Metropolitan Governance and Finance in São Paulo

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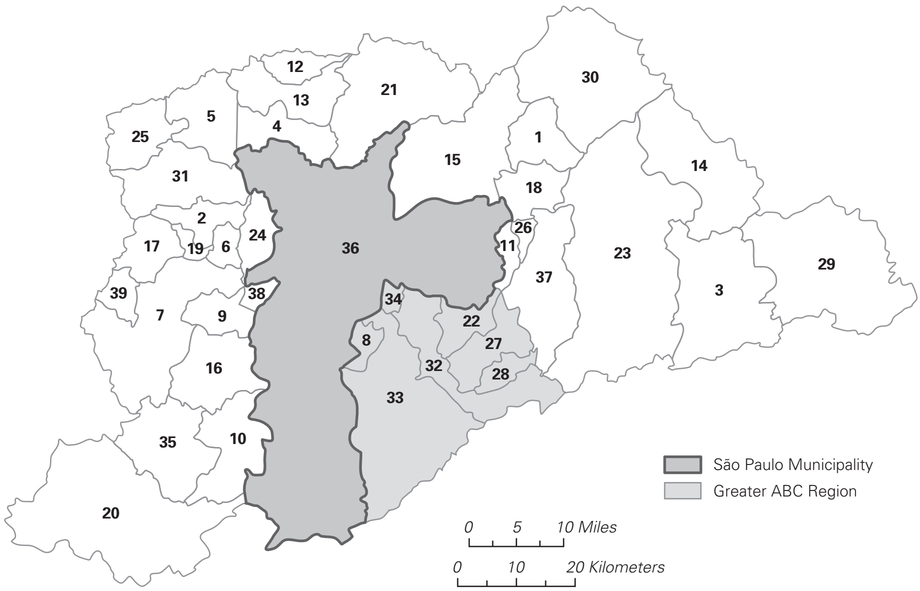
DEBORAH L. WETZEL

With a population of 11.2 million residents, São Paulo is the largest city in Brazil, the largest city in the southern hemisphere, and the world's seventh largest city by population. The city is anchored to the São Paulo metropolitan region (SPMR), which with 20 million dwellers is among the five largest metropolitan areas in the world (Olinto 2011). The city is the capital of the state of São Paulo, the most populous Brazilian state, and exerts a strong influence in commerce, finance, the arts, and entertainment throughout Brazil and Latin America.

The SPMR was created in 1973, though São Paulo state had previously created administrative regional bodies in the late 1960s. The 1973 SPMR had 37 municipalities. An additional municipality was included in 1983, and another in 1991. Thus, the SPMR now comprises 39 municipalities, including the municipality of São Paulo (figure 12.1). As one of world's prominent metropolitan areas, São Paulo has undergone significant challenges and transformations. The city has experienced a decline in its manufacturing base, with significant implications for the incomes and living conditions for the people of the metropolitan area. As the SPMR seeks to reinvent itself, it must rely on metropolitan governance structures that provide little authority and coordination and on fiscal systems that are tied to the past and, at least for São Paulo municipality, take steps to address the city's increasing debt. Addressing key issues of effective planning, fiscal management, and delivery of services will be critical for the future of the SPMR, as will making use of the region's strong human resources and access to technical and research centers.

This chapter draws on a recent study carried out by the World Bank on the City of São Paulo. The author would like to thank Tom Kenyon and his team. See the references for further detail. The author would also like to thank Georges Darido and Leonardo Padovan for their support.

FIGURE 12.1
The São Paulo metropolitan region



1 Arujá	**11** Ferraz de Vasconcelos	**21** Mairiporã	**31** Santana de Parnaíba
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4 Caieiras	**14** Guararema	**24** Osasco	**34** São Caetano do Sul
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10 Embu-Guaçu	**20** Juquitiba	**30** Santa Isabel	

SOURCE: Adapted from Arretche (forthcoming).

This chapter looks at São Paulo's recent past to understand how metropolitan governance and finance have affected the development of this region and contributed to its challenges. After some background on the SPMR, its history, and recent economic changes, the chapter considers how metropolitan areas fit into the governance structures of Brazil and the impact this has had on the SPMR. A discussion of fiscal issues and management follows, with a snapshot of the SPMR as a whole and a discussion of fiscal data and expenditure management related specifically to São Paulo municipality. Then, after a look at some special financial tools that have been created to address specific needs, the chapter concludes with challenges going forward and thoughts regarding how they might be addressed.

Transformation of Economic Activity in São Paulo and Its Implications

In the early days of the Brazilian Republic in the late 1800s, São Paulo was a hub of the coffee economy, one of Brazil's main commodities during the period.[1] Strategically located between a main port (Santos) and the coffee plantations, São Paulo's location and the nature of coffee production laid the foundations for the future. Because coffee trees require about five years to yield a first crop (unlike sugar cane, which can be harvested within a year), production of coffee required greater financial capital over a longer period of time. Landowners moved closer to the state government in the municipality of São Paulo, which was the source of funding, and national and international banks clustered close to these prominent clients, thereby launching São Paulo's role as a financial center.

At the turn of the nineteenth century, the presence of financial capital, combined with significant immigration from both Europe and Japan and a location near a large port, made São Paolo an attractive base for manufacturing industry. Over the course of the twentieth century, changes in both domestic policy toward coffee and international markets, combined with an import substitution strategy, reinforced the focus of São Paulo as a center of manufacturing and finance (Biderman and Lopes 2011). High-, mid-, and low-tech manufacturing accounted for about 40 percent of São Paulo's economy in the late 1970s (figure 12.2). Efforts to stabilize the Brazilian economy under the Cruzado Plan stabilization program in 1986 and the opening of the economy in the late 1980s reduced the protection of the manufacturing sector and significantly shifted the underlying economic structure of the SPMR.

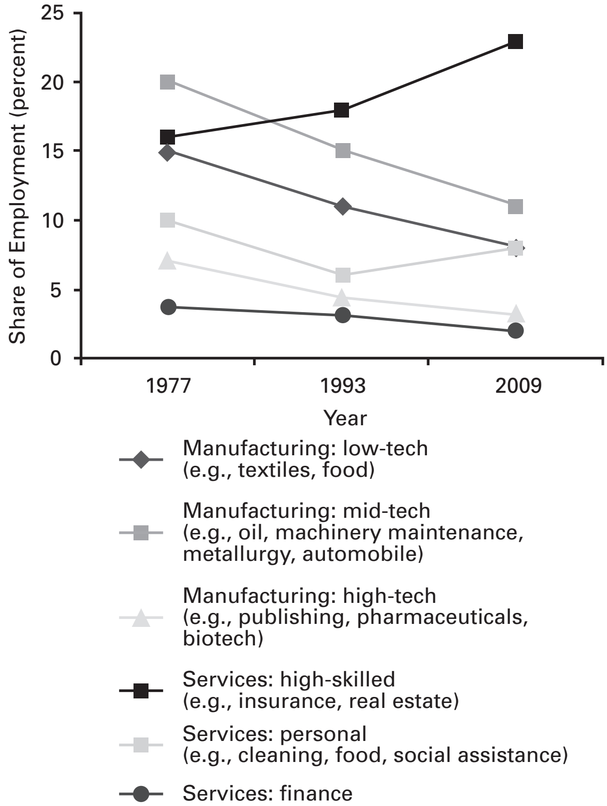
With the turn of the twenty-first century, São Paulo faces yet further demographic and economic shifts that suggest continued transformation. São Paulo's economy has become increasingly based on the tertiary sector, with an emphasis on services (figure 12.2). The presence of several universities and important research centers and think tanks, complemented by investment in science, technology, and innovation by the state of São Paulo, makes the metro region a desirable location for companies. At the same time, with the decline in the importance of manufacturing, there has been an increase in informal economic activity across the region, which leads to significant pressures in the provision of housing, infrastructure, and social services (Olinto 2011).

Deindustrialization of the SPMR's manufacturing base was also accompanied by significant shifts in the population. For some 30 years, the SPMR has experienced a shrinking of population at its central core and rapid population increase in lower-income districts in the suburban "belt" around São Paulo municipality. This reflects both an exodus from the center due to higher housing costs and the attraction of migrants from other parts of the country (figure 12.3).

Given the changes in economic activity and population shifts, average household per capita income in the SPMR has fluctuated during the 1980s, 1990s, and 2000s (figure 12.4). Per capita income in São Paulo increased quickly after the two major stabilization programs: the Cruzado Plan in 1986 and the Real Plan in 1994. In more

[1]Brazil was declared a republic in 1889.

FIGURE 12.2
Structural transformation in São Paulo



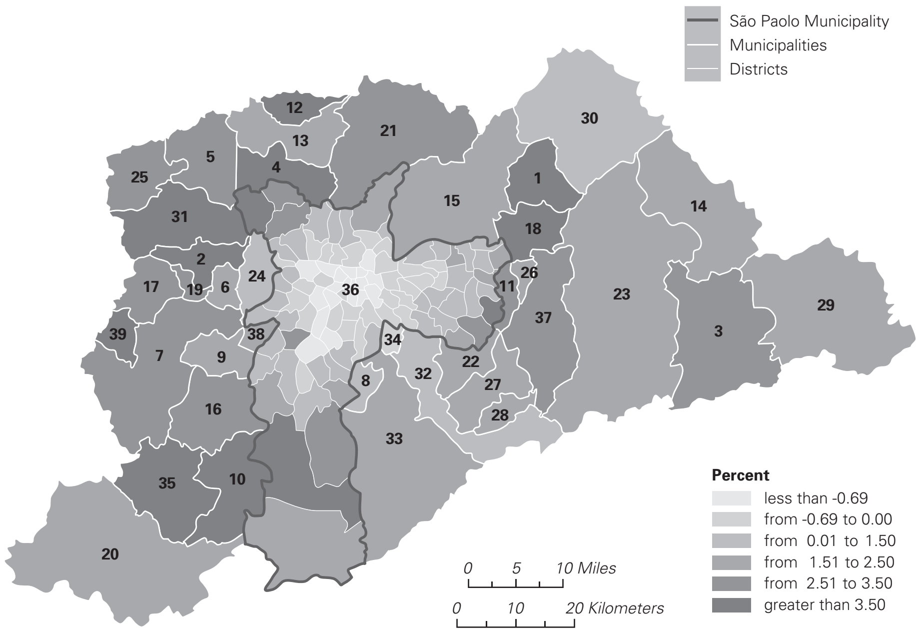
SOURCE: Jordan, Fiori and Kilroy (2011).

recent years, although incomes have grown in line with Brazil's overall growth, per capita incomes in the SPMR have not risen much beyond those of the early 1980s.

Average per capita incomes in the SPMR have changed relative to other metro areas in Brazil. Before 1989, SPMR household income per capita was higher than for other metro areas. Since that time, its position has steadily deteriorated. By 2009, SPMR's average per capita income was lower than that of the Federal District (Brasilia), Rio de Janeiro, and Porto Alegre.

Changes in economic activity and income per capita have also translated into sharp fluctuations in the poverty rate in the SPMR with peaks in 1984 and 1993 (figure 12.5). From 1981 to 2001, SPMR poverty rates were the lowest among metro areas in Brazil, but the rate increased significantly from 1996 to 2004, when it reached a third peak of 27 percent, higher than all other metropolitan areas. SPMR has yet to recover its place as the SPMR with the lowest poverty rates. However, the SPMR has always had less inequality than other Brazilian metro areas (figure 12.6). There was a significant increase in inequality from 1996 to 2002, the period when the economy was opened up and protection of the manufacturing sector was reduced. Inequality was reduced after 2002, following improvements in economic growth and employment and the expansion of social assistance programs.

FIGURE 12.3
Population growth by district in the SPMR



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SOURCE: Brazilian Institute of Geography and Statistics, census data for 1991 and 2000, São Paulo Municipal Planning Secretariat.

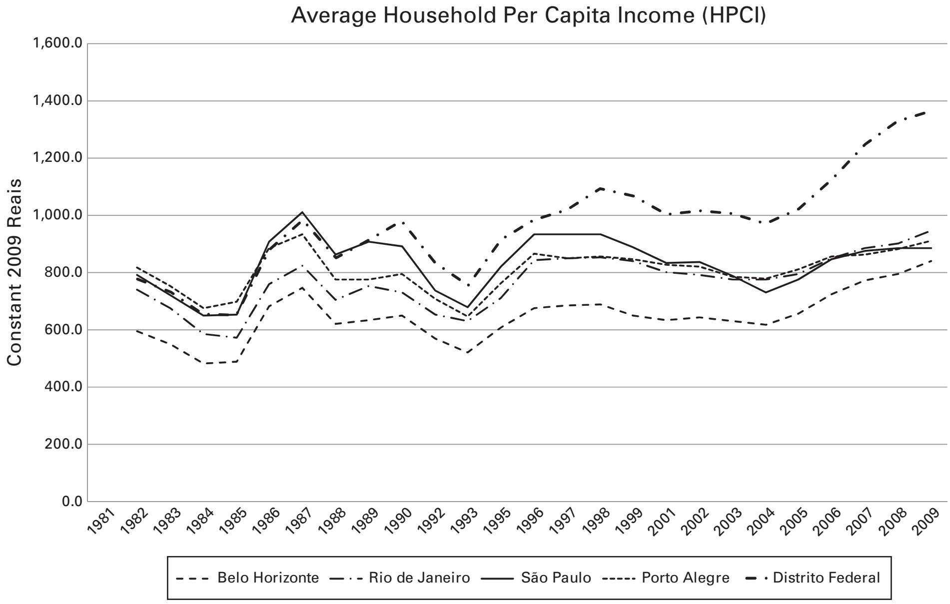
The changes in the SPMR's economic base, combined with population shifts, have caused significant mismatches in land and labor markets (see World Bank 2012). The loss of industrial employment in the center of the SPMR has not been matched by new commercial activities. There is little overlap between growth in land use for commercial purposes and population growth. SPMR thus has large segments of population in places without jobs or access to transport.

Growth in the peripheral areas of the SPMR has also had negative environmental consequences.[2] Growth and illegal settlements threaten São Paulo's sources of drinking water, such as the Guarapiranga and Billings reservoirs. The withdrawal

[2] This and other points in this paragraph are drawn from World Bank (2012).

FIGURE 12.4

Per capita income in the SPMR and other metro areas (in constant 2009 reais)

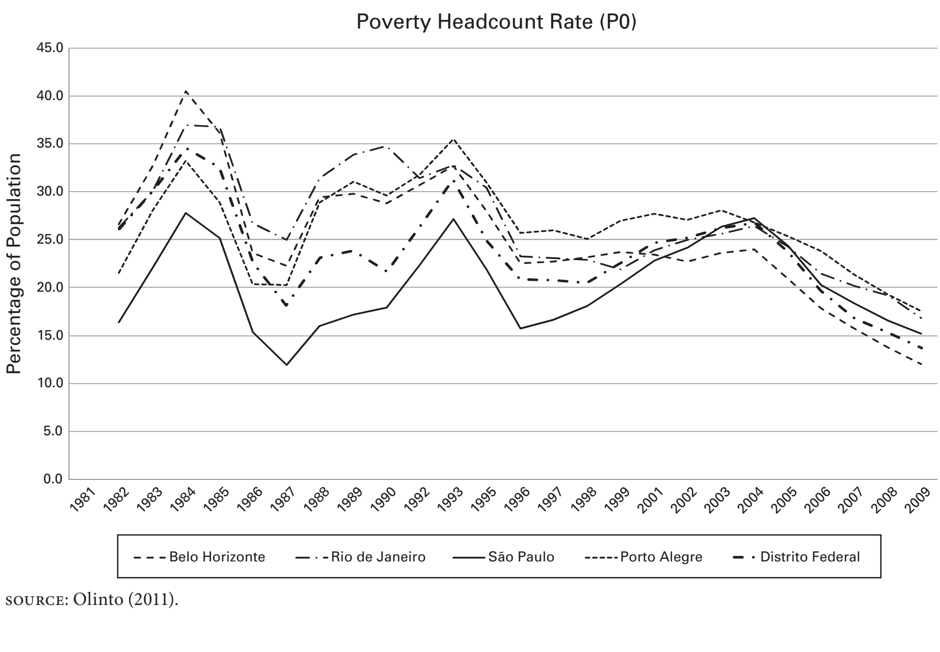


NOTE: In September 2012, one Brazilian real equaled US$0.49. From 2009 to 2012 this exchange rate fluctuated between US$0.40 and US$0.60.

SOURCE: Olinto (2011).

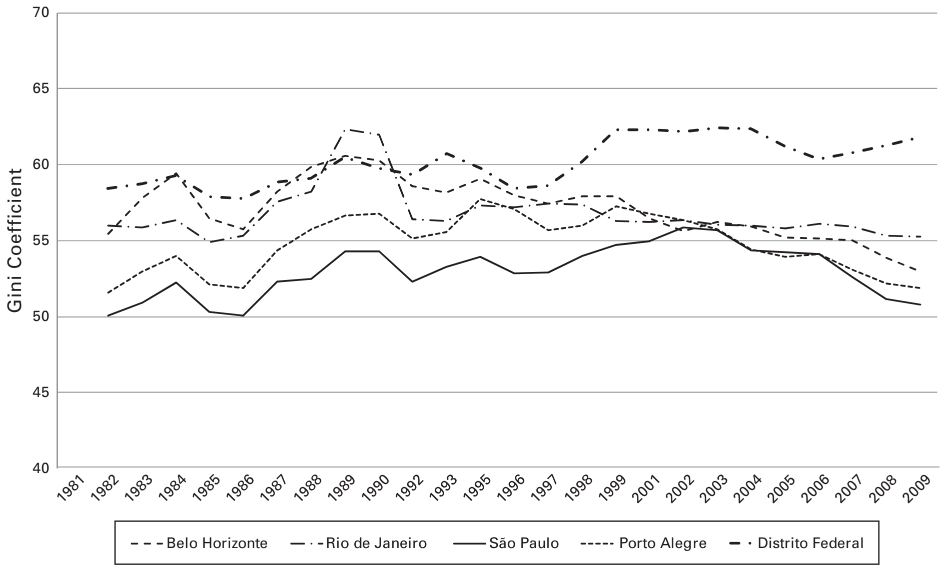
FIGURE 12.5

The evolution of poverty in the SPMR and other metro areas



SOURCE: Olinto (2011).

FIGURE 12.6
The evolution of inequality in the SPMR and other areas



SOURCE: Olinto (2011).

of heavy industry has left vestiges of brownfield sites, some with leakage of toxic chemicals. Gaps in public transport infrastructure have also led to levels of road congestion that are among the highest in Latin America. São Paulo has the highest level of aggregate emissions of carbon dioxide, particulate matter, carbon monoxide, nitrous oxide, and sulfur dioxide from transport sources among Latin American cities.

This brief overview of the SPMR's economic transformation and its implications highlights a number of challenges. On a global level, São Paulo seeks to maintain or increase its relative weight as a global and regional center. With a gross domestic product in recent years of over US$200 billion, the SPMR has an economy comparable to small middle-income countries, such as Colombia or Malaysia, or city-states, such as Hong Kong and Singapore (see Jordan, Fiori, and Kilroy 2011). However, São Paulo's global position has been deteriorating relative to other rapidly growing cities in Latin America and in Asia.

A second challenge is that, within Brazil, other metropolitan areas, such as Belo Horizonte, the Federal District, Porto Alegre, Rio de Janeiro, and increasingly Recife and Salvador, have become attractive centers of growth and opportunity. As educational attainment at the secondary level has converged across the country, São Paulo has lost what was once a source of competitiveness. The commodity booms of the 2000s have also benefited other metropolitan areas more than São Paulo.

A third challenge is whether the ongoing structural transformation of the SPMR will be sufficient to drive higher levels of growth and competitiveness, as well as address spatial issues and the unfavorable trend in poverty. While growth in the service sector has compensated for the decline of manufacturing, continuous efforts to reinvent the economy are needed. These will also require immense investments in infrastructure to make growth and jobs accessible across the city, to address environmental issues, and to develop an attractive and livable metropolitan area for the twenty-first century.

These challenges place a premium on effective coordination, management, and fiscal health of the public entities that comprise SPMR, and particularly the city of São Paulo. The next sections consider these in turn.

Metropolitan Governance in Brazil and São Paulo

Article 25 of the Brazilian Federal Constitution of 1988 gives the states the right to create metropolitan governance structures. This was a shift from the 1967 constitution, which vested the authority to create metropolitan regions with the "Union," that is, the federal government. Paragraph 3 of Article 25 states, "The States may, by means of a supplementary law, establish metropolitan regions, urban agglomerations and micro regions, formed by the grouping of adjacent municipalities, in order to integrate the organization, the planning and the operation of public functions of interest." While giving states the authority to create such bodies, the constitution does not set any further requirements regarding structures or funding.

The 1988 constitution also established municipalities as full federation members with the same autonomy and sovereignty as the states. With this status, municipalities (of which there are more than 5,500 in Brazil) are not subordinated to states, or to any structures created by states, such as metropolitan areas.

The implications of these two aspects of the 1988 constitution for metropolitan authorities in Brazil are significant. While states have created metropolitan authorities or agencies, there are no formal mechanisms for funding or specific tools to implement metropolitan policies. As a result, such agencies have tended to focus on developing strategies and plans but have not had the teeth or mechanisms to support implementation of plans or policies (see Arretche forthcoming; Rezende and Garson 2006).

Given the autonomy of municipalities, any actions undertaken by a metropolitan agency must be specifically agreed to by all the municipalities involved. With the great spatial and economic differences across most metropolitan areas, coordination can be a challenge as incentives for joint action by municipalities may vary considerably. Veto points for moving forward on effective action multiply with the number of mayors and municipal councils involved. Political economy factors can also play an important role, for example, the political alignment, or lack thereof, of a state governor and the mayor of the core city of a metropolitan area can determine the ability to agree and move forward on metropolitan objectives.

While the federal level no longer has the right to create metropolitan areas, it does have an influence on how metro areas function through regulations that affect the ability of municipalities to work as a consortium. President Luiz Inácio Lula da Silva, early in his first term (2003–2007), created the Committee for Federative Articulation to help provide guidance on metropolitan policies. The committee consists of representatives of the union (federal) level and representatives of three nationwide municipal organizations (the Mayor's National Front, the

National Confederation of Municipalities, and the Brazilian Municipality Association) and the Forum of Metropolitan Entities. In 2005, the Consortia Law (law 11.107) was approved allowing consortia (of municipalities and otherwise) to take on a juridical status and thus allowing consortia to borrow and offer guarantees (see Arretche forthcoming). The law also allows consortia to exercise supervisory, regulatory, and planning roles.

After the approval of the 1988 constitution, 26 of Brazil's 27 states adopted constitutional articles at the state level establishing their metropolitan competencies, elaborating the criteria for metropolitan institutions, and typically including provisions for guaranteeing municipal and civil society involvement. Despite these constitutional articles, the need to find effective strategies for design and implementation of metropolitan plans, and reaching agreement with the municipalities of the metropolitan area on implementation of such plans remain key vulnerabilities.

Governance of the SPMR reflects the pressures and tensions that result from the 1988 constitution. Over time, a variety of government agencies have been created, but the ability of these agencies to play more than an advisory role has been limited. The role of planning and coordination was carried out by a state-level enterprise created in 1974: the Metropolitan Planning Enterprise for the Greater São Paulo Metropolitan Area. In 1994, Complementary Law 760/94 created the Development Council, composed of a representative of each municipality and state-level representatives.

SPMR transportation is overseen by the Metropolitan Enterprise for Urban Transportation and the São Paulo Company for Metropolitan Trains located under the secretary for metropolitan transportation. In May 2006, the governments of the state and municipalities in the SPMR signed an agreement creating the Integrated Transport Executive Committee as an executive board for the metropolitan transport system. The committee was designed as a tool to (1) strengthen partnership between the state and municipal transport secretariats; (2) align urban transport planning, administration, and oversight; (3) promote efficiency by setting operational standards and investment priorities; and (4) advocate an integrated vision of passenger accessibility through unified analysis and tariffs. In practice, the committee has functioned mostly as an ad hoc board of institutions generally lacking the capacity and continuity to analyze issues in detail or to drive a metropolitan agenda (see Darido 2011).

Interestingly, within the SPMR, subgroups of municipalities have formed various consortia to find cooperative solutions to address specific issues. In 1996, the "Baixada Santista" group of nine municipalities was formed to address issues related to the functioning of the Santos Port. In 2000, 19 cities established the Metropolitan Region of Campinas. The Greater ABC Chamber was created in 1997, building on the antecedents of the 1990s to bring mayoral, private-sector, and civil society groups together in seven municipalities (see figure 12.1) to address issues related to the automobile industry and watershed protection. The chamber and its associated forum have been a space for agreement and negotiation, reflecting that "bottom-up" coordination and activity can help to move metropolitan efforts forward.

In June 2011, the government of São Paulo state issued a new law (Complementary Law 1.139.2011) reorganizing the institutions of the SPMR. The law creates a variety of structures, building on those of the past:

- A development council for the metropolitan region (thereby legally ending the previous such councils from 1974 and 1994). The development council includes each mayor or his or her representative and representatives of the state that address issues of common interest. Two representatives from the Legislative Assembly are also included. The law emphasizes the importance of parity of municipalities and the state and of public meetings and consultations. Subjects for the council's deliberations include planning and land use; transport and the regional transport network; housing and sanitation; environment; economic development; social support; and sports and recreation.
- A consultative council, to elicit and present to the development council the proposals and views of civil society, the legislative branch at both the state and municipal levels, and the executive side of the state and municipal level. The consultative council will also be asked for views on key issues and proposals by the development council.
- Technical groups (*câmaras themáticas*) to pursue specific issues of interest to the SPMR.
- A regional enterprise, *entidade autarquia*, linked to the Secretariat of Metropolitan Development to organize, integrate, plan, and execute functions of common public interest to the SPMR, such as the regional transport network; housing and sanitation; and environmental issues. This enterprise will (1) collect revenues, whether shared or delegated or through charges and fees; (2) elaborate plans, programs, and projects of common interest, set goals for them, and oversee their execution; and (3) exercise other functions as needed and required by the law.
- A regional development fund, also linked to the Secretariat of Metropolitan Development. The resources of the fund will be overseen by six members, four representing the development council and two representing the regional enterprise, and will be administered by a formal financial entity. The functions of the fund are (1) to contribute financial and technical resources to address key metropolitan issues, as discussed above; (2) to undertake studies, analyses, and projects with the objective of improving municipal public services; and (3) to reduce social inequalities across the SPMR.

These new structures are clearly intended to bolster cooperation across the region and build mechanisms to address issues of common interest among the state and the SPMR municipalities. Over the years, many such structures have been created to support coordination and development across the SPMR, but with the limited funding and decision-making authority built into the constitution, they have not been able to do much more than provide an advisory role. Those that have been most successful have had a clear agenda (e.g., integrated transport) or have been able to bring together different stakeholders to solve specific issues (the Greater ABC Chamber). The effectiveness of these relatively new structures will be seen as time passes.

Metropolitan Finance

While the 1998 constitution gives states the right to create metropolitan institutions, it did not provide a specific mechanism for funding such institutions.[3] It does, however, give both the states and municipalities more autonomy in raising revenues and provides for a variety of transfers. Funding for metropolitan areas in Brazil is thus an amalgam of funding provided by the state-level and municipal governments. As the SPMR well demonstrates, coordination issues exacerbate the difficulties in funding effective public services and investment for the metropolitan areas.

With their autonomous status, municipalities in Brazil have a set of "own taxes" at their disposal:

- Tax on services, largely collected in cities with over 50,000 people.
- Tax on property and urban territory, the tax of greatest importance in medium-sized cities.
- Transfer tax on the sale of buildings.

Municipalities may also use betterment levies and charges for street lighting, business licenses, and other economic activities. These taxes become more important the smaller the size of the city.

Municipalities also receive a share of certain state taxes:

- 25 percent of the state value added tax: 75 percent of this amount is distributed by origin based on economic activity, and 25 percent to benefit the poor (based on state law).
- 50 percent of the vehicle tax.
- 22.5 percent of the tax on industrial products and the tax on federal profits, which form the Municipal Participation Fund. This fund is divided into two parts: 10 percent for municipalities that are capitals of states and 90 percent for other cities.
- 100 percent of profit taxes paid on city enterprises or foundations.
- 70 percent of tax in gold-related financial operations.
- 50 percent on rural territorial tax.

States and municipalities also benefit from transfers to fund specific activities, including education, health, social assistance, and investment, as well as a variety of discretionary transfers and, when relevant, royalties.

The Fiscal Responsibility Law, approved in 2000, also provides an important framework for management of state and municipal finance. The objective of this law was to regularize the planning, transparency, and accountability of subnational finances in order to prevent the budgetary overruns that had caused fiscal problems in the past. States and cities report annually to the national treasury on their fiscal status and alignment with the law's provisions. Key aspects of the Fiscal Responsibility Law include the following:

[3] This section draws heavily on Sakho (2011).

- Adoption of a broad definition of public debt, including short-term debt (annual debt operations), contingent liabilities, and counterpart funding.
- Prohibition of renegotiation of debt between different levels of government.
- Limits on total public debt (200 percent of current revenue), as well as limits on payments on debt repayment (13 percent of current revenue).
- Coherence between the annual budget law and the four-year pluriannual plan.
- Prohibition of new investment without evidence of ability to cover operational costs.
- Limitation of personnel expenditure to 60 percent of current revenues.

Aggregate fiscal accounts for all 39 municipalities of the SPMR are not available; however, Arretche (forthcoming) presents an overview of the distribution of revenues and expenditures of the SPMR in 2009. This provides a snapshot of the balance between the city of São Paulo and suburban São Paulo.

Table 12.1 shows that some two-thirds of SPMR revenues derive from the city of São Paulo, and one-third from the suburban parts of the SPMR; 44.5 percent of total operating revenue in the SPMR comes from own-source revenues, such as taxes and user fees. São Paulo city relies especially on service taxes and property taxes, while the suburban areas raise revenues mostly from property taxes, service taxes, and other own-source revenues. Intergovernmental transfers provide some 47.7 of revenues, with 19 percent from the federal government and 29 percent from the state. Intermunicipal transfers are effectively nonexistent.

Table 12.2 presents the distribution of spending within the SPMR for 2009. As with revenues, São Paulo city spending accounts for about two-thirds of metropoli-

TABLE 12.1

Distribution of operating revenues within the SPMR, 2009 (percent)

Revenue source	Central city	Suburban	SPMR
Taxes			
Property taxes	8.5	3.1	11.7
Property-related taxes	1.8	0.4	2.2
Income taxes	2.2	0.7	2.9
Service taxes	15.7	3.5	19.2
User fees	0.5	0.7	1.1
Other own-source revenue	3.8	3.7	7.4
Total own-source revenue	32.4	12.1	44.5
Intergovernmental transfers	26.9	20.8	47.7
Union transfers	9.9	9.1	18.9
State transfers	16.9	11.7	28.6
Intermunicipal transfers	0.2	0.0	0.2
Other transfers	9.7	4.3	14.0
Federal deductions	3.4	2.8	6.2
Total revenues	65.7	34.4	100.0

source: Data from Arretche (forthcoming).

TABLE 12.2
Distribution of operating expenditures within the SPMR, 2009 (percent)

Expenditure	Central city	Suburban	SPMR
General government	3.5	6.7	10.2
Transportation	4.9	0.7	5.6
Security	0.6	0.5	1.1
Police	0.4	0.3	0.7
Other security	0.2	0.2	0.4
Environment	0.6	0.3	0.9
Water	0.0	0.0	0.0
Sanitation	0.8	1.8	2.6
Education	14.5	8.3	22.8
Health	12.4	7.6	20.0
Social services	1.3	0.8	2.1
Pensions	10.4	1.6	12.0
Culture and recreation	1.1	0.6	1.7
Urban development and planning	7.4	3.4	10.8
Housing	1.4	0.6	2.0
Debt charges	6.5	0.6	7.1
Total expenditures	66.0	34.0	100.0

SOURCE: Data from Arretche (forthcoming).

tan spending, and suburban areas account for about one-third. As expected, given constitutional mandates, spending on education at 22.8 percent and on health at 20.0 percent are significant and are split between the city and suburban areas. Notably, spending on pensions at 10.8 percent and on general government at 10.2 percent are two significant spending items, with pensions mostly a city expenditure and general government expenditures more significant in suburban areas; 10.8 percent of SPMR spending in 2009 was on urban development and planning, and 7.1 percent on debt charges, mostly on the part of the city. Transport is about 5.6 of total SPMR spending, also largely carried out by the city. According to Arretche (forthcoming), neither the city nor suburban governments spend much on environment, water, and sanitation, which are covered by state enterprises or by the state government.

Given São Paulo municipality's weight in the spending of the SPMR and its overall magnitude as a city, it is of value to consider its fiscal policy and patterns in more detail over time. São Paulo's budget at R$20 billion in 2009 (about US$9 billion) is the largest of Brazilian cities, more than twice that of Rio de Janeiro and more than that of most states in Brazil. São Paulo is a leader in Brazil when it comes to fiscal innovation and reforms to improve tax efficiency, yet issues with expenditure management are leading to significant debt issues that will need to be addressed in the near future.

The government of São Paulo municipality has managed fiscal aggregates well in recent years through efforts at improving tax administration. Figure 12.7 shows fiscal balances from 2004 to 2010. Revenues have increased steadily in all years except 2009, the year most affected by the recent global crisis. The municipality has maintained its primary balance (i.e., the difference between current revenues and current spending) between 1.5 and 3.0 percent of municipal GDP.

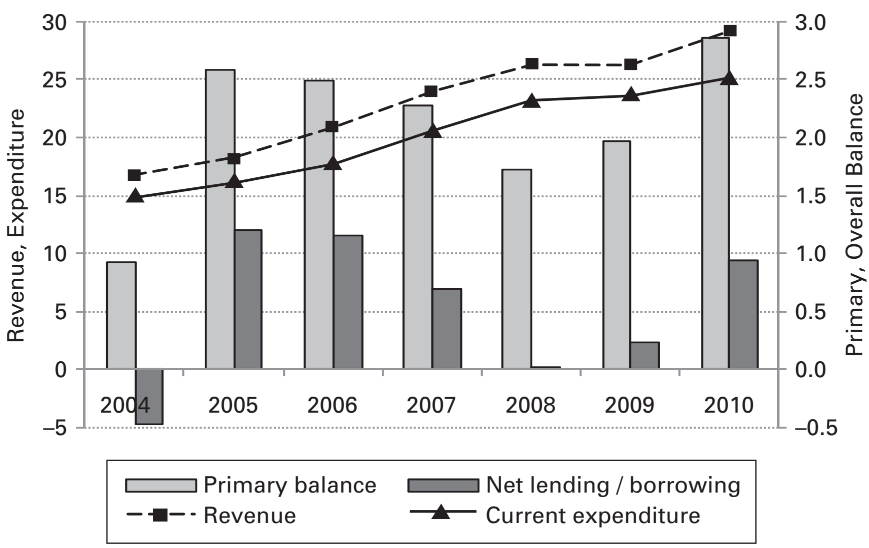
Revenues and expenditures of the municipality have increased at a very rapid rate, as shown in table 12.3. The compound annual growth rate of current revenues was 9.7 percent in real (inflation-adjusted) terms from 2004 to 2010. Tax revenues were boosted by significant improvements in tax collection efforts, despite reductions in tax rates, particularly including garbage and public light contributions, and reductions in tax on property and urban territory and exemptions on service taxes to boost economic activity. Overall current spending grew at 9 percent, just under the rate of revenue collection, driven by expenditures in goods and services, which grew at 14.3 percent from 2004 to 2010. Interest payments averaged 10 percent of total current expenditures and increased 7 percent in real terms from 2004 to 2010.

Figure 12.8 shows the composition of revenues and expenditures for São Paulo municipality in 2010. Own-source revenues accounted for 44 percent of total revenues, with 24 percent coming from the tax on services, 14 percent from tax on property and urban territory, and 3 percent each from the transfer tax on the sale of buildings and the tax on city enterprises and foundations.

Transfers provided 41 percent of total revenue in 2010 and in general accounted for 40 percent of total revenues from 2004 to 2010. Transfer revenues (shared taxes) benefited from growing tax collections by the federal and state governments, from

FIGURE 12.7

Evolution of fiscal balances in São Paulo municipality, 2004–2010 (2010 R$ billions)



SOURCE: Sakho (2011).

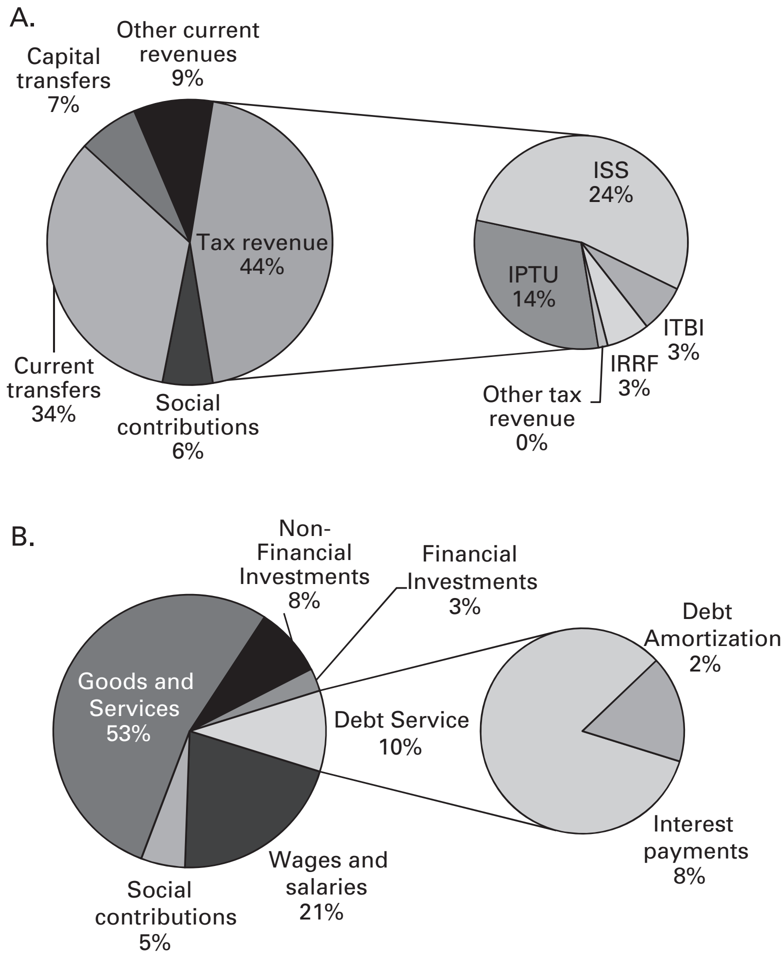
TABLE 12.3

Current revenues and expenditures of São Paulo municipality, 2004–2010 (2010 R$ millions)

	2004		2005		2006		2007		2008		2009		2010		2004–10
Unit: 2010	Values	%	Values	%	Values	%	Values	%	Values	%	Values	%	Values	%	CAGR
Total revenue	**16,815**	100	**18,273**	100	**20,920**	100	**24,026**	100	**26,351**	100	**26,297**	100	**29,225**	100	9.7
Taxes	7,802	46	8,467	46	9,733	47	10,676	44	11,296	43	11,499	44	13,095	45	9.0
Social contributions	19	0	0	0	0	0	1,559	6	1,587	6	1,658	6	1,663	6	110.8
Transfers	7,247	43	7,391	40	8,299	40	8,808	37	9,939	38	10,384	39	11,842	41	8.5
Other current revenues	1,747	10	2,415	13	2,889	14	2,983	12	3,529	13	2,755	10	2,625	9	7.0
Current expenditure	**14,993**	100	**16,210**	100	**17,715**	100	**20,612**	100	**23,252**	100	**23,740**	100	**25,142**	100	9.0
Compensation of employees	4,663	31	5,297	33	6,617	37	6,589	32	7,137	31	7,188	30	7,475	30	8.2
Pensions	1,918	13	1,214	7	95	1	106	1	45	0	0	0	0	0	−100.0
Interest payments	1,531	10	1,810	11	1,940	11	2,183	11	2,347	10	2,145	9	2,293	9	7.0
Goods and services	6,880	46	7,889	49	9,063	51	11,734	57	13,723	59	14,407	61	15,374	61	14.3

SOURCE: Sakho (2011).

FIGURE 12.8
Composition of São Paulo municipality government revenue (A) and expenditure (B), 2010



Abbreviations: IPTU, Tax on property and urban territory; IRRF, Profit tax on city enterprises or foundations; ISS, Tax on services; ITBI, Tax on transfer or sale of buildings.
SOURCE: Sakho (2011).

which municipalities receive a fixed share, as discussed above. In particular, the municipality received a 33 percent increase in transfers from São Paulo state originating from the state value added tax. Capital transfers grew almost ninefold, on the back of agreements (*convênios*), which marked the increase in public infrastructure investments that are part of Brazil's Growth Acceleration Program (Programa de Aceleração do Crescimento, PAC) launched in 2007. Capital transfers from agreements are expected to continue to grow, as the second phase of the program (PAC-2) outlines further large public investment projects from 2011 to 2014. Transfers from the Fund for Maintenance and Development of Basic Education more than doubled in real terms, partly due to higher resource receipts for preschools and increased enrollment rates. Yet transfer expenditures to the fund also rose over the period, due to increased earmarking of resources toward the education fund, with rising contribution shares since 2007. The municipality's contribution to the fund from its shared revenues from the state value added tax, tax on exported industrial products, and the Municipal Participation Fund rose gradually from 15 percent in 2007 to 20 percent in 2009 (table 12.4).

Figure 12.8 also shows the composition of total spending for São Paulo municipality in 2010. Expenditures on goods and services have been the main driver of current expenditure growth. Constitutionally mandated spending on education and health form one part of this spending, but other factors include the rise in external contracting of services to social organizations in areas such as garbage collection, cleaning, and health; subsidies to the transport company to compensate for the cost of the single tariff pass (*bilhete único*) losses; and transfers to indirect administration companies such as the municipal hospitals, as well as transfers to the pension funds. Employee compensation grew significantly in 2005 and 2006, leveling off thereafter. Interest payments grew over the period, except for 2009 because the limit imposed by the Fiscal Responsibility Law capped interest payments at 13 percent of net real revenue.

Investment has been modestly growing since 2006 and, despite a drop in 2009, recovered slightly in 2010 (figure 12.9). The municipality has maintained investment levels of 6–8 percent of net current revenues, which is quite modest given the investment needs of the city. Note that in 2010, 7 percent of the state government of São Paulo's total expenditures were spent on direct investment, and of this, about 49 percent of investments went to logistics and transport, which reflects road construction and maintenance, and 21 percent went to metropolitan transportation, mainly urban rail (São Paulo Company for Metropolitan Trains and the underground rail service at the SPMR) (Sakho 2011).

Most of São Paulo municipality's public debt stock (more than 90 percent, so-called intra limite debt) consists of debt renegotiated with the treasury through Provisional Measure 2185 in May 2000 (when the national treasury renegotiated most of the states' and large municipalities' debts). Through this agreement, the federal government took on São Paulo municipality's debt and directly repaid the financial institutions with federal government securities. The municipality's balance was refinanced into 360 monthly installments (30 years) indexed by a price index and an additional interest spread of 9 percent per year capitalized on a monthly basis. Provisional Measure 2185 also capped the value of monthly debt service installments paid by the municipality to the federal government at 13 percent of its revenue. If total debt service of the debt refinanced in 2000 and contracted since 2000 rises above 13 percent, the debt service amount exceeding 13 percent is recapitalized into the overall debt.

Despite these arrangements, São Paulo's municipality's net consolidated debt exceeds the limit set by the Fiscal Responsibility Law and has been growing in recent years. Net consolidated debt is defined as the totality of public debt contracts (internal and external), tax and social contributions installment debts, and debts due to judicial rulings (*precatórios*), net of certain financial asset deductions. Because of growing fiscal revenues and fiscal adjustments, the net consolidated

TABLE 12.4

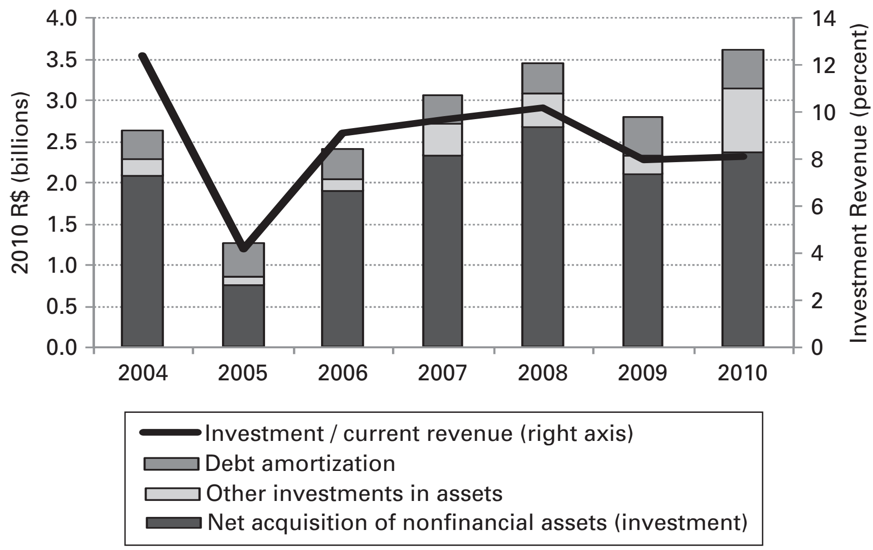
Evolution of transfers to São Paulo municipality, 2004–2010 (2010 R$ millions)

	2004	2005	2006	2007	2008	2009	2010	CAGR 2004–2010 (%)
Transfers revenues	7,246,930	7,391,469	8,298,828	8,808,236	9,939,499	10,383,829	11,841,926	9
(As a share of total revenue)	43	40	40	37	38	39	41	
Current transfers	7,056,112	7,109,195	7,901,664	8,354,185	9,108,077	9,414,804	9,852,996	6
Federal and state transfers	5,846,783	5,865,841	6,479,482	6,721,706	7,001,276	6,996,162	7,273,545	4
SUS	1,119,461	892,544	1,054,257	1,057,124	1,003,781	1,134,179	1,037,525	–1
ICMS	3,203,280	3,267,754	3,530,173	3,693,585	4,045,539	3,896,993	4,272,594	5
IPVA	1,110,418	1,209,496	1,374,164	1,463,838	1,429,322	1,432,555	1,394,669	4
Other	413,624	496,048	520,888	507,160	522,634	532,434	568,757	5
Multigovernmental FUNDEB transfers	1,087,532	1,169,849	1,253,838	1,487,983	1,922,121	2,300,320	2,444,032	14
Convenios	118,975	62,471	143,479	109,408	125,721	72,370	85,870	–5
Private transfers	2,821	11,033	24,865	35,088	58,958	45,953	49,016	61
Capital transfers	190,818	282,274	397,164	454,052	831,422	969,025	1,988,930	48
Transfers expenses	**597,689**	**611,423**	**653,643**	**879,665**	**1,168,504**	**1,370,518**	**1,457,792**	**16**
Transfers to FUNDEB	597,689	611,423	653,643	879,665	1,168,504	1,370,518	1,457,792	16
Net transfers revenues from FUNDEB	*489,843*	*558,426*	*600,196*	*608,319*	*753,617*	*929,802*	*986,240*	*12*
Net transfers revenues	**6,649,241**	**6,780,046**	**7,645,186**	**7,928,572**	**8,770,995**	**9,013,311**	**10,384,135**	**8**
(As a share of total revenue)	40	47	45	39	37	36	36	

Abbreviations: CAGR, Compound Annual Growth Rate; FUNDEB, Fund for Maintenance and Development of Basic Education (O Fundo De Manutenção e Desenvolvimento de Educação Basico e de Valorização dos Profissionais da Educação); ICMS, State Value-Added Tax (Imposto Sobre Operações Relativas à Circulação Mercadorias); IPVA, Vehicle Tax (Imposto sobre a Propriedade de Veículos Automotores); SUS, Unified Health System (Systema Unifacado de Saúde).

SOURCE: Sakho (2011).

FIGURE 12.9
Evolution of capital expenditures in São Paulo municipality



SOURCE: Sakho (2011).

debt-to-revenue ratio fell steeply from 246 percent in 2004 to 190 percent by 2007. Since 2007, however, the debt-to-revenue ratio has deteriorated. By the end of 2010, the municipality's net consolidated debt stock stood at 213 percent of net current revenue, above the 200 percent ceiling established by the Fiscal Responsibility Law.

Debt service has been growing modestly, driven recently by higher interest payments (figure 12.10). However, while debt service growth has been in line with the rise in revenues seen above, debt service obligations above the 13 percent ceiling have been contributing to growth of the debt stock.

Planning and Budgeting and Their Implications for Investment

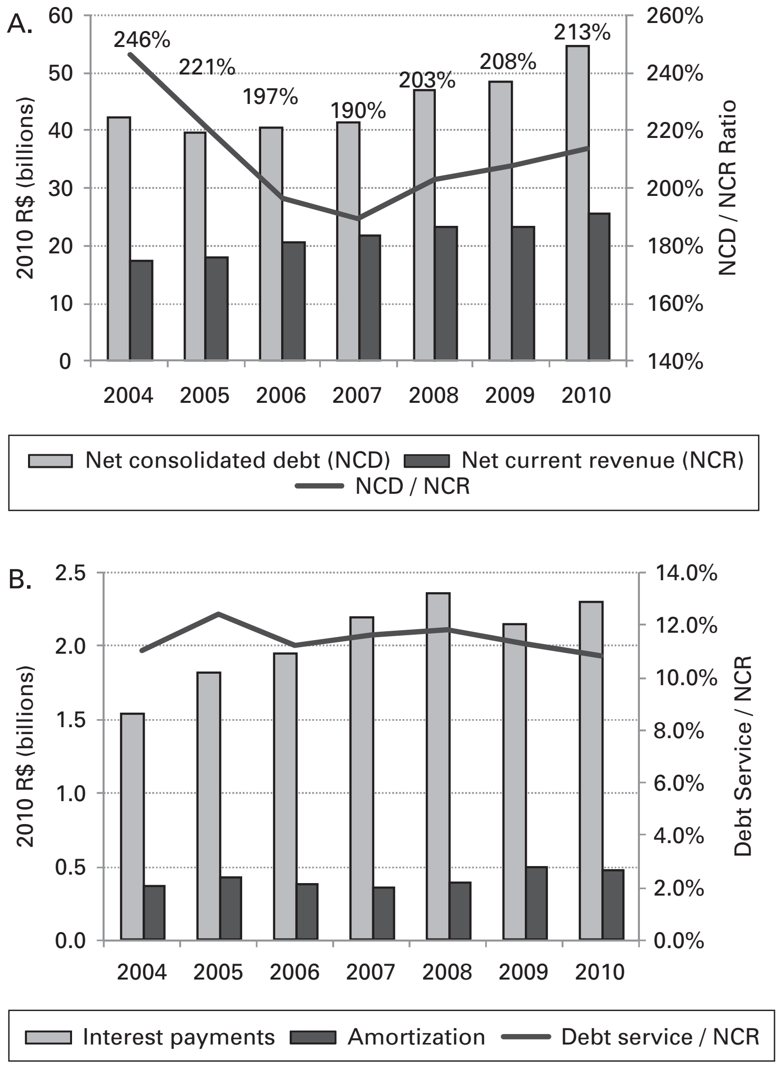
A key issue for São Paulo municipality, and for the SPMR as a whole, is the issue of planning and budgeting.[4] Budget management practices at the municipal and state level exacerbate the problems of coordination described above and make efficient use of resources to address key needs, especially investment needs, very difficult.

Planning

Taking São Paulo municipality as an example, table 12.5 shows four key planning instruments used by the city. The SP 2040 plan is currently under development by the Secretariat of Urban Development and is intended to develop a consensual long-term strategic view of the city, taking into account the spatial dimension. It is

[4] This section draws heavily on Clarke (2011).

FIGURE 12.10
Evolution of São Paulo municipality's debt (A) and debt service (B)



SOURCE: Sakho (2011).

being developed through extensive consultations, and the intention is that it should guide all other planning instruments. There are no specific fiscal or financial indicators.

The Strategic Directive Plan (PDE, Plano Diretor Estratégico) is also a comprehensive plan developed by the Secretariat of Urban Development that sets broad goals for São Paulo municipality; it defines, among other things, the city urban development policy, the overall scope of city sectoral public policies, and its urban-environmental plan. It was also elaborated in consultation with civil society. The PDE also calls for the formulation of regional plans, land zoning laws, transport, mobility, and housing plans. The annual investment program and annual budget

TABLE 12.5
São Paulo muncipality's planning instruments

Instrument	Time frame	Responsible agency	Objective
SP 2040: vision and long-term planning for the city of São Paulo	2012–2040	SMDU	States long-term development strategies for the city around five axis: social equilibrium promotion, sustainable urban development, mobility and accessibility, environmental improvement, and business opportunities
Strategic Directive Plan (PDE)	2002–2012	SMDU	States the strategy for urban development, including land and environmental zoning, over the ten-year period
Agenda 2012: city targets program	2009–2012	SEMPLA	Presents strategic actions, indicators, and targets for the city and its regional divisions and subdivisions aligned with electoral campaign promises for the three-year period
Pluriannual Plan (PPA)	2010–2013	SEMPLA	Sets directives, objectives, and targets, framing the budget allocation for the four-year period

Abbreviations: SEMPLA, Municipal Secretariat of Planning (Secretaria Municipal do Planejamento); SMDU, Secretariat of Urban Development (Secretaria Municipal de Desenvolvimento Urbano).
SOURCE: Clarke (2011).

laws are expected to incorporate the guidelines and priorities set forth by the PDE, but there are no formal mechanisms to ensure that this happens.

The Agenda 2012 is the result of a civil society initiative that amended the Organic Law of the Municipality to require the mayor to present a plan with strategic actions, indicators, and quantitative targets for each municipal district, in accordance with campaign promises and the PDE. The Agenda 2012 was developed by the secretary of planning and is structured around six axes: rights, sustainability, creativity, opportunities, efficiency, and inclusivity. Although there was no explicit cost information or a resource envelope to the agenda, the targets were set implicitly, taking funding constraints into consideration.

The fourth planning instrument at the center of government is the pluriannual plan (PPA, Plano Plurianual). Its focus is to establish directives, objectives, and targets, including on a regional and district basis, for the municipality and continuous program expenditures. It is a four-year plan developed in the first year of the mandate of a new government and extends into the first year of the mandate of the next government. It is probably best characterized as a detailed list of activities (particularly investments) to be carried out by the municipality. These activities have an expenditure provision attached both for the total and for the full four-year period, but these are indicative figures. The PPA in principle includes all municipal expenditures (including payroll and debt service) for the four-year period.

Each of these planning instruments attempts to express priorities and choices at a moment in time. However, none of them really constitutes a plan of action to be followed. The result is that each of the plans confers some authority on policy decisions, but in practice, their overlapping nature and lack of connection with the resources likely to be available mean that the real decisions are made, almost independently, in the preparation of the annual budget, and even more so during the process of execution of the annual budget. The patchwork of plans, which also include separately developed sectoral strategies, means that consistent priorities for the municipality are not being clearly defined.

In principle the Budget Guidelines Law (LDO, Lei de Diretrizes Orçamentárias) serves as the link between the PPA and Annual Budget Law. It takes from the PPA the current year targets and priorities. The LDO sets more specific rules for budget formulation and lays the ground for eventual changes in tax or spending based on changes in legislation. In compliance with the Fiscal Responsibility Law, it introduces fiscal targets for the current year and two additional years into the future and discusses fiscal risks and tax exemptions. Crucially, however, there is no mechanism for the outer year fiscal targets in the LDO to have any impact on the budgets in future years.

The final step of the planning process is the Annual Budget Law. The resources are allocated by programs and actions in each institution as well as by economic category (capital and current expenditures). The budget shows the resources allocated to each action and program in order to fulfill the current-year targets set by the LDO, in accordance with the PPA. However, since strategies are rarely costed, there are few mechanisms to ensure that the budget is allocated according to the resources needed to comply with the targets.

Budget Preparation

The budget preparation process starts in May with the issuance of budget instructions establishing the budget preparation calendar. The districts (*subprefeituras*) carry out public hearings, and subsequently, all budget units submit their budget proposals. Revenue forecasts are prepared at the same time by the Secretariat of Municipal Finance, so that budget requests can be reconciled with available resources. For the 2011 budget, the budget requests were about 40 percent higher than forecast resources, but they can be as high as double forecast revenues.

The budget allocations are made on an incremental basis. Based on historical spending patterns and ongoing contracts, the secretary of planning estimates the minimum amount of resources needed to guarantee the current provision of public services (recurrent expenditures) and other obligations, such as debt payments and judicial orders. Debt payments are defined for the budget process as the required legal minimum of 13 percent of net real revenue of the Fiscal Responsibility Law, not the amount required to ensure a downward ratio of debt to income. After taking into account the amount needed to pay for the recurrent expenditures and the total resource envelope estimated by Secretariat of Municipal Finance, provided all legal earmarks are complied with, the Secretariat of Planning derives the investment envelope, as a residual.

The choice of investment projects to be financed is somewhat ad hoc, involving consideration of whether they are foreseen in the Agenda 2012, if they have technical viability, and if they are ready for execution. Projects may still be included if they do not comply with these criteria but are often allocated only symbolic funding with the possibility of becoming eligible for further funding during the year. There is no formal costing system, and calculations of future recurrent expenditures from investment do not enter the formal budget process or affect the investment decisions. The provision for contingencies is very small.

Once the draft budget is prepared, it is submitted to the city council. The councilors can amend the budget to include new expenditures, with no limit on the number of amendments. However, for new spending to be introduced, amendments to cut expenditure in other areas or raise revenues are required. For the 2011 budget, more than 5,000 amendments were proposed, of which 1,415 were incorporated into the budget (see Clarke 2011).

Budget Execution

Once the budget is approved, the Secretariat of Municipal Finance issues an administrative regulation setting bimonthly forecasts of revenue in accordance to the revenue estimate in the budget, which sets spending limits for each budget unit. The regulation allows The Secretariats of Planning and Finance to freeze (*contingenciar*) resources (and corresponding expenditures) during budget execution. This is normally done at the beginning of the year. In 2010, R$1.8 billion of a R$26.8 billion budget (6.7 percent) was frozen, while in 2011 the freeze was more severe: R$5.6 billion out of R$35.6 billion (15.7 percent). The resource freeze arises from the inherent uncertainty regarding revenue collection and the need to fulfill the fiscal targets but also implies considerable uncertainty by budget units on the availability of resources. The allowances for expenditure are set by budget unit and revenue source, but the line secretariats can move resources from one unit to another. They can also unfreeze expenditures by offering to freeze other budget line items of an equivalent amount, as long as payroll and debt service expenditures are maintained. Requests for additional budget allocations must be submitted to the Secretariat of Planning during two periods of the year: April to August and October to November.

Frozen resources can be freed up throughout the year. The secretaries of planning and finance hold weekly meetings to evaluate revenue collection vis-à-vis the estimate and budget execution. Since a sizable amount of resources is frozen at the beginning of the year, since 2005 no additional resources have been frozen during the year. The executive can also alter the resources allocated to each program and action, up to the amount equivalent to 15 percent of all planned expenditures. However, the changes made within programs and within the same government agency and expenditure element are not counted within the 15 percent limit on budget reallocation.

The budget preparation and execution process of São Paulo municipality has particular implications. The first is that priorities are only very tenuously transmitted throughout the process, with few mechanisms in place to focus priorities and assure that they are addressed. The second implication is the very strong inertia in the whole process, with a focus on maintaining existing programs and structures. It is this aspect of the process that has led to the current situation of the municipality increasing debt, despite rapid growth of revenues. A third implication of the existing system is that it is fraught with uncertainty, which hinders any effective planning or coordination with other municipalities in the SPMR.

Table 12.6 shows the 2010 budget outcomes in São Paulo municipality at the level of major functions. For example, expenditure in environmental management was 44 percent lower than budgeted, while expenditure on transport was 37 percent higher than budgeted. Table 12.7 shows that these deviations in the transport budget did not occur only in 2010. From 2008 to 2010, major expenditures took place without having originally been budgeted or are budgeted and not spent. The fact that the deviations from the original budget can be so large and widespread implies that the budget process itself lacks credibility. The effect of this is that any focus on results or longer-term objectives for the city, and for the SPMR more broadly, becomes very difficult.

TABLE 12.6

Planned and executed 2010 budget for São Paulo municipality, by function (R$ millions)

Function	Budget	Revised	Actual	Deviation (%)
Total	27,898	29,209	26,952	–3
Education	6,253	6,214	5,540	–11
Health	5,399	5,444	4,911	–9
Pensions	4,051	4,139	4,004	–1
Special charges	2,755	3,169	3,135	14
Urban development	2,550	2,702	2,461	–3
Transport	1,707	2,402	2,346	37
Housing	1,041	991	900	–13
Social assistance	692	804	700	1
Legislature	579	543	476	–18
Administration	463	463	428	–8
Environmental management	424	279	239	–44
Sanitation	415	378	358	–14
Culture	362	376	311	–14
Public safety	302	306	254	–16
Sports and leisure	239	280	254	6
Communications	165	154	152	–8
Judicial	127	137	124	–3
Labor	118	116	78	–34
Energy	114	117	116	2
Trade and services	68	124	120	77
Other	73	70	46	–37

SOURCE: Data from Municipal Secretariat of Planning, São Paulo.

TABLE 12.7
Intrayear changes in São Paulo municipality's transport budget (R$ millions)

	2008			2009			2010		
Expenditure	Budget	Actual	Difference (%)	Budget	Actual	Difference (%)	Budget	Actual	Difference (%)
Total	1,512	1,847	22	1,836	1,875	2	1,707	2,346	37
Current expenditure	1,064	1,431	34	1,219	1,763	45	1,443	1,662	15
Roads	417	409	–2	429	477	11	561	548	–2
Urban Collectives	556	947	70	707	1,183	67	787	1,035	31
Capital expenditure	447	416	–7	617	111	–82	264	683	159
Railway		275	NA	218	50	–77	10	650	6,399
Roads	26	20	–22	93	18	–81	65	19	–70
Urban collectives	420	121	–71	305	43	–86	189	13	–93

NA, not available.
SOURCE: Data from Municipal Secretariat of Planning, São Paulo.

Investment Planning

Some of the biggest deviations in the budget occur in the area of investment expenditure. As noted, in the existing system, investment is treated as a residual item in the budget planning and execution process. Given that the future development of the city of São Paulo and the broader SPMR will depend upon the capacity to identify, finance, and complete appropriate investments in infrastructure, it is important to consider the processes by which investment is planned and executed.

There is no formal investment planning and screening process, and investment decisions are normally taken alongside other items of the budget. Currently investment proposals included in the Agenda 2012 or that are financed with earmarked funds, such as federal and state transfers, are prioritized, but these are also not immune from budget cuts if resources are seen to be inadequate. In addition to transfers from other levels of government, whose resources are directed to the investment projects, the other mechanism to raise funds to finance investments is a form of development bond (*certificado de potencial adicional de construção*, CEPAC), which also requires the resources to be spent in a specific city district or subregion.[5]

In practice, in line with broader metropolitan plans, the municipality has been prioritizing investments in housing and public transportation. The major investments are decided by the secretary of urban development together with the mayor, on the basis of technical information rather than an economic evaluation.

Other cities in the SPMR confront the same difficulties as São Paulo city in planning and budgeting, hindering coordination across the metropolitan area. Spending in the city of São Paulo constitutes some two-thirds of spending for the SPMR. The way in which it allocates resources and the efficiency with which they are used are thus critical for the ability of the SPMR to strengthen its competitiveness and meet the needs of the future. Current approaches to fiscal management have

[5] A CEPAC is a bond issued by the municipality that grants the holder specific development rights.

provided sustained increases in revenues and expenditures but do not seem to take into account increasing concerns about debt levels. The multiplicity of planning instruments in the city suggests that prioritization of spending is difficult and is often something that is imposed by other levels of government, either at the federal or the state level. The nature of the budget process also locks the city into incrementalism and uncertainty. While many state-of-the-art budget tools exist, it may be worth refocusing them on drawing down of the debt, creating space for investment, and improving the predictability of budget implementation as a foundation for both the city and the SPMR going forward.

Some Other Tools to Support Public Finances

São Paulo city has over the years developed some specific mechanisms to further urban development and raise revenue. Here a few are briefly described to demonstrate ways in which the city of São Paulo has pursued urban development in a constrained environment.[6]

Progressive Property Taxes

The city of São Paulo approved the use of a progressive property tax in July 2010. The objective was to create a tax instrument that would incentivize improved land uses for specific properties. The framework identifies underutilized or deteriorated properties and establishes a deadline for improvements. Owners failing to make such improvements would be charged staged increases in property tax assessments over time, which over a five-year period could increase up to 15 percent of the property value. If, after a specified deadline, the owner has failed to carry out the works stipulated by the authorities, the property can be expropriated in exchange for municipal bonds (CEPACs).

The law regulating the progressive property tax initially provided for application of the progressive tax to specific areas of the municipality: those with unbuilt or underbuilt land that would be suitable for housing and with existing infrastructure. To date, the municipal government has not notified owners in the areas where the instrument can be applied, so the instrument remains unused.

Enhanced Development Rights

Originally developed in the 1970s, the idea of enhanced development rights (*otorgo oneroso*) draws on the possibility of separating the "right to property" from the "right to build" with the aim that the city could charge for construction rights. The instrument was first approved and regulated in 1986 and was linked specifically to slum clearance programs. Originally, the enhanced development rights awarded the right to increase development densities for specific lots occupied by favelas (slums) in exchange for the responsibility of constructing social housing elsewhere in the city. By 1995, the requirement to build housing was removed from the legal framework, and

[6] This section draws from Samad (2011).

its attractiveness increased. From 1988 to 1998, enhanced development rights are estimated to have produced significant revenues for the municipal government.

The early use of this instrument was characterized by some complications that limited the impact of the program. First, accurately valuing and charging for enhanced development rights proved very difficult. Counterpart contributions were frequently underestimated. Second, revenues generated from the granting of developer rights were not consistently used for the intended purpose of social housing. Third, legal challenges were raised against the instrument, suggesting that the sale of exceptions to zoning was illegal, and these operations were declared unconstitutional in 1998.

A new enhanced development rights instrument was introduced in 2002 with the Strategic Master Plan. A series of decrees, laws, and government directives were produced providing detailed guidance on the procedures to be followed for approving applications and monitoring the amount of building potential actually "sold." A management structure was also developed linked to the Department of Building Approvals and the Department of Urban Planning in order to oversee use of the new instrument. From 2007 to 2009, an estimated US$200 million (R$408 million) was generated for the Municipal Urban Development Fund by enhanced development rights. This amount represented about 16 percent of total receipts and 20 percent of the amounts collected in property taxes in 2008.

Urban Operations

The Urban Operation is a legal tool of São Paulo city that can be used to designate areas for government-sponsored development projects, under which financiers/developers pay for development rights. Typical projects have supported the development and/or update of infrastructure, housing to replace slums, installing urban amenities in line with desired density, and protecting the environment, usually through a development consortium. Unlike the enhanced development rights, in which financial counterpart contributions are channeled into building housing outside the demarcated area, Urban Operation resources can be used only within the demarcated areas. The Urban Operation concept has been used for some time and with regulations set for each operation, with developers and financiers paying substantial sums for the enhanced building rights within the demarcated areas.

Ten urban operations are under way, five of which are implementing regulations. These operations include initiatives to revitalize old industrial and railway areas, as well as the building of highway links in the SPMR and addressing environmental issues (see box 12.1). They have proven to be an effective means to raise resources for the municipal development. At the end of 2010, these operations had generated significant resources with positive balances ranging from R$18 million to R$671 million.[7]

[7] Samad (2011) describes in details the specifics of four Urban Operations currently under way (Centro Urban, Água Branca, Faria Lima, and Água Espraiada).

BOX 12.1

São Paulo's proactive approach to environmental issues

Metropolitan areas typically suffer from a wide range of environmental issues: from high carbon dioxide emissions due to traffic congestions, to polluted water supplies, to declining biodiversity. São Paulo municipality, the heart of the SPMR, has taken a proactive approach to addressing these issues.

In 2009, São Paulo was the first city in Brazil to create a policy and guidelines for addressing climate change and a municipal committee to ensure that words were followed up with action. Emissions have already been reduced by 12 percent, and São Paulo plays a key role in the executive committee of the C40 Cities Climate Leadership Group and on the International Council for Local Environmental Initiatives (ICLEI).

On the mitigation side, São Paulo has already held three auctions of carbon credits, worth some $75.5 million reals (about US$38 million). The city has also developed a program of vehicle inspection and is moving to cleaner forms of transport, such as clean buses and bicycles, reducing the number of hospital internments and deaths in the city and saving on health costs.

On the adaptation side, the city government is creating many more parks and green spaces: 24 to date, with a goal of 100 by the end of 2012. The city is one of 21 cities in the world to take part in the Local Action for Biodiversity program of ICLEI, with the aim of bringing together issues related to urban biodiversity, poverty, and sustainable development.

Rethinking the urban space is also part of the plan to address environmental issues. Key urban operations are under way to restore rundown industrial areas and to address water and waste management. A multisectoral effort is under way to restore key watersheds in São Paulo city and in the broader metro area. The city has also created an environmental civil guard, with some 540 agents overseeing environmental measures and controls across the city. And the city has mapped areas that are highly vulnerable to risk, such as flooding or landslides, and it is including such concerns in the development of key infrastructure, including the construction of roads.

Although climate change and environmental sustainability pose enormous challenges, São Paulo demonstrates that local efforts and solutions can not only help to address these global issues but also make a more healthy, attractive, and desirable city in which to live.

SOURCE: São Paulo Research Foundation-FAPSEP (2012).

CEPACs

CEPAC is a bond issued by the municipality and sold in public auction that grants its holder the right to augment the construction area in excess of legislation or to construct buildings that deviate from the guidelines and use foreseen by the legislation. This right, however, can be exercised only within the perimeter of the respective Urban Operations, discussed previously. CEPACs are also used for paying suppliers or defraying compensation payments for expropriated properties needed to make way for urban interventions, subject to the agreement of all involved. The first CEPAC was issued in 2004, by means of the São Paulo Stock Exchange; R$30 million was raised (100,000 CEPACs with a face value of R$300).

Use of CEPACs requires providing security for investors, which involves monitoring of both the financial market and the progress being made in the Urban Operation. The Securities Commission has issued specific normative instructions (instruction 401/2003) covering the trading and distribution of CEPACs, ruling that no CEPAC can be issued without the issuing municipality seeking prior registration of the bonds in the commission. Considerable effort goes into developing the prospectus and in providing supplemental updates.

São Paulo city has been creative in developing instruments that specifically support urban and metropolitan development while providing a source of revenue. Other, smaller municipalities in the metro area may not have the projects or technical capacity required to use such instruments, but the innovations that have helped support São Paulo municipality's finances at the margin could potentially be deployed for the SPMR as a whole.

The SPMR Going Forward

The SPMR has seen much change over the decades and, as with all large metro areas, will continue to face pressures resulting from a growing population and economic transition. This brief review of governance and public finance in the SPMR highlights the growth and changes of the region over time and trends in public finance to address these changes. There are many issues to be addressed going forward, but two are especially important.

The first relates to finding effective mechanisms for coordination across the SPMR. As noted above, metropolitan areas are created at the state level, but each municipality has sovereignty and veto power over plans and programs to be implemented in its jurisdiction. This places a premium on creating mechanisms for coordination in which both the view of the state level and the views of the municipalities included in the metro area can be balanced. In the SPMR, the challenge is bringing together 39 different entities, with one much larger than the others, to make joint decisions and implement programs. Over the years, many such structures have been created to support coordination and development across the SPMR, but with the limited funding and decision-making authority built into the constitution, more often than not they have served only an advisory role. The new recently developed structures of the SPMR, including the development council, the consultative council, the technical groups, and the regional enterprise to support implementation of SPMR plans, allow for representation of all municipalities in the SPMR and may be able to play a more effective and concrete role than previous structures. However, the tension between the state and municipalities over who has ultimate decision-making authority and use of resources continues to be built into the system. Leadership can help to move the agenda forward, but finding solutions that work for all of the relevant municipalities will continue to be a challenge.

The second issue relates to effectively building investment priorities into the budget, which will continue to be a critical challenge. While amalgamated, detailed fiscal accounts for the SPMR are not available, the information that exists suggests that the municipalities of the SPMR do have at their disposal the tools to raise revenues, as well as significant transfers from higher levels of government. Given its size, São Paulo city is clearly the driver of the fiscal balances for the region as a whole. Given the economic and demographic changes in the SPMR, pressures for both social services and investment needs continue to grow. Many plans, programs, and strategies are created to address these needs, but which plan takes precedence and how they are linked to the actual resources available are never quite clear. Finally, in budget legislation, as well as in the budget process, critical investment spending is treated as a residual, subject to fluctuations in revenue collection. Uncertainty over the resources available for investment makes it extremely difficult to coordinate across two municipalities, much less 39, and creates a significant obstacle to meeting the immense investment needs of the SPMR.

São Paulo city has come up with innovative mechanisms to finance investment and urban renewal through urban operations and the issuance of bonds for enhanced development rights in specified areas. While these are useful, they are difficult to use for cross-jurisdictional purposes. A key priority for the metro region is to build investment priorities into the budget more effectively at all levels. Without this, it will be extremely difficult to undertake the investments necessary to economically, socially, and environmentally renew the SPMR so that it maintains it place on the global stage.

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