Applying Negotiation Skills in the Design of Public Policies: 
analysis of the City of São Paulo’s Invoice Program

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Abstract: The author argues that by applying problem-solving negotiation skills in the design of public policies, public administrators benefit from more effective and wide-ranging outcomes in the realization of their goals. In order to demonstrate this idea, the author analyzes how negotiation skills – such as identifying key actors and their interests, recognizing hard-bargaining tactics and changing the players, knowing your best alternative, creating value and building trust – permeated and contributed to the success of the City of São Paulo’s Invoice Program (“Programa Nota Fiscal Paulistana”), a public policy aimed at combating tax evasion of service tax in the City of São Paulo.

Keywords: Negotiation skills; Public policies.

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1 Introduction

Public administrators have a very challenging job: managing and coordinating multiple, distinct and oftentimes contentious interests within a society. The design of public policies has to be cautiously planned in order to incorporate and serve, to the maximum extent possible, these different interests. In pursuing public welfare, public administrators, as representatives of the state, have the power to enact rules and demand obedience, through various mechanisms of law enforcement. Enforcing a rule, however, may be costly and not as effective as would be desirable. In this paper, I argue that by applying problem-solving negotiation skills in the design of public policies, public administrators benefit from more effective and wide-ranging outcomes in the realization of their goals. In order to demonstrate this idea, I will analyze the City of São Paulo’s Invoice Program (‘Programa Nota Fiscal Paulistana’), and how negotiation skills permeated it and contributed to its success.

2 What is the City of São Paulo’s Invoice Program?

The City of São Paulo’s Invoice Program was enacted on December 8, 2005, by the Bill of Law no. 14,097, approved by the City of São Paulo legislative power. Its basic aim is to combat tax evasion of service tax (‘Imposto Sobre Serviços’ – ISS), increasing collections, and consequently, the city’s annual budget. The service tax is the most substantial source of revenue derived from taxation in the City of São Paulo. As a general rule, the taxpayer, as prescribed by federal law, is the service provider. Nevertheless, as the service tax is an indirect tax (such as the sales tax and the value added tax – VAT), the taxpayer does not bear the ultimate economic

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2 The program was refined in 2008 and 2011, by the Bills of Law no. 14,865 and 15,406, which amended the original text.

3 As the United States, Brazil is a federal republic with autonomous state and local governments. Taxes are imposed in Brazil at the federal, state, and municipal levels. According to article 156, of the Brazilian Federal Constitution, the municipalities shall have the competence to institute taxes on: (i) urban buildings and urban land property; (ii) inter vivos transfer, on any account, by onerous acts, of real property, by nature or physical accession, and of real rights to property, except for real security, as well as the assignment of rights to the purchase thereof; and (iii) services of any nature not included in article 155, II, as defined in a supplementary law.

4 In 2012, the City of São Paulo collected around US$ 7.6 billion in municipal taxes. The amount of service tax collected was of around US$ 4.5 billion, representing 59.2% of the revenue derived from municipal taxation. I thank Municipal Tax Auditor Douglas Amato for kindly providing me with this information over email.

5 Article 5th, of Supplementary Bill of Law n. 116/2003.
burden of the tax. After the consumer pays the price of service – including the amount representing the service tax – the service provider files a tax return and forwards the tax proceeds to the municipal tax authority with the return. The economic burden of the tax is, therefore, shifted to the ultimate service consumers.

One of the main challenges in the collection of service taxes is that many service providers, in order to avoid the tax incidence, do not declare – as required by law – their transactions to the Municipal Tax Authority. In such cases, they provide the service contracted, without issuing the respective invoice. In other words, the consumer pays the entire price of the service, including the amount corresponding to service tax, and the taxpayer does not transfer the tax proceeds to the government.

Before the launching of the City of São Paulo’s Invoice Program, the service consumer, in theory, did not have any monetary incentive to demand an invoice, since the price he or she paid for the service wouldn’t change because of its issuing. For example, if one would go to a hairdresser and pay US$40,00 for a haircut, the price of the service would be $40,00 – including service tax – irrespective of whether the consumer asked for the invoice or not. And, if the consumer did not ask for the invoice, the odds that the service provider would not issue it, in order to appropriate the amount equivalent to the service tax payable, could be significant.

In the City of São Paulo, service tax rates range from 2% to 5%, and are based on the price of the service. Service tax can only be levied on services included in the list of taxable services described in federal law. Examples of taxable services usually contracted by natural persons are services of education, parking, hairdresser, and laundry, among others. Accounting, cleaning, and computer programming are examples of services ordinarily contracted by legal entities.

With a view to avoid the losses caused by the purposeful evasion of service tax by service providers, the City of São Paulo’s Invoice Program gives the consumer an incentive to declare the transaction: for every invoice the consumer demands he or she is reimbursed with a part of the tax proceeds collected.

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6 The article 82, of the City of São Paulo Decree n. 52,151/2012, that currently rules the service tax, provides that “On the occasion of the service provision, the respective invoice or valet parking coupon should be issued”. The extinct Municipal Decrees n. 44,540/04 and 50,896/09, in articles 96 and 82, respectively, had similar provisions.

7 In some cases of tax evasion, though, the tax provider and the tax consumer would agree on different prices, taking into account if the tax was going to be transferred or not by the tax provider to the municipal treasury. This, of course, is an illegal conduct, proscribed by law.
As a general rule, this reward corresponds to 30% of the amount of the service tax, in the case of services contracted by natural persons, and to 10% of the amount of the service tax, in the case of services contracted by legal entities. The credit can be utilized in two different manners: it can be directly deposited into the service consumer’s checking or savings account, or it can be deducted from any property tax amount related to urban building or urban land property indicated by the service consumer.

In order to give consumers extra incentives to demand invoices, the City of São Paulo’s Invoice Program recently introduced a monthly lottery scheme under which consumers who are natural persons can benefit. Upon agreeing to the terms of the lottery on the Program’s website, the consumer is given an electronic lottery ticket for each invoice he or she demands, irrespective of the invoiced amount. Extra tickets may be assigned for each US$25 spent by the consumer.

According to Normative Instruction n. 09/11, issued by the Municipal Secretariat of Finance and by the Sub-Secretariat of Municipal Revenue, in each monthly lottery, 137,553 prizes must be awarded, ranging from one prize in the amount of around US$25,000 to 132,000 prizes of around US$5.

The information related to the credits awarded to consumers and lottery prizes – if applicable – are all detailed in the City of São Paulo’s website, in a webpage specifically designed for this purpose.

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8 For the purposes of the present paper, I will focus on the major rules of the program, disregarding some minor details that are not relevant to the argument furthered herein.
9 Article 2º of Municipal Law n. 14,097/05.
10 The original version of the Program, detailed in the Municipal Law n. 14,097/05, provided for the utilization of the credit solely as a deduction of 50% of the property tax amount related to urban building or urban land property indicated by the service consumer. In 2011, the municipal law was amended in order to incorporate the option of the deposit of the credit in the consumer’s checking or savings account. This option was originally designed in 2007 in an Invoice Program launched by the State of São Paulo in order to combat tax evasion on ICMS (acronym for “Imposto Sobre Circulação de Mercadorias e Serviços”), a state tax equivalent to the VAT. The considerable increase in the amount of ICMS collected by the State of São Paulo Tax Authority by the use of this option, inspired the City of São Paulo to imitate the model and adapt it to the service tax. According to the State of São Paulo states, the collection of ICMS increased by 23.3%, from 2007 to 2010, as a result of the State of São Paulo’s Invoice Program. “Arrecadação de ICMS cresceu 23,3% com Nota Paulista, diz governo”, G1 Economia e Negócios. Available at: <http://g1.globo.com/economia-e-negocios/noticia/2010/10/arrecadacao-de-icms-cresceu-233-com-nota-paulista-diz-governo.html>. Last visited: May 1, 2013.
11 The lottery was not an original component of the Program and was only added to it in September of 2011, according to provisions of the Municipal Law n 14,406/2011. The number of participants in the monthly lotteries increased 332% since its creation, going from 76,000 to 253,000. “Ganhadores do 17º sorteio da Nota Fiscal Paulistana recebem prêmio da Prefeitura de São Paulo”. Prefeitura de São Paulo, Finanças e Desenvolvimento. Available at: <http://www.prefeitura.sp.gov.br/cidade/secretarias/financas/noticias/?p=12021>. Last visited: May 2, 2013.
12 The amounts detailed in the Program rules are in Brazilian Reais. For the purposes of this paper, I am considering the US Dollar to Brazilian Real Exchange Rate to be USD$1 = BRL 2.
13 The value of the three major prizes will be doubled in the months of January, May, August, October and December.
designed for the Invoice Program. Each consumer can access the webpage, register with the Program and check his or her personal information, by entering his or her taxpayer identification number and password. This webpage also displays the amount of money redistributed under the Program, the number of invoices issued, along with relevant links to the applicable legislation.

From its launching in November 2006 until August 2012, the Program increased the collection of service tax in the amount of US$ 1.753 billion. More than US$400 million has been credited to consumers, and around US$ 20 million has been awarded in lottery prizes. It is possible that the price of services has increased because of the Program – so that service providers can somehow compensate for the money they earlier “saved” through tax evasion –, but there are no statistical studies that have successfully proved this so far.

3 What are the negotiation skills that inspired the Program?

3.1 Identifying key actors and their interests

A good negotiator must bear in mind not just his or her own interests but also those of other parties involved in a negotiation. If one goes into a negotiation focused solely on his or her personal goals and does put oneself in the other party’s shoes, the chances of the parties bargaining solely over positions and locking themselves into those positions are high. Arguing over positions is not recommended, since it produces unwise outcomes, is inefficient, and endangers an ongoing relationship.

Constructing an efficient public policy is not any different from taking part in a multiparty negotiation. Like good negotiators, public administrators, when designing a public policy must take into account the interests of all the people that are going to be affected by it. The primary objective of any public policy is enhancing public welfare, but that does not mean incorporating all the people’s interests, since they are often distinct or even conflicting. For this reason, the

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15 In Brazil, the taxpayer identification number is national, and is known as CPF (short for “Cadastro das Pessoas Físicas” – Natural Persons Register), for natural persons, and as CNPJ (acronym for “Cadastro Nacional das Pessoas Jurídicas” – National Legal Entities Register), for legal entities.
16 I thank City Attorney Rodrigo Panizza and Municipal Tax Auditor Douglas Amato for kindly providing me with the following: ARELLANO; PICCHIA, 2012.
17 FISHER; URY; PATTON, 2011.
preliminary and fundamental step public administrators must take when formulating public policies on contentious issues, is the identification and assessment of the key actors and their interests.¹⁸

In the design of the City of São Paulo’s Invoice Program, the public administrator made a wise identification of the key actors involved. The more predictable actors – the Municipal Tax Authority and the potential tax evaders, i.e. service providers – were identified and their interests were assessed and evaluated. Service tax evasion results in significant losses to the City, and maintaining this status quo is obviously not in the City’s interest. The Tax Authority’s primary interest lies in the immediate transfer of the tax collected by service providers to itself. Such transfer would save expenditures on tax audits, and on other administrative or judicial mechanisms of tax enforcement. The potential tax evaders, on the other hand, are interested in reducing their tax liability, and in order to accomplish this goal, they lie to the tax authority by hiding their taxable transactions.

3.2 Recognizing Hard-Bargaining Tactics and Changing the Players

Well-trained negotiators are prepared to cope with hard-bargaining tactics, such as bluffing, puffing, and lying. According to Robert H. Mnookin, Scott R. Peppet and Andrew S. Tulumello, “A critical first step is to be able to recognize adversarial tactics and to know how they work”¹⁹ and a “technique for dealing with [such] difficult tactics is to change the game by changing the players”.²⁰ The City of São Paulo’s Invoice Program has successfully used this technique. Apart from the tax authority and the taxpayers, another critical player in this setting is the tax consumer. By adding the tax consumers as key actors in order to solve the tax evasion problem, the public administrator changes the game and circumvents the hard tactics employed by service providers. Considering that it is not in the services providers’ interests to declare their transactions, the tax authority brings in the consumers and gives them an incentive to declare taxable transactions. Thus, this mechanism has inculcated the habit of demanding invoices among

¹⁸ When invited as a Guest Speaker in the Harvard Negotiation Workshop, on April 24, 2013, Former Massachusetts Governor Michael Dukakis stressed the importance of identifying the key actors involved in order to accomplish positive results in multiparty negotiations.

¹⁹ MNOOKIN; PEPPET; TULUMELLO, 2000.

²⁰ Idem, ibidem.
the inhabitants of the City of São Paulo and promoted fiscal education in its population, which is in the city’s best interests.

3.3 Knowing your Best Alternative

“The reason you negotiate is to produce something better than the results you can obtain without negotiating”.21 Traditionally, the results one can obtain without negotiating are known as BATNA – acronym for Best Alternative to a Negotiated Agreement. The BATNA is “the standard against which any proposed agreement should be measured”22 and “has the advantage of being flexible enough to permit the exploration of imaginative solutions”.23

To combat service tax evasion, tax authorities ordinarily have one natural BATNA: auditing potential tax evaders and initiating administrative or judicial mechanisms of tax enforcement, as the case may be. This process, however, is expensive, time consuming, requires a large, trained workforce and entails a lot of red tape that is best avoided. Especially in a city as large as São Paulo, the number of service providers is enormous, and it is very unlikely that the tax authority would be able to audit all the potential tax evaders. The huge backlog of cases in courts, the long response time from the Brazilian judicial system as well as the lack of efficient and concrete judicial measures against evading taxpayers aggravates the situation.

Given this BATNA, the City of São Paulo’s Invoice Program appears to be an imaginative solution and a very compelling alternative to combat tax evasion. Although creating the Program’s electronic platform was expensive, the increase in the collection of service tax in the amount of US$ 1.753 billion, from November 2006 to August 2012, indicates that the Program has paid off in the long run. The fact that it is entirely electronic also presents advantages compared to the aforementioned BATNA. Before the introduction of the Program, paper invoices were issued, and had to be retained by taxpayers for 5 years. Under the Program, electronic invoices are issued, which are available for online consultation for 5 years and kept, thereafter, in magnetic media indefinitely. Finally, the Program can also be considered advantageous in comparison to the analyzed BATNA for promoting fiscal education and, as furthered explained, for building trust between the City and its citizens.

21 FISCHER; URY; PATTON, 2011.
22 Idem, ibidem, p. 102.
23 Idem, ibidem, p. 102.
3.4 Creating Value

“For many, distributing value – as opposed to creating it – is the essence of negotiating.”

In this sense, “a negotiation often appears to be a ‘fixed-sum’ game; $100 more for you on the price of a car means $100 less for me.” Likewise, in cases of tax evasion, every $100 that a taxpayer “saves” by evading taxes means $100 less for the tax authority. From the perspective of this relationship alone, the issue is a purely distributional one – while the tax authority’s primary interest lies in collection of the service tax, the service provider is keen to appropriate this same amount corresponding to service tax.

At first glance, the only way for the tax authority to solve this fixed-sum conflict, and enforce the taxpayer’s legal obligation, seems to be resorting to the aforementioned BATNA: auditing potential tax evaders and initiating administrative or judicial mechanisms of tax enforcement. However, the formulation of the City of São Paulo’s Invoice Program, as previously referred, proved to be a much more effective, wide-ranging and imaginative solution to the problem. Moreover, by bringing in a third key actor – the service consumer – and giving him or her an incentive to declare the taxable transaction, the Program enhances social welfare, by creating value not only for the tax authority but also for the service consumers. A “pie” that initially seemed to be fixed and immutable is enlarged by the Program and enjoyed by more people. Furthermore, the electronic character of the Program creates value even for service providers, who are able to save the money previously spent on issuing paper invoices and maintaining a record of them for a 5 year duration. The electronic system also facilitates much more broad-based control by the tax authority, and prevents potential evaders from creating unfair tax competition, thus benefiting honest taxpayers.

24 MNOOKIN; PEPPET; TULUMELLO, 2000.
25 FISHER; URY; PATTON, 2011.
26 In 2007, one year after the Program was launched, 66,792,966 electronic invoices were issued. In 2011, this number practically doubled, and 130,421,562 electronic invoices were issued. As already mentioned, this represented a significant increase in the amount of service tax collected by the municipal tax authority (ARELLANO; PICCHIA, 2012).
3.5 Building Trust

Although there are no statistical studies to prove the same, it is possible to infer that the City of São Paulo’s Invoice Program has contributed to building trust among its participants. Two main sets of relationships have benefited, in the case, from trust building.

The first is the relationship between service providers and service consumers. By demanding an electronic invoice, the consumers are assured of the fact that providers will transfer the amount corresponding to the service tax to the tax authority. Paper invoices allowed for frauds and tax evasion, even when regularly demanded by consumers.

Secondly, the Program also builds trust among the government and its citizens. In a city as large of São Paulo, home to more than 11 million people of very distinct economic backgrounds, many citizens feel distanced from the government, and often complain of an excessive tax burden without concomitant public services of good quality. The City of São Paulo’s Invoice Program brings these people closer to the government. By requiring periodic visits to the program’s website – so that the consumer can enjoy the rewards he or she gains – the Program brings the citizens closer to the administration.

The success of the Program, moreover, proves that citizens and the government may have, oftentimes, overlapping interests, even when this does not seem evident at first glance. It is in the best interests of both the City and its citizens in having the City’s budget increased, the tax burden on service consumers alleviated and people educated to abide by tax rules. Identifying common goals and engaging in efforts in order to achieve them also has the power to build trust.

Finally, some specific rules of the Program seem to have been carefully drafted to meet citizens’ personal satisfaction, and create empathy in them towards the government. For instance, in the months of January, May, August, October and December, which correspond to the City’s Anniversary, Mother’s Day, Father’s Day, Children’s Day and Christmas, respectively, the bigger monthly lottery prizes are for larger amounts. The State, in this sense, is no longer the Thomas Hobbes Leviathan. It is instead an empathetic interests coordinator and a wise problem solver. Why not trust it?

27 Normative Instruction n. 09/11, issued by the Municipal Secretariat of Finance and by the Sub-Secretariat of Municipal Revenue.
28 In order to preserve the trust generated by the Program, it is critical that it is well managed and unsusceptible to corruption.
4 Conclusion

In this paper, I have demonstrated that by applying problem-solving negotiation skills in construing the City of São Paulo’s Invoice Program, the Municipal Tax Authority has benefitted from a more effective and broad-based policy to combat service tax evasion. In the case of this particular Program, the negotiating skills utilized were (i) identifying key actors and their interests; (ii) recognizing hard-bargaining tactics and changing the players; (iii) knowing your best alternative; (iv) creating value; and (iv) building trust. Considering the multitude of interests and relations involved in a city as large and diverse São Paulo, I argue that the success of the Program is a clear indicator that positive outcomes will result from the use of problem-solving negotiation skills in the design of future public policies.

References

