., 30% of the electorate. This has happened, with the exception of the 1998 election, even when no credible candidacy from the opposition was available and even when a PFL's candidate won the electoral race. The control of 1/3 of the electorate means that PFL and its leader have always been under threat if a credible competitor is available. This contradicts the common view of political analysts and of the media that in Bahia electoral competition, at least for the Executive, is low and free of risks.

Because electoral competition is not without risks, Bahia's political elite has had to deliver some type of public goods to remain competitive. In Bahia two types of policies,

which can be labeled as public-goods policies, have been prioritized by the PFL. Firstly, economic modernization through a well designed strategy to industrialize the metropolitan region and later to make tourism an important economic activity, the latter cutting across several regions of the state. A competent bureaucracy with the support of the political elite has been responsible for the design and the advocacy of these two strategies. Secondly, a severe fiscal adjustment, which began in ACM's 2nd term as governor (1979 – 1983), interrupted by the following governor – João Durval Carneiro - but which returned in Waldir Pires' term (1987 – 1991), and has been followed ever since. This shows that even before states' fiscal adjustment became a national priority, Bahia's governors were adopting it. These two public-good policies have been made viable because of the existence of a rock-solid bureaucracy and because lawmakers have never been a source of constraint for their approval given the Executive's high control of the budget. However, the public goods towards social improvements has never been in PFL's agenda and has never managed to attract a competent bureaucracy or advocacy groups.

Bahia exhibits an average degree of institutionalization, only very recently state's institutions have become relatively institutionalized, thus positioning the state as a case in which institutions are still moving towards rule enforcement.

Summing up the arguments, although the results of Bahia's elections have traditionally favored one party, this does not mean that competition for the Executive has low electoral contestability. The PFL has managed to guarantee a steady number of votes and whenever there is a viable and credible candidate from other party coalition, PFL ends up losing the election. Furthermore, because contestability is possible, PFL has to deliver selected public goods to keep its captive electorate and to expand it beyond its traditional number of votes. Legislative support to PFL has not been fragmented and the provision of private goods to address the demands of parliamentarians is centralized at the Executive through means other than the budget. The oversight of the Executive by other institutions is moving forward but the state cannot yet be labeled as enjoying high institutionalization but it is rather in a transition phase.

The control of one party throughout more than two decades has created, on the one hand, incentives for the delivery of two kinds of public goods – economic modernization mainly through industrialization and severe fiscal adjustment, thus making possible to label Bahia as a case of patrimonial entrepreneurship politics. On the other hand, improvements on social policies and on the social conditions of the population have lagged far behind. This shows that Bahia's political elites (i) have made policy choices privileging the state's economic performance and fiscal soundness; (ii) that these choices have been pursued both in the military and democratic regimes and (iii) that other political institutions, mainly the Legislative, have not constrained the purse of these policy choices.

Box 3

Bahia's Public Administration

The modernization of Bahia's bureaucracy started in 1967 through a comprehensive reform launched by governor Lomanto Junior with the technical support of the Federal University of Bahia. This has made a deep change in the administration, with the adoption of planning, administrative and financial systems and with the selection of civil servants in a more technical rather than personal or family-ties bases. However, as also happened at the federal level, modernization has not been extended to the government's entire portfolio. Since its early years there was a trend to differentiate agencies in charge of economic and planning activities from those in charge of social programs; in the latter politicians acted as brokers between their supporters and the services provided to them. This role of politicians has, however, changed lately with the universalization of the access to two crucial social services – education and health care. A recent survey carried out in Salvador with 40% of the poorest found out that among them there is no more need for a politician's intermediation to have access to these services. This was not the case of the years prior to universalization, when enrolment in a state school, for instance, required, many times, the intermediation of a politician, as reported by former governor Pires himself. Furthermore, the bureaucracy who has come out from the 1967 reform was clearer separated: those allocated in social secretariats were less paid and had less benefits than those allocated in planning and financing functions.

Another feature of Bahia's bureaucracy seems to be peculiar to the state and it was used by ACM as a way to build his own group of faithful followers who later constituted his own political group. As argued elsewhere, the creation of ACM's own political group was a master-stroke. The strategy was to capture young and talented professionals, in particular those graduated in economics and public administration, granting them major positions in the administration's agencies, thus creating a group of what can be labeled technocrats-turned-politicians. In doing so ACM brought to the recently reformed administration skilled professionals who were carefully chosen to occupy key positions. In doing so ACM was also preparing his own political group with a large team of technocrats. Later ACM sponsored their careers as elected politicians and slowly took ground from his old allies, mainly the Magalhães and the Vianna families, who had opened the doors for ACM's political upgrading. This characteristic of Bahian politics plays against an oft-quoted argument that ACM's political ties are with traditional politicians, thus making him a representative of conservative and oligarchic interests. Technocrats-turned-politicians started their careers as state secretaries or as heads of state companies and then the selected ones ran for Congress, not for the state Legislative. They were also appointed to federal positions, both during the military years and after redemocratization, and also, depending on how ACM evaluated their loyalty, ACM sponsored their candidacies to Salvador's and to Bahia's chief executive (Souza, 1997: 125). Bahia's bureaucracy is now constituted by what is left of a technocracy who has joined the civil service in the 1970s, by temporary and low-paid workers, and by appointed positions at state secretariats and agencies (*cargos em comissão*).

The Table below shows a longer series and it still confirms that Bahia has decreased its payroll expenditure considerably in relation to Real Net Revenue (RLC), even before the issue of the Fiscal Responsibility Law, remaining below the national average and the ceiling set up by the Fiscal Responsibility Law.

Payroll expenditure, 1995-2000

State	In R\$ million as in December 2000						In percentage of the RLR					
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
Bahia	2 533	2 647	3 136	3 080	2 863	2 348	55	54	50	51	52	45
Brazil	60	67	64	71	73	70	62	65	60	62	63	58
	988	034	615	926	553	754						

6.6. Pernambuco

The state of Pernambuco is understood as example of high contestability between elite groups and well-developed level of checks-and-balance. The state was ranked in the third position in our index of checks & balances. According to our framework, such combination of institutional features are expected to produce an environment which leads to intertemporal cooperative transactions and governance enhancing incentives, leading to the prevalence of public good provision and economic development. However, the available

income to citizens has been below of the national average. In addition, the two democratic periods in which the state was analyzed (1946-1964 and 1985-now), it has been basically governed by two different elite-groups, conservative and liberals, that have alternated in power in both executive and legislative branches. Usually the electoral races are very competitive and polarized between these two groups. As a consequence, this alternation of power has fostered a great level of volatility and discontinuity of public policies.

As the executive is the main political player holding several institutional powers and tradable currencies under his/her discretion, the governor has always been able to build a majority legislative coalition at the state assembly. Only a small number of legislators remain in the opposition. This majority is built as a consequence of two interconnected reasons: first, post electoral political party switch of state legislators toward parties supporting the executive's coalition. In the last three elections, 45 state legislators switched their parties migrating to governing parties. Second, governor's coattail; In fact, the executive is the most important force influencing voters on the elections to state legislatures. Good examples are the PFL, PMDB and PSB that obtained the largest number of seats in the state Assembly when the governor representing those parties won the executive electoral races: PMDB with the election of Arraes in 1986; PFL with the election of Joaquim Francisco in 1990; and PSB with the reelection of Arraes in 1994.

	1986	1990	1994	1998	2002	2006
PDS/PPB/PP	1	1		3	3	1
PDT	6	6	4	1	3	2
PFL	18	15	17	12	7	8
PL		4	2	1	2	1
PMDB	19	8	5	4	7	3
PSB		4	16	12	5	7
PSDB		2	2	6	6	6
PT		2	2	3	5	5
PTB		1	1	2	1	6
Others	5	6		5	10	10
Total	49	49	49	49	49	49

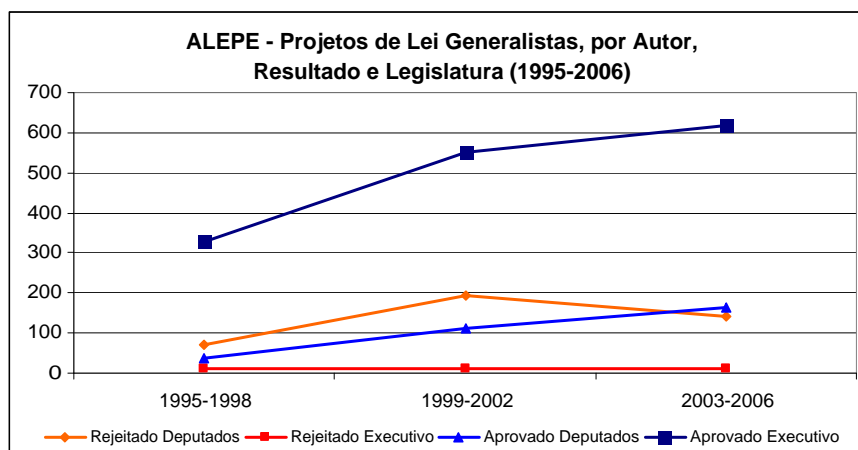
Source: TRE-PE

The reelection of Jarbas Vasconcelos in 2002, who had been elected governor of Pernambuco in 1998, breaks the cycle of political alternation of elite-groups in power. However, the election of the Arraes' grandson, Eduardo Campos, in 2006 may just suggest that Pernambuco has a bigger electoral cycle after the approval of the reelection for executive posts in 1997. Although the governor has been able to put together a majority of political parties supporting his/her administration, the level of fractionalization and the number of effective parties have increased. The great number of parties that are able to elect a state representative explains the increase of fractionalization and the effective

number of parties, which was respectively .69 and 3.3 in 1986 and jumped to .93 and 13.7 in 2006. While the majority coalition during the Arraes' administrations were very heterogeneous, ranging from right-wing to left-wing political parties, the Jarbas Vasconcelos' coalition was more homogeneous, center-right.

Fractionalization and Effective Number of Parties (1986-2006)						
	1986	1990	1994	1998	2002	2006
Fractionalization (Fp)	0,69	0,83	0,75	0,85	0,92	0,93
Effective Number of Parties (Np)	3,3	6,1	4,0	6,7	12,1	13,7

However, the increase in the effective number of parties, fractionalization, or coalition heterogeneity did not lead to a paralysis of the government or reduction in the executive's preponderance in the policymaking process in the legislature. As we can see in the Figure below, the executive has been the most important legislator both approving and rejecting what the governor wants. The number of new legislation initiated by state legislators is very low and the governor rarely sees his/her bills rejected by the Assembly.



Given the extreme preponderance of the executive and the alternation of power between the two elite-groups, the main public policy outcome of the state of Pernambuco is characterized by the volatility and discontinuity. What the previous administration had implemented is easily replaced by new policies and programs. That is, when a new administration takes power, almost all managerial position in the state bureaucracy is replaced by the new elite that was elected. The professionalization of civil servants is restricted to small bureaucratic islands especially at the financial sector. This creates great discontinuity of policies and programs especially on social policies which are designed and financed by the federal administration. In addition, as a consequence of the high political

competition, politicians from both groups look for policy results at the short-run, which provide possibilities for the incumbent to claim political credit.

7. Policy implications

The main message of this report is that institutions matter for economic and social outcomes. The focus of the study was on checks and balances institutions but we also considered the role of the bureaucracy and the media for public sector accountability. The empirical tests and case studies provide robust evidence that the quality of state institutions influences the policy-making process and hence development outcomes. But the results are conditional on the pattern of political contestability in the states. We have consistent evidence that checks and balances and political competition matter and interact at the state level as complements. High quality institutions mitigate the negative effects of political competition including policy volatility and discontinuities in programs and projects, private regardlessness of policies and corruption. In contexts where political competition is intense and political polarization stronger, leading to great alternation in power, strengthening institutions becomes a top priority.

The policy implications of the study can be summarized as six main recommendations. The first is that second-best politically viable solutions should replace optimal technical solutions. There are no first best solutions of the type “one size fits all” for the Brazilian states. Development programmes should be targeted rather than comprehensive. A solution that is optimal for São Paulo may be not so for other states not only for the obvious oft-quoted differences in scale and socio-economic conditions but mostly because of the differences in the political institutions and features of the state political system. States in the same region such as Bahia and Pernambuco, or Espírito Santo and Minas Gerais, have very distinct political systems and differ enormously in terms of the quality of their checks and balances institutions.

. Projects and programs should be designed so as to be consistent with the structure of incentives produced by existing institutions. Incentive incompatibility may undermine projects in these areas. Attention to contextual incentive structures is key. Most programmes currently being implemented for the states are comprehensive and do not take into account the differences among the states (e.g Promoex, Pnage). Programmes should be targeted at groups of states instead of being universalistic in scope. Targeted programmes may require careful justification and appropriate design because the states may demand equal treatment.

Second, the manifested political will of Mayors or Governors should not guide development programmes. Strong leadership may undermine institutions and may not be sustainable overtime. All too often multilateral institutions in Brazil and elsewhere associate themselves with strong local political leaders. Encouraged by their dynamism and political will, multilateral institutions have used implicitly or explicitly, leadership as a criterium in the choice of programs and projects. Many governors have become reform champions and many successful cases are presented as models on the expectation of future demonstration effects. While short term commitments may be welcomed for the initiation of programmes, in the longer term they maybe have negative effects. These innovative projects are only sustainable, however, only when high quality institutions are in place. In

contexts of political polarization, governors may have strong incentives to show that the programs initiated by their political adversaries do not work.

Third, programmes should prioritize the strengthening of sub-national institutions. Specific projects should be created aimed at the checks and balances institutions, sectoral bureaucracies and regulatory institutions. These may include training programmes but also comprehensive programs of institutional improvements. Governments with short policy horizons have disincentives to professionalize bureaucracy or evaluate programs. It is necessary then to link these initiatives to other current operations to make them politically viable, and to introduce mechanisms that ensure program continuity.

Fourth, the general picture that comes out from the analysis is extremely negative for a number of states. These should be targeted for programmes of institutional building. The available data on the state's public sector is dimly scant in a number of states, suggesting that a concerted effort should be made in the area of information systems. Similar efforts are needed in the area of human resources. This is an area where a targeted effort is required aimed at the states with the weakest public sector machineries.

Fifth, states with intense alternation between groups in power may face strong problems in the implementation stage and therefore projects with longer time horizons may not be prioritized. If they are key priorities in the development agenda, conditionalities have to be inbuilt in the programmes so as to ensure continuities. Where the local institutions are weak it is necessary to involve federal institutions actively. This is particularly needed in the North and part of the Northeastern regions.

Sixth, it is necessary to strength the mechanisms and institutions that generate and publicize information on government's activities in a number of smaller states. Information asymmetries between citizens and governments are very significant and they create disincentives for governments to engage in the production of public goods.

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