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# Impact of Governance Structure on Economic and Social Performance: A Case Study of Latin American Countries

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## **Abstract**

Defined as "the division of public authority between two or more constitutionally defined orders of government – and a set of ideas which underpin such institutions", federalism emphasizes issues such as shared and divided sovereignty, multiple loyalties and identities, and governance through multi-level institutions. Proponents of federalism have linked federalism with improved economic and social benefits, including increased political participation and personal liberties, efficient public and private markets, and a check on governmental power. Nevertheless, few studies have attempted to empirically prove these claims. In "Federalism's Values and Value of Federalism", Robert Inman created a multiple regression model to assess the contribution of federal governance to a country's economic and social performance. Although Inman's model provides an important empirical framework, his broad analysis did not incorporate the unique context and history of different countries, or explain the variation in the results. Hence, through a case-study of six Latin American countries and analysis of key social, economic, and rights indicators, this paper seeks to answer the following research question: How does federalism affect the economic and social performance of Latin American countries? The conclusions are as follows: (1) Diffusion of political power improves rights performance and democratic accountability, of which federalism provides an important institutional framework, (2) The contribution of federalism to aggregate economic performance remains ambiguous, (3) Decentralization improves access to public goods, in both federal and unitary governments, (4) Federalism, however, potentially creates political fragmentation that may block important reforms or give rise to a power vacuum for populist leaders. As a result, rights performance, democratic accountability, and economic and social progress may stall or deteriorate.

## **Keywords**

government, latin america, economics, culture

## **Comments**

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# Impact of Governance Structure on Economic and Social Performance

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## A Case Study of Latin American Countries

Joyce Meng

4/25/2008

**Abstract:** Defined as “the division of public authority between two or more constitutionally defined orders of government – and a set of ideas which underpin such institutions”, federalism emphasizes issues such as shared and divided sovereignty, multiple loyalties and identities, and governance through multi-level institutions. Proponents of federalism have linked federalism with improved economic and social benefits, including increased political participation and personal liberties, efficient public and private markets, and a check on governmental power. Nevertheless, few studies have attempted to empirically prove these claims. In “Federalism’s Values and Value of Federalism”, Robert Inman created a multiple regression model to assess the contribution of federal governance to a country’s economic and social performance. Although Inman’s model provides an important empirical framework, his broad analysis did not incorporate the unique context and history of different countries, or explain the variation in the results. Hence, through a case-study of six Latin American countries and analysis of key social, economic, and rights indicators, this paper seeks to answer the following research question: ***How does federalism affect the economic and social performance of Latin American countries?*** The conclusions are as follows: (1) Diffusion of political power improves rights performance and democratic accountability, of which federalism provides an important institutional framework, (2) The contribution of federalism to aggregate economic performance remains ambiguous, (3) Decentralization improves access to public goods, in both federal and unitary governments, (4) Federalism, however, potentially creates political fragmentation that may block important reforms or give rise to a power vacuum for populist leaders. As a result, rights performance, democratic accountability, and economic and social progress may stall or deteriorate.

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## Introduction

In 1979, William Riker proclaimed, “Although Americans seldom realize it, this is an age of federalism – most of them derived and inspired by the Constitution of the United States.”<sup>1</sup> The thirty years that followed showed this statement to be increasingly true. According to the Forum of Federations, although only 24 of the world’s 193 countries currently utilize federal political systems, their citizens comprise 40% of the world’s population. In addition, approximately two countries make a transition to federalism each year, while many others consider incorporating federalist elements into their constitutions.<sup>2</sup> In particular, federations account for most of the territory of North and South America, contained in Canada, the United States, Mexico, Venezuela, Columbia, Brazil, Argentina, and the British West Indies.

Federalism’s appeal derives from a general conviction that decentralization improves economic and political performance and accountability. Existing academic literature has focused on federations and the ability of regional governments to shape economic reform processes aimed at improving and instituting market mechanisms. Accountable to their own electoral incentives, regional officials may eschew national government resistance to market-friendly initiatives and adopt their own entrepreneurial policies.<sup>3</sup> Likewise, various development experts and institutions have advocated fiscal and political decentralization as a means to profoundly transform and improve the performance of the public sector. The logic extends that by devolving authority over public goods, services, tax authority, and user charges to the local level, decentralization encourages greater efficiency in the provision and consumption of public goods due to a better understanding of local priorities and contexts.<sup>4</sup>

In regards to political performance, political scientists generally agree that based on historical outcomes, federalism leads to different policy outcomes. Although the impact of federalism on political participation, democratic stability, and political accountability differs depending on the particular characteristics of the federal system and the distribution of power within the society, theorists argue that federalism enhances democracy by providing checks

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<sup>1</sup> Riker, William. *Soldiers of the State*. Public Affairs Press, Washington. 1979.

<sup>2</sup> Forum of Federations, “Federalism by Country.” <[http://www.forumfed.org/en/federalism/by\\_country/index.php](http://www.forumfed.org/en/federalism/by_country/index.php)> Accessed: 22 March 2008

<sup>3</sup> Wibbels, Erik. *Federalism and the Market*. Cambridge University Press. New York, 2005.

<sup>4</sup> Wiesner, Eduardo. *Fiscal Federalism in Latin America: From Entitlements to Markets*. Inter-American Development Bank, 2003.

and balances of existing governmental policies and practices. For example, a political party out of power nationally may still retain residual power in regional and local offices. The party's divergent views or reservations to national government policies provide not only a source of creative tension, but also promotes the effective criticism of government to strengthen democracy and protect citizens' rights.<sup>5</sup>

In order to empirically test the hypothesis that federalized government improves economic and social performance, Robert Inman constructed a model that classified a sample of 73 countries as a constitutionally-based federal democracy, an administratively-based federal democracy, a unitary democracy, a federal dictatorship, or a unitary dictatorship. After introducing additional controls to correct for bias, he created a multiple regression model of governance structure on eleven measures of economic, democratic, and rights performance. His conclusions were as follows: (1) decentralization does uniquely contribute to the protection of property, political, and civil rights, (2) although policy decentralization and its benefits can be achieved within a unitary government, constitutionally-established provincial or state governments provide an extra and important protective barrier for policy decentralization, (3) adding policy decentralization or provinces does not improve economic or rights performance in dictatorships.<sup>6</sup>

Although Inman's model provides an important empirical framework to analyze the contribution of federal governance to greater political participation, personal rights and liberties, and public and private sector economic efficiency, his broad analysis could not fully incorporate the unique context and history of different countries. In particular, given differing historical and cultural contexts, the underlying rationale for the contribution of federal governance to economic and social performance may differ by region. Hence, since Inman's empirical model spans across countries of differing income levels, geographic location, and historical evolution, a case study would reveal critical insights to assess and supplement the conclusions of the empirical model, explaining the variation within the model.

### ***Research Question***

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<sup>5</sup> Bodenhamer, David. *Federalism and Democracy*. Democracy Papers, U.S Department of State. <<http://usinfo.state.gov/products/pubs/democracy/dmpaper4.htm>>

<sup>6</sup> Inman, Robert. "Federalism's Values and the Value of Federalism" NBER Working Paper 13735, January 2008.

This paper seeks to answer the following question: ***How does federalism affect the economic and social performance of Latin American countries?*** During the course of the nineteenth century rebellion against Spain, many Latin American countries created federal governments, adapting the American model to their own circumstances. Although not all of these federations survived – for example, Chile became a unitary state and the Central American Federation dissolved – many of the largest countries in Latin America remain federations.<sup>7</sup> Since many Latin American countries share a similar culture and historical evolution, a case study of countries with different governance structures can reveal generalizable insights about the impact of governance structure on rights protection, democratic accountability, and economic performance.

In terms of organization, this paper first summarizes the current state of federalism in Latin America, providing theoretical foundations linking federalism and fiscal decentralization in Latin America to improved economic and social performance. Second, the paper presents an overview of the selected countries and explains the methods of comparison. Third, the paper presents cases about each country, describing government structure, providing a table of indicators, and explaining their implications. Fourth, the paper compares and contrasts indicator results to determine whether governance structure did indeed improve economic, rights, and political performance.

### ***Summary of Results***

The findings of the case study are summarized as follows:

1. Diffusion of political power improves rights performance and democratic accountability, of which federalism provides an important institutional framework.
2. The contribution of federalism to aggregate economic performance remains ambiguous.
3. Decentralization improves access to public goods, in both federal and unitary governments.
4. Federalism, however, potentially creates political fragmentation that may block important reforms or give rise to a power vacuum for populist leaders. As a result, rights performance, democratic accountability, and economic and social progress may stall or deteriorate.

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<sup>7</sup> Riker, William. Soldiers of the State. Public Affairs Press, Washington. 1979.

## Federalism in Latin America

### *Definition of general concepts and terms*

Defined as “the division of public authority between two or more constitutionally defined orders of government – and a set of ideas which underpin such institutions”, federalism emphasizes issues such as shared and divided sovereignty, multiple loyalties and identities, and governance through multi-level institutions.<sup>8</sup> According to Edward Gibson, federalization has meant a “process of political decentralization that has given greater protagonism to sub-national governments and political actors, has often heightened the importance of territorial representation (as opposed to population representation) in national political institutions, and has redistributed power and resources between levels of government.”<sup>9</sup>

Proponents of federalism have linked federalism with improved economic and social benefits, including increased political participation and personal liberties, efficient public and private markets, and a check on governmental power. In designing political structures for newly formed states, federalism has emerged as a popular alternative, associated with attempts at conflict resolution and political integration. As a contractual linkage, federalism provides for power sharing, cuts around the issue of sovereignty, and supplements but does not seek to replace or diminish prior organic ties where they exist.<sup>10</sup> Given the high degree of ethnic, religious or language fractionalization of in many countries, the federal principle has emerged as a popular remedy for addressing seemingly intransigent political problems with a historical basis in conflicting national, ethnic, linguistic, and racial claims.

According to the Inter-American Development Bank, decentralization is a “process whereby a country successfully adopts macroeconomic and sector policies to encourage the provision and consumption of goods and services at a particular level of government – institutional arrangement or policy area – where it will be most efficient to do so.”<sup>11</sup> Prominently emerging during the past two decades as a key public sector reform in developing countries, academics and practitioners have recommended decentralization as a means to

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<sup>8</sup> Knop, Ostry, Simeon, Swinton. Rethinking Federalism: Citizens, Markets, and Governments in a Changing World. UBC Press, British Columbia, 1995.

<sup>9</sup> Gibson, Edward. “Federalism and Democracy.” Federalism and Democracy in Latin America. Johns Hopkins University Press, 2004.

<sup>10</sup> Elazar, Daniel. Federalism as Grand Design. University Press of America, 1987.

<sup>11</sup> Wiesner, Eduardo. Fiscal Federalism in Latin America: From Entitlements to Markets. Inter-American Development Bank, 2003.



improve government performance and support economic development. Inextricably linked with democratization through the emphasis on giving citizens more voice in shaping public resource allocation, many international development agencies have provided substantial financial and technical support for decentralization initiatives. Nevertheless, Paul Smoke and other experts have pointed out that the normative ideas of decentralization from social science often have little empirical evidence or adequate consideration of the application of complex reform in different contexts.<sup>12</sup> Hence, analyzing the actual implementation of decentralization in a particular country and its corresponding results provides a much more robust determination of overall sustainability and impact.

### ***Origins of Modern Federalism in Latin America:***

Latin America's three largest countries – Brazil, Mexico, and Argentina – are federal republics, comprising 65% of the region's population. Hence, understanding the dynamics of federalism and analyzing its associated political outcomes is essential. In Latin America, the debt crisis of the 1980s sparked dramatic changes in economic and political organization. Coinciding with the beginnings of liberalization – the first movement of the transition to democracy – the Latin American public sphere shifted politics from the state to the societal level.<sup>13</sup> As an alternative to the central state as an agent of national economic development and fiscal management, Latin American governments transitioned towards increasing the predominance of provincial and municipal governments in managing fiscal and administrative responsibilities. In economic investment and production, private enterprise began to supplant state-owned enterprises. Given that the political features of federalism supported a structure of decentralization, a profound redistribution of power occurred, empowering local governors with political and fiscal resources with formal constitutional power.<sup>14</sup>

Simultaneously, disenchantment with the military governments of the 1960s-1970s erupted in mass participatory demonstrations against central authority and their abuses of civil and human rights. Throughout the 1980s, power devolved from military authorities to civilian parties, thereby validating federal institutions and empowering sub-national actors. As in the case of human rights movements in Argentina and Brazil, the mass mobilization of civilians undercut the power of central authority, affirming the importance of rights protection as a non-

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<sup>12</sup> Smoke, Gómez, Peterson. *Decentralization in Asia and Latin America*. Edward Elgar Publishing Limited, 2006.

<sup>13</sup> Avritzer, Leonardo. *Democracy and the Public Space in Latin America*. Princeton University Press, 2002.

<sup>14</sup> Gibson, Edward. "Federalism and Democracy." *Federalism and Democracy in Latin America*. Johns Hopkins University Press, 2004.

negotiable matter.<sup>15</sup> Likewise, urban social movements in Brazil and Mexico sought to improve the material infrastructure of the urban poor through the creation of independent neighborhood organizations. Challenging conventional forms of political mediation by refusing to accept party incorporation for material benefits, these autonomous citizen organizations profoundly changed local politics and the distribution of public goods.

As a consequence of the confluence of economic and political change, the growing presence of alternative policies and institutional innovations firmly challenged the entrenched central authority. Through liberalization and the discrediting of central authority, Latin American societies restored political competition and increased the predominance of sub-national actors. Emphasizing local action and grassroots mobilization, collective action increased the overall level of political participation, of which federalism provided an important political framework.

In general, Latin America's decentralization process can be organized into two distinct periods – the “first generation period” beginning in the early 1980s and the “second generation period” that began in the late 1990s. According to a study by the Inter-American development bank, the first-generation phase was largely characterized by:

1. Constitutional reforms that incorporated automatic and unconditioned transfers for the central government to the sub-national level (i.e.: Constitution of 1988 in Brazil, Constitution of 1991 in Colombia)
2. Targeted fiscal transfers to specific sectors and to low-income groups
3. Devolution of resources and responsibilities
4. Delegation of some limited taxing and spending authority
5. Lack of any independent evaluation of results

In this early phase, the government faced difficulties in managing the fiscal transfers efficiently, especially when sequencing flaws, in which setting the revenue decentralization target preceded devolution of responsibilities, led to a loss of accountability and duplication of expenditures. In 1994, the Inter-American Development Bank observed that other than Chile, the transfer system in Latin America were severely flawed, especially since decentralization policies failed to take into account market-based principles, such as incentives and public choice theory. In addition to destabilizing the overall macroeconomic framework, the transfer systems did not increase sectoral decentralization or spur development of strong local

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<sup>15</sup> Avritzer, Leonardo. Democracy and the Public Space in Latin America. Princeton University Press, 2002.

institutions in health, education, and other social services. In fact, decentralization increased haphazard government spending, as sub-national governments enacted initiatives with little regard for budget constraints. As a result, serious fiscal problems emerged in Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico, and Venezuela by the early 1990s.<sup>16</sup>

In an attempt to restructure decentralization policies, Brazil, Chile, and Mexico began implementing a “second generation” approach, characterized by macroeconomic budget constraints, a strong intergovernmental regulatory framework, and more intensive use of incentives at the sectoral level.<sup>17</sup> Overall, these reforms seek to create a market-based system of fiscal decentralization in order to harness the benefits of maximizing the efficiency of local public goods and improving information at the local level, while minimizing the costs of fiscal irresponsibility.

### ***Case Study Selection***

In his paper, Inman defines governance along three institutional dimensions – number of provincial governments ( $N \geq 2$  for federal;  $N = 1$  for unitary), policy assignment for the provision of important government services between central and provincial governments ( $A$  close to 1 for federal;  $A$  close to 0 for unitary), and constitutionally protected provincial representation to the central government legislature ( $R=1$  for federal; 0 for unitary). Federal and unitary governments may be either democratic or dictatorial ( $D=1$  if democratic,  $D=0$  if dictatorial).

Inman then categories federal governments as having two or more provinces ( $N \geq 2$ ), each with substantive policy responsibilities ( $A$  close to 1) and provincially elected representation in the central legislature ( $R=1$ ). Unitary governments either lack politically independent provincial governments, or if provincial governments lack independent policy authority ( $A=0$ ) or central government representation ( $R=0$ ).

The following summarizes the methodology Inman used to assign values to countries:

- **Policy Assignment (A):** annual percentage of all government revenue raised by provincial, state, and local governments, averaged over the years 1965-1995. Mean = .21 (S.D. = .16). A country is classified as an administrative federation ( $A=1$ ) when its score ranks in the upper two quartiles.

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<sup>16</sup> Wiesner, Eduardo. Fiscal Federalism in Latin America: From Entitlements to Markets. Inter-American Development Bank, 2003.

<sup>17</sup> *Ibid.*

- **Democracy (D):** Country has been considered democratic for 50 percent or more of the years from 1960-2000. Mean = .52 (S.D. = .50).
- **Central Government Representation (R):** De jure, constitutionally-based federation

To provide a meaningful contrast among different governance dimensions, the following six countries were selected. Brazil and Argentina – Latin America’s largest federal republics – serve as the benchmark case of federal democracy. All other cases differ along a governance dimension in order to provide insight about the differential impact of institutional structure.

	<b>Assignment (A): % of revenue assigned to locales</b>	<b>Provincial Representation (R) (Yes =1, No = 0)</b>	<b>Democracy (Yes=1, No=0)</b>	<b>Chosen Cases (GDP per capita)<sup>18</sup></b>
<b>Benchmark Cases: Federal/Democracy</b>	1 (close to 1 as possible, in IV quartile according to Inman’s classification)	1	1	Brazil (10,073) Argentina (16,080)
<b>Case #1:</b> Federal/Democracy, but low provincial revenue assignment	0 (close to 0 as possible)	1	1	Venezuela <sup>19</sup> (7,480)
<b>Case #2:</b> Administrative Federal/Democracy	1 (close to 1 as possible, in IV quartile according to Inman’s classification)	0	1	Uruguay (11,969)
<b>Case #3:</b> Federal/Dictatorship	1 (close to 1 as possible, in III quartile according to Inman’s classification)	1	0	Mexico <sup>20</sup> (11,369)
<b>Case #4:</b> Unitary/Democracy	0 (close to 0 as possible)	0	1	Chile (12,811)

<sup>18</sup> GDP per capita data comes from 2006 estimates by the International Monetary Fund

<sup>19</sup> Despite the fact that Hugo Chavez has concentrated the power of judicial and legislative branches and created media restrictions, he still operates within a generally democratic framework. He was elected through free and fair elections, and has not succeeded in making a blatant political move to radically undermine Venezuelan democratic infrastructure. For example, Chavez acknowledged defeat on December 3, 2007 when voters rejected his public referendum to change the constitution. The referendum would have overhauled term limits defined in the constitution, placed more of the military under his control, permit media censorship in times of emergency, and eroded the independence of the central bank. In addition, Chavez has to step down from power on January 2013.

<sup>20</sup> Despite significant democratic reforms in Mexico over the past decade, Mexico is still categorized as a dictatorship due to its long historical precedent of authoritarian rule and PRI dominance. Although the monopolistic control of PRI was first challenged in the late 1970s, it was not until 1989 that the first non-PRI governor of a state was elected. In general, democracy has been significantly entrenched in Latin American countries over the course of the past two decades. According to the Economist Democracy Index (January 2007), no country in Latin America received classification as an “Authoritarian Regime”. Mexico received a rating of 6.67, placing the country within the “Flawed democracy” category.

### ***Benchmark Case: Federal Democracy – Brazil***

From a historical perspective, Brazil endured a series of tumultuous political changes, which has led to strong democracy and federalism in the most recent decades. Following a military coup in 1964, significant centralization occurred, thus weakening pre-existing federal institutions. The military government centralized distribution of government revenue and expenditures, and limited the representation and autonomy of state governments. In addition, the government also eliminated important democratic checks, including the suspension and repression of the legislature and enactment of preferential policies to strengthen executive control.<sup>21</sup> With the ousting of the military government in 1985 due to severe recession and civilian outrage, Brazil embarked on a long process of democratic consolidation, decentralization, and economic recovery. To provide a systematic check on the power of centralized government, the 1988 constitution adopted significant reforms to ensure state and local representation.

Divided into 26 states and a Federal District, with each state in turn divided into 5,500 municipalities, Brazil's triple-tiered government is regulated by the Federal 1988 Constitution. In general, the constitution protects sub-national autonomy by allowing states to adopt its own constitution and directly elect its legislature and governor with very limited interference by the federal government. Similar to the states, municipalities directly elect their own councils and mayors. Paralleling the relation between federal and state government, state governments have limited ability to compel or prohibit actions by municipalities in their jurisdiction.<sup>22</sup>

According to the most recent Handbook of Federal Countries, the republican regime in Brazil has been marked by two general characteristics:

1. A plebiscitary presidentialism in which a strong President is sided by a symmetric, bicameral, multi-party, and regionalist, legislative power and an independent judiciary
2. A federative system which reproduces the presidential division of powers at the state level and accords considerable constitutional autonomy to states and municipalities

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<sup>21</sup> Samuels, Mainwaring. "Strong Federalism in Brazil." *Federalism and Democracy in Latin America*. Johns Hopkins University Press, 2004.

<sup>22</sup> Wiesner, Eduardo. *Fiscal Federalism in Latin America: From Entitlements to Markets*. Inter-American Development Bank, 2003.

From a fiscal perspective, Brazil's 1988 constitution explicitly divides up revenues, assigning a specific tax base to each level of government and forming a system of tax sharing that redistributes revenues among levels of government and regions. Overall, the creation of new taxes, raising existing taxes, and increasing the transfer of Federal collected taxes to sub-national enhanced the financial capabilities of state and local governments.<sup>23</sup> In particular, in forming the broad-based value-added tax (ICSM), with rates freely determined by the states, the constitution eliminated a series of state excises on communications, fuels, electric power, minerals, and transportation. Likewise, the government eliminated federal exemptions and restrictions on the use of funds by states as a means to reaffirm the revenue-sharing system.<sup>24</sup> As shown in the Table 1, the federal government share of total expenditures has largely declined since the 1970s and 1980s when the Brazil remained under centralized, authoritarian rule, dropping from 68.2% in 1980 to 59.9% most recently.

The recent increase in federal government share of total expenditures reflects the tension between decentralization and macroeconomic stability, especially in light of recent financial crises. In Brazil, recentralizing changes occurred as an indirect effect of the federal government's attempt to clamp down on hyperinflation in 1994. For example, the Real Plan of 1993-1994 forced sub-national governments to increase transparency in their expenditures, thus exposing the debts of state banks. Due to the popularity of the plan, state governments received a public mandate to keep fiscal accountability and reduce overspending.<sup>25</sup>

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<sup>23</sup> Castanhar, José. Fiscal federalism in Brazil: historical trends present controversies and future challenges." VIII Congreso Internacional del CLAD sobre la Reforma del Estado y de la Administración Pública. Oct 2003.

<sup>24</sup> Diaz-Cayeros, Alberto. Federalism, Fiscal Authority, and Centralization in Latin America. Cambridge University Press, 2006.

<sup>25</sup> Eaton, Dicovick. "Decentralization and Recentralization in Argentina and Brazil: The Menem and Cardoso years." Decentralization in Asia and Latin America. Edward Elgar Publishing Limited, 2006.

Table 1. Fiscal Division in Brazil (1960-2000)

Year	Share of Total Revenue			Share of Total Expenditures		
	Central	State	Municipal	Central	State	Municipal
1960	63.9	31.3	4.7	59.5	34.1	6.4
1965	63.8	30.9	5.9	54.8	35.1	10.1
1970	66.7	30.6	2.7	60.8	29.2	10.0
1975	73.7	23.5	2.8	68.0	23.3	8.7
1980	74.7	21.7	3.7	68.2	23.3	8.6
1985	72.8	24.9	2.4	62.7	26.2	11.1
1990	67.3	29.6	3.1	57.1	28.0	14.9
1995	67.2	28.0	4.8	56.3	27.5	16.2
2000	69.2	26.2	4.6	59.9	25.1	15.0

Source: Samuels, Mainwaring, "Strong Federalism in Brazil", 2004

Table 2 summarizes some key social and economic indicators of Brazil, which will be used as a basis for comparison to other Latin American countries. As evidenced in the data, Brazil has enjoyed the benefits of prudent macroeconomic management in recent years, with credible inflation targeting and considerable improvement in its external position. In 2000, Brazil approved the Fiscal Responsibility Law, which broadly recognizes the importance of fiscal rules to accomplish national economic objectives and the technical macroeconomic precepts to reach fiscal targets. According to Afonso and de Mello, the Fiscal Responsibility Law forms the basis of a "rules-based system of decentralized federalism...and has been motivated by the recognition that market control over sub-national finances should be strengthened by fiscal rules and appropriate legal constraints."<sup>26</sup> Brazil has largely recovered from the economic stress of 2002-2003, with real GDP growth reaching 3.5% in 2006. To enhance its growth potential, Brazil would require further institutional capacity development, improvements in the efficiency of the public sector, and sustained fiscal discipline.<sup>27</sup> In addition, after instituting significant democratic reforms after the ousting of the coup, Brazil has established a strong democratic tradition that has led to improving performance in civil and political rights. Elections are deemed free and fair by independent observers, and Brazilians have voted five times in national elections since the restoration of civil rule in the mid-1980s.<sup>28</sup>

<sup>26</sup> Wiesner, Eduardo. *Fiscal Federalism in Latin America: From Entitlements to Markets*. Inter-American Development Bank, 2003.

<sup>27</sup> "Brazil: Economic Overview." *Country Watch*. 2007.

<sup>28</sup> "U.S. Congratulates Brazil on October 29 "Free, Fair" Election" US Department of State. October 2006.

Table 2. Key Social and Economic Indicators of Brazil (1970-2006)

Brazil	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
GDP growth (annual %)	11.0	5.9	1.4	4.5	1.3	2.0	3.1
GDP per capita (constant 2000 US\$)	2,390.6	3,125.5	3,262.8	3,508.8	3,379.5	3,642.9	3,829.0
GINI Index	NA	NA	57.7	59.3	60.3	59.6	58.1
Household final consumption expenditure (per capita)	1,398.6	1,811.7	2,148.3	2,092.2	2,047.3	2,356.9	2,438.1
Immunization, DPT (% of children ages 12-23 months)	NA	NA	53.6	59.2	72.8	85.2	97.3
Improved sanitation facilities (% of pop with access)	NA	NA	NA	NA	71	73	74.5
Improved sanitation facilities, rural (% of rural pop with access)	NA	NA	NA	NA	37	37	37
Life expectancy at birth, total (years)	59.3	61.6	63.0	64.8	66.5	68.5	70.4
Poverty headcount ratio at \$2 a day (PPP) (% of population)	NA	NA	34.1	29.4	27.9	22.4	21.8
Urban population (% of total)	58.16	63.98	68.96	72.7	76	79.16	82.98
Freedom House - Political Rights	5	4	3.4	2.2	2.2	2.4	2.4
Freedom House - Civil Rights	5	4.6	3	2.2	3.4	4	2.8
Transparency International - Corruption Perceptions Index	NA	NA	4.67	3.51	3.655	3.94	3.5
Heritage Foundation - Index of Economic Freedom	NA	NA	NA	NA	NA	53.1	62.0

Source: World Bank Development Indicators, Freedom House, Transparency International, Heritage Foundation

Overall, globalization has posed a significant challenge to Brazilian federalism through three fundamental processes. First, financial deregulation has significantly increased foreign currency and interest rate speculation, thus reducing overall government ability to manage national macroeconomic policies. Second, due to differences in labor costs, fiscal load, and infrastructure, foreign direct investment has penetrated sub-national regions unevenly. Third, the homogenization of economic policies in response to the debt crisis of the 1980s has opened national economies to international trade, thus weakening the influence of the state and sub-national actors. As a consequence, Brazil faces the paradox in which globalization induces centralization, but the centralized government loses significant influence as the economy continues to liberalize.<sup>29</sup>

### **Implications**

In perspective, federalism played an important role in strengthening democratic institutions after a long period of military rule. The constitutional structure of democratic federalism provided an important check on government to ensure representation at local levels, which military rule had suppressed. Federalism also provided an essential constraint on presidential or executive power – a mechanism to prevent political rights abuses that had occurred under military rule, such as the suspension of the legislature, purging of elected officials without approval, and unlimited budgetary control by the executive.<sup>30</sup> Simultaneously,

<sup>29</sup> Grau, Eros Roberto. “Brazilian Federalism under the Pressure of Economic Globalization” Federalism, rule of law, and multi-culturalism in Brazil. Institute of Federalism Fribourg Switzerland. Volume 38. 2001.

<sup>30</sup> Samuels, Mainwaring. “Strong Federalism in Brazil.” Federalism and Democracy in Latin America. Johns Hopkins University Press, 2004.



federalism empowered the civil rights of citizens by strengthening democratic institutions at the municipal level and increasing the ability of citizens to participate in local politics. For example, Section II of the Federal Constitution of 1988 enshrines the civil rights of individuals – an example of the reinforcing relationship between democracy and federalism, in which federalism provides the structure to enhance the protection of rights essential to democracy.<sup>31</sup> Unsurprisingly, the Freedom House scores of Brazil from the mid-1980s onward demonstrate a marked improvement – an example of democratization mutually reinforced by federal reform and political decentralization. Federalism in Brazil, however, has also increased political fragmentation as increased space for competition weakened the power of large political parties. Currently, Brazil has an estimated thirty political parties, none with a majority, although 90% of elected representatives belong to the six main parties.<sup>32</sup> As a result, negotiations and obtaining consensus on contentious policies has often proven difficult, resulting in stalled government.

Federalism's effect on Brazil's economic performance, however, remains much more ambiguous. As Brazil's history attests, various institutional factors influence the ability of federalism to affect central government. Comparing Brazilian federalism from the 1980s to early 1990s after the initial transition to civilian government to federalism in the late 1990s under the Cardoso regime reveals important insights about the impact of federalism on economic performance. In the early 1980s, federalism constrained the ability of the president to enact much-needed economic reforms. Especially given the high degree of political fragmentation, obtaining political consensus to support comprehensive reforms proved difficult. As a result, state debts to federal government burgeoned, state governments stalled much-needed macroeconomic stabilization policies,<sup>33</sup> and institutional inertia resulting from new layers of bureaucracy created obstacles for economic resiliency and flexibility. For example, newly empowered states exercised fiscal powers irresponsibly, which impeded the central government's ability to reduce Brazil's internal debt and establish macroeconomic stability – an example of the challenges of first generation fiscal decentralization.

Federalism under the Cardoso regime, however, differed dramatically. By managing to obtain multi-party support and overcoming the divisive nature of political fragmentation, Cardoso created coherency and consensus in the Brazilian government. In comparison to the

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<sup>31</sup> "Constitution of Brazil." <<http://www.v-brazil.com/government/laws/titleII.html>> Accessed: April 19, 2008

<sup>32</sup> Pires-O'Brien, Joaquina. "Brazil under Labor Government." *Contemporary Review*, Sep 2004

<sup>33</sup> Samuels, Mainwaring. "Strong Federalism in Brazil." *Federalism and Democracy in Latin America*. Johns Hopkins University Press, 2004.

earlier period, Cardoso managed to control inflation and improve macroeconomic stability with broad support from Congress, which passed several important economic reforms. Since Cardoso's regime controlled over 70% of the seats in the Chamber of Deputies and 80% of the seats in the Senate during his first term<sup>34</sup>, Cardoso had the political capital and support to win negotiations with state actors, even in the passing of various constitutional amendments and the curtailing of state debt. Illustrating the complex bargaining game that federalism creates between central and sub-national actors, the relationship between federalism and economic performance in Brazil depended on the political context and various institutional variables in constant flux.

### ***Benchmark Case: Federal Democracy – Argentina***

In creating a theoretical framework for the universal origins of federalism, William Riker developed the theory of the “federal bargain”, in which constituent units of a federation trade sovereignty for security and military power. Under Riker's theory, the two necessary preconditions involve: 1) a group of individual polities exist, all with strong identities and substantial sovereignty, 2) as a group they perceive external threats, which could conceivably be mollified under a federation.<sup>35</sup>

According to Gibson and Falleti, however, Riker's theory fails to take into account the unique geopolitical conditions that led to the Argentine federation. Although international wars and security threats existed, they did not occur continuously, apply consistently to all constituent elements of the federation, or coincide with the two major federal milestones – the 1931 Argentine Confederation Pact and the constituent assembly of 1853 (inauguration of the Argentine Federation). Rather, Argentine federalism emerged as a response to interprovincial conflict between “centralizers” and “peripheralizers”.<sup>36</sup>

To address the issue of inter-provincial conflict, the 1853 Argentine constitution established a republican, representative, and federal form of government, instituting a clear division of power among the Executive, Legislative, and Judicial branches. In addition, the Constitution explicitly protects the autonomy of provincial and municipal governments. Article I of the constitution proclaims the establishment of a “federal republican form of government”,

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<sup>34</sup> *Ibid.*

<sup>35</sup> Stepan, Alfred. Arguing Comparative Politics. Oxford University Press, 2001.

<sup>36</sup> Gibson, Falleti. “Regional Conflict and the Origins of Argentine Federalism.” Federalism and Democracy in Latin America. The John Hopkins University Press, 2004.

with Article V asserting that each province would enact its own constitution in accordance to the principles of the National Constitution in return for the latitude to fully exercise its own institutions independently. In Section 14b, the constitution also explicitly endows national and provincial entities with “financial and economic autonomy” to enact social policies. Most notably, Section 123 affirms that each province “enacts its own Constitution, ensuring municipal autonomy” in “institutional, political, administrative, economic, and financial aspects.”<sup>37</sup>

Throughout Argentine history, the principles of decentralization in the Constitution have endured various periods of suspension. For example, during the populist Peronist era, centralization increased with federal revenue collection and spending, though the provinces benefited from the expanded largesse of the federal government. In 1949, the federal government raised taxes from 1.5% to 8.0%, thus providing a substantial windfall of revenues to regional governments. In fact, Cayeros contends that Perón maintained his popularity with provincial officials by keeping the federal bargain. On the other hand, Perón harmonized many regional social and public works programs under his Five Year Plan and the total revenue share transferred to regional governments, approximately 20%, remained the same as before. Most notably, during his second administration, Perón adopted a reform that established that taxes earmarked for investment and public works with a national impact would be excluded from the total revenue pool available for the provinces, even though the money would eventually be spent on the provinces. In essence, this important reform limited the discretionary spending of provincial governments in favor of national action.<sup>38</sup> When the military coup disposed of the Peronist government, centralization further increased, especially since the hierarchical and authoritarian rule reduced the level of provincial autonomy. Hence, the series of military governments enhanced the centralization that had started to occur under the Peronist government.<sup>39</sup>

Since the ousting of military rule in 1983, Argentina has gradually increased the level of fiscal decentralization. As aforementioned, the constitution directly mandates sub-national governments to provide the majority of social expenditures and economic infrastructure, from

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<sup>37</sup> Constitution of Argentina. Government of Argentina. Accessed: April 1, 2008.

<[www.argentina.gov.ar/argentina/portal/documentos/constitucion\\_ingles.pdf](http://www.argentina.gov.ar/argentina/portal/documentos/constitucion_ingles.pdf)>

<sup>38</sup> Cayeros, Alberto. *Federalism, Fiscal Authority, and Centralization in Latin America*. Cambridge University Press, 2006.

<sup>39</sup> Gustafson, Lowell. “Factionalism, Centralism, and Federalism in Argentina” *Publius*, Vol. 20, No. 3. Summer 1990. pp. 163-176

education, health services, and welfare systems to roads, ports, and the management of natural resources. Nevertheless, the national government plays an important regulatory role in overseeing the programs and preserving a baseline of quality, often in the form of supplementing the poorest programs. As a consequence of constitutional structure, Argentina has one of the most decentralized public sectors in Latin America, in which sub-national governments account for nearly 50% of total consolidated public sector expenditures and more than two-thirds of public sector expenditures, excluding pensions.<sup>40</sup>

Argentina	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
GDP growth (annual %)	3.7	2.1	(0.1)	(1.4)	6.8	2.3	2.8
GDP per capita (constant 2000 US\$)	6,905.3	7,053.1	6,921.9	6,303.9	6,665.1	7,746.6	7,518.6
GINI Index	NA	NA	NA	44.5	45.4	49.2	52.1
Household final consumption expenditure (per capita)	7,400.9	7,222.3	NA	NA	8,353.4	8,781.6	8,197.8
Immunization, DPT (% of children ages 12-23 months)	NA	NA	52.6	73	82.2	82.2	84.5
Improved sanitation facilities (% of pop with access)	NA	NA	NA	NA	81	86	90
Improved sanitation facilities, rural (% of rural pop with access)	NA	NA	NA	NA	45	59	78.5
Life expectancy at birth, total (years)	67.1	68.7	69.9	70.9	71.9	73.0	74.3
Poverty headcount ratio at \$2 a day (PPP) (% of population)	NA	NA	NA	2.0	5.8	10.1	18.2
Urban population (% of total)	79.74	81.76	83.74	85.8	87.48	88.6	89.7
Freedom House - Political Rights	4	4.4	4	1.8	1.4	2.2	2.1
Freedom House - Civil Rights	2.5	4.8	3.6	1.4	3	3	2.3
Transparency International - Corruption Perceptions Index	NA	NA	4.94	5.91	3.055	2.96	2.9
Heritage Foundation - Index of Economic Freedom	NA	NA	NA	NA	NA	71.5	61.2

Source: World Bank Development Indicators, Freedom House, Transparency International, Heritage Foundation

As Table 3 illustrates, Argentina has endured a volatile economic history. In the 1990s, Argentina's GDP grew tremendously at an average rate of 6.8% between 1990 and 1994. By the late 1990s, however, inflexible economic policies and a failure to adopt essential structural reforms left the country vulnerable to external shocks.<sup>41</sup> In order to combat inflation, Argentina had adopted a fixed exchange rate regime, simultaneously liberalizing markets. Nevertheless, government debt continued to escalate as social expenditures increased and as the government adopted an import-substitution policy to promote industrialization. In 2001 and 2002, currency speculation and massive withdrawals of capital drove Argentina to near economic collapse, in which GDP registered a negative growth rate of 4.4% and 10.9% respectively. Coupled with skyrocketing inflation and an erosion of currency value, the government declared bankruptcy on foreign debt. Since 2003, however, Argentina has largely recovered as consumer and investor confidence slowly improved.<sup>42</sup> As a consequence,

<sup>40</sup> Tommasi, Saiegh, Sanguinetti. "Fiscal Federalism in Argentina: Policies, Politics, and Institutional Reform." *Economía, Journal of the LACEA*. Spring 2001.

<sup>41</sup> "Argentina: Economic Overview." *Country Watch*. 2007.

<sup>42</sup> *Ibid.*

Argentina has experienced strong growth, though controlling inflation and instituting structural reforms remain a challenge. Similar to Brazil, Argentina's rights performance has improved substantially with the abdication of the military regime in 1983 and the restoration of democratic accountability.

### ***Implications***

Similar to Brazil, returning to the federal constitution of 1853 after a long period of military rule represented a conscious effort to diffuse power through a federal arrangement. Political decentralization not only enhanced the power of regional governors, but gave individuals additional voice and representation through increased independence from the central government.<sup>43</sup> Consequently, political rights steadily improved as individuals and various civil society organizations, such as neighborhood associations and human rights organizations, increased their public presence, demanding changes that the central governments sometimes did not approve. Likewise, fiscal and administrative federalism increased citizens' access to basic needs, especially since decentralization of important social welfare programs improved overall access. As empirical support, Habibi, et al. conducted a study on the social impact of decentralization, in which two indicators of health and education were regressed on two decentralization measures in Argentine provinces from 1970-1994. The study concluded that decentralization positively influences the effectiveness of public policy directed towards an improvement in the level of human development. According to the authors, decentralization reduced intra-regional disparities and increased on aggregate the level of human development in the areas of health and education.<sup>44</sup> Hence, administrative and fiscal federalism has contributed to improved social performance in Argentina.

Comparing the Menem presidency of the early 1990s to earlier administrations reveals insights about the impact of federalism and decentralization on economic performance. Although Menem's government spurred a series of reforms that strengthened the level of responsibility of regional governments, such as introducing the Decentralization Bill of 1991 to decentralize education, the administration centralized authority of tax revenues as a means to

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<sup>43</sup> Maki, Andrew. "Decentralization and Political Participation: Argentina and Chile in Comparative Perspective." Connecticut College, 2006

<sup>44</sup> Habibi, Huang, Miranda, Murillo, Ranis, Sarkar, Stewart. "Decentralization in Argentina." Economic Growth Center Working Paper, Yale University, 2001.

maintain a stable, liberal agenda at the national level.<sup>45</sup> Unlike his presidential predecessors, Menem managed to evade the constraints of the 1987 Co-Participation law, which would have forced a level of revenue decentralization. Various experts argue that without control over provincial revenues, Menem would not have the capacity to implement neoliberal reforms such as privatization, tariff liberalization, and deregulation. Increasing central authority in the economy, however, has yielded mixed results. In the short-term, Menem's administration reduced inflation through a pegged exchange rate, restored foreign investor confidence, and reined in rampant macroeconomic issues that earlier administrations had struggled with.<sup>46</sup> Despite Argentina's strong growth in the 1990s and seeming improvement in various macroeconomic indicators in the short-term, the country bordered on the verge of economic collapse in 2001-2003, since greater decentralization did not lead to fundamental improvements in macroeconomic responsibility and spending restraint. By 2000, an estimated 40% of Argentina's population lived below the official poverty line despite the country's earlier wealth.<sup>47</sup>

When comparing Argentina to Brazil, the other large federal republic in Latin America, it appears that decentralization and federalism in both countries contributed to strengthening democratic institutions, improving political and civil rights, and increasing access to public goods. Economic results, however, illustrate mixed conclusions. Initially, federalism and decentralization impeded macroeconomic stability in Brazil, especially since sub-national actors often enacted policies without appropriate fiscal constraint and Congress blocked important macroeconomic reforms introduced by the executive branch. Effective political bargaining under Cardoso's regime, however, revealed that important economic reforms could be enacted under a federal governance structure if party alignment occurs. In some sense, "centralizing" congruency between officials at different tiers and branches of government proved essential. In contrast, in Argentina, although centralization of tax revenues and fiscal power in the central government led to initial macroeconomic improvement in comparison to earlier administrations that had a greater level of fiscal decentralization, the results were short-lived as neoliberal reforms failed to deliver sustained benefits.

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<sup>45</sup> Eaton, Kent. "Decentralization, Democratization and Liberalization: The History of Revenue Sharing in Argentina, 1934-1999." *Journal of Latin America*. Vol 33, 1-28

<sup>46</sup> Nash, Nathaniel. "Argentine President Clears Hurdle to Second Term." *New York Times*. 16 November 1993.

<sup>47</sup> "Overcoming Human Poverty." UNDP. <[http://hdr.undp.org/en/media/assignment\\_poverty.pdf](http://hdr.undp.org/en/media/assignment_poverty.pdf)>

### **Case #1: Venezuela (Federal / Democracy but low provincial revenue assignment)**

Comprised of 22 states, one federal district, and 72 island dependencies, Venezuela has a long history of federal traditions. On December 21, 1811, the General Congress of Venezuela adopted the first Constitution of an independent Latin American state. Modeling the federalist principles of the US Constitution, Venezuela created seven colonial provinces, all of which had never previously been under one governing body before.<sup>48</sup> Enabling the union of independent states, the Constitution contained the precepts of federalism: the predominance of state sovereignty and republicanism, supremacy of the Constitution as a representation of the will of the people, separation of powers, territorial distribution of power, and declaration of citizens' and states' rights.<sup>49</sup>

Nevertheless, federalist principles came under challenge when a series of civil wars resulted in the dissolution of the First Republic in 1812. In fact, Simón Bolívar – the Liberator of South America – attributed the failure of the Venezuelan republic to federalism. To promote solidarity, Bolívar introduced centralism, evidenced in the constitutional reorganization of Venezuela in 1819 and in its disappearance and integration into the Republic of Colombia in 1821.<sup>50</sup> By the first half of the 20<sup>th</sup> century, consolidation of the National State by autocratic regimes reinforced centralizing tendencies, almost provoking the disappearance of territorial distribution of power and autonomy.<sup>51</sup>

Similar to the evolution of other Latin American countries, democratization in the latter half of the 20<sup>th</sup> century accompanied a return to federalist principles. In response to the *Punto Fijo* of 1958, an agreement of the three principal political parties to guarantee the consolidation of Venezuelan democracy, the 1961 constitution re-established political federalism. Although provinces gained greater voice, the president retained the prerogative to appoint state governors personally, reflecting the parties' belief that national democratic consolidation needed to precede democratic transition at the provincial level. Although the Senate guaranteed equal territorial representation to the states with additional party provisions, the constitution did not assign important fiscal and administrative responsibilities to

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<sup>48</sup> Brewer-Carías, Allan. "Problems of the Centralized Federation and Sub-national Constitutionalism in Venezuela." Center for State Constitutional Studies. March 2004.

<sup>49</sup> "Venezuela." *Handbook of Federal Countries*. Forum of Federations, 2002.

<sup>50</sup> *Ibid.*

<sup>51</sup> Brewer-Carías, Allan. "Problems of the Centralized Federation and Sub-national Constitutionalism in Venezuela." Center for State Constitutional Studies. March 2004.

the states. With limited ability to raise revenue through taxes or sustain administrative responsibilities, the state governments depended on national governments for support. Nonetheless, the constitution assigned each state fiscal resources by an automatic budget allocation equivalent to at least 15% of the nation's income, of which 30% was assigned equally and the remaining 70% was based on population.<sup>52</sup>

By the late 1980s, however, increasing competition and electoral opportunities at the sub-national level and the re-election of governors and mayors profoundly transformed the political system. As political decentralization advanced, politicians began building their careers in municipalities and state government, rising from the sub-national to the national level. To gain support from political parties, successful politicians needed to demonstrate administrative and political success at the sub-national level, incentivizing a greater importance to local politics and support of regional initiatives. By 1991, the transformation of the political system empowered regional actors to call for the expansion of fiscal decentralization. Taking advantage of the changing environment, governors and mayors collectively organized in 1989 to pressure Congress to transform the structure of revenues at the regional and local levels.<sup>53</sup>

In December 1999, a new constitution replaced the 1961 Constitution, primarily promoted by current president Hugo Chávez. As the first constitution approved by popular referendum in Venezuelan history, the Constitution significantly changed the structure of Venezuelan government and enshrined a series of basic rights claims of the people, including free education and health care, environmental stewardship, and protection of the rights of minorities to uphold their own cultures. With 350 articles, the Constitution comprehensively addresses a series of complex social and political issues. Article 4 of the Constitution declares, "The Bolivarian Republic of Venezuela is a decentralized Federal State on the terms set forth in this Constitution, governed by the principles of territorial integrity, cooperation, solidarity, attendance and shared responsibility." In addition, Article 136 asserts that "Public Power is distributed among Municipal Power, that of the States Power and National Power. National Public Power is divided into Legislative, Executive, Judicial, Citizen and Electoral. Each of the

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<sup>52</sup> Penfold-Becerra, Michael. "Federalism and Institutional Change in Venezuela." *Federalism and Democracy in Latin America*. Johns Hopkins University Press, 2004.

<sup>53</sup> *Ibid.*



branches of Public Power has its own functions, but the organs charged with exercising the same shall cooperate with one another in attaining the ends of the State.”<sup>54</sup>

In practice, however, the Venezuelan federation remains relatively centralized, in which states have a rather minimal role in developing public policies. Despite the principles of federalism in the 1999 constitution, the 1999 constitution reflects a much greater degree of centralization than that of the 1961 constitution, especially in fiscal policy. In regards to taxation, the Constitution reserves the power of taxation to the federal government only – state and local governments have providence only over official stationary and stamps. Article 167 articulates that states can collect taxes only when the National Assembly expressly transfers the power of a specific form of taxation by law, which has not yet occurred.<sup>55</sup> Under the current National Budget law, states claim a minimum of 15% to a maximum of 20% of total national income. To supplement income, states with hydrocarbon reserves can claim additional economic privileges or make additional claims from national funds, such as the Intergovernmental Fund for Decentralization or the Interstate Compensation Fund.<sup>56</sup>

In addition, the 1991 constitution fails to enumerate substantive competencies and responsibilities of the sub-national governments in important matters of social and economic policy. By eliminating the Senate, Venezuela has adopted a federal government in name, but without a federal chamber in which states have equal representation. In addition, the constitution explicitly asserts that delegates to the National Assembly ought to represent their own principles and conscience about the greater national good, above the mandates and instructions of their representative state.

According to Diaz-Cayeros, Venezuela is the most centralized of the Latin American federations, of which the centralized fiscal bargain involves the abdication by the states of all tax authority and the virtual abandonment of federalism. Coupled with lack of strong state representation and power, the federal government could eschew promised transfers to states. Especially since the federal government controls oil revenue, the state maintains strong

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<sup>54</sup> “Constitution of the Bolivarian Republic of Venezuela.” Australia Venezuela Solidarity Network. Accessed: April 10, 2008. <<http://www.venezuelasolidarity.org/?q=node/53>>

<sup>55</sup> Penfold-Becerra, Michael. “Federalism and Institutional Change in Venezuela.” Federalism and Democracy in Latin America. Johns Hopkins University Press, 2004.

<sup>56</sup> “Venezuela.” Handbook of Federal Countries. Forum of Federations, 2002.

discretion in fund allocation, which has bred redistributive allocation policies to small states at the expense of larger, more productive regions.<sup>57</sup>

Venezuela	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
GDP growth (annual %)	3.9	4.0	(1.8)	1.5	4.0	0.9	4.2
GDP per capita (constant 2000 US\$)	6,172.0	6,344.4	5,339.2	4,929.1	5,131.9	5,041.8	4,727.4
GINI Index	NA	NA	55.8	48.8	41.7	49.2	46.1
Household final consumption expenditure (per capita)	1,801.8	2,729.3	3,003.9	2,757.9	2,797.1	2,527.9	2,611.4
Immunization, DPT (% of children ages 12-23 months)	NA	NA	50.8	55.4	64.8	60	75.5
Improved sanitation facilities (% of pop with access)	NA	NA	NA	NA	NA	68	68
Improved sanitation facilities, rural (% of rural pop with access)	NA	NA	NA	NA	NA	48	48
Life expectancy at birth, total (years)	65.6	67.7	68.6	70.2	71.7	72.5	73.7
Poverty headcount ratio at \$2 a day (PPP) (% of population)	NA	NA	8.9	6.6	5.1	15.1	14.8
Urban population (% of total)	73.28	77.24	80.4	82.74	85.56	89.18	92.5
Freedom House - Political Rights	2	1.4	1	1	1.8	2.4	3.3
Freedom House - Civil Rights	2	2	2	2.2	3	3.2	4.3
Transparency International - Corruption Perceptions Index	NA	NA	3.19	2.5	2.5425	2.54	2.2
Heritage Foundation - Index of Economic Freedom	NA	NA	NA	NA	NA	55.5	52.3

Source: World Bank Development Indicators, Freedom House, Transparency International, Heritage Foundation

Table 4 illustrates some clear economic and social indicators for Venezuela. Dependent on hydrocarbon sales, which account for approximately 80% of total exports and half of the national government’s revenue, Venezuela’s economy remains subject to cycles of boom and bust.<sup>58</sup> Since GDP growth and investment correlate strongly with world oil prices, Venezuela faces the significant challenges of economic diversification, controlling inflation in times of high oil prices, and providing sustainable long-term growth. Most recently, real GDP grew by 10.3% in 2005-2006 and 8.0% in 2007, reflecting the benefits of the fiscal windfall driven by high oil prices, which in turn have fed private consumption and fixed investment.<sup>59</sup>

Given the recent administration, democratic accountability has weakened, as evidenced in the Freedom House indicators. Hugo Chavez has pushed for various reforms that significantly concentrate power in the executive branch, while limiting decentralization and representation of sub-national governments. Late 2007, Chavez announced his intent to amend the 1999 constitution with proposals such as: abolition of term limits for president, redefinition of private poverty, removal of the autonomy of the Central Bank of Venezuela, and introduction of “communal councils” at the local government level.<sup>60</sup> The public, however, handed Chavez a

<sup>57</sup> Diaz Cayeros, Alberto. *Federalism, Fiscal Authority, and Centralization in Latin America*. Cambridge University Press, 2006.

<sup>58</sup> Alvarez, Cesar. “Venezuela’s Oil-Based Economy” *Council on Foreign Relations*. <<http://www.cfr.org/publication/12089/>> November 2006.

<sup>59</sup> “Economic Performance: Venezuela.” Country Profile 2008: Venezuela. The Economist, 2008.

<sup>60</sup> “Constitutions, institutions, and administration.” Country Profile 2008: Venezuela. The Economist, 2008.

defeat in December 2007 by a close margin of 2%. Nevertheless, various institutions of the 1999 Constitution have been weakened with the concentration of power in the executive branch, especially in the judicial system. Bypassing important checks and balances, the Chavez administration dissolved the First Administrative Court, which handles cases brought by citizens against the state. The administration has also expanded the size of the Supreme Court and reduced the barriers of judicial appointment.

### ***Implications***

Unlike the other Latin American countries in this case study, Venezuela has slowly increased the level of centralization, moving away from its long federal traditions – most notably in the recent Chavez administration. Testifying to the constant tension between centralization and decentralization in a federal democracy, the case of Venezuela illustrates the difficulty of categorizing the government structure across various institutional dimensions. Although the 1999 Constitution declares Venezuela a federation, in practice, the government has progressively centralized revenues and reduced representation and responsibilities of the sub-national governments in social and economic policy.

As Table 4 of key social and economic indicators reveal, political and civil rights have eroded over time. Unlike the other Latin American countries in this study, Venezuela did not go through a military dictatorship – the country had remained a democracy in the 1970s, when most Latin American countries fell under military rule. 1958 marked the arrival of full democracy in Venezuela, with the overthrow of Pérez Jiménez's dictatorship. Hence, Venezuela had a much more stable democracy and protection of civil and political rights in the 1980s compared to other countries. Recently, however, Hugo Chavez's regime and its acts of political suppression have reduced the overall level of democratic accountability in Venezuela.

Although the intuitive conclusion may be to associate increasing centralization and the undermining of federal institutions with deterioration in rights performance, this conclusion fails to capture important historical facts. Certainly, although Chavez's initiatives to concentrate power in the executive branch reflect simultaneous erosion in federal institutions and political rights, various experts have argued that *federalism itself caused the fragmentation of political parties that led to populist presidencies*, such as that of Chavez.

According to Penfold-Becerra, the enhanced political competition, the division between regional and national elections, the reelection of governors and mayors, and an increase in their financial autonomy through national party leaders – all characteristic aspects of federalism – contributed to the fragmentation of the party system and to the personalization of the vote. With intensified political competition that federalism provides, governors and mayors took advantage of windows of opportunity to enhance their own political power and weaken the power of party leaders. Certainly, many of the national politicians who at first supported direct election of governors and mayors in 1989 – an important federal reform – did not envisage the emergence of a new political system that would undermine the traditional power structure of party politics. Nevertheless, as accountability, transparency, and political competition increased, personalization of the vote undermined entrenched powers. Taking advantage of the power vacuum, political outsiders, such as Chavez, gained access to regional and local offices, as well as to the presidency and the national legislature.<sup>61</sup> Coupled with the concentration of fiscal power at the central authority, such populist leaders have great latitude to enact policies that potentially undermine democratic rule, especially given the dependence of state governments on federal revenues and the high level of discretionary fiscal power.<sup>62</sup>

Hence, federalism has a rather ambiguous effect on democratic accountability and rights performance in Venezuela. Although the current weakening of federal institutions under the Chavez regime has decreased rights performance, federalism itself had contributed to a new political context that facilitated the rise of such populist leaders. Nevertheless, despite Chavez's success in increasing presidential power, he remains unable to undermine the full federal system. Despite the elimination of the senate, direct election of governors in 23 states and mayors in more than 300 hundred municipalities check his overall level of power and counterbalance presidential privilege in the executive branch. In some sense, the defeat of Chavez's constitutional amendments in December 2007 reflects the activation of the federal system and democracy.<sup>63</sup> Regardless, federalism's dynamic in Venezuela reveals the complex nature of the effects of increased political competition on democratic accountability and rights performance.

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<sup>61</sup> Penfold-Becerra, Michael. "Federalism and Institutional Change in Venezuela." *Federalism and Democracy in Latin America*. Johns Hopkins University Press, 2004.

<sup>62</sup> Diaz Cayeros, Alberto. *Federalism, Fiscal Authority, and Centralization in Latin America*. Cambridge University Press, 2006.

<sup>63</sup> Penfold-Becerra, Michael. "Federalism and Institutional Change in Venezuela." *Federalism and Democracy in Latin America*. Johns Hopkins University Press, 2004.

## **Case #2: Uruguay (Administrative Federal / Democracy)**

As a presidential representative republic, Uruguay is a unitary government with a high level of fiscal decentralization. As a small country of three million people – with approximately half living in the capital city of Montevideo – sub-national governments traditionally lacked significant economic or social roles. Nevertheless, according to an Inter-American Bank study, when placed into comparative perspective, Uruguay ranks highest in Latin America in terms of proportion of public expenditure managed by sub-national governments. In addition, despite its unitary structure, the Uruguayan government provides for one of the greatest participation in sub-national governments in total public expenditure. Although falling behind the large federalist states of Argentina, Brazil, and Mexico, Uruguay's sub-national governments proportionally spend more than all other countries of Latin America, with exception of Bolivia of Colombia.<sup>64</sup> In fact, in 1996, Uruguay ranked sixth in Latin America in its decentralization effort. Moreover, despite a unitary constitution and traditions, Uruguay ranked first in Latin America with regard to political autonomy and participation at the sub-national level.<sup>65</sup>

In regards to territorial distribution, Uruguay consists of nineteen departments, governed by municipal officials with terms of five years. The members of the Departmental assembly form the legislative body of each department. The most recent 1967 constitution and its associated reforms establish a presidential representative democratic republic, guarantee a bicameral legislature with representation from the departments, and explicitly assert a unitary form of government.<sup>66</sup> In addition, the structure of the Senate limits provincial representation, especially since elected officials must follow party discipline in voting matters rather than local priorities. Section 16 of the Constitution explicitly outlines the structure of the departmental governments. In particular, Articles 273 and 275 enumerate the main responsibilities of the Departmental assembly and the intendente (official), which include: enacting the laws of the government and Constitution, managing provincial budgets, defining taxes and price controls, and creating local policies and projects.<sup>67</sup>

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<sup>64</sup> Filgueira, Kamil, Lorenzo, Moraes, Rius. "Decentralization and Fiscal Discipline in Sub-national Governments: The Bailout Problem in Uruguay" Inter-American Development Bank. May 2002.

<sup>65</sup> "Latin America after a Decade of Reforms. Economic and Social Progress Report" Inter-American Development Bank. John Hopkins University Press, 1997.

<sup>66</sup> "Government of Uruguay." Library of Congress. <<http://countrystudies.us/uruguay/61.htm>>

<sup>67</sup> "1967 Constitution of Uruguay and its Associated Reforms." Political Database of the Americas. <<http://pdba.georgetown.edu/Constitutions/Uruguay/uruguay04.html>>

Despite a long unitary tradition, decentralization in Uruguay has been largely driven from a top-down approach. Over the past two decades, sub-national political offices have risen in responsibility, power, and appeal. Similar to the situation in Chile, however, decentralization occurred as a result of a national-level political game, in which national politicians decided to devolve responsibilities to the departments. Unlike the situation in Argentina and Brazil, in which sub-national actors played an important role in pushing decentralization, sub-national officials remained relatively passive in Uruguay throughout the process of decentralization.<sup>68</sup> Both expenditures and resources available to sub-national governments have increased relative to the central government, measured as a percentage of GDP and a percentage of total government expenditures, while the Constitutional reform of 1996 introduced additional measures to transform the role of departmental governments. As an example of further decentralization at the local level, in Montevideo, the Departmental assembly passed a decree in 1993 to create a decentralized municipal and administrative structure through Zonal Community Centers. Aspiring towards social, political, and administrative decentralization, the initiative established direct participation of the people in local government, transferred decision-making to district bodies, and devolved the administrative organizational structure.<sup>69</sup>

According to an Inter-American Development Bank study, these trends have fostered an extremely competitive political environment at the sub-national level, in which local politics play a key role in electoral politics and party strategies. As a result, the influence and power of local political elites on their parties and on the entire political system has significantly risen. Coupled with increasing fiscal responsibilities for providing public goods and services, the current trend towards decentralization has resulted in some issues of fiscal indiscipline.<sup>70</sup>

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<sup>68</sup> Eaton, Kent. Politics Beyond the Capital: The Design of Sub-National Institutions in South America. Stanford University Press, 2004.

<sup>69</sup> Chavez, "Daniel. Decentralization and Participatory Urban Management in Montevideo" Transnational Institute, 2005.

<sup>70</sup> Filgueira, Kamil, Lorenzo, Moraes, Rius. "Decentralization and Fiscal Discipline in Sub-national Governments: The Bailout Problem in Uruguay" Inter-American Development Bank. May 2002.

Table 5. Key Social and Economic Indicators of Uruguay (1970-2006)

Uruguay	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
GDP growth (annual %)	0.8	4.6	(2.8)	4.2	4.3	2.2	1.7
GDP per capita (constant 2000 US\$)	4,045.9	4,641.0	4,767.1	4,715.4	5,388.3	6,234.8	6,120.5
GINI Index	NA	NA	43.7	42.3	NA	44.5	44.7
Household final consumption expenditure (per capita)	3,085.3	3,057.5	3,041.7	3,058.9	3,650.6	4,513.7	4,345.5
Immunization, DPT (% of children ages 12-23 months)	NA	NA	62.4	77.6	93.8	91.6	93.5
Improved sanitation facilities (% of pop with access)	NA	NA	NA	NA	100	100	100
Improved sanitation facilities, rural (% of rural pop with access)	NA	NA	NA	NA	99	99	99
Life expectancy at birth, total (years)	68.8	69.6	70.7	71.9	72.8	73.7	75.0
Poverty headcount ratio at \$2 a day (PPP) (% of population)	NA	NA	3.7	2.7	NA	4.6	4.8
Urban population (% of total)	82.8	84.2	86.12	87.92	89.6	90.82	91.7
Freedom House - Political Rights	4	5.6	5.2	1.8	1.2	1.4	1.0
Freedom House - Civil Rights	4.5	5.6	4.6	2	2	2	1.0
Transparency International - Corruption Perceptions Index	NA	NA	NA	NA	3.21	4.38	6.3
Heritage Foundation - Index of Economic Freedom	NA	NA	NA	NA	NA	66.2	68.8

Source: World Bank Development Indicators, Freedom House, Transparency International, Heritage Foundation

Table 5 presents some key economic and social indicators in Uruguay. Dependent on agricultural and livestock exports and economic linkages to its larger Latin American trade partners, notably Argentina and Brazil, Uruguay’s economy remains vulnerable to adverse external shocks. As shown in Table 5, from 1999-2002, Uruguay suffered a severe recession as a result of spillover of the currency crisis in Argentina and serious debt sustainability problems. Since the crisis, Uruguay’s economy has recovered with a favorable external environment, the adoption of structural reforms to improve macroeconomic stability, and the implementation of various initiatives to restore market confidence and strengthen the financial system. Coupled with strong export growth performance, GDP grew 6.6% and 4.0% in 2006 and 2005, respectively. Nevertheless, due to Uruguay’s excessive dependency on agricultural exports and its regional trade partners, the underlying roots of economic vulnerability still persist.<sup>71</sup>

Uruguay’s rights performance has improved substantially – a result of democratization after the ending of military rule. In particular, the leftist Frente Amplio (Broad Front) achieved prominence, creating a movement to engage civil society to create a democratic and socially equitable regime. Since its foundation in 1971, the Frente Amplio had campaigned against authoritarian rule, garnering broad support from leftist coalitions. When the Frente Amplio assumed control of municipal government in Montevideo, the party implemented a series of important movements and initiatives that supported decentralization and the institutionalization of democracy. Most predominantly, the Frente Amplio reorganized municipal administration in order to increase social and political accountability, prioritized

<sup>71</sup> “Economic Overview: Uruguay.” Country Watch, 2008.

social investment and equitable access to urban public goods, and advocated decentralization as a natural response to neoliberalism.<sup>72</sup>

### ***Implications***

Similar to other Latin American countries, a military government ruled Uruguay until the early 1980s, when a plan announced the return to civilian rule. Since the first national elections in 1984, Uruguay has implemented a series of significant democratic and economic reforms, as evidenced in the improvement of rights indicators in Table 5. Nevertheless, Uruguay still retained its unitary governance structure, although the intendentes and legislature of the departments gained more significant administrative responsibilities. As aforementioned, despite its unitary constitution and traditions, Uruguay ranks first in Latin America with regard to political autonomy and participation at the sub-national level. In addition, through fiscal decentralization, sub-national governments retain a significant amount of responsibility, albeit less than the large federal republics of Brazil and Argentina, but much more than the rest of Latin America. Comparing Uruguay to Brazil and Argentina reveals interesting results, especially since although all three countries have experienced a similar historical trajectory – military dictatorship, democratization, increase in administrative responsibility at the sub-national level through fiscal federalism – Uruguay retains its unitary structure according to the Constitution.

In regards to political and economic rights, Uruguay has achieved marked improvement, in step with Brazil and Argentina. Similar to using federalism as a mechanism to promote democratic accountability and diffuse centralized authority, Uruguay instituted elections at the municipal level and improved the institutions of direct democracy. To illustrate, in the last 15 years, citizen referendums have repealed laws and modified the constitution, from confirming amnesty to military leaders to protecting water resources and obstructing the privatization of public utilities.<sup>73</sup> In fact, despite the Constitution's declaration of unitary governance, the government of Uruguay reflects a high degree of political and fiscal decentralization (at the departmental and municipal levels), similar to that of federal republics. In essence, Uruguay's governance structure closely parallels that of federal democracies.

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<sup>72</sup> Chavez, "Daniel. Decentralization and Participatory Urban Management in Montevideo" Transnational Institute, 2005.

<sup>73</sup> Valente, Marcela. "Latin America: Direct Democracy – Progress and Pitfalls." IPS, 16 May 2007. <<http://ipsnews.net/news.asp?idnews=36967>>. Altman, David. "Direct Democracy in Latin America." Centro de Investigación Sobre Democracia Directa, 2006. <[http://www.dd-la.ch/download/Case04\\_Uruguay.pdf](http://www.dd-la.ch/download/Case04_Uruguay.pdf)>



The difference, however, fundamentally lies in size. As a small country, Uruguay does not need to establish a complex governance structure with various layers of bureaucracy in order to effectively mediate regional and local interests. In addition, although representatives of the national legislature have a mandate to serve the entire country rather than advocate the interests of a territory – in conflict with the principles of federalism – Uruguay’s small size makes the two objectives nearly congruent, especially since approximately half of the population resides in the capital city of Montevideo. With only two layers of government – departmental and central – Uruguay has created an effective democratic environment with significant political and fiscal autonomy at the local level. Hence, the implications suggest that diffusing power and increasing political participation at the local level does not necessarily require a federal governance structure. In short, although federalism enhanced rights protection and democratic accountability, as in the case of Argentina and Brazil, Uruguay’s unitary government accomplished the same end through alternative means.

From an economic perspective, Uruguay’s fiscal decentralization has also created issues of indiscretion by sub-national governments, as in the case of Argentina and Brazil, especially when responsibilities and resources lack clear definition. In federal countries, sub-national officials can circumvent fiscal constraints through public debt issuance both domestically and internationally. Although the sub-national authorities of unitary governments such as Uruguay do not have these channels to misbehave, an Inter-American Development report revealed that sub-national governments find other ways to finance non-compliance through accumulating debts with other government agencies and obtaining discretionary transfers from the central government.<sup>74</sup> Hence, even unitary governments face the difficulties encountered by federal governments as result of administrative decentralization. Weighing the costs of fiscal irresponsibility against the benefits of increased access to public goods at the local level, however, yields an ambiguous result. Although Filgueira, et al. claim that decentralization potentially inhibits processes of fiscal discipline, especially when sub-national governments become a last resort for clientelistic policies, administrative decentralization has improved equitable access to public goods and greater citizen participation in the definition of budgetary priorities. Hence, an important policy recommendation is that if central authorities better delineate the responsibilities of sub-national authorities and create a transparent system of

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<sup>74</sup> Filgueira, Kamil, Lorenzo, Moraes, Rius. “Decentralization and Fiscal Discipline in Sub-national Governments: The Bailout Problem in Uruguay” Inter-American Development Bank. May 2002.

inter-governmental transfers with clear rules and regulations, then countries could obtain the benefits of administrative federalism while minimizing the costs of fiscal irresponsibility.<sup>75</sup>

### ***Case #3: Mexico (Federal / Dictatorship)***

The 1917 Constitution establishes Mexico as a federal republic – Article 40 states that “it is the will of the Mexican people to organize themselves into a federal' democratic, representative Republic composed of free and sovereign States in all that concerns their internal government' but united in a Federation established according to the principles of this fundamental law.”<sup>76</sup> Nevertheless, although the Constitution declares a federal government, in practice, Mexico has been extremely centralized, both politically, and economically, until recently. Moreover, despite the guarantees of democracy and representation in the Constitution, Mexico achieved neither until the 1990s.<sup>77</sup>

Under the Constitution, the president has substantial power, with the ability to appoint important public officials in the executive, legislative, and judicial branches with limited oversight. In fact, until 1997, the president also appointed local officials in the Federal District. In addition, the central government retained substantial power in social policy. Until the 1990s when the government first began to decentralize health and education, the federal government had exclusive responsibility in key areas of policy, including commerce, education, health, labor, agriculture, energy, natural resources, and food policy. Despite the fact that the constitution reserves residual power for the states, nearly all of the provisions in the constitution limit state influence, enhancing the economic and political power of the central government. In regards to fiscal power, the federal government collects all income taxes and consumption taxes. Although states and municipalities eventually receive a share, the criteria for resource distribution remain contentious, especially since the federal government exercises a significant amount of discretion in allocation.<sup>78</sup>

As described by Acosta Romero: “ The theory of our federalism may run deeply, but the practical realities are such that the powers of the political and policy processes have become increasingly centralized in the republic's federal executive...Mexican federalism is an aspiration

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<sup>75</sup> *Ibid.*

<sup>76</sup> “1917 Constitution of Mexico.” <<http://www.ilstu.edu/class/hist263/docs/1917const.html>>

<sup>77</sup> “Mexico.” Handbook of Federal Countries. Forum of Federations, 2002.

<sup>78</sup> *Ibid.*

punctuated by the reality of an undeniable centralism which is characterized by an increasingly pervasive presidency.”<sup>79</sup>

In the past two decades, however, decentralization efforts have occurred in conjunction with the democratization movement. As a means to promote more equitable regional development and divest excessive responsibilities, the federal government transferred health and education to the state governments, increased the share of revenue available for sub-national governments, and set more transparent standards for fiscal allocation. Nevertheless, the central government retains significant control over key areas of decision making.<sup>80</sup> Regardless, increasing political pluralism and the renewal of federalism in political debate has led to a substantial effort to identify a federal arrangement which can meet developmental inequities, with particular emphasis on administrative, spatial, and economic decentralization.<sup>81</sup>

In regards to the impact of decentralization initiatives, Ochoa-Reza argues that federal features exerted important influence in the promotion of Mexico’s democratic transition. By opening new electoral spaces at the sub-national level, federalism allowed opposition parties to enter into competition with the Institutional Revolutionary Party (PRI) – thus activating the federal system. When sub-national opposition politicians gained power, they mobilized supporters to reform electoral laws to provide an essential democratic check against the dominant party. Collectively, these pressures influenced the national government to re-evaluate and re-negotiate legal and institutional measures that eventually contributed to democratic consolidation. More importantly, as federal opened up space for political contestation at lower levels of government, increasingly democratic multiparty participation across three levels of government not only promoted democracy, but began to transform the precepts of the constitution into a working federal framework.<sup>82</sup>

For the purposes of this case study, Mexico is categorized as a dictatorship under Inman’s methodology as a result of its long history of repressive, authoritarian rule. In perspective, until the election of Vicente Fox in 2000, the Institutional Revolutionary Party (PRI)

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<sup>79</sup> Rodriguez, Victoria. “Recasting Federalism in Mexico.” *Publius*. 28:1. Winter 1998.

<sup>80</sup> “Mexico.” *Handbook of Federal Countries*. Forum of Federations, 2002.

<sup>81</sup> Díaz-Cayeros, Alberto. “Decentralization, Democratization, and Federalism in Mexico” Centro de Investigación para el Desarrollo, 2004.

<sup>82</sup> Ochoa-Reza, Enrique. “Federalism and Mexico’s Transition to Democracy.” *Federalism and Democracy in Latin America*. John Hopkins University Press, 2004.

had controlled the presidency for 71 years.<sup>83</sup> After the fall of dictatorship of Porfirio Díaz in 1910, all revolutionary leaders united to form the modern-day equivalent of the PRI party, which ruled as a virtual one-state party until 1988, supported by massive electoral fraud and strict internal discipline. In fact, in a debate with Octavio Paz in 1990, Mario Vargas Llosa described Mexico's political system as "the perfect dictatorship".<sup>84</sup> Currently, although Mexico is still considered a "Flawed Democracy" by the most recent ranking by the Economist,<sup>85</sup> Mexico has made important progress in democratic reform,<sup>86</sup> as evidenced in the improvement in rights indicators shown below in Table 6.

Mexico	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
GDP growth (annual %)	6.4	6.4	3.4	1.2	3.9	2.9	2.9
GDP per capita (constant 2000 US\$)	3,784.0	4,375.6	5,157.1	4,813.9	5,139.8	5,288.8	6,018.6
GINI Index	NA	NA	46.3	NA	51.1	48.8	49.2
Household final consumption expenditure (per capita)	2,778.5	3,060.4	3,475.5	3,218.8	3,584.1	3,491.8	4,194.1
Immunization, DPT (% of children ages 12-23 months)	NA	NA	44	55.6	80.8	94.8	93.8
Improved sanitation facilities (% of pop with access)	NA	NA	NA	NA	58	67	77
Improved sanitation facilities, rural (% of rural pop with access)	NA	NA	NA	NA	13	25	39
Life expectancy at birth, total (years)	62.2	65.3	67.2	69.4	71.8	74.3	74.7
Poverty headcount ratio at \$2 a day (PPP) (% of population)	NA	NA	39.7	NA	22.5	27.7	18.5
Urban population (% of total)	60.52	64.2	67.62	70.76	72.86	73.92	75.5
Freedom House - Political Rights	4.5	4	3	3.8	4	3.6	2.1
Freedom House - Civil Rights	3	3.4	4	3.8	3.8	3.8	2.3
Transparency International - Corruption Perceptions Index	NA	NA	1.87	2.23	3.165	3.56	3.4
Heritage Foundation - Index of Economic Freedom	NA	NA	NA	NA	NA	59.6	63.3

Source: World Bank Development Indicators, Freedom House, Transparency International, Heritage Foundation

Table 6 contains some key economic, political, and social indicators of Mexico. In perspective, since the 1980s, the Mexican economy has undergone a profound transformation as a result of economic liberalization and the joining of the North American Free Trade Agreement in 1994. As the 12<sup>th</sup> largest economy in the world on a PPP basis, Mexico has one of the highest per-capita incomes in Latin America, and is the only Latin American country in the Organization for Economic Cooperation and Development (OECD).<sup>87</sup> Since the 1994 crisis, Mexico's macroeconomic fundamentals have improved substantially through significant policy changes and economic structural reforms, thereby producing a stronger and more stable economy. Fiscal consolidation has reduced the public debt, and credible monetary policy has

<sup>83</sup> Buchsbaum, Herbert. "A New Mexico—or still the old?" New York Times. 27 September 2002.

<sup>84</sup> Amsterdam, Robert. "A Perfect Dictatorship?" Robert Amsterdam Blog.

<[www.robertamsterdam.com/2007/02/a\\_perfect\\_dictatorship\\_1.htm](http://www.robertamsterdam.com/2007/02/a_perfect_dictatorship_1.htm)> Accessed: April 10 2008

<sup>85</sup> "The Economist Intelligence Unit's index of democracy" The World in 2007.

<[http://www.economist.com/media/pdf/DEMOCRACY\\_INDEX\\_2007\\_v3.pdf](http://www.economist.com/media/pdf/DEMOCRACY_INDEX_2007_v3.pdf)> Accessed: April 10 2008

<sup>86</sup> Preston, Dillon, Myers. *Opening Mexico: The Making of a Democracy*. Farrar, Straus and Giroux, 2004.

<sup>87</sup> "GNI Per Capita, 2006" World Bank Development Indicators, 2007.

lowered inflation to meet the central bank target of 3.0%. Hence, from 1995 to 2006, GDP growth averaged 3.6% per year.<sup>88</sup> Buoyed by exports and strong investment, GDP growth peaked at 4.8% in 2006, though labor productivity comprised a very small percentage.<sup>89</sup> As an export-oriented economy, Mexico has a highly open economy, with exports accounting for approximately 31.9% of total GDP in 2006.

### ***Implications***

As described by Romero, Mexico attests to a clear situation in which the principles established in the Constitution did not translate to political reality. As a result, classifying countries as federal versus unitary requires much greater attention to detail than merely looking at Constitutional mandates. For example, although the Constitution creates a federal republic of free and sovereign states, sub-national governments had very minimal power in economic and social policy until relatively recently. Reflected in PRI dominance, the president exercised substantial powers that limited the oversight and influence of other governmental branches. In addition, sub-national governments faced significant resource constraints, and the central government's tax sharing policies reflected a degree of discretion that bred clientelism and the entrenchment of existing power structures.

Fundamentally, however, Mexico's example illustrates how federal institutions positively influence democratization – a fundamental element of rights performance. Similar to Brazil and Argentina, Mexico's strengthening of federal institutions opened up new electoral spaces that promoted political party competition that eventually led to reform and democratization. In addition, the federal structure provided an important institutional check against existent power structures. Ochoa-Reza further confirms that federal reforms played an essential role in democratic consolidation, especially since from a historical perspective, the various decentralization reforms of 1986, 1991, and 1993 simultaneously strengthened the federal system while improving democratic accountability.<sup>90</sup>

In direct contrast to Venezuela and Brazil, however, in which federalism resulted in the fragmentation of political society into multiple regional parties – a common anticipation in federal systems – regional actors in Mexico participated within polity-wide parties, thus

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<sup>88</sup> "Economic Survey of Mexico" OECD, 2007

<sup>89</sup> World Development Indicators, 2007

<sup>90</sup> Ochoa-Reza, Enrique. "Federalism and Mexico's Transition to Democracy." Federalism and Democracy in Latin America. John Hopkins University Press, 2004.

strengthening a unified coalition against the PRI. In fact, federalism played an essential role in improving electoral transparency and facilitating the presidential transition from the PRI party to the “Alliance for Change” candidate Vicente Fox in 2000 – a coalition formed by the National Action Party (PAN) and the Ecologist Green Party of Mexico (PVEM). According to Rodriguez, federal institutions not only provided a horizontal check on presidential power in Mexico through the legislature and judiciary branch, but also created a vertical cooperative framework of responsibility and mutual support among different levels of government,<sup>91</sup> all which ultimately improved political and civil rights.

In regards to federalism’s affect on social performance, federalism in Mexico has a rather ambiguous result. In general, the government has made great strides in decentralizing education expenditure, removing infrastructure construction funds from presidential discretion, and increasing revenue sharing among levels of government. In particular, funds for regional development witnessed a substantial transformation, as in the case of the Social Infrastructure Fund which evolved from discretionary allocation to allocation based on transparent poverty and public service needs.<sup>92</sup> Decentralization, however, has created many additional challenges of equity and appropriate resource allocation. For example, on a per-capita basis, education decentralization led to increasing inequity in per capita transfer of education funds among regions. Skoufi and Shapiro’s 2006 evaluation of the Mexico’s Quality Schools Program (PEC) confirmed the exacerbation of the issue of inequity. Nevertheless, repetition, dropout, and failure rates decreased overall in schools where parents and teachers jointly developed school improvement programs, excluding indigenous areas.<sup>93</sup> In theory, fiscal and administrative federalism should reduce intra-regional inequities, as in the case of Argentina, but the opposite has transpired in education in Mexico, in which increased fiscal decentralization exacerbated regional resource inequities. In perspective, however, given that central government has a monopoly over taxes and governmental revenue, sub-national actors remain dependent on the economic resources of the government, signifying that full administrative federalism has not yet occurred in Mexico. As a result, it remains difficult to draw a direct connection between the level of administrative decentralization and regional inequity in the provision of social goods.

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<sup>91</sup> Rodriguez, Victoria. “Recasting Federalism in Mexico.” *Publius*. 28:1. Winter 1998.

<sup>92</sup> Díaz-Cayeros, Alberto. “Regional Resource Allocation in Mexico.” *Federalism and Democracy in Latin America*. John Hopkins University Press, 2004.

<sup>93</sup> Winkler, Donald. “Identifying the Impact of Education Decentralization on the Quality of Education.” USAID, 2007.

In regards to the impact of federalism on economic performance, Mexico's federal reforms of the 1990s coincided with economic liberalization and profound economic transition, which generated income growth, investment, and productivity increases. The direct link between federalism and economic reform, however, remains tenuous, especially since fiscal federalism has created additional difficulties of fiscal irresponsibility at the sub-national level, similar to the cases of Argentina, Brazil, and Uruguay. Given that Mexican exports to the United States account for nearly a quarter of the country's Gross Domestic Product (GDP) and more than 80% of total exports<sup>94</sup>, however, Mexico's economy inextricably links to that of its northern neighbor. Nevertheless, in aggregate, Mexico's economic performance has improved steadily with structural reform, facilitated by greater fiscal discipline on the part of central government. Such comprehensive economic reforms, however, required unified national action, which potentially would not have occurred if Mexico had been fully decentralized politically at that time. For example, Salinas used his broad powers as a PRI president to pass NAFTA, leveraging the strong coalition of his party to pass the treaty despite popular resistance to trade liberalization, even among PRI's constituents.<sup>95</sup> Under a more federal and democratic government, however, such a contentious treaty would have encountered much more political resistance. As aforementioned, federalism can create political competition and divisiveness that limits the ability to enact major policy changes, as in the case of Brazil before the Cardoso administration. In summary, although federalism played a key role in democratization in Mexico, its effects on social and economic policy remain indeterminate.

#### ***Case #4: Chile (Unitary / Democracy)***

Since its independence in 1810, Chile has had a long unitary tradition, further strengthened under military rule. As a relatively small unitary state consisting of 15 regions, 51 provinces and approximately 346 municipalities, Chile's current institutional structure was developed under the military dictatorship of General Augusto Pinochet, who ruled the country from 1973 to 1990. The Constitution of 1990, created under Pinochet's supervision for transition back to civilian rule, explicitly states in Article 2 – "The State of Chile is unitary. Its territory is divided into regions. The law shall provide that administration thereof be functional

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<sup>94</sup> "Background Note: Mexico." US Department of State. February 2007.

<sup>95</sup> Thacker, Strom. "NAFTA coalitions and the political viability of neoliberalism in Mexico" *Journal of Inter-American Studies and World Affairs*. Summer 1999.

and territorially decentralized.”<sup>96</sup> Nevertheless, municipalities and regional governments have specific responsibilities and powers in the administering, delivering social services, and investing in infrastructure.

From a historical perspective, under Pinochet’s regime, strict military authority and an ideological desire to reduce the involvement of the state in the economy created an odd combination of central control at the national level and decentralization at the municipal level.<sup>97</sup> Pinochet established a military hierarchy of government, in which governors headed provinces and mayors oversaw municipalities. Directly named by the President and loyal to the central government before their own territories, appointed sub-national officials ensured the influence of the national government at all levels. In attempting to improve efficiency in the provision of public goods to parallel the private market, however, Pinochet streamlined government and devolved a significant level of administrative responsibility to the municipalities. Acting like ‘service delivery agents’, municipal governments provided local public service on a cost-effective basis, without having local governing power. As a result, decentralization extended Pinochet’s hierarchical control, consistent with his political and macroeconomic objectives.<sup>98</sup>

From a historical perspective, Chile’s transition to democracy only occurred relatively recently, when a Constitution establishing a transition itinerary was approved in 1980. Despite significant political repression and human rights atrocities, Pinochet instituted a series of important economic reforms. Coined by Milton Friedman as the “Miracle of Chile”, Pinochet liberalized the economy, privatized state-owned enterprises, stabilized inflation, and encouraged foreign investment. Labor discipline imposed through repression of unions, liberalization of prices, exchange rate devaluation, increased investment in public works, and high copper prices spurred GDP growth and investment.<sup>99</sup> Unsurprisingly, Chile’s free-market experience has been celebrated as a testament to the success of the neoliberal developmental paradigm – used as a model for many other countries. Even after the end of the Pinochet regime, democratic leaders continued the neoliberal economic reform initiated by the military government.

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<sup>96</sup> “Constitution of Chile: Official Translation.” <<http://confinder.richmond.edu/admin/docs/Chile.pdf>> Accessed: April 12, 2008

<sup>97</sup> Stewart, Ranis. “Decentralization in Chile.” <[http://hdr.undp.org/docs/publications/ocational\\_papers/oc14.htm](http://hdr.undp.org/docs/publications/ocational_papers/oc14.htm)>

<sup>98</sup> *Ibid.*

<sup>99</sup> Ffrench-Davis, Ricardo. Economic reforms in Chile: From Dictatorship to Democracy. University of Michigan Press, 2002.



Nevertheless, despite success in controlling inflation and stabilizing the economy, the free market reforms led to a widening income gap, increased poverty, and unemployment. Many critics challenge the basis of the “Miracle of Chile”, arguing that the celebrated economic growth must be viewed in light of the catastrophic recessions of 1975 and 1982, that poverty widened dramatically as the percentage of those living in extreme poverty doubled from 1970 to 1990, foreign debt skyrocketed, that environmental standards decreased, and that many important export gains can be explained away by fortuitous factors in the greater global economy.<sup>100</sup>

Recently, Chile has made decentralization a priority. While maintaining fiscal restraint and strict macroeconomic accountability, Chile’s decentralization initiatives have focused on building institutions, developing processes, and creating the right incentives to flow from processes and institutions. Rather than wide-open devolution of resources and competencies, Chile has favored selective and sectoral decentralization, most notably in health and education.<sup>101</sup> In addition, Wiesner argues that unlike the decentralization initiatives of other Latin American countries, Chilean decentralization has achieved greater progress as a result of the application of tight fiscal and budget constraints, combined with incentives to enhance the efficiency of overall public and private resource allocation. Although transfers from national to the sub-national level comprise approximately 0.7% of GDP, experts caution that simply larger transfers do not indicate that real and effective decentralization has occurred. In fact, under Chile’s unique system of intra-municipal transfers, wealthy provinces have transferred up to 41% of their municipal-level tax revenues.<sup>102</sup>

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<sup>100</sup> Collins, Lear. Chile's Free Market Miracle: A Second Look. Food First Books, 1995.

<sup>101</sup> Wiesner, Eduardo. Fiscal Federalism in Latin America: From Entitlements to Markets. Inter-American Development Bank, 2003.

<sup>102</sup> *Ibid.*

Table 7. Intergovernmental Shares of Total Expenditures (Net of Transfers, % of Total)

Chile - Intergovernmental Expenditure Shares	1990	1995	2000
National	91.4	90.4	89.6
Regional	1.1	1.4	1.5
Municipal	7.5	8.2	8.9
Total	100	100	100

Chile - Tax Revenues by Level of Government	1990	1995	2000
National	92.8	92.6	91.4
Municipal	7.2	7.4	8.6
Total	100	100	100

Source: Wiesner, 2003; Ministry of Finance Budget Office

Hence, despite centrist tendencies and low central government transfers to sub-national actors, Chile has embarked on a significant process of decentralization, albeit different from the typical model in Latin America given its strict fiscal discipline. As shown above in Table 7, the share of expenditures concentrated at the regional and municipal levels has grown modestly along with tax revenues raised at the municipal level, though the rising trend towards municipalization should also be viewed in light of increasing incentive-intensive sectoral decentralization and greater sub-national policy influence.

Table 8. Key Social and Economic Indicators of Chile (1970-2006)

Chile	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
GDP growth (annual %)	1.6	3.4	1.3	7.4	7.3	5.4	4.2
GDP per capita (constant 2000 US\$)	2,234.9	2,083.7	2,361.7	2,667.0	3,520.3	4,613.1	5,289.6
GINI Index	NA	NA	NA	57.2	55.3	57.5	56.3
Household final consumption expenditure (per capita)	1,807.2	1,434.9	1,666.9	1,635.0	2,168.6	2,941.3	3,424.8
Immunization, DPT (% of children ages 12-23 months)	NA	NA	95.8	94.6	92.6	92	94.2
Improved sanitation facilities (% of pop with access)	NA	NA	NA	NA	84	87	90.5
Improved sanitation facilities, rural (% of rural pop with access)	NA	NA	NA	NA	52	57	62
Life expectancy at birth, total (years)	63.0	67.2	70.0	72.3	74.0	75.4	77.6
Poverty headcount ratio at \$2 a day (PPP) (% of population)	NA	NA	NA	24.5	12.2	9.7	7.6
Urban population (% of total)	76.5	79.5	81.8	82.9	83.7	85.0	86.9
Freedom House - Political Rights	4	6.8	6	5.4	2	2.2	1.6
Freedom House - Civil Rights	3.5	5	5	4.4	2	2	1.3
Transparency International - Corruption Perceptions Index	NA	NA	6.5	5.5	6.6	7.4	7.2
Heritage Foundation - Index of Economic Freedom	NA	NA	NA	NA	NA	73.8	76.6

Source: World Bank Development Indicators, Freedom House, Transparency International, Heritage Foundation

As shown above in Table 8, Chile has one of South America's most stable and prosperous nations. Overall, Chile has the highest nominal GDP per capita in Latin America. Within Latin America, Chile leads in terms of competitiveness, macroeconomic stability, economic freedom, low corruption perception, human development, democratic accountability, and political stability. According to the most recent Global Competitiveness Report, Chile ranks

as the 26<sup>th</sup> most competitive country in the world.<sup>103</sup> Although Chile bests other Latin American countries in terms of fiscal restraint and macroeconomic management, the country ranks fourth worst in terms of income distribution in Latin America and 80<sup>th</sup> in the world, behind much poorer countries such as Zambia, Nigeria, and Malawi.<sup>104</sup>

### ***Implications***

From various economic and social perspectives, Chile outpaces the rest of Latin America. As the least corrupt and most business-friendly country in Latin America, Chile has harvested the benefits of foreign investment, income growth, and productivity increases. Chile's performance, however, is less attributable to its unitary governance structure, but rather on an important precedent set under the dictatorship of Pinochet.

In regards to the impact of unitary government on economic performance, Pinochet's dictatorship had the power to suppress wages and institute austere macroeconomic reforms, such as privatization despite increased unemployment and forced economic liberalization. Before 1973, Chile had a long turbulent history of democratic rule with chronic inflation and uneven economic growth, especially since democratic politics often polarized political consensus, thereby impeding important macroeconomic and structural reforms.<sup>105</sup> Through authoritarianism combined with centralized, unitary rule, Pinochet transformed Chile from one of the poorest countries in Latin America to one of the wealthiest from an aggregate perspective.

The fact that Pinochet managed to set a precedent for Chilean economic development that continued through its democratic transition, however, represents a singular example – not reflective of unitary governments as a whole. The military dictatorships in Argentina, Brazil, and Uruguay all centralized government and created varying degrees of unitary rule, but failed to accomplish macroeconomic reform. In fact, in all three cases, severe macroeconomic mismanagement of the 1980s debt crisis provided an important political impetus for restoration of civilian rule. As a result, Pinochet's purported "miracle" in Chile reflects less on its unitary structure, but on the specific policies of the administration. *Unitary and centralized rule,*

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<sup>103</sup> "Global Competitiveness Report 2007-2008." World Economic Forum. <<http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>> Accessed: April 13, 2008

<sup>104</sup> "Economy of Chile." Wikipedia. <[http://en.wikipedia.org/wiki/Economy\\_of\\_Chile](http://en.wikipedia.org/wiki/Economy_of_Chile)> Accessed: April 13, 2008

<sup>105</sup> Keech, William. "Democracy, Dictatorship and Economic Performance in Chile." Carnegie Mellon University, 2004.

*however, does increase the ease of enacting comprehensive reform.* Without political competition or dissent, Pinochet could implement unpopular policies, such as the sale of state-owned enterprises despite severe unemployment and the privatization of public utilities. By taking an austere defense of private property, Pinochet created a business environment that incentivized investment from abroad by restoring confidence that business transactions would be enforceable with force. On the other hand, dictatorships have also entrenched opportunities for acute corruption and the misuse of public resources for private gain. A survey of dictatorships in the world today exposes the fact that plenty of autocratic rulers exist without accomplishing important macroeconomic stabilization reforms. Hence, one cannot conclude that unitary governments and dictatorships always produce beneficial economic results.

From a rights perspective, Chile falls in line with the other Latin American countries in this case study. Despite its unitary structure, Chile has improved democratic accountability, providing for checks and balances against authority. Every four years, Chile holds nationwide presidential, parliamentary, and municipal elections. Voters elect 38 senators and 120 deputies for parliament, and one mayor and a full body of councilmen per municipality. Similar to Uruguay, given Chile's small population and geographic area, traditions of direct democracy and political participation at the plebiscitary level emerge strongly. Hence, the evidence suggests that unitary governments can accomplish the same level of rights performance as federal governments, despite the absence of greater influence of sub-national governments. In essence, paralleling the political decentralization of federal governments, democratic consolidation in unitary governments focuses on strengthening representation and responsibility at the municipal and local levels of government.

From a social welfare perspective, Chile outpaces the rest of Latin America, though significant income inequality reveals the unintended consequences of neoliberal reform. Paradoxically, Pinochet's successes in various social policies, such as promoting universal immunization and improving health infrastructure, depended on administrative decentralization, as in health care, in direct contrast to centralization. As a result, one cannot categorically claim that unitary governments provide greater social benefits, especially since Uruguay and Chile – the two unitary governments – are both small countries with limited geographic span, have relatively homogeneous populations, and adopt decentralization as a strategy for resource allocation. In general, both Uruguay and Chile confront fewer challenges in administering social welfare programs due to a combination of population demographics and

geography. In comparison, the large federal republics – Brazil, Argentina, and Mexico – face formidable difficulties in bureaucratic control and administration of social programs as a result of sheer geographic area, large and heterogeneous population, and significant ethnic diversity.

## **Comparison of Results**

### ***Economic Performance***

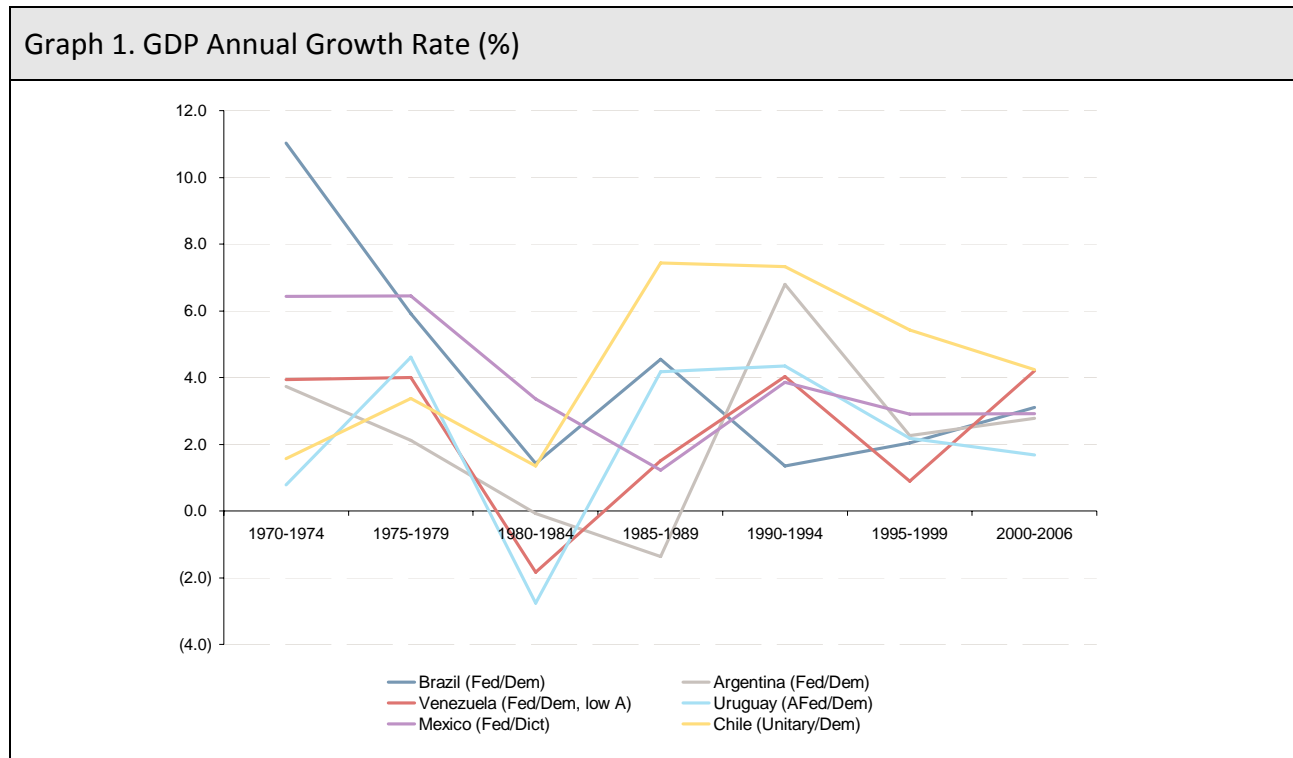
As Graph 1 illustrates, GDP annual growth rate is a rather volatile measure – from the period of 1970 to 2006, Latin American countries underwent a series of boom-bust cycles. Economic growth rates across Latin America averaged 6% in the 1970s, fueled by an import-substitution strategy reliant on liquidity in sovereign debt markets, driven by the surplus of investment from abroad. The 1980s, commonly referred to as the “lost decade”, however, brought a period of severe recession with high oil prices, high interest rates, and the reduction of liquidity as US dollars went to OPEC. With a looming debt crisis, Latin America’s GDP contracted, shrinking to pre-1970s levels. Inflation skyrocketed and debt service in the region required approximately one-third of the entire region’s export earnings.<sup>106</sup>

From the graph below, Chile seems to have weathered the shock better than the other countries, managing to recover comparatively faster. In the 1990s, Chile also achieved higher, more stable GDP growth rates, though the gap has eroded over time. Chile’s performance, however, is less associated with its unitary structure than the strict macroeconomic discipline and structural reforms initiated under the Pinochet regime that facilitated recovery and growth. The GDP growth rates of the benchmark cases of Argentina and Brazil fluctuate wildly, often not in synchronicity, though in the most recent periods, differences in GDP annual growth rates have narrowed. As mentioned earlier, given Uruguay’s dependence on trade and remittances from its large Latin American neighbors – notably Argentina and Brazil – its GDP growth rates parallel that of the benchmark cases. Given Venezuela’s oil economy, the country managed to recover in a more sustained fashion from the crisis of the 1980s – a result of rising oil exports that buoyed GDP growth. From cursory inspection, GDP growth rates do not suggest that federal governments achieve profoundly better performance – too many particularistic elements of economic structure explain away the variation. Nevertheless, the fact that GDP growth rates have stabilized and improved in the 1990s suggest that in addition to an upturn in

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<sup>106</sup> Daly Hayes, Margaret. “The U.S. and Latin America: A Lost Decade?”. *Foreign Affairs Magazine*, 1988.

the global macroeconomic context, decentralization reforms may have contributed to greater economic performance.



Source: World Development Indicators, 2007

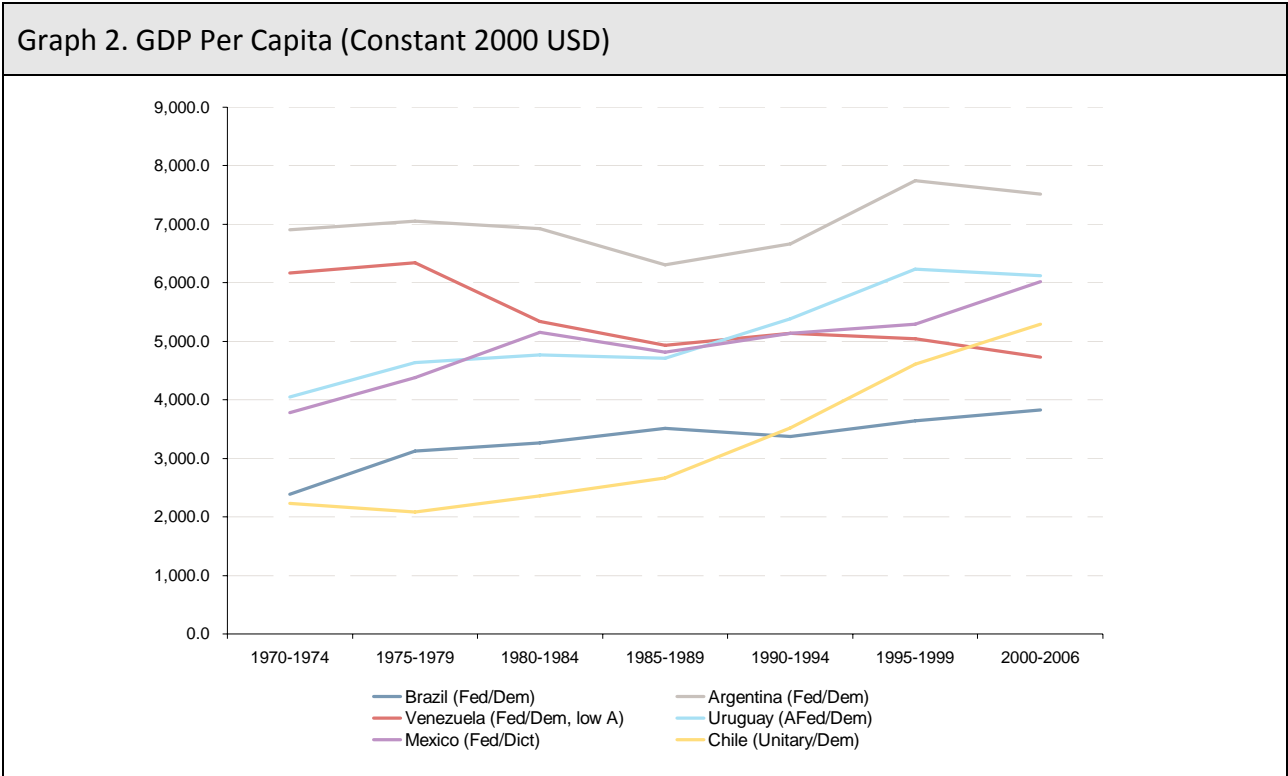
As shown in Graph 2, GDP per capita in Argentina outpaced the rest of Latin America for the entire period from 1970-2006. In fact, in 1900, Argentina had the sixth highest per capita national income in the world, and was considered a potential economic rival to the United States.<sup>107</sup> Argentina’s failure to industrialize, however, caused the country to lag behind, especially as agricultural and commodity prices began to fall. Brazil’s GDP per capita, however, remains the lowest among the cases. As the fifth-largest country in the world by geographical area and the fifth most populous country<sup>108</sup>, GDP per capita stagnated as population growth outpaced income growth.<sup>109</sup> Hence, just from looking at Brazil and Argentina alone, it is difficult to draw a conclusion about the GDP per capita of federal democracies given the wide variance.

<sup>107</sup> “Background to the Crisis in Argentina” Crisis States Research Center – London School of Economics. <<http://www.crisisstates.com/associated/CAW/background.htm>>

<sup>108</sup> “Brazil.” CIA World Factbook. <<https://www.cia.gov/library/publications/the-world-factbook/geos/br.html#Geo>> Accessed: April 11, 2008

<sup>109</sup> “Brazil: The Labor Force and Income Levels.” <<http://countrystudies.us/brazil/70.htm>> Federal Research Division of the Library of Congress, 1998. Accessed: April 11, 2008

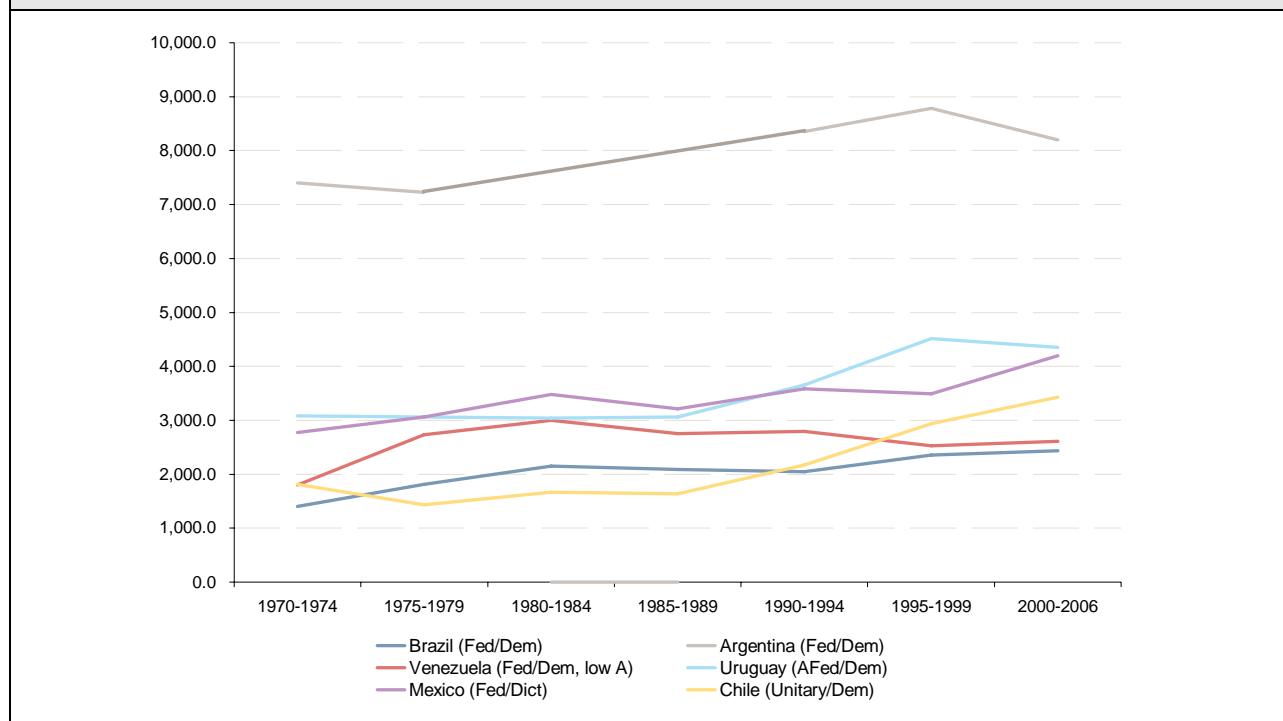
Chile achieved the greatest improvement as a result of structural reforms that enhanced the overall macroeconomic context, bringing GDP per capita nearly monotonically upward despite the economic shocks. Overall, GDP per capita has more than doubled from levels in the early 1970s. GDP per capita for Mexico and Uruguay has also improved modestly with a gain upwards of \$2,000, approximately a 50% improvement from the early 1970s to the most current period. Venezuela, however, has sustained a decline in GDP per capita, falling from approximately \$6,200 in the early 1970s to \$4,700 recently. Since the 1990s, with the exception of the Venezuela, GDP per capita has grown substantially after the stagnation of the 1980s.



Source: World Development Indicators, 2007

The aforementioned trends in GDP per capita extend to the trend in household final consumption per capita, as shown in Graph 3. Argentina outpaces the rest of the countries, while Brazil remains the lowest. Chile has improved the greatest, with modest gains in Mexico and Uruguay. Venezuela, however, has experienced a decline in household final consumption per capita. From inspection, it is difficult to draw a conclusion about the impact of governance structure on economic performance, especially in light of the wide variation in the benchmark cases and the particularistic elements of economic structure.

Graph 3. Household Final Consumption Per Capita (Constant 2000 USD)



Source: World Development Indicators, 2007

As shown in Table 9, the federal democracies – Brazil and Argentina – appear to have GINI coefficients that are on the high end. Throughout the period from 1980-2006, Brazil had the highest GINI coefficient. Developmental experts have intensively studied Brazil’s income inequality, suggesting that heterogeneous levels of education in the work force account for severe income inequality. International comparisons reveal that from the period of 1978 to 1998, although 70% of all countries in the world had a per capita income below Brazil’s, 10% of the richest families in Brazil had access to 50% of the aggregate family income, while the poorest 50% of households only accounted for 10% of aggregate income.<sup>110</sup> According to a recent World Bank study, the Real Plan – a policy of macroeconomic stabilization – contributed to the recent modest reduction in the GINI coefficient.<sup>111</sup> Argentina’s GINI coefficient, however, has worsened over the past decades – a result of adopting neoliberal policies. Altimir attributes the deterioration in income equality to growing unemployment in the successive crises in the

<sup>110</sup> Bugarin, Mirta. “Human Capital and Income Concentration in Brazil” University of Brazil, 2007.

<sup>111</sup> Clements, Benedict. “The Real Plan, Poverty, and Income Distribution in Brazil” World Bank, 1997.

<<http://www.worldbank.org/fandd/english/0997/articles/0180997.htm>>



1980s, and unemployment generated by the restructuring of production and the increase in labor force participation in the 1990s.<sup>112</sup>

Chile has the second highest GINI coefficient, although the level of absolute poverty has fallen. As a result of liberalization, privatization, and other macroeconomic reforms, the income distribution of Chile has changed in the following manner: the entire distribution has shifted to the right such that nearly everybody has earned more than previously, the dispersion of the distribution remains broadly stable so that the level of overall inequality has not changed greatly, and a simultaneously compression and expansion of the tails signifies that inequality among the rich has increased, though inequality of the poor has declined.<sup>113</sup> As aforementioned, to combat the high level of disparity, Chile has used decentralization as a mechanism to reduce regional inequalities.

Uruguay has one of the lowest GINI coefficients, in light of the country's agriculturally-oriented economic structure, similar geographic climate, and small population. In the period of marked trade liberalization from 1990-1994, the GINI coefficient of Mexico worsened, but then moderated in the last two periods. Especially in perspective with Mexico's recent reforms to increase the level of decentralization and responsibility of sub-national governments as a mechanism to reduce intra-regional inequity, the moderation of inequality could potentially be attributed to these efforts. Venezuela, however, has registered a significant decrease in the GINI coefficient from 55.8 in the earliest period to 46.1 more recently, attesting to the efficacy of the government's pro-poor, socialist reforms.

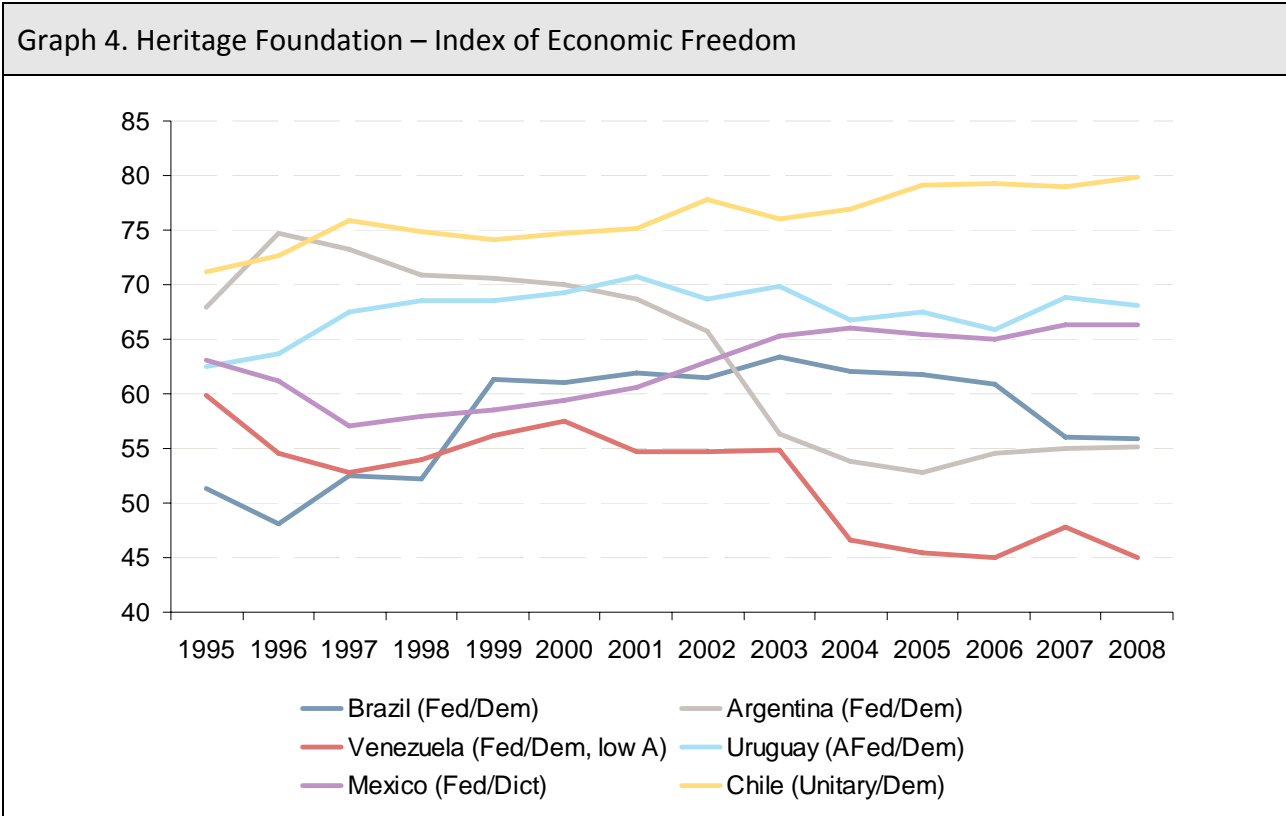
GINI Index	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
Brazil (Fed/Dem)	57.7	59.3	60.3	59.6	58.1
Argentina (Fed/Dem)	NA	44.5	45.4	49.2	52.1
Venezuela (Fed/Dem, low A)	55.8	48.8	41.7	49.2	46.1
Uruguay (AFed/Dem)	43.7	42.3	NA	44.5	44.7
Mexico (Fed/Dict)	46.3	NA	51.1	48.8	49.2
Chile (Unitary/Dem)	NA	57.2	55.3	57.5	56.3
Benchmark (Average)	57.7	51.9	52.8	54.4	55.1

Source: World Development Indicators, 2007

<sup>112</sup> Altimir, Oscar. "Income Distribution in Argentina, 1974-2000." United Nations, ELAC. 53-82. CEPAL Review N° 78.

<sup>113</sup> Contreras, Larrañaga, Litchfield, Valdes. "Poverty and Income Distribution in Chile." Cuad. econ. v.38 n.114 Santiago ago. 2001.

As shown below in Graph 4, according to the Heritage Foundation, Chile has one of the highest rankings in overall economic freedom, a combination of the elements of: business freedom, trade freedom, fiscal freedom, government size, monetary freedom, investment freedom, financial freedom, poverty rights, freedom from corruption, and labor freedom. Uruguay is ranked second, with Mexico and Brazil making moderate improvements over time. The scores of Argentina and Venezuela, however, have worsened over time, especially in light of Argentina’s default in 2001 and the series of nationalizations of private enterprises that have occurred in Venezuela under the Chavez presidency.



Source: Heritage Foundation, 2007

**Implications**

In general, it is difficult to draw definitive conclusions about the contribution of governance structure on the level of economic performance, especially since as discussed earlier in each of the case analysis implications, federalism has a rather ambiguous effect on economic growth. Nevertheless, from the indicator analysis presented above, the following trends emerge:

1. **Unitary governments in Latin America appear to have the political consensus to promote policies which increase the level of economic freedom.** Chile and Uruguay have a higher ranking in terms of economic freedom, although the gap has declined with time. As aforementioned, unitary governments generally have greater political consensus necessary to pass comprehensive economic reforms. In general, unitary governments reduce the overall number of political offices available, which in turn, reduces the level of political fragmentation. In contrast, in federal democracies, layers of sub-national actors and increased level of political competition potentially incubate potential dissent to macroeconomic reform, especially with the fragmentation of political parties. As parties fragment, most notably in the case of Brazil, important macroeconomic reforms may stall in indefinite political contestation.
2. **The economic performance of the federal governments does not appear consistent with each other.** GDP per capita of the two federal democracies – Brazil and Argentina – represent the min and max of the region. Likewise, GDP growth rates often move in opposite directions, as in the period from 1985-1999, in which significant growth gains in Brazil corresponded to stagnation in Argentina, and vice-versa. These results confirm the analysis in the case implications section that federalism often results in mixed economic performance, especially in light of the constant tension between centralization and decentralization of central government involvement in the economy and the complexity of ascertaining political capital in a federation to promote macroeconomic reform.
3. **Reform-oriented dictatorship under unitary governments potentially increases economic performance.** Chile's significant GDP growth, gains in GDP per capita, and high ranking in the economic freedom index support the implications that unitary governments provide the structure for reform-oriented dictatorships to institute significant macroeconomic reforms. As anecdotal support of the benevolent dictatorship theory, it appears that similar to Lee Kuan Yew of Singapore, Chiang Kai Shek of Taiwan, and General Park of South Korea, Pinochet played an instrumental role in Chile's economic "miracle" through his ability to implement austere reforms for macroeconomic stabilization and fiscal restraint. Nevertheless, one must keep in mind that military dictatorships in other Latin American countries – Brazil, Uruguay, and Argentina – did not yield significant improvements in any economic indicators, especially since the ruling military elites did not prioritize economic reform as their political agenda. Likewise, Mexico's greatest economic improvement did not

correspond to its experience under PRI dictatorship, but rather, with the introduction of political competition and democratic reforms. In addition, the human costs of such dictatorships, quantified in terms of human rights abuses and a widening income gap, must be weighed against the benefits, especially since economic gains may be short-lived.

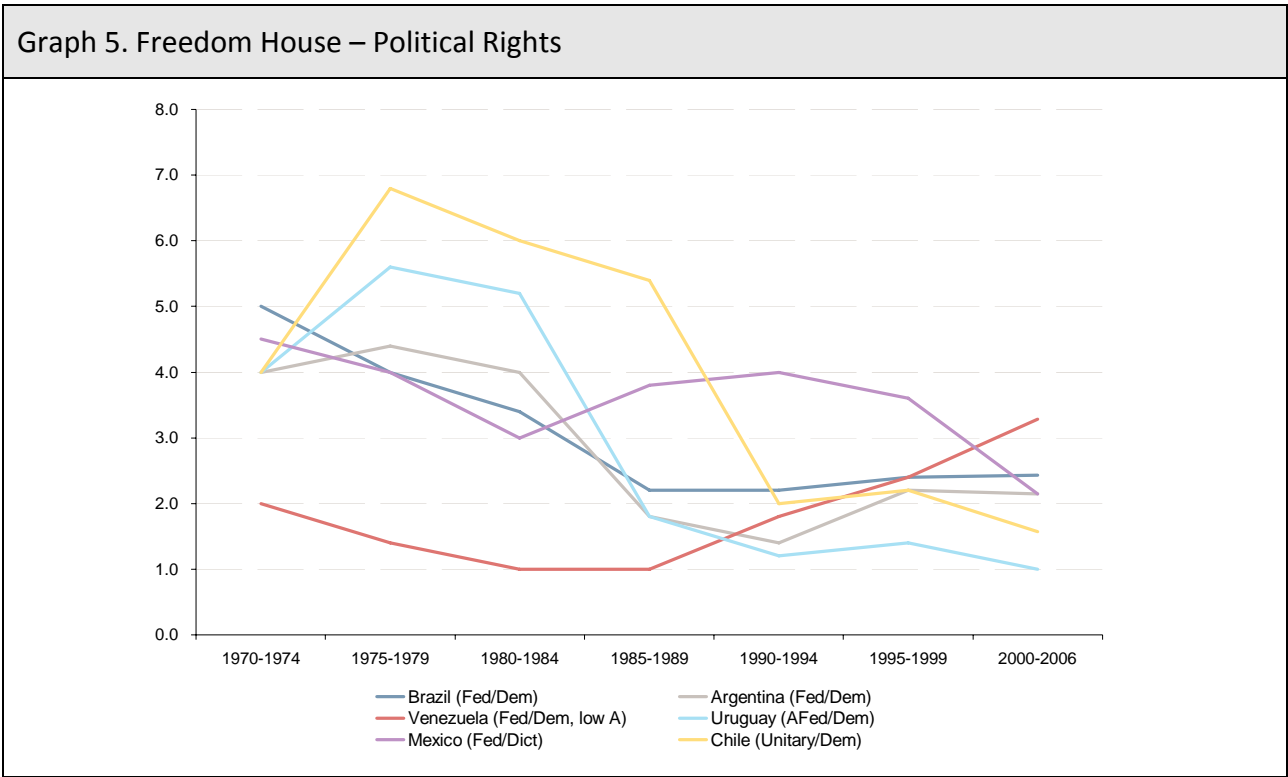
- 4. Despite implications #1 and #3, increasing centralization potentially decreases economic performance.** Buoyed by high oil prices, one may expect Venezuela's economic indicators to have improved dramatically in the most recent periods. High GDP growth, however, does not correspond with a substantial improvement in annual household consumption, which has largely stagnated or declined. Most significantly, the index of economic freedom has continually dropped in Venezuela, corresponding with increasing government centralization and government involvement in the economy under the Chavez administration, manifested in the nationalization of foreign companies and the use of price controls. Hence, the data confirms the analysis that since federalism potentially intensifies political fragmentation and creates a power vacuum for a populist leader, the lack of institutional checks coupled with fiscal centralization could lead to deteriorating economic freedom and performance. Likewise, Menem's reforms to centralize central government control over the economy precipitated the collapse of the Argentine economy in 2001, especially in light of reforms that failed to curtail fiscal irresponsibility at the regional level, yet held the economy pegged to an unsustainable exchange rate.

### ***Rights Indicators***

As shown in Graphs 5 and 6, the majority of Latin American countries endured repressive military regimes in the 1970s, which eventually devolved to civilian rule by the mid to late 1980s. Venezuela is the exception to this trend, in which the Pérez Jiménez military dictatorship lost credibility in 1958, giving way to true democratic reform. As a result, Venezuela enjoyed democratic political and civil rights long before its Latin American neighbors.

Steady improvements in political and civil rights can be observed in nearly all of the countries, with exception to Venezuela, which has experienced a recent erosion of rights as a result of the Chavez presidency and increasing reforms to centralize government and remove important checks and balances. As shown in Graph 5, Mexico's political rights have not improved significantly until recently – a consequence of PRI domination and institutionalized electoral fraud. Overall, increasing political rights correspond with many federal and

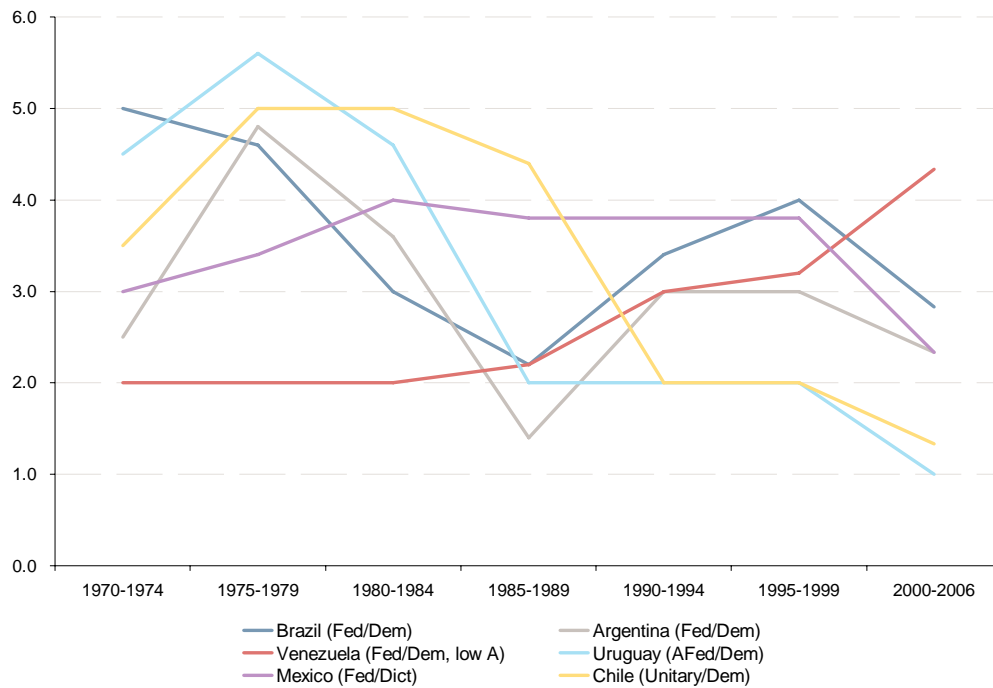
decentralization reforms, which emphasized increasing political representation at the local level and promoting greater autonomy of sub-national actors to check central government.



Source: Freedom House, 2007

From a civil rights perspective (Graph 6), the majority of Latin American countries have experienced a marked improvement, especially as civilian advocacy groups denounced the human rights atrocities committed under military rule and as democratic governments enshrined civil and human rights in constitutional reforms, as elucidated in earlier case study section. Venezuela, however, is the exception as the government has become increasingly intolerant of dissident opinion. Chile and Uruguay have made the greatest improvements as the devolution of military rule has left lasting democratic reforms with an emphasis on the protection of civil rights.

Graph 6. Freedom House – Civil Rights



Source: Freedom House, 2007

Corruption perception is an important measure, as it directly affects the level of government accountability, efficiency in resource allocation, and the capacity to attract foreign investment. Chile ranks as one of the most cleanly perceived governments – a legacy of the Pinochet regime that emphasized reduction of government influence in the economy, neoliberal reforms, and a desire to model government under private enterprise. Augusto Pinochet himself once said, “[Military rule aims] to make Chile not a nation of proletarians, but a nation of entrepreneurs.”<sup>114</sup> In order to attract investment and restore business confidence in Chile, Pinochet established a legacy of strict adherence to fiscal and macroeconomic accountability and created a culture intolerant of corruption, though his own personal corruption remains a source of hypocrisy.<sup>115</sup> Uruguay has also made important institutional arrangements against corruption, thus becoming Latin America’s second least corrupt country, according to Transparency International. For example, on August 12, 1997, Uruguay passed into

<sup>114</sup> Dandan, Zaldy. "Gracias mi general" Marianas Variety. 2006.

<<http://www.mvariety.com/editorialpage/editorial01.htm>> Accessed: April 12, 2008

<sup>115</sup> Kornbluh, Peter. “The Secret Pinochet Portfolio.” National Security Archive. 15 March 2005.

<<http://www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB149/index.htm>> Accessed: April 13, 2008

law the Inter-American Convention against Corruption. As a relatively small country, Uruguay has maintained relatively effective oversight over the accountability of its officials and instituted a culture intolerance of corruption.<sup>116</sup>

Argentina and Brazil have currently relatively similar corruption perceptions measures, although Argentina experienced a marked deterioration in corruption perception in the period of 1985-1994. The economic shocks and its consequences of eroding the middle class and causing great unemployment eroded many important institutional checks on corruption.<sup>117</sup> In addition, the Menem and de la Rúa administrations were associated with rampant political corruption, including pandering spoils to the masses in return for electoral security.<sup>118</sup> Mexico has made moderate gains in reducing the perception of corruption, largely with electoral reform and the ending of PRI domination, while Brazil has more or less remained at similar levels to the past. Perhaps as a consequence of oil rents, Venezuela has one of the worst corruption perceptions ranking, especially since a large portion of oil revenue passes through the government. According to Gustavo Coronel, corruption in Venezuela stems from three main causes: motive, opportunity, and impunity. As an example of the resource curse, thousands of public employees who feel underpaid monetize their public offices illegally, protected by the lack of administrative procedures and controls, chaotic management of bureaucrats, and low possibility of penalization. Coronel estimates that approximately \$10 billion has been stolen under the Chavez administration with no punitive measures.<sup>119</sup>

Many experts have intensively studied the relationship between decentralization and corruption, especially since decentralization has achieved acceptability as a developmental paradigm against the inefficiency of centralized states. In theory, decentralization can reduce corruption and minimize the undersupply of infrastructure support for private investors through inter-jurisdictional competition. In addition, decentralization reforms can conceivably harden budget constraints so that governments do not bail out inefficient enterprises.<sup>120</sup> Simultaneously, however, decentralization introduces new problems of agency, oversight, and inter-jurisdictional externalities. An empirical, cross-country study by Fisman and Gatti

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<sup>116</sup> “Inter-American Convention Against Corruption.” Organization of American States, 1997.

<[www.oas.org/juridico/English/Sigs/b-58.html](http://www.oas.org/juridico/English/Sigs/b-58.html)>

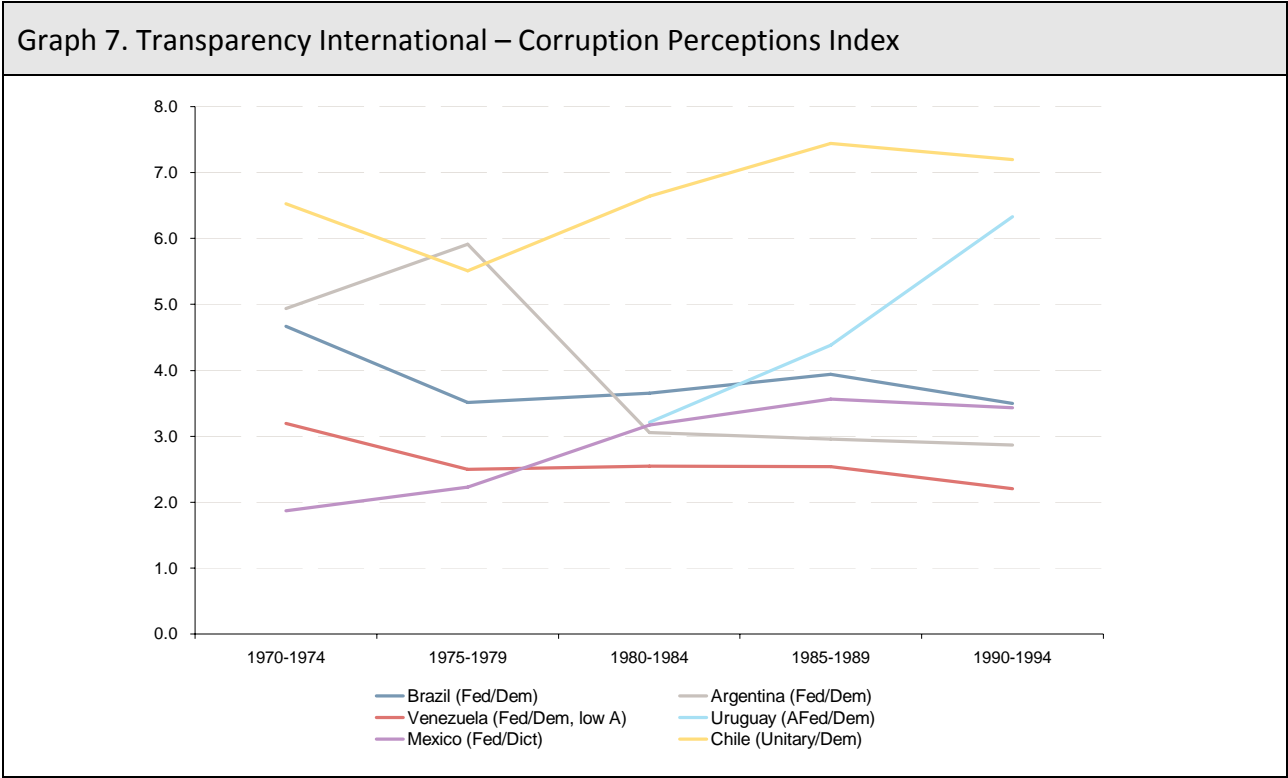
<sup>117</sup> Svampa, Maristella. *La Sociedad Excluyente*. Taurus, 2005.

<sup>118</sup> Schneider, Donald. *Latin American Political History*. Boulder: Westview, 2007.

<sup>119</sup> Coronel, Gustavo. “Curbing Corruption in Venezuela” *Journal of Democracy*. Vol 7, No 3, July 1996, pp. 157-165.

<sup>120</sup> Bardhan, Mookherjee. “Decentralization, Corruption And Government Accountability: An Overview” *Handbook of Economic Corruption*, 2005.

confirmed that a strong negative relationship exists between fiscal decentralization in government expenditure and corruption. Theoretically, by devolving power to local levels, centralized bureaucracy loses its monopoly to divert resources to the non-poor, especially in light of willingness to pay bribes.<sup>121</sup> Nevertheless, the predictive capacity of the model remains nebulous, as the relationship between decentralization and corruption depends on legal origins and other country-particularistic elements.



Source: Transparency International, 2007

**Implications**

Regardless of governance structure, rights performance in Latin America has substantially improved as military government transitioned to civilian rule. The following trends emerge from the data:

1. **Unitary governments (especially when democratic) appear to be less corrupt.** Chile and Uruguay, both unitary governments, have a lower level of perceived corruption. Especially since unitary governments remove additional layers of bureaucracy and have greater central government oversight on public funds and projects, such governance structures may

<sup>121</sup> Fisman, Gatti. “Decentralization and Corruption: Cross-Country and Cross-State Evidence.” World Bank, 1999.



effectively reduce the level of corruption. Conversely, the large federal democracies rank at the higher end of perceived corruption. In theory, introducing more government layers and creating a complex system of inter-governmental transfers potentially increases the opportunity for corrupt activities. In addition, increased political competition potentially incentivizes vote-pandering activities and potential clientelism. These results coincide with published empirical studies that investigate the link between corruption and federal governance structures. According to an empirical study by Plekhanov, federal structure of government may contribute to the persistence of corruption, as voters may be incentivized to elect rent-seeking politicians for their own personal benefit.<sup>122</sup> Plekhanov's model reveals that corruption at the federal level may be contagious at the regional level as well, hence contributing to the persistence of corruption. Nevertheless, centralization in federal governments may also increase the level of corruption, as in the case of Brazil and Argentina under military rule and in Venezuela, where concentration of fiscal power and oil revenue at the central level has bred rent-seeking behaviors and spoils. Consequently, finding the appropriate balance presents a formidable challenge.

2. **Decentralization and federalism provide an institutional check for democratic accountability and help in rights performance.** Brazil, Argentina, and Mexico have both experienced a substantial improvement in civil and political rights. In the case of Mexico, democratization corresponded with increasing decentralization and enforcement of federal precepts established in the constitution, especially since such reforms increased political competition and opened up new channels of representation and dissent. Similarly, in Brazil and Argentina, the institution of federal republic created an institutional structure that would purposefully diffuse the centralized power structure that had existed under military rule. By introducing new layers of representation, federalism provides a mechanism to check potential government abuse of civil rights and to introduce more avenues of political participation and the exercise of democratic prerogatives.
3. **Unitary governments have accomplished similar improvements in rights performance through enhancing direct democracy and municipal representation – a form of decentralization at a local level.** The profound impact of the rising import of municipal politics in Uruguay and Chile attest to the fact that even in unitary governments,

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<sup>122</sup> Plekhanov, Alexander. "Endogenous Corruption in a Federation," *The B.E. Journal of Economic Analysis & Policy*: Vol. 7: Iss. 1 (Topics), Article 20.

decentralization and increasing representation at the local level have a positive effect on democratic accountability and rights performance. As in the case of the Frente Amplio's role in creating participatory representation at the municipal level in Uruguay and intensification of plebiscitary politics in Chile, unitary governments have recognized the benefits of creating democratic institutions at the local level – a form of decentralization that parallels the reforms of the largest federal republics at a smaller scale. Decentralization through municipalization thus improves political representation and civil rights.

### ***Health and Other Social Indicators***

Although Chile outpaced the rest of Latin America in the earlier periods, the majority of Latin American countries have converged in terms of providing DPT immunization (Graph 8). In explaining Chile's initial ability to reach such a large proportion of children, the Pinochet regime decentralized the centralized health care system, shifting resources away from the hospitals in the major cities to more widely dispersed primary health care clinics under municipal control, which emphasized preventative measures such as immunization and education in basic hygiene.<sup>123</sup>

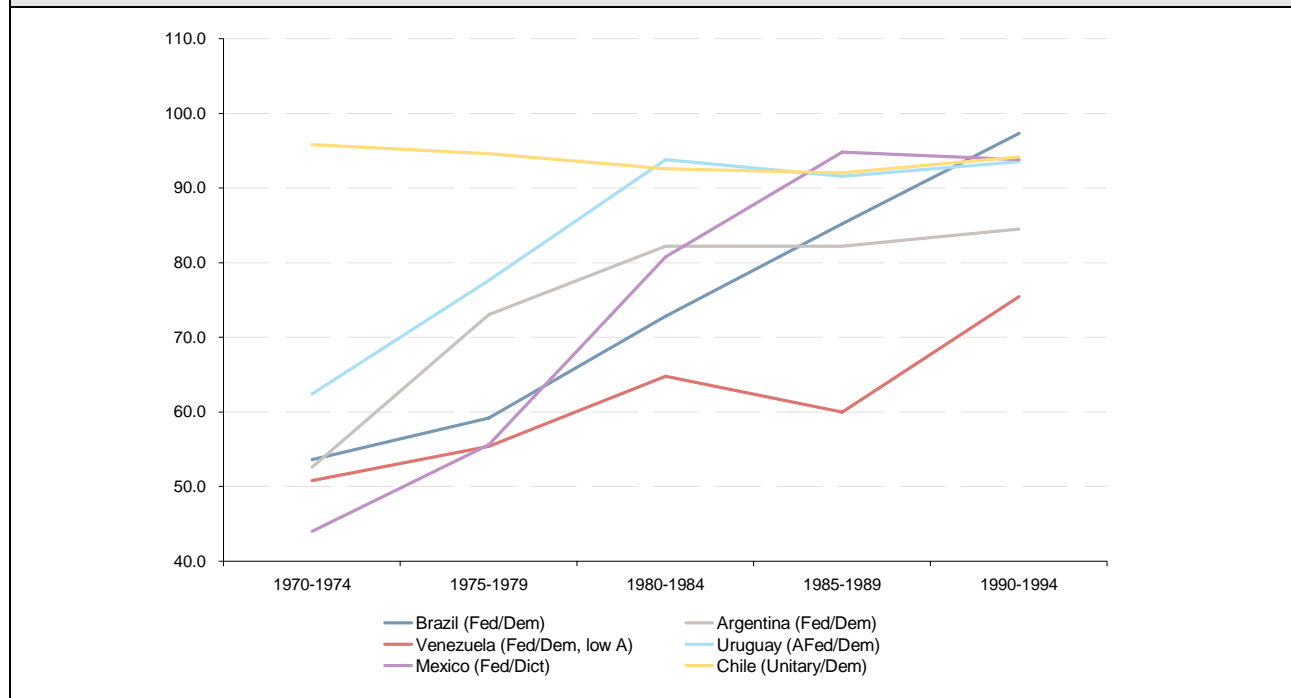
In fact, Brazil, Argentina, Mexico, Uruguay, and Venezuela – all the countries in this case study – have pursued health care decentralization reforms in the past twenty years, to varying degrees of success. At the beginning of the 1980s, health care systems in Latin America generally provided a low quality of health services and used financial resources inefficiently. Decentralization of health care served as an avenue to increase the efficiency and responsiveness of government because the devolution of resource allocation decisions to locally elected leaders would better match the mix of services produced by the public sector and the preferences of the local population.<sup>124</sup> As a result of decentralization, better access to health for the poor and emphasis on preventative care emerged, which explains the dramatic improvement in immunization. Throughout the past two decades, the World Bank, United Nations, USAID, and Inter-American Development Bank all have emphasized the importance of decentralization in their health care policy recommendations and health programs.

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<sup>123</sup> Ward, Jonathan. *Latin America: Development and Conflict Since 1945*. Routledge, 2004.

<sup>124</sup> Zipperer, Melanie. "Latin American Experiences with Decentralization of Health Care: The Cases of Brazil and Bolivia." World Bank Group. December 1999.

Graph 8. Immunization, DPT (% of children ages 12-23 months)

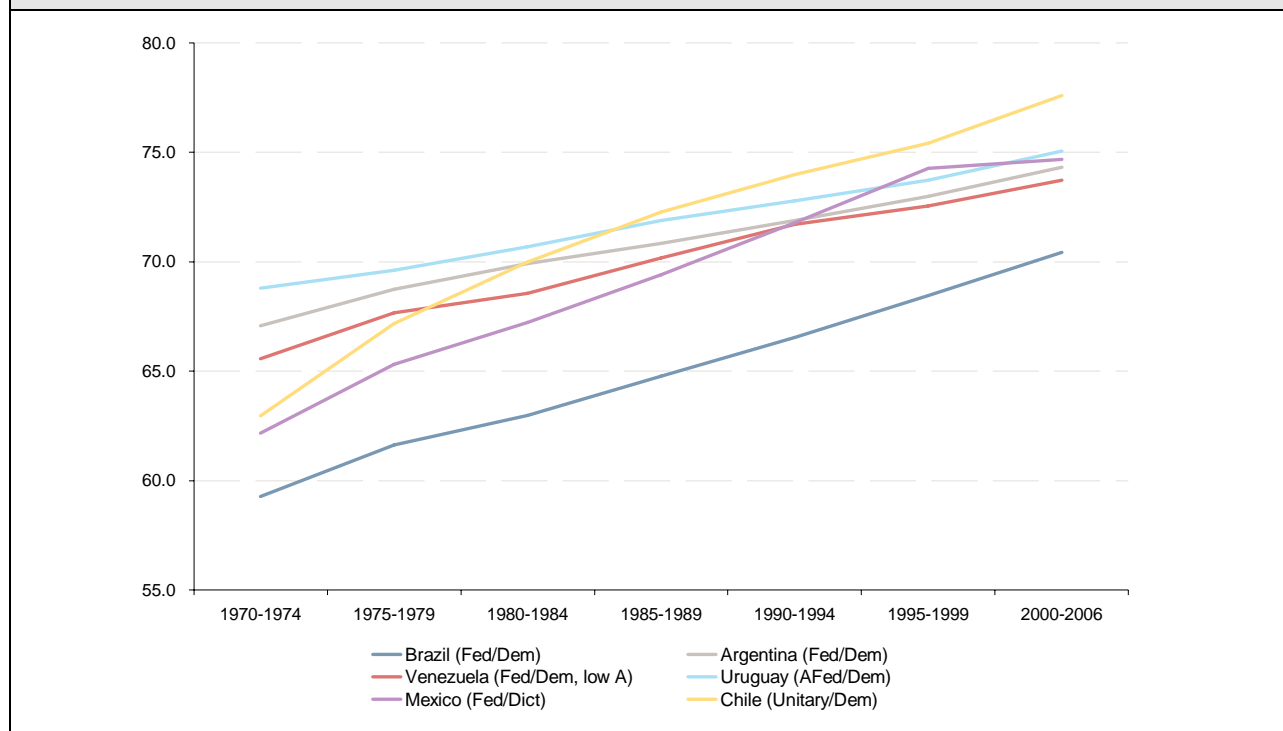


Source: World Development Indicators, 2007

As illustrated in Graph 9, the majority of countries have a similar upward trend in life expectancy, especially given the simultaneous reforms in the health care system and improvement in the overall macroeconomic context. The benchmark cases of Argentina and Brazil exhibit wide deviation, as Argentina has a life expectancy at the median, while Brazil has the lowest life expectancy throughout the period. Especially since Brazil has a much greater population, assuring access to health care and confronting severe income disparities have posed difficult policy challenges. A study by Messias confirmed that illiteracy rates and income disparities were negatively associated with life expectancy in Brazil, thus confirming the relationship between income distribution and health outcomes.<sup>125</sup> As Brazil has the highest GINI coefficient of all the countries in this case study, its comparative lower life expectancy at birth may reflect the pernicious effects of socioeconomic inequality. Mexico and Chile exhibit the greatest improvement in life expectancy at birth, while Uruguay, Argentina, and Venezuela illustrate modest gains over time.

<sup>125</sup> Messias, Erik. "Income Inequality, Illiteracy Rate, and Life Expectancy in Brazil" *American Journal of Public Health*. 2003 August; 93(8): 1294–1296.

Graph 9. Life Expectancy at Birth (Years)

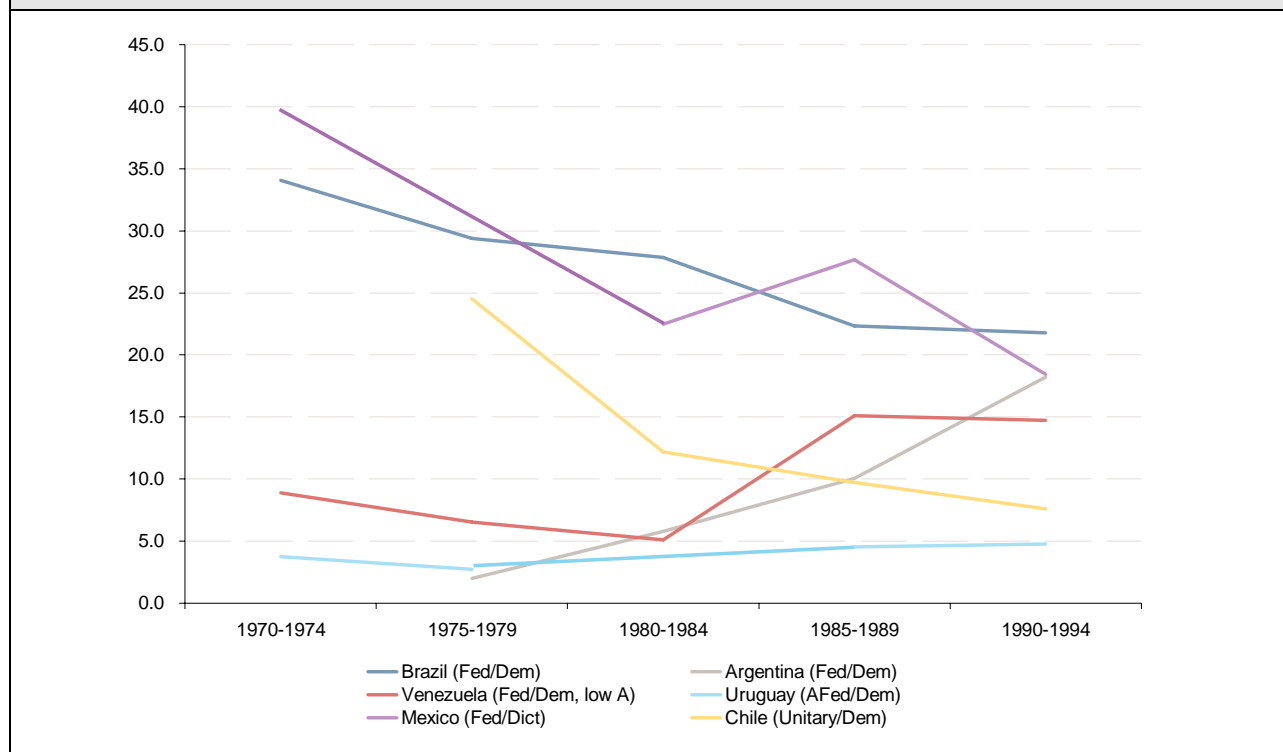


Source: World Development Indicators, 2007

In regards to the percentage of the population following below the \$2/day PPP threshold (Graph 10), Brazil, Mexico, and Chile made substantial improvements, while poverty increased significantly in Argentina and Venezuela. The poverty headcount in Uruguay has remained roughly similar throughout the four decade period. The recent deterioration in the poverty headcount percentage in Argentina can be explained by the exchange rate devaluation and financial crisis of 2001, in which many residents either lost their savings or found their value eroded by skyrocketing inflation. At the beginning of the 1980s, Argentina had one of the lowest poverty rates in Latin America, but now ranks at the median.

In the early 1990s, poverty increased in Venezuela as a result of series of neoliberal reforms that privatized various public services as well as important state-owned enterprises in oil and mining, thus spurring unemployment. It remains to be seen whether the nationalization of oil and natural resource companies will improve Venezuela's poverty gap. Since Chavez garners the greatest support from impoverished barrios, his anti-poverty record has a dramatic impact on his political capital.

Graph 10. Poverty headcount ratio at \$2 a day (PPP) (% of population)



Source: World Development Indicators, 2007

### Implications

**Administrative federalism and decentralization improves access to health and other public goods.** Regardless of governance structure, decentralization of health and social services appear to improve access. For example, under Pinochet’s unitary government, shifting resources away from the hospitals in the major cities to more widely dispersed primary health care clinics under municipal control – a form of decentralization – contributed to high rates of immunization and other preventative measures such as education in basic hygiene, which proved essential for overall health. As a result, Chile outpaced the rest of Latin America during this period, in which all other countries utilized centralized health care systems.

In fact, Brazil, Argentina, Mexico, Uruguay, and Venezuela – all the countries for this case study – have pursued health care decentralization reforms in the past twenty years. As shown in the indicators, for all of these countries, life expectancy at birth has greatly increased and poverty headcount have significantly decreased, thus suggesting a connection between decentralization and increased access to health care and services. In general, decentralization of social services increases the efficiency and impact of public goods and resources because

local agents generally have a better understanding of the preferences and priorities of the local population. Unsurprisingly, the indicators confirm the analysis in the case study section that linked decentralization reforms to greater equity in access social goods. As a result, the data supports the policy recommendations of various international developmental agencies which advocate decentralization as a mechanism for improved delivery of public goods. As federal governments require a political structure of decentralization, assign significant administrative responsibilities to sub-national actors, and give sub-national governments greater fiscal latitude, one may reasonably conclude that federalism provides an institutional framework that facilitates an optimal structure for the delivery of public goods and social welfare programs.

### ***Rural-Urban Dynamic***

To analyze whether federalism has contributed to more effective provision of services at both a rural and urban level, one can analyze disparities in access to basic needs. In theory, decentralization would aid in decreasing the rural-urban divide by concentrating resource allocation and access at the local level. As shown in Table 10, urbanization has occurred over the past three decades throughout Latin America, dramatically altering the rural-urban composition. With the explosion of primate cities such as Sao Paolo, Mexico City, and Buenos Aires, many rural residents have migrated to the cities in search of greater opportunities, only to form slums and settlements outside of the city’s fringes. Throughout the period, Uruguay has one of the most urbanized populations out of the six countries.

Urban population (% of total)	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2006
Brazil (Fed/Dem)	58.2	64.0	69.0	72.7	76.0	79.2	83.0
Argentina (Fed/Dem)	79.7	81.8	83.7	85.8	87.5	88.6	89.7
Venezuela (Fed/Dem, low A)	73.3	77.2	80.4	82.7	85.6	89.2	92.5
Uruguay (AFed/Dem)	82.8	84.2	86.1	87.9	89.6	90.8	91.7
Mexico (Fed/Dict)	60.5	64.2	67.6	70.8	72.9	73.9	75.5
Chile (Unitary/Dem)	76.5	79.5	81.8	82.9	83.7	85.0	86.9
Benchmark (Average)	69.0	72.9	76.4	79.3	81.7	83.9	86.4

Source: World Development Indicators, 2007

Table 11. Access to Improved Sanitation Facilities (Rural vs. Urban)

Improved sanitation facilities (% of total population with access)	1990-1994	1995-1999	2000-2006
Brazil (Fed/Dem)	71.0	73.0	74.5
Argentina (Fed/Dem)	81.0	86.0	90.0
Venezuela (Fed/Dem, low A)	NA	68.0	68.0
Uruguay (AFed/Dem)	100.0	100.0	100.0
Mexico (Fed/Dict)	58.0	67.0	77.0
Chile (Unitary/Dem)	84.0	87.0	90.5
Benchmark (Average)	76.0	79.5	82.3
Improved sanitation facilities (% of rural population with access)	1990-1994	1995-1999	2000-2006
Brazil (Fed/Dem)	37.0	37.0	37.0
Argentina (Fed/Dem)	45.0	59.0	78.5
Venezuela (Fed/Dem, low A)	NA	48.0	48.0
Uruguay (AFed/Dem)	99.0	99.0	99.0
Mexico (Fed/Dict)	13.0	25.0	39.0
Chile (Unitary/Dem)	52.0	57.0	62.0
Benchmark (Average)	41.0	48.0	57.8
% Difference (Rural and Total Population)	1990-1994	1995-1999	2000-2006
Brazil (Fed/Dem)	34.0	36.0	37.5
Argentina (Fed/Dem)	36.0	27.0	11.5
Venezuela (Fed/Dem, low A)	NA	20.0	20.0
Uruguay (AFed/Dem)	1.0	1.0	1.0
Mexico (Fed/Dict)	45.0	42.0	38.0
Chile (Unitary/Dem)	32.0	30.0	28.5
Benchmark (Average)	35.0	31.5	24.5

Source: World Development Indicators, 2007<sup>126</sup>

Argentina has one of the lowest rural-urban gaps, while Brazil and Mexico have one of the highest. Although all three are federal governments, it remains difficult to conclude that federalism contributes to this disparity. Chile and Uruguay, both unitary countries, have a much lower rural-urban disparity, partly since Chile has an overall higher level of income and Uruguay faces lower administrative difficulty in providing access, given its small size.

### **Implications**

1. **Federal governments in Latin America appear to be characterized by a greater urban-rural gap.** In general, Mexico and Brazil exhibit a significant access gap between the rural and total population. In perspective, these two countries have the greatest rural population as a percentage of total population. Generally, federal governments are geographically larger

<sup>126</sup> The data on Uruguay does not seem to be very reliable, especially given the claim of 100% access to sanitation facilities in urban areas and 99% in rural areas.

than unitary governments. In Latin America, Brazil, Argentina, and Mexico clearly dwarf Uruguay and Chile in terms of total geographic area. As a result, such large governments utilize federalism as a mechanism to solve the challenges of oversight and representation over an expansive geography. Especially in light of a high rural-urban gap, countries may perceive federalism as a viable method of increasing local representation that would effectively allocate resources to difficult to reach areas. As aforementioned, the Mexican government justified federal reforms to improve the efficiency and equality of resource allocation. Hence, this implication suggests that a high rural-urban divide, especially when coupled with a large geography, may compel a country towards adopting federalism as a governance structure.

- 2. Decentralization reforms potentially aid in the process of reducing the rural-urban gap.** As aforementioned, the persistence of a rural-urban gap over a large geographic area may provide a compelling reason to create federal institutions. For example, politicians have invoked federalism and decentralization reforms as a mechanism to reduce inequities across states in Mexico, as in the case of public education and health. With the exception of Brazil, the urban-rural access gap has decreased over the last three periods, coinciding with second-generation decentralization reforms. In particular, Argentina provides a clear example of a substantial reduction in the urban-rural access gap, in which the gap fell from 36% from 1990-1994 to 11.5% in the most recent period. Likewise, Mexico registered a 7% improvement. Although unitary governments have also improved, the magnitude of change is smaller. Hence, the indicator appears to confirm the implication that federal institutions can aid in the process of reducing a rural-urban divide.

## Conclusions

Fundamentally, federalism's appeal derives from a general conviction that decentralization improves economic and political performance and accountability. An analysis of the governance structure, historical evolution, and various economic, rights, and social indicators of six Latin American countries suggest that federalism provides positive benefits, thus confirming the Inman's conclusion that decentralization provides unique benefits. Federalism's aggregate contribution to economic and rights performance, however, depends largely on the actual political dynamic particular to each country. As illustrated in the analysis, a cursory survey of the Constitution and the use of broad indicators, such as average revenue assignment and presence of democracy over the past 40 years, mask the fact that in actuality,



countries such as Mexico and Venezuela may have not their explicit political objectives enumerated in the Constitution. The following four conclusions summarize the main findings of the case study:

**1. Diffusion of political power improves rights performance and democratic accountability, of which federalism provides an important institutional framework.**

In Mexico, the strengthening of federal institutions opened up new electoral spaces that promoted political party competition that eventually led to reform and democratization. In addition, the federal reforms bred coalitions that provided an important institutional check against existent power structures and PRI domination (Pages 32-36, 50-52). Likewise in Argentina and Brazil, federalism played an important role in strengthening democratic institutions after a long period of military rule (Pages 7-8, 11-12, 14-15, 18-19, 50-52). The constitutional structure of democratic federalism provided an important check on government to ensure representation at local levels, which military rule had suppressed (Pages 7-8). Federalism also provided an essential constraint on presidential or executive power – a mechanism to prevent political rights abuses that had occurred under military rule (Page 11).

In unitary governments such as Chile and Uruguay, increasing municipalization – a form of decentralization – has strengthened political voice, participation, and representation at the local level (Pages 27-29, 38-39). As Uruguay implemented elections at the municipal level and improved the institutions of direct democracy, traditions of direct and participatory democracy have considerably progressed, from direct citizen referendums to the rise of civil society organizations aiming to engage municipal governments (Pages 27-31). In fact, despite the Constitution's declaration of unitary governance, the government of Uruguay reflects a high degree of political and fiscal decentralization, similar to that of federal republics (Page 27). Likewise in Chile, the rising appeal and predominance of local office has created new channels of political participation in plebiscitary politics and increased the level of representation at the local level (Page 42).

Conversely, Venezuela has slowly increased the level of centralization, moving away from its long federal traditions (Pages 22-24) – most notably in the recent Chavez administration. Overall, federalism has a rather ambiguous effect on democratic accountability and rights performance in Venezuela. Although the current weakening of federal institutions under the Chavez regime has decreased rights performance (Pages 23-24, 50-52), federalism

itself had contributed to a new political context that facilitated the rise of populist leaders due to political fragmentation (Page 25-26). Likewise, as Latin America's most centralized federation, the concentration of fiscal power at the central government reduces the capacity of state and local governments to check such populist leaders, who have the resources to enact broad policy changes, often financed by oil revenues (Page 23-24). Hence, as shown in the case of Venezuela, fiscal centralization increased the ease of political centralization, especially since sub-national governments depend on the resources and support of the central government. Nevertheless, the federal system in Venezuela has provided important checks against Chavez's increasing political agenda to consolidate his executive power (Page 26).

## **2. The contribution of federalism to aggregate economic performance remains ambiguous.**

Federalism's effect on economic performance remains ambiguous, seen through the examples of Brazil and Argentina (Pages 43-50). As Brazil's history attests, various institutional factors influence the ability of federalism to affect central government. In Brazil, federalism constrained the ability of the president to enact much-needed economic reforms in the early 1980s due to a high degree of political fragmentation and dissent. As a result, state debts to federal government burgeoned and state governments stalled much-needed macroeconomic stabilization policies. Federalism under the Cardoso regime, however, differed dramatically. By managing to obtain multi-party support and overcoming the divisive nature of political fragmentation, Cardoso created coherency and consensus in the Brazilian government, thus managing to control inflation and improve macroeconomic stability with broad support from Congress (Page 15-16). In Argentina, centralization of tax revenues and fiscal power in the central government under the Menem administration led to initial macroeconomic improvement in comparison to earlier administrations that had a greater level of fiscal decentralization, the results were short-lived as neoliberal reforms failed to deliver sustained benefits (Page 19-20).

In Mexico, federal reforms of the 1990s coincided with economic liberalization and profound economic transition, which generated income growth, investment, and productivity increases (Pages 37, 43-50). The direct link between federalism and economic reform, however, remains tenuous, especially since fiscal federalism introduced new problems of fiscal irresponsibility at the sub-national level (Pages 8-9, 37). Fiscal irresponsibility, however, can also exist in unitary governments, as in the case of Uruguay, in which financial indiscretion by sub-national actors occurs through accumulating debts with other government agencies and

obtaining discretionary transfers from the central government (Page 28, 31). As discussed in an Inter-American Development Bank report, first generation decentralization reforms in the early 1990s in Latin America often failed to take into account market-based principles, such as incentives and public choice theory, thus destabilizing the overall macroeconomic framework, especially in light of haphazard government spending (Pages 8-9).

In comparing federal to unitary governments, Chile sets an example of a unitary government with significant economic performance. Pinochet's purported economic "miracle" in Chile reflects less on its unitary structure, but on the specific policies of the administration (Page 38-39, 43-50). The military dictatorships in Argentina, Brazil, and Uruguay all centralized government and created varying degrees of unitary rule, but failed to accomplish macroeconomic reform. Nevertheless, unitary and centralized rule, however, does increase the ease of enacting comprehensive reform (Pages 38-39, 41-42, 49). Without political competition or dissent, Pinochet could implement unpopular policies, such as the sale of state-owned enterprises and the privatization of public utilities. The social costs, however, remain great. In addition, dictatorships have also entrenched opportunities for acute corruption and the misuse of public resources for private gain. A survey of dictatorships in the world today exposes the fact that plenty of autocratic rulers exist without accomplishing economic reform.

### **3. Decentralization improves access to public goods, in both federal and unitary governments.**

Throughout the past two decades, the World Bank, United Nations, USAID, and Inter-American Development Bank have all emphasized the importance of decentralization in social welfare programs. In theory, decentralization of social services increases the efficiency and impact of public goods and resources because local agents are often more attuned to the preferences and priorities of the local population. As confirmed in the indicators and analysis of historical evolution, decentralization and administrative federalism have increased access to social goods, lowered regional inequities, and improved efficiency in resource allocation by taking into account local priorities (Pages 56-62). For example, in Argentina, decentralization reduced intra-regional disparities and increased on aggregate the level of human development in the areas of health and education (Page 19).

Decentralization benefits both unitary and federal governments. Most notably, under Pinochet's unitary government, the municipalization of the hospital system contributed to high

rates of immunization – well above the performance of all other Latin American countries which had adopted centralized health systems (Page 56-57). In fact, all the case study countries – Brazil, Argentina, Mexico, Uruguay, Venezuela, and Chile – have pursued health care decentralization reforms in the past twenty years. As shown in the indicators, life expectancy at birth, immunization, and poverty headcount reflect a connection between decentralization and increased access to health care and services (Pages 56-60). Acting like ‘service delivery agents’, municipal governments in Chile provided local public service on a cost-effective basis, without having local governing power (Page 38-39). In Uruguay, the reorganization of municipal administration increased the level of social accountability, thus facilitating social investment and access to urban public goods (Pages 28-29).

In regards to federalism’s unique contribution, federal governments generally require a political structure of decentralization. In most cases, sub-national actors in federal countries have significant administrative responsibilities and greater fiscal latitude, thus providing an institutional framework that facilitates an optimal structure of delivery of public goods and information. Nevertheless, decentralization reforms can still be effectively carried out in unitary governments, which use municipal channels and other regional government networks. Conversely, federal governments that have a degree of fiscal centralization and limited administrative responsibilities at the sub-national level, such as in Mexico before the 1990s, do not harness the full benefits of decentralization (Pages 32-33, 36).

**4. Federalism, however, potentially creates political fragmentation that may block important reforms or give rise to a power vacuum for populist leaders. As a result, rights performance, democratic accountability, and economic and social progress may stall or deteriorate.**

Most notably, in Venezuela, the enhanced political competition, the division between regional and national elections, the reelection of governors and mayors, and an increase in their financial autonomy – all – all characteristic aspects of federalism – contributed to the fragmentation of the party system and to the personalization of the vote (Pages 23, 25-26).<sup>127</sup> With intensified political competition, governors and mayors took advantage of windows of opportunity to enhance their own political power and weaken the power of party leaders. As accountability, transparency, and political competition increased, personalization of the vote

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<sup>127</sup> Penfold-Becerra, Michael. “Federalism and Institutional Change in Venezuela.” Federalism and Democracy in Latin America. Johns Hopkins University Press, 2004.

undermined entrenched powers, giving rise to populist outsiders such as Chavez. Nevertheless, according to Penfold-Becerra, despite Chavez's success in increasing presidential power, he remains unable to undermine the full federal system, especially since direct election of regional and sub-national authorities check executive influence – an example of federalism's positive contribution to democratic accountability through increased layers of political competition and oversight (Page 26).

Although federalism stalled economic reform in Brazil (Page 15) and created a political vacuum in Venezuela, federalism actually strengthening a unified coalition against the PRI in Mexico, enhancing political cohesiveness rather than undermining the party system. In fact, federalism played an essential role in improving electoral transparency and facilitating the presidential transition from the PRI party to the "Alliance for Change" candidate Vicente Fox in 2000 (Page 35-36). As a result, determining the net effect of federalism on the party system requires careful analysis of the unique political context of the country.

In general, the findings appear to support Inman's conclusions. The case studies confirm that decentralization uniquely contributes to the protection of property, political, and civil rights. In addition, although unitary governments can benefit from policy decentralization, federalism provides an important institutional framework to maintain and support decentralization with adequate fiscal and administrative support.<sup>128</sup> The effect of decentralization and federalism on economic performance in Latin America, however, remains ambiguous, contrary to Inman's original findings. His third conclusion, that adding policy decentralization does not improve economic or rights performance in dictatorships remains untested as the military dictatorships of Latin America corresponded with a period of centralization. Although Chile benefited economically from centralization, the other countries suffered from severe economic mismanagement, which further sparked the impetus for return to civilian rule. In all cases, political and civil rights suffered under military dictatorship.

In general, the insights of this case study provide a series of useful policy implications for Latin American countries by analyzing the relationship between decentralization and governance structure on economic, rights, and social performance. As Latin America's three largest countries – Brazil, Mexico, and Argentina – are federal republics, comprising 65% of the

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<sup>128</sup> Inman, Robert. "Federalism's Values and value of Federalism" NBER Working Paper, January 2008.

region's population, understanding the dynamics of federalism and analyzing its associated political and economic outcomes is essential to promoting human development.

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