

WORKING PAPER 266

Get What You Want, Give What You Can: Embedded Public Finance in Porto Alegre

Aaron Schneider and Marcelo Baquero
May 2006



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Abstract

The problem of public finance in Latin America is a structural contradiction. The historical pattern of insertion in the international economy creates a large number of poor who have very real material needs for public services, but they cannot individually or collectively contribute the funds to pay for them. Rich people hold wealth, but they are unwilling to contribute to public services that go to other groups while they turn to private schools, education and transportation. They are especially unwilling to hand over their wealth to governments perceived as corrupt, inefficient, and illegitimate. This raises a basic puzzle: how do governments provide for those in need while securing the compliance of those with wealth?

In this context, the innovation of participatory budgeting is a striking example of embedded public finance in which taxes and expenditures are rooted in government legitimacy. Three elements comprise embedded public finance:

- Democratic participation in which an increasing number of citizens participate in public decisions, and different groups, especially the poor, have been incorporated;
- Progressive public spending in which investment in poor neighbourhoods has increased both in absolute terms and in relation to rich neighbourhoods;
- Competent governance in which perceptions of corruption have decreased, and administrative structures riddled with clientelism and patronage have been reformed.

These three elements rest atop a political coalition that joins middle sector and poor voters. Because these citizen groups have different needs, the state had to tailor the benefits it extended to the demands of each group. This strategy allowed the state to mobilise distinct contributions from each group, votes from the poor and tax compliance from those with wealth.

Keywords: public finance, participatory budgeting, tax, Port Alegre, investment, public expenditure.

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1 Introduction

In January 2003, a citizen reported to a municipal official to pay his property taxes. In most cases, this would not be all that remarkable, but this was different. This was a man living on unregistered land on an island in the river next to the city of Porto Alegre, Brazil; he was a poor migrant from another region without legal ownership; the city had no realistic record of acreage on the island or his presence there; he was under no real obligation to property tax. Yet, he voluntarily came forward. Even more surprising, he was not alone; there were several hundred similar cases. Why would a person voluntarily pay a tax they did not necessarily have to pay? When asked, he explained, 'We want to pay our taxes. It's the right thing to do. It would give us more security, more peace of mind. If we are not paying, after all, we can't make the claim for user-rights ... The participatory budget has operated here for many years, and I even go to the meetings, but I didn't feel I could make demands. Until now. It wasn't because I didn't have needs, but until now, I hadn't paid any taxes.'

This example speaks eloquently of a unique innovation in public finance. That innovation, participatory budgeting, has changed the way citizens view the state, altered the organisation and performance of the public sector, and allowed the state to mobilise previously untapped revenues. This new fiscal regime, with participatory budgeting at its heart, responds to a fiscal straightjacket that constrains developing countries, and Brazil in particular. They operate in an environment of resource scarcity made worse by the inadequacy, inefficiency, and inequity of revenues, rooted in the illegitimacy of state administrations. Nicholas Kaldor long ago asked, 'Will underdeveloped countries learn to tax?' (1963), and among developing regions, Latin American countries have learned to tax less and more regressively than any others (Lledo, Schneider, and Moore 2002; Bird, Martinez-Velazquez and Torgler 2004; Tanzi and Zee 2000). Yet, tax in Latin America is not a problem because of a lack of resources; these are mostly middle income countries with pockets of extreme wealth waiting to be mobilised (IADB 1998; Schneider, Acharya and Ugaz 2005).

The problem of public finance in Latin America is structural; the historical pattern of insertion in the international economy has concentrated domestic wealth and created a host of social and political problems. Poor people have very real material needs and they depend on public services for survival, but they cannot individually or collectively contribute the funds to pay for them. Rich people hold wealth, but they are unwilling to contribute to public services that go to other groups while they turn to private schools, education, and transportation. They are especially unwilling to hand over their wealth to governments perceived as corrupt, inefficient, and illegitimate. This raises a basic puzzle: how do governments provide for those in need while securing the compliance of those with wealth?

In this context, the performance of Brazil's government in raising taxes has been particularly remarkable. The country mobilises 37 per cent of GDP in tax revenues, a quantity that places it among OECD countries despite a far lower per capita income and a distribution of wealth among the most unequal in the world. In Porto Alegre, tax capacity has also expanded significantly, but it has expanded in a distinctive fashion. The rest of the country has raised taxes while leaving serious distortions, inefficiencies, and imperfections, largely as a result of concentrating on indirect and cumulative taxes that increase the tax take but exacerbate the dead-weight losses for the economy (Varsano 1998: 2003). Tax effort in Porto Alegre is different. It provides a unique opportunity to study the way revenue, spending, and legitimate government go together.

At the root of expanded tax capacity is a new regime of embedded public finance composed of three elements:

- Democratic participation in which an increasing number of citizens participate in public decisions, and different groups, especially the poor, have been incorporated;

- Progressive public spending; investment in poor neighbourhoods has increased both in absolute terms and in relation to rich neighbourhoods;
- Competent governance; perceptions of corruption have decreased, and administrative structures riddled with clientelism and patronage have been reformed. As a result, embedded public finance mobilises resources for development; tax revenue has risen, over and above transfers from central government.

We connect these elements by tracing the niche marketing strategy associated with participatory budgeting. It embedded public finance in a cross-class coalition of poor and middle class voters in which categories of voters perceived their relationship with the state in different ways. This is only natural; middle class voters and lower class voters care about different things. Yet, the need for a government to tailor its appeals is overlooked in most analyses of public finance and governance more generally.

In the following section, we draw from literature on state-society linkages to derive a model of embedded public finance. We then proceed to examine the institutional innovations that were designed to create closer links between state actors and social groups, and explore some puzzling patterns of participation that suggest differences in the ways groups connected to the state. We then trace the revenue and expenditure implications of embedded public finance in Porto Alegre, with particular attention to the kinds of revenues mobilised and the distribution of expenditures that followed. Finally, we report the results of a public opinion survey that traces the way in which citizens perceived their relationship with the state. In effect, the state offered the tailored benefits social groups demand while seeking the contributions each group could offer.

2 Embedded public finance

To understand the nature of the state-society relationship constructed around participatory budgeting, Peter Evans's provocative concept of embedded autonomy is useful. Evans described the nature of state society linkages in developmental regimes as a combination of autonomy and embeddedness. His concept charted an intermediate path between (1) Marxist and pluralist views that reduced the state to a response to social forces and (2) elitist views that looked only at the nature of state institutions and political elites. Evans focused on the way actors within the state embedded themselves in relevant social groups (Evans 1995). 'The power of embedded autonomy arises from the fusion of what seem at first to be contradictory characteristics. Embeddedness provides sources of intelligence and channels of implementation that enhance the competence of the state. Autonomy complements embeddedness, protecting the state from piecemeal capture, which would destroy the cohesiveness of the state itself and eventually undermine the coherence of its social interlocutors' (Evans 1995).

The combination of embeddedness and autonomy allows a virtuous circle of responsive and capable authority. First, state actors are close enough to society to perceive the demands of different groups. Second, state actors have the autonomy to manipulate their policies to selectively respond to societal demands in ways that build a support base patching together potentially disparate and competing groups. As a result, the state can call upon the contribution of these groups, mobilising resources, legitimacy, and political support necessary to promote development. The balance between embeddedness and autonomy is difficult. Too much autonomy and states become exclusionary, illegitimate, and potentially authoritarian. Too much embeddedness and the state becomes a captured instrument of narrow interests.

In the context of public finance, embedded autonomy refers to a system that gathers and distributes resources through close links between state actors and their societal counterparts. Participatory budgeting institutions assist in this task by penetrating society but remaining open enough to be sensitive to societal demands. As a result, the state can call on the political and material support of citizens.

The interesting aspect of participatory budgeting for the current project is the innovative exchange dictated by the social composition of embeddedness. In Porto Alegre, the sectors targeted include lower class and middle sectors, which have different demands and different potential contributions. The nature of the state-society relationship therefore has to be customised. Middle sectors exchange their tax contributions for democratic and participatory governance; poor voters offer their political support for redistributive spending. To examine these patterns, the following sections will explore the evolution of participatory budgeting over the last 16 years, patterns of public finance and participation, and the results of a survey of citizen perceptions in 2003. In particular, the study shows how an effective, progressive, embedded public finance operates.

Before proceeding, it is useful to emphasise that the current analysis stands apart from previous studies of participatory budgeting in a number of ways. First, this study is state-centric. It considers how state actors designed institutions to achieve fiscal capacity and political support during the 1990s. The attempt to 'See Like a State' (Scott 1998) stands in contrast to most studies of participatory budgeting which focus primarily on society. Society-focused approaches emphasise the widespread and diffuse normative results of a more deliberative democracy (Fung and Wright 2003; 2001). Studies of this type usefully examine the social conditions necessary to introduce participatory budgeting (Baierle 1998a, 1999; Cabannes 2004; Goldfrank 2005; Wampler 2004; Avritzer and Navarro 2003), the impact of deliberation on popular consciousness (Avritzer 1999; Baierle 1998b; Abers 1998, 2000); and the social capital generated by an empowered and active civil society (Baicocchi 2003: 58; Navarro 1998a).

Curiously, diffuse social capital and heightened citizen consciousness did not translate directly into greater state legitimacy and ability to mobilise resources (Baquero et al. 2005). Brazilians, like most people, do not like paying tax, and no amount of public feeling makes them want to hand over their paycheck. In Brazil in general, tax morale is relatively low and democracy is only moderately supported (Torgler 2004).

On the other hand, it is clear that in Porto Alegre state capacity strengthened, government paid far more attention to the poor, and institutions opened to popular participation. In some ways, the fact this shift did not depend on a massive groundswell of fellow-feeling is propitious; we do not have to change human nature to achieve embedded public finance. What made embedded public finance possible was targeted links to specific social groups. This paper looks at how these links operated.

In all the literature on the topic, nobody has framed participatory budgeting in quite this way. Part of the reason may be the intellectual biases of international observers and Brazilian progressives. Internationally, many of those most interested in participatory budgeting see it as a fulfillment of citizen rights to participation and public services. To talk of links to specific groups implies an unpalatable particularism and exclusivity in which some benefit and others do not. In Brazil, targeting has an even worse association; Brazilian progressives see targeting as a code for neoliberal social programs that cut overall spending to sustain fiscal discipline while leaving a few crumbs to the very poorest. Brazilian progressives much prefer to use the language of universalism, in which entitlements are guaranteed to all, and no distinctions are made among citizens (Draibe 2004).

Participatory budgeting was neither particularistic nor neoliberal, but the fear of these concepts blinded observers to certain features of the system. The revenue side of participatory budgeting remains remarkably misunderstood. Most observers note that participatory budgeting emerged just when the central government increased transfers and the municipal government raised taxes. They treat the availability of additional resources as something exogenous, outside, and apart from the real action taking place on expenditures. This separation between revenues and spending is a symptom of public finance more generally in which inflows and outflows are treated as separate entities to be managed by different administrations and understood with different concepts. The case of participatory budgeting demonstrates that the two sides of the fiscal ledger are intimately linked.

3 Participatory budgeting institutions

Following their electoral capture of the mayor's office in Porto Alegre in 1988, Workers' Party activists structured participatory institutions that consistently attracted thousands of people to meetings to discuss the budget. These meetings offered government access to citizens both directly and indirectly, through the publicity gained as a result of opening public decisions to participation. As a result, the government was able to greatly increase its tax receipts, restructure public action towards investment, and target investments towards poor neighbourhoods and social sectors. The institution and the patterns of public finance are now so well entrenched that they survived the exit of the Workers' Party from power in 2004. The new administration has continued with participatory budgeting, impressive fiscal revenues, and honored the spending priorities chosen in participatory meetings.

The Workers' Party administration initially faced a bankrupt municipal government, an opposition majority in the city legislature and a hostile public among neighbourhood associations linked to the party of the outgoing administration. To meet these challenges and mobilise support, the administration established an open system of neighbourhood meetings that would make decisions on the budget (Fedozzi 2000: 132–46). The meetings allowed 'unorganised' community movements to participate, skirting hostile neighbourhood associations (Baiocchi 2004; Goldfrank 2003) as well as creating a direct link between the executive and the populace that would avoid mediation through the municipal assembly (Goldfrank and Schneider, forthcoming).

Participatory meetings were held in each neighbourhood. These produced delegates to 16 regional meetings for the city. As an incentive to increase neighbourhood participation, the number of regional delegates was a weighted proportion of the number of people that showed up to neighbourhood meetings (Avritzer 2002b). Regional meetings then occurred periodically during the budget cycle and involved information sharing, deliberation on priorities and projects, oversight of projects being implemented, and selection of delegates to a city-wide budget council. In this council, two councilors from each region entered discussions with municipal representatives to select priorities for investments and allocate spending across regions.

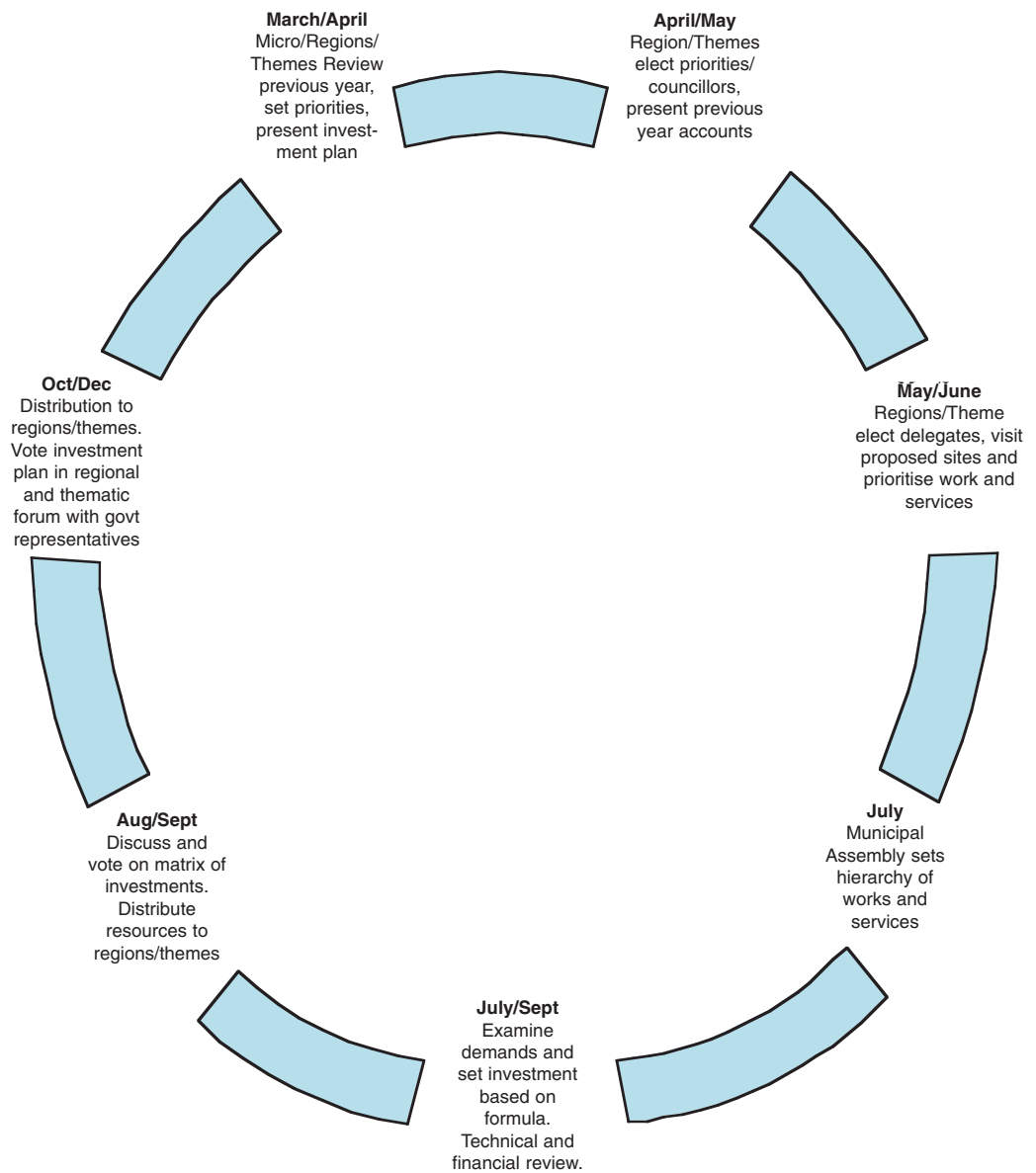
The priorities of the regions entered a formula that determined the level of investments to different sectors and across regions. The formula took into account factors such as the infrastructure needs of different neighbourhoods, levels of poverty, and the population of the neighbourhoods. The resulting allocation was discussed in the council and, once approved, integrated directly in the municipal budget sent to the legislature (dos Santos 1998). During the subsequent year, regional meetings and the council of delegates would oversee implementation, and towards the end of each year, could decide on modifications to the process, such as changes to the investment formula, designation of regions, and structure of participation.

One modification to the structure occurred under the second Workers' Party administration that began in 1993. The administration introduced thematic meetings alongside the regional ones. Like the regional meetings, thematic meetings opened participation widely, selected priorities, elected councilors to the municipal council, and oversaw implementation, but the thematic meetings differed in their focus on city-wide issues. The five thematic regional meetings in 2002 were city organisation and urban development; health and social assistance; economic development and tax systems; transport and circulation; and education, culture, and leisure. The establishment of the thematic meetings was intended to help promote more city-wide investments (Abers 2000: 84–5); to give greater attention to middle-class professionals whose personal material needs were met, but who had professional interests in contributing to municipal planning and policy ('E Hora da Classe Media disputar espaço no OP', *Zero Hora* 22 December 1992; Navarro 1996: 27; Baiocchi

2004: 49–51); and to better include the established corporatist organisations such as unions and business associations (Fedozzi 2001: 133–4).

Figure 3.1 below describes the participatory budget cycle as it operates throughout the fiscal year.

Figure 3.1 Participatory budget cycle



The installation of participatory budgeting implied a rearrangement of municipal institutions. Bureaucratic hierarchies and ministerial tasks had to be adjusted to link them vertically to regions of the city and groups within society. Much of the administrative apparatus that would articulate these links was subordinated directly to the authority of the Mayor’s office or indirectly to the Mayor through Secretaries. At the heart of the process was the Cabinet of Planning (GAPLAN), with primary responsibility for strategic planning, managing the investment plan, and coordinating the annual budget proposal. Some of these tasks had previously been located in the Secretary of Planning, but they were consolidated under the authority of the Mayor beginning in 1990.

The other major bureaucratic instrument within the participatory budget was the Community Relations Coordination (CRC), which was also moved under the direct authority of the Mayor's office. The CRC officers were responsible for representing the government in each of the participatory meetings, coordinating them, and securing links with the communities. The office itself was a buzz of activity, and CRC employees were among the most talented and charismatic proponents of participatory budgeting. They appointed regional (CROP) and thematic (CT) coordinators who would accompany the meetings by providing technical assistance and general direction to community organisations for the articulation of demands. Finally, the secretaries of municipal agencies had their own assessors who would provide a link between individual agencies and the public (Fedozzi 2000: 68).

Together, the CRC and the GAPLAN created a new bureaucratic architecture of budgeting that articulated the embedded public finance envisioned by the Workers' Party. GAPLAN would be the technical and rational agency, developing budgets according to formal rules and subject to secretarial and executive oversight. CRC would be the penetrative agency that would extend the state into the communities to gather information, justify decisions, and deliberate priorities with citizen participants (Fedozzi 2001: 103–6). These were not insignificant appendages to the state; they were major sites of bureaucratic authority and policy influence, and they were supported by hundreds of partisan activists, dedicated to the participatory budget process and loyal to the Mayor (Gert and Sintomer 2005).

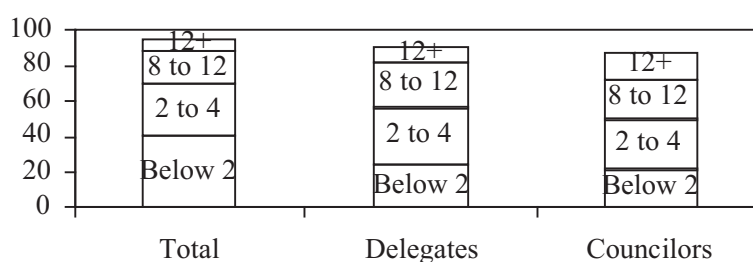
It should be mentioned that the dramatic changes in administrative processes and structures were not accepted by all within the municipal administration. There was a sizeable group who, for partisan or professional reasons, did not support the shift to a participatory process for deciding investments (Fedozzi 2001: 87). They were backed by a strong corporate identity rooted in the state-led development plans of preceding decades that had produced vertical hierarchies of professional cadres within technical and bureaucratic structures. These groups posed an obstacle to initial changes, and the municipal administration had to overcome them. To do so, the administration offered retirement plans to some, gained the trust of others by honoring salary increments offered by the outgoing Mayor, and reorganised the most important portions of the planning bureaucracy directly under the office of the Mayor. In addition, by arranging municipal agencies according to the geographic boundaries of the participatory budgeting regions and decentralising some authority to these regionalised entities, the administration disarticulated vertical hierarchies of individual agencies. As a result, bureaucrats came to identify with regional improvements and respond to the demands of the community rather than the career incentives present in sectoral agencies (Navarro 1997).

In sum, the municipal administration that came to power in 1989 sought to reorganise the way in which public finances were managed. The institutions they constructed included participatory meetings that operated first in different regions of the city, and later, thematic, city-wide meetings. These institutions incorporated mechanisms of accountability and deliberation for the public to choose investment priorities and oversee government, and allowed government access to members of the community. These would be the roots of an embedded public finance that could target differentiated moral and material appeals to various sectors of the population. In exchange, the state could secure the contributions each group could offer. The sections below trace out the way poor and middle sector groups were increasingly drawn into closer contact with state actors through participatory meetings.

4 Participation: who, where and why

Some of the most striking research on participatory budgeting has focused on patterns of citizen participation. This paper will attempt neither to cover all of this literature, revise the conclusions, nor add anything particularly new (Nylen 2002: 135; Giacomoni 1993; Schmidt 1994; Fedozzi 2000; Tavares 1995; Abers 1996; Baiocchi 2000; Goldfrank 2003; Wampler 2004). Participation increased over time, which was a significant achievement in itself. There is evidence that people participate for different reasons. This provides the first clue that something unusual was happening; embedded public finance would have to be customised for different groups. Participation rapidly increased over time. From 1989 to 2000, participation in the two rounds of budgeting rose from 1,510 to 19,025, with a peak of over 20,000 in 1999. The pattern of participation is also revealing when disaggregated by income group. In a survey conducted by the non-governmental organisation CIDADE in 2002, the patterns of lower class participation and representation are evident. In all the meetings, those with incomes below two minimum salaries made up almost 40 per cent of the participants, but they were 23 per cent of the regional delegates and 21 per cent of the municipal councilors. More lower-middle and middle income groups gained representation in these meetings, though the very poor remain an important group. The figure below shows the percentage of participants from income groups measured in terms of minimum salaries per household in which the minimum salary in 2002 was around US\$80.

Figure 4.1 Participation by different income groups



Adapted from www.ongcidade.org/site/capa/capa.php, checked 19 June 2005.

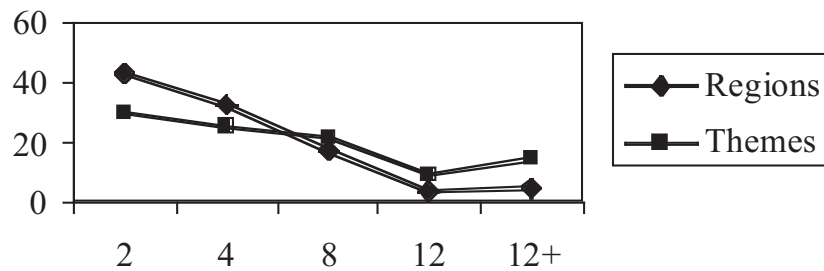
Interesting patterns also emerge when one compares different types of meetings. In almost all the meetings, it was the case that poorer people outnumbered more wealthy ones. On the other hand, poorer groups dominated thematic meetings much less, as had been intended by the state actors who designed thematic meetings to attract middle sectors.

The other main observation to be made on participation patterns was the justifications people gave for participation. When asked, most people explained their participation because they appreciated 'investment in poor areas', i.e. the material benefit of budgeting. Yet, the other top six responses were all decidedly non-material: honesty, seriousness, innovation, democracy, competence, and transparency. This division between the material and non-material benefits of budgeting attracted our interest. Though it was not the central question to be answered here, we were curious to know who was participating for what reason?

We conducted a survey in the spring of 2003 (Baquero *et al.* 2005). That survey cluster-sampled by neighbourhood to ensure a representative number of middle sector and poor respondents. The details of the survey will be discussed below. Among the 687 respondents, the survey showed some interesting patterns of who participated for what reasons. There were two different justifications for participation. One justification was material and the other non-material. Interestingly, poor respondents were most interested

in the material benefits they hoped to receive, and middle sector respondents, by contrast, were attracted by both material benefits and the democratic and transparent nature of governance. In formal terms, middle sector citizens were 2.26 times more likely to participate in meetings if they thought participatory budget had decreased corruption, and they were 2.24 times more likely to participate if they had received material benefits from participatory budgeting. Poor citizen participation did not change with opinions of democracy and corruption; rather, the likelihood of participation for poor citizens increased 2.79 times if they thought they received material benefits.¹

Figure 4.2 Average percent participation by income (avg minimum salaries 2002)



Adapted from Gomes *et al.* (2003: 16).

These results are not intended to explain why people participate, nor are they intended to evaluate representation. This has been the focus of most of the literature on the quality of participation (Hickey and Mohan 2004). In contrast, we are interested in viewing society through the ‘eyes’ of the state. What might state elites have seen had they designed appeals that they thought would resonate when looking at society? We found that poor citizens and those associated with organised sectors of civil society participate most, though both lower and middle sectors were involved. It was also clear that the motivations for participation varied significantly, with poor citizens attracted by the potential to secure material benefits and middle sectors also seeking non-material benefits. This is consistent with observations from public opinion surveys in other parts of the world where those whose immediate needs are met seek ‘post-material’ values in their public action (Inglehart 1990). These results are also suggestive of the kind of embedded public finance the government of Porto Alegre would have to build to be successful. Before exploring embedded public finance in more detail, we explore its fiscal components in the next section.

1 We performed a logistic regression of participation on survey responses to questions relating to ‘the best thing about the participatory budget is the democratic process,’ ‘participatory budgeting decreases corruption,’ and ‘I’ve received material benefits from the participatory budget.’ For middle sectors, the coefficient on ‘corruption’ (0.82) and the coefficient on ‘material benefits’ (0.81) were both statistically significant at $p < .05$. For the lower classes, only the coefficient on ‘material benefits’ (1.02) was statistically significant at $p < .05$. The survey will be discussed in greater detail below.

5 The fiscal story – revenues

These patterns of participation differentiated groups on the basis of income. This was reflected in the types of appeals used to legitimate government and had distinct fiscal impacts: the government implemented tax policies that draw from those with wealth and directed investments to the poorer regions of the city.

The participatory budgeting project began in the context of extremely fragile finances. The public administration in 1988 was characterised by 'bloated mayoral office, low salaries, dissatisfied employees, decayed equipment, old vehicles, obsolete machinery, investment capacity around zero; in sum, absolute incapacity of municipal authority to attend to the minimal needs of maintaining services, investment, and renewal' (Verle and Muzell 1994: 26). Within five years, the city had turned itself around, including 'a rationalisation of expenses and inherited debts; refinancing of the deficit; administrative restructuring; and recuperating receipts' (Cassel and Verle 1994: 29).

To understand this shift, it is important to know the bases on which Brazilian municipal governments survive. Own-sources of funding in municipalities like Porto Alegre include taxes on several bases (services, income retained at source on salaries, transfer of property, and property), fees on services like garbage, sewage, and lights; profits on public companies (which were few); and financial gains (which were significant until the end of inflation in 1994). In the late 1990s, municipalities gained an additional boon to their finances with the transfer of health service funds (SUS). For many cities, the largest sources are constitutionally-mandated transfers from higher levels of government, which were greatly increased following the 1988 Constitution.

For many municipalities, increased transfers were double-edged. On the one hand, they provided income and authority; on the other hand local governments had to find administrative resources to manage inflows. Where administrative costs or unfunded mandates were high, transfers could actually imply a net loss for a municipality, especially with respect to earmarked transfers like SUS. In terms of the embedded public finance discussed here, the increase in transfers was especially problematic. Transfers are a source of revenue, but they do not depend on deep links to society. In fact, a source of financing independent of any links to society may cut people off from government, rather than encourage embedded public finance (Prud'Homme 1998).

In Porto Alegre, however, the period covered by participatory budgeting demonstrated impressive evidence of a more embedded fiscal contract. Over and above transfer receipts, the city greatly increased its own-receipts, and the fiscal condition of the government improved greatly. Total receipts increased 269 per cent from 1988 to 2004, though the number drops to 216 per cent if one discounts the earmarked health funds. More impressive, the increase in tax effort (338 per cent) far outpaced what one might expect simply as a result of economic growth, which was only 18 per cent in the city (Carvalho dos Santos 2005).

In particular, a close look at the kinds of taxes the municipality mobilised tells the story of a city seeking to raise money from particular segments of society. At 27 per cent of total taxes, the two main municipal taxes are the taxes on services (ISQN) and the tax on property (ITPU). In tax reforms between 1989 and 1991, the services tax was raised to levels equivalent to other major cities, and its yield increased by 172 per cent between 1988 and 2004. More important for the current analysis and for city finances, the main target of efforts to mobilise resources was the property tax. Returns increased by 416 per cent over the period, passing from 3 per cent of 1989 tax receipts to 10 per cent in 2004.

Several means of raising the property tax were employed. The city closed exemptions and loopholes, revalued properties, published a list of large debtors as an 'invitation to pay,' made the rate more progressive, and when progressivity was declared illegal by the Supreme Court in the late 1990s, recuperated revenue in 2003 with new rates on specially

classified properties. All of these efforts followed a common underlying principle that ‘those who had more should pay more’ (Navarro 1998b; Verle 1991). To a Workers’ Party seeking to appeal to citizens on the basis of income, property tax represented both the most productive tax handle available as well as the most just.

In addition to this resource mobilising potential, the property tax also served as a regulatory device (Fedozzi 2000: 82). The city could set rates to privilege different categories of residential, business, and landholding property owners, and give incentives to new patterns of land use (Goldsmith and Vainer 2001). In particular, the government discouraged large landholders from storing value in extensive holdings, a common practice under the high inflation of the early 1990s, but with negative implications for housing shortages and city centre congestion.

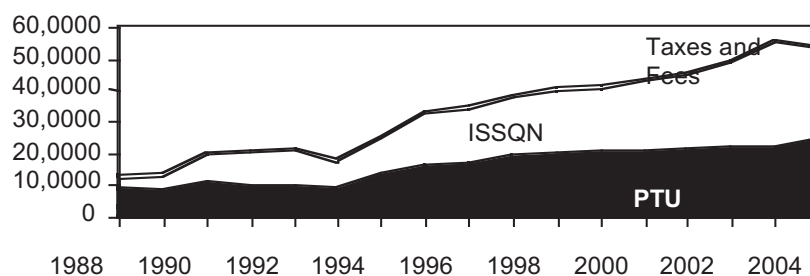
Some of the regulatory functions of the property tax emerged from the artistry of legislative negotiation. For example, the 2003 reform was dubbed a ‘green’ property tax that raised rates while giving incentives to environmentally friendly uses of land and encouraging a more rational usage of urban spaces. The environmentally friendly label ‘green’ earned moderate support from potentially opposed middle sectors. At different moments, similar exemptions were extended to retired people, the unemployed, churches, unions, and those with property of low value. Though these exemptions might have perforated the tax net, the city would pass tax increases with exemptions as temporary measures, and then gradually eliminate the exemptions over time.

One indication that the citizenry consented to these justifications for tax was an impressive decrease in tax avoidance. According to the Secretary of Finance, failure to pay property tax fell from 20 per cent at the start of the 1990s to 13.5 per cent by 1995. ‘The population has realised that there are no more holidays, and no more advantages to not pay on time’ (Arno Augustin, quoted in *Zero Hora* 9 August 1996).² The mayor attributed improved fiscal morality to improved monitoring and attaching tax to ability to pay.

These increases in revenue were directly related to participatory budgeting in several ways. First, the city used participatory meetings to mobilise support for tax reforms. Tarso Genro, the mayor elected in 1992 and again in 2000 observed, ‘The tax increase will be the expression of the political will of the general society’ (Tarso Genro, as quoted in *Zero Hora* 17 August 2002). This political was built in the 16 regional meetings, the Municipal Budget Council, and especially the Thematic Meeting on Taxation. Because the government knew that opposition legislators would oppose proposed tax changes, the city submitted proposals first to the participatory meetings. ‘The objective of the government was exactly to search outside the parliament the most support possible as a form of pressuring the deputies’ (*Zero Hora* 23 March 2000).

As an indication of the improvements in tax effort, the figure below plots own taxes over time in constant values. The city defied predictions of resource ‘fungibility’ which would suggest that local governments decrease their tax effort when they experience an increase in transfers (Prud’Homme 1995). Porto Alegre also goes beyond the ‘flypaper’ effect which predicts that cities will let money ‘stick where it hits’ by adding new transfers to old taxes without changing their own effort (Rosen 1997). Instead, Porto Alegre re-doubled its tax effort almost at the same time as it received major increases in transfers.

2 The practice of avoiding property tax through holidays had been an ‘industry’ in Brazil. Property-owners would delay payments and allow penalties to accrue until the government offered an amnesty. By then, inflation would have eroded the cost of the payments, and those who owed could make a healthy profit.

Figure 5.1 Tax receipts (2004 R\$1,000)

Adapted from Carvalho dos Santos (2005: Annex 9).

This tax increase was not an exogenous boost in revenue that allowed other things, like increased spending and participation to occur; but rather revenues, representation, and expenditures were closely related. The Mayor from 1997–2000 sensed this relationship when he explained that people were willing to contribute more taxes because they understood that ‘taxes return to them in the form of public services’ (Raul Pont, quoted in *Zero Hora* 13 December 1999). The following section examines exactly how those public services were made more effective and progressive.

6 The fiscal story – expenditures

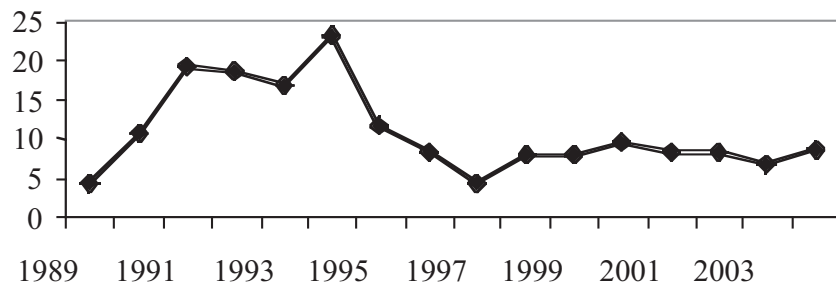
The expenditure side of the fiscal ledger involves changes to public services that included an increase in quantity, more transparent delivery, and a greater effort to target poor communities. Participatory budget institutions were associated with this shift in two ways. First, participatory budgeting included a decision-making process in which poor citizens had privileged access as a result of their higher levels of participation. Second, the formula used to distribute funds and to make other institutional decisions, such as the boundaries of different regions, gave preference to the poorest neighbourhoods that had the weakest infrastructure.

The main areas of interest here were investments and personnel, and the main allocative decisions were across sectors and neighbourhoods. The shifts produced by participatory budgeting were long overdue; in the 1970s and 1980s, public services had not adjusted to economic and social changes occurring in the city, including a decline in industrial production and employment, an increase in the service sector, and population growth as a result of in-migration, especially from the interior of the state. The municipal administration, however, had responded only by expanding personnel haphazardly, failing to rationalise administrative functions and increasing both the number and costs of personnel far more rapidly than was sustainable. While the population grew by 25 per cent, the number of public servants grew by 86 per cent, and the number of retired employees collecting pensions grew by 174 per cent. The burden for the public administration was exacerbated by the populist strategy of the outgoing Mayor in 1988, who gave the entire public sector a 237 per cent salary raise in the final month of his mandate (Fedozzi 2000: 81–2). This may have contributed to his victory in the governor race of 1990, but it saddled the city administration with an unsustainable wage bill.

In subsequent years, personnel expenses were brought under control. They fell from 100 per cent of current receipts in 1989 to 68 per cent in 1993 and were below 50 per cent from 1997 to 2001 (or an average of 65 per cent excluding the SUS transfers). They began to creep upwards after 2001, in part because receipts were not expanding as rapidly as before, but at no point did personnel expenses exceed federal ceilings that were eventually established in the 2000 Fiscal Responsibility Law.

In the 1980s, spiraling recurrent costs (especially personnel and interest payments) squeezed investment capacity, but from 1991 to 1995 the city greatly increased investments, which peaked at R\$172 million in 1994. For most of the 1990s, when loans were scarce and interest rates high, investment was sustained with own-receipts. After 1999, capital inflows in the form of loans began to return, and investments moved upwards after a lull during the second half of the 1990s. As a percentage of current receipts, investments peaked at 23 per cent in 1994, and they hovered around 8 to 10 per cent for most of the latter half of the decade.

Figure 6.1 Investment as percentage of receipts



From: Cavalho (2005).

Much of this investment was directed towards social sectors especially education. In particular, Brazilian municipal and state governments are expected to provide primary education, which is widely considered to be especially important to the poor. In 2004, Porto Alegre spent above the mandatory federal minimum on primary education and spent far more than the amount financed by the national government. The federal government, through the FUNDEF program, offered cities R\$2945 per month per student. The city spent R\$1199 per student, 3.6 times what was expected, and when one considers the high rate of well-to-do students sent to private schools (19 per cent of students in Porto Alegre are sent to private elementary schools), this represents a relatively targeted effort to direct funds towards education for the poorest citizens.

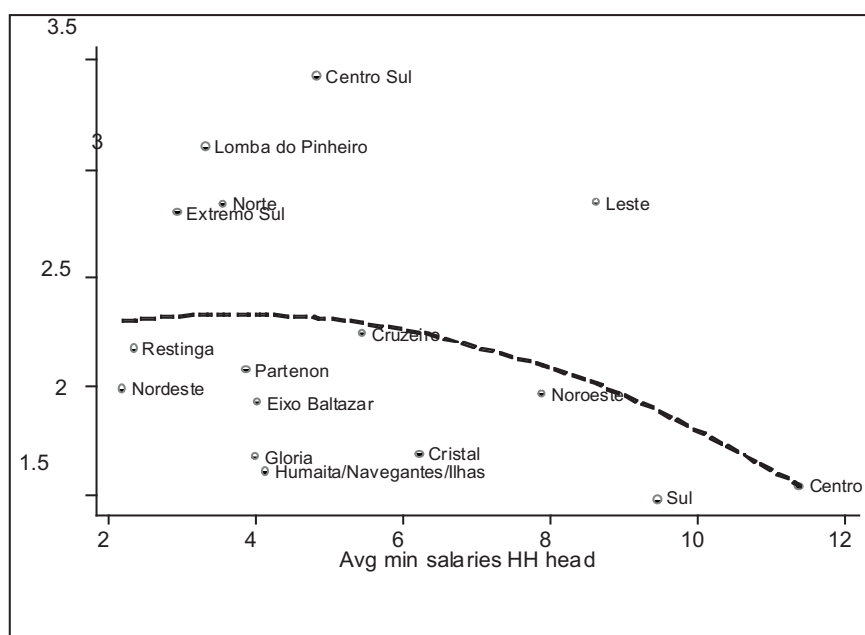
Another pattern of investment emerges when one examines the demands expressed in participatory budgeting. From 1993 to 1999, the top three priorities were sanitation, housing, and paving. The order switched from year to year, but that normally remained the top three. In 1992, 2002, and 2003, education was among the top three, and in 2000, health entered (Gomes *et al.* 2003: 35). This prioritisation led to some impressive achievements. More than 96,000 houses were connected to potable water sources, and the proportion of households with access rose from 83 per cent to 99 per cent. Over 130,000 houses were connected to the municipal sewerage system, raising the percentage with access from 46 per cent to 82 per cent (PMPA 2000). Other services also improved. The number of paved roads increased by 182 per cent, with the rate of new paving increasing from 4 to 20 kilometres per year. The garbage service doubled, and street lighting increased by 290 per cent.

A close look at the distribution of investments suggests that the city was also giving preferential access to the poor. To some degree, this can be attributed to the formula for investments which included a weighting associated with levels of poverty and need for infrastructure. As a result, poorer neighbourhoods received greater investment in their chosen priorities. In addition, the over-representation of the poor among participants gave

them additional power within participatory budget deliberations.³ It is difficult to get an accurate measure of the incidence of spending without extensive household surveys, but an impression is possible by disaggregating the city by neighbourhood. Census data from 1991 shows average income (in minimum salaries) of heads of households. There are obvious differences across the city, with the average income in Centro (Centre) more than five times the average income of household heads in the Nordeste (Northeast). There are also differences in the value of investments as a percentage of the total, with Centro Sul (Centre South) receiving more than twice the amount of investments as Sul (South). These differences were evident in per capita provisions Restinga received 35 kilometres of paving for each 1,000 people, Lomba do Pinheiro received 41, while Eixo received only 9.

We can use the data collected and analyzed by Adalmir Marquetti (2003: 139, 141) to examine the relationship between investment and average income of household heads. Following Marquetti, the best fit appears to be a quadratic regression of investment value on income of household heads. Investment value along the vertical axis is displayed in terms of average annual investment value from 1992 until 2000, and it stays relatively flat in very poor and poor neighbourhoods before tapering rapidly once the average income increases in the wealthier neighbourhoods.

Figure 6.2 Neighbourhood investment



Source: Marquetti (2003: 139, 141).

To summarise, Porto Alegre underwent rapid change beginning in 1989. The city government introduced an innovative participatory decision-making model, increased its revenues by drawing more from wealthy citizens, expanded fiscal capacity, and directed that capacity towards investments in poor neighbourhoods. These accomplishments are important and impressive, and they have rightfully attracted international attention to the city. They also bring us back to our original puzzle. How did the city mobilise revenues from

³ It should be noted that the population weighting that was also in the formula had an ambiguous impact, as some of the most densely populated areas were actually not the poorest (Marquetti 2003).

those with wealth to distribute to those without? More specifically, were middle sectors really willing to contribute? What did the poor offer in exchange for their increased benefits? How were these relationships between state and society institutionalised and articulated within participatory budgeting? To answer these questions, we returned to some of the curious patterns emerging in the evidence on participation, in which middle sectors participated more in the thematic meetings; lower sectors participated more in the regions; some people sought material benefits; and others sought non-material quality of life issues. These patterns suggest an avenue to understand embedded public finance.

7 Embedded public finance in Porto Alegre

This section examines the evidence from our public opinion survey on links between state and society. Middle sectors were asked to contribute tax revenues in exchange for cleaner and more democratic government. Poor citizens were asked to contribute political support in exchange for material benefits. These were not particularistic exchanges of a clientelistic sort; rather, they represented a customised and targeted version of citizenship in which government drew on the assets citizens had available and responded effectively and accountably to their demands.

Other researchers have also been intrigued by the difference between material and non-material demands. Schmidt compared the demands of different neighbourhoods and observed that poorer areas demanded street paving and basic sanitation while wealthier neighbourhoods demanded more parks and street-cleaning (1994: 138–54, as cited in Fedozzi 2001). These quality of life issues make sense for middle sectors. They are the professional classes, the small business-owners, and the public sector workers whose experience of government is frequent and direct. They depend on government not for basic needs but for the regulatory frameworks associated with property rights, business practice, and lifestyle. For government to reach these sectors, it would have to adopt principles of ‘good governance’ in the traditional, liberal sense. Middle sectors want states that operate effectively, efficiently, and democratically; in short, they want to address long-standing problems of clientelism, corruption, and authoritarianism in Brazilian public administration (Weyland 1996; Nunes 1997).

The administration knew these were the demands of middle sectors, and sought to respond (Navarro 1996: 30). In 1992 the Mayor commented, ‘The middle sectors, in many regions, did not attend the meetings ... It is now the moment to reinforce the presence of the middle classes; allowing citizens to control, oversee, and criticise the state and the government’ (*Zero Hora* 22 December 1992). Other Workers’ Party politicians linked middle sector demands for good government directly to tax contributions. Iria Charão, the official who managed the participatory budget at the state level from 1999 to 2002 explained, ‘Citizens, who always paid the bill without knowing where the money from taxes was going, now know. Despite all the fights over tax, the voters approved the proposal to raise taxes because they had decided where the money was to be spent’ (*Zero Hora* 19 November 2000).

This is not to say that middle sectors did not appreciate increases in investment and public activity. Some among their ranks were direct beneficiaries, even if the investments targeted poor neighbourhoods where they did not live. Among middle sectors, remember, were public employees who continued to receive decent salaries, and most important, were paid on time. Construction firms obtained contracts for the infrastructure investments undertaken, and they too were paid on time (Abers 2000). Finally, middle sectors valued the international fame associated with being the home of participatory budgeting. To be sure, there were those among their ranks that bridled at the increases in taxes, the progressive rhetoric, and the leftist history of the Workers’ Party; yet for 16 years, the

Workers' Party governed in Porto Alegre with impressive middle sector support.

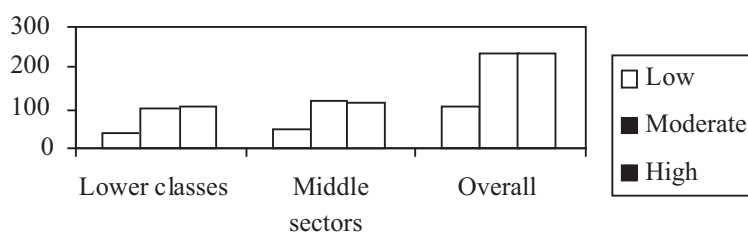
Lower class groups also valued democracy, efficiency, and transparency, but these needs were dominated by more material ones. Some observers criticise material demands as immediate, narrow and single-issue. In particular, critics feared that popular movements with narrow demands were doomed to disappear once demands were met (Kowarick and Singer 1993). Yet, for much of the population, material needs were very real and were of the first order. It was not that they were uninterested in democracy and transparency; rather, they simply had other demands that came first. 'In reality, the community movements were more worried in securing goods and urban services than the discussion of the institutional engineering to democratise the state' (Fedozzi 2001: 97).

In exchange for material benefits, the Workers' Party asked for political support from lower sectors. One form of support was participation in the budgeting meetings. Poor people began to participate massively once funds available for allocation increased after 1990. High levels of participation lent legitimacy to the government, and when this legitimacy was insufficient to win legislative battles, the mayor called on citizens to fill the gallery of the Assembly, pressure the opposition, and support executive plans, all of which participatory budgeting participants dutifully provided. The most important form of political support, of course, was electoral, and lower sector citizens, with their massive numbers, were a crucial base of electoral support for the Workers' Party. The party finally lost power in 2004, but this was after four consecutive mayoral victories in a city and a state known for electoral volatility and see-sawing voting patterns.

These observations lend support to the notion that participatory budgeting embedded public finance with customised benefits to meet differentiated group demands. For additional evidence that citizens perceived these links to the state, we turn to our opinion survey. Intentionally, we had clustered our sample to obtain a relatively even split of middle sector and lower sector respondents. Among our sample of 687 respondents, 320 identified themselves as middle or lower middle class and 260 identified themselves as working, poor, or lower class.⁴

First, we wanted to explore citizen perceptions of participatory budgeting. Respondents were asked whether they trusted a series of different institutions, among them participatory budgeting, and participatory budgeting ranked higher in confidence than all other possibilities, including government, parties, and fellow citizens. 233 respondents reported high levels of trust in participatory budgeting, 232 moderate levels, and 103 low levels. These were relatively evenly split between and among middle and lower class respondents, with slightly more lower class respondents reporting high confidence and slightly more middle sectors reporting moderate confidence.

Figure 7.1 Trust participatory budget by group (no. respondents)

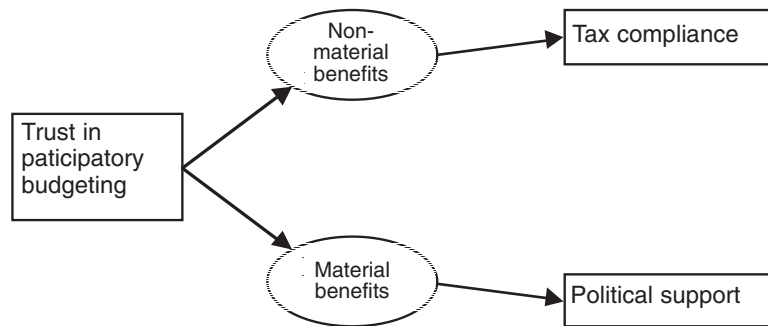


⁴ These proportions intentionally oversampled middle sectors to get a reasonable number of respondents from each group. Other self-reported measures of class were highly correlated with these, and the regression results were robust to different measures of class.

We also wanted to explore the benefits people perceived. If groups perceived benefits, they would be more willing to pay tax and offer political support. More interesting, embedded public finance required different groups to connect participatory budgeting to different forms of support. Lower sectors would have to perceive material benefits if they were to offer political support; and middle sectors would have to perceive non-material benefits if they were offer tax contributions.

Figure 7.2 displays the steps in the causal process that we were interested in exploring. Citizens that trusted participatory budgeting would have to perceive certain benefits (non-material benefits for the middle sectors, material benefits for lower sectors), and these benefits would have to produce different contributions (tax compliance for middle sectors, political support for lower sectors).

Figure 7.2 Causal process



To confirm that perceived benefits operated as a causal mechanism to link participatory budgeting to tax and political support, we tested the link between different material and non-material benefits and participatory budgeting. Among both middle and lower sectors, and for several different measures of benefits, there was a clear positive relationship between participatory budgeting and perceived benefits. Appendix 1 presents the statistical correlations and a discussion of these results.

Our model operates on the intuition that citizens that perceive benefits were positively disposed to make contributions to the state, and different citizens are expected to make different contributions. In particular, middle sector groups had to be induced to offer taxes and poor groups had to be induced to offer their political support. To get at these contributions, we asked people a series of questions about tax and voting. The results for tax were not surprising; most people do not view taxes favorably. This result is even more expected in Brazil where tax levels increased by over 10 per cent of GDP in 10 years. Of 573 valid responses, 326 were not satisfied with what they paid in tax. Only 173 people were a little satisfied with their tax burden and only 70 were very satisfied.

Within both the poor and middle sectors, confidence in participatory budgeting was associated with satisfaction with tax contributions. For lower class respondents, this was not all that surprising; they were not the ones who paid most taxes, though Brazil’s regressive tax system meant they paid more than one might expect. It was more important to secure the compliance of middle sector citizens; they were the ones with resources that could be mobilised. Both the lower classes and the middle sectors were more satisfied with their tax contributions if they trusted participatory budgeting. Each increase in participatory budgeting trust was associated with a 0.27 increase in tax satisfaction for lower classes, a 0.15 increase for middle sectors, and a 0.20 increase overall. These coefficients appear in the first column of Table 7.1; satisfaction with tax ranged from zero to two.

We wanted to use our model of causal mechanisms to discern what kind of benefit people had to be offered to convince them to pay tax. We ran regressions for tax satisfaction with both an independent variable (trust in participatory budgeting) and causal mechanisms (non-material and material benefits). If both independent and intermediate variables remained significant, it would provide a weak confirmation of the causal path leading from trust in participatory budgeting to benefit and on to support for tax. The tests are reported in the table below with standard errors in parentheses. The model without intermediate variables is included in the first column, and the comparison of coefficients across the columns separates the impact of trust in participatory budgeting from any independent impact of the causal process indicators.⁵ The percentage decline in the coefficient is the amount of the explanatory ‘power’ that has to be shared with the intermediate variable.

Table 7.1 Were people satisfied with tax, and why?

		Simple model	Full model	Full model
		Tax	Tax	
Middle	Trust PB	.15*** (.057)	.13* (.070)	5.28
	Material benefits		.028 (.070)	
	Non-material benefits		.35** (.15)	
N		263	210	
Lower classes	Trust PB	.26*** (.071)	.18** (.087)	8.68
	Material benefits		.18** (.089)	
	Non-material benefits		.023 (.18)	
N		205	161	
Overall	Trust PB	.20*** (.042)	.16*** (.051)	2.22
	Material benefits		.082 (.052)	
	Non-material benefits		.19*(.082)	
N		513	406	

*p<.1, **p<.05, ***p<.01

Consistent with the earlier results, trust in the participatory budget was positively associated with evaluations of tax. Those who trust participatory budgeting were 0.16 more satisfied with their tax contributions (middle sectors 0.13 and the poor 0.18 more satisfied). In terms of the causal process indicators, the non-material benefits of participatory budgeting were more important for middle sectors while lower classes were more interested in the material benefits of participatory budgeting. An increase in non-material benefits led to a 0.35 increase in middle sector satisfaction and an increase in material benefits led to a 0.18 increase in lower class satisfaction. Interestingly, material benefits were not significant for

5 To make the coefficients comparable, we re-ran the original equation with only the cases that had observations on all the variables in the full model.

middle sectors and non-material benefits were not significant for the poor. These results appear in the second column of Table 7.1.

Adding the causal mechanism variable led to a slight decrease in the coefficient on trust in participatory budgeting. Overall, the coefficient fell by 2.2 per cent, while the dip was 5.3 per cent for middle sectors and 8.7 per cent for the lower classes. These results appear in the last column of Table 7.1. They indicate that a small amount of the correlation between trust in participatory budgeting and tax satisfaction in the first model was perhaps coming from excluded intermediate variables.

These results suggest that lower class citizens and middle sectors linked positive feelings about participatory budgeting to satisfaction with tax. Lower class citizens that felt confident in participatory budgeting perceived increased social investment and for this reason were satisfied with their tax contributions. By contrast, middle sectors that felt confident in participatory budgeting were more likely to perceive increased efficiency in the public sector and for this reason were satisfied with their tax contributions. Viewed through the eyes of the state, more tax revenue could be mobilised from middle sectors because they perceived non-material benefits from participatory budgeting. From the poor, more revenues were available because they perceived material benefits.

We ran a similar test for an indicator of political support, identification with the Workers' Party. Unlike the example of tax, in which the most important constituency was the middle sector that possessed resources, the most important constituency for partisan identification was the lower sectors. They were the most numerous in the city, and their political support sustained state legitimacy and partisan power. Previous research has shown that partisan identifiers are the most likely to vote for a party, engage in activism, do the street-level work of contacting and mobilising voters, and are one of the keys to electoral success (Campbell, Converse, Stokes and Miller 1960; von Mettenheim 1990).

Once again, we began with a simple model that just related participatory budget trust to Workers' Party identification. There was a strong positive association that held for both lower class and middle sector groups. Overall, the likelihood that a respondent would identify with the Workers' Party increased 2.2 times for each increase in trust in participatory budgeting. Among middle sectors, the ratio was 2.1 times and among lower classes the ratio was 2.3 times.

To check for different causal paths across groups, we next included the material and non-material benefits in the model. The coefficient on trust in participatory budgeting remained significant, with respondents that trusted participatory budgeting 1.8 times as likely to identify with the Workers' Party, and a ratio of 1.7 among middle sectors and 1.8 among lower sectors.

Once again, the non-material benefits of participatory budgeting were more important for middle sectors, and the material benefits were more important for lower sectors. If they perceived non-material benefits (drop in corruption), the likelihood that middle sectors identified with the Workers' Party increased 2.8 times, while lower classes increased their likelihood of partisan identification by only 1.9 times. Instead, material benefits (increased investment in poor neighbourhoods) provided the more important causal process for lower classes. Their partisan identification increased 2 times for each perceived increase in material benefits while middle sector partisan identification increased only 1.9 times and overall the ratio was 1.6.⁶

For the whole sample and the middle sectors, the changes in the coefficients across models were relatively small, 4 per cent and 5.5 per cent respectively. For lower classes the change

6 Again, we re-ran the simple model with only the cases with scores on all the variables.

was much higher, 24 per cent, suggesting that a large portion of the explanatory power of trust in participatory budgeting was coming from the intermediate variable of perceived material benefits.

Table 7.2 Were people willing to lend political support, and why?

		Simple model	Full model	% Change
		Partisan ID	Partisan ID	
Overall	Trust in participatory budgeting	.77*** (.14)	.59***(.18)	3.96
	Material benefits		.49* (.26)	
	Non-material benefits		.75*** (.23)	
	N	563	418	
Middle sectors	Trust in participatory budgeting	.77*** (.20)	.53** (.25)	5.53
	Material benefits		.65* (.38)	
	Non-material benefits		.90*** (.32)	
	N	281	218	24
Lower classes	Trust in participatory budgeting	.84*** (.25)	.54* (.31)	
	Material benefits		.70 (.44)	
	Non-material benefits		.64* (.38)	
	N	231	162	

*p<.1, **p<.05, ***p<.01

It has long been evident that participatory budgeting coincided with increased tax capacity and support for the government. What was not clear was how general good-feeling about participatory budgeting translated into these valuable resources the state could draw from citizens. This section has used data from a public opinion survey to trace the process by which confidence in participatory budgeting is translated into tax capacity and political support. In particular, it shows that the linkages between state and society articulated by participatory budgeting differ across social groups. For middle sector groups interested in non-material benefits, participatory budgeting is perceived in terms of democratic values and transparent government. For lower classes, participatory budgeting is perceived in terms of greater investment in poor areas and increased social assistance. These causal processes offer what social groups want from the state, and in return, the state draws contributions. From middle sectors, the main contribution is tax; from lower classes, the main contribution is political support.

8 Conclusions

When the Workers' Party was elected in 1988, it implemented an innovative set of budgeting institutions that incorporated direct participation from citizens. This required a reorganisation of the budget process and an adjustment of the public bureaucracy to initiate a new pattern of public decision-making. The participatory process attracted wide public involvement, and it was particularly effective in mobilising the participation of lower class citizens.

Over the ensuing 16 years, participatory budgeting has coincided with a rapid increase in tax burdens, particularly for middle sectors. In addition, there was a steady improvement of public services and allocations to social sectors, especially those targeted towards poor parts of the city. These fiscal and institutional changes are brought together in a system of embedded public finance in which state actors targeted social groups with the benefits each group wanted, and in exchange, government secured the assets each group could offer. In the case of the middle sectors, the exchange was good government for tax contributions. In the case of the lower classes, the exchange was material benefits for political support.

This innovation is of particular importance to the Leftist parties currently coming to power in Latin America. In Brazil, Chile, Venezuela, Uruguay, and Argentina, governments led by Leftist leaders have been elected in recent years; upcoming elections in Nicaragua and Mexico could potentially deliver two more; Left parties are important in El Salvador and Guatemala; and popular movements have brought down governments in Ecuador and Bolivia. Though these movements vary from indigenous to populist to socialist to social democratic, they share one commonality: all would like to address severe inequalities within their countries by mobilising resources (Shifter and Jawahar 2005). It used to be that the threat of Leftist redistribution scared middle sectors which preferred Rightist options that, arguably, promised competence. The Porto Alegre example demonstrates that it might be possible to combine good government with just government, and maintain a cross-class coalition while doing it.

Appendix 1 Testing the causal mechanism

Our model posits benefits perceived as the intermediate step that links independent variables (trust in participatory budgeting) to dependent variables (tax payments and political support). In this role, benefits are the causal mechanism, 'the real-world phenomenon of causation' (Brady and Collier 2004: 277).

To test perceived benefits as intermediate variables, we made use of several survey questions on non-material (efficiency, corruption) and material (investment in social sectors) benefits, and we separated our sample in middle sector and lower class populations. Among lower sectors, in a logistic regression, the likelihood they believed government was efficient increased by 2.14 times for each increase in participatory budget trust. For middle sectors that ratio was 1.74 times, and overall the ratio was 2.09. A similar pattern was evident for the decrease in corruption, for which each increase in lower class respondent trust increased the likelihood 2.68 times, increases in middle sector trust increased the likelihood 2.58 times and overall the ratio was 2.60. Trust was measured low, moderate and high, and the perceived non-material benefits were measured either 'not at all' or 'improved.'

Respondents that trusted participatory budgeting were also more likely to perceive material benefits. Among all respondents, each increase in trust in participatory budgeting was associated with a 0.29 increase in perceived investment in social assistance (0.30 middle sector and 0.28 lower class). A similar pattern was evident for perceived investment in poor

neighbourhoods. Overall, each increase in trust was associated with an increase in the likelihood that respondents perceived increased investment by 2.30 times (2.47 among lower classes and 3.02 among middle sectors). Social assistance was measured on a continuous scale and investment was measured on a binary 'not at all-improved' scale.

These coefficients, reported in the table below with standard errors in parentheses, confirm that citizens perceived both material and non-material benefits from participatory budgeting. The coefficients in the logistic regression equations are reported in the text as logistic odds-ratios and as logit coefficients in the table for comparison across columns.

Table 8.1 Perceived benefits of participatory budgeting

		Non-material benefits		Material benefits	
		Public sector efficiency	Decrease in corruption	Social assistance investment	Investment in poor neighbourhoods
Overall	Trust PB	.77*** (.14)	.95***(.14)	.29***(.044)	.83***(.15)
	N	563	475	462	461
Middle sectors	Trust PB	.93*** (.20)	.93*** (.20)	.28*** (.063)	1.10*** (.23)
	N	281	245	234	231
Lower classes	Trust PB	.84*** (.25)	.98*** (.24)	.30*** (.068)	.91***(.23)
	N	231	185	188	188

*p<.1, **p<.05, ***p<.01

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