

BTI 2010 | Brazil Country Report

Status Index	1-10	8.05	# 17 of 128	
Democracy	1-10	8.20	# 20 of 128	➔
Market Economy	1-10	7.89	# 19 of 128	➔
Management Index	1-10	7.18	# 6 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	190.1	HDI	0.81	GDP p.c.	\$	9684
Pop. growth	% p.a.	1.0	HDI rank of 182	75	Gini Index		55.0
Life expectancy	years	72	UN Education Index	0.89	Poverty ²	%	12.7
Urban population	%	85.1	Gender equality ¹	0.50	Aid per capita	\$	1.6

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

Brazil meets the minimum requirements for a democracy under the rule of law. During the first half of President Luiz Inacio Lula da Silva's second term of office, standards of stateness and the rule of law have remained unchanged. The level of democratic consolidation has not changed significantly. The government's efforts to realize political reforms were not successful until early 2009. However, in October 2007, the Supreme Court made legislative party-switching more difficult by upholding an electoral court decision from February 2007, which had said electoral seats in the lower chamber of Congress belonged to parties and not to individual deputies, and that any legislators switching parties would thus lose their mandates. The new situation made the political panorama more transparent, because the lineup of forces in Congress no longer changes from one week to the next. During the period under review, the level of satisfaction with democracy, democratic convictions and interpersonal trust within Brazilian society improved slightly, but still remains very low.

The country's level of development has not changed significantly in the last two years. Brazil continues to have one of the highest levels of income inequality in the world. However, the reforms initiated by the Lula administration have yielded effects. During the last several years, poverty reduction and income distribution indicators have dramatically improved. Millions of Brazilians moved out of poverty. The income inequality index value also came down, thanks to low inflation and economic growth, targeted transfer programs and improvements in labor productivity due to improved schooling. Developmental imbalances between the relatively developed southern and southeastern regions and the socioeconomically disadvantaged northern and northeastern regions have not lessened in recent years. The gender gap in terms of economic opportunity seems to be narrowing, but women remain at a substantial disadvantage.

The institutional framework for market-based economic action has also been further strengthened in recent years. The Lula administration continued its commitment to

macroeconomic stability, and macroeconomic indicators have shown noticeable improvement as a result. In April 2008, Brazil was awarded an investment-grade rating by one of the two main U.S. credit rating agencies. Commitment to primary surplus and improvement of debt management along with reduction of the debt/GDP ratio has helped to significantly reduce the vulnerability of public finances to adverse shocks. Exports and reserves are at their highest historic levels and inflation and country risk at their lowest. The highest priority set by President Lula for his second term was to accelerate growth. The government's Accelerated Growth Program (PAC) envisages increased public investment in infrastructure and increased public credit. Public infrastructure spending from 2007 to 2010 has been projected to reach over 500 billion reais. In recent years, Brazil achieved annual growth rates of 4% to 4.5%, and growth has strongly benefited the poor. In December 2008, the environment ministry published an ambitious national Global Climate Change Plan, envisioning cutting the rate of Amazon deforestation in half by 2017. It was the first time Brazil has set concrete national goals for slowing deforestation and reducing its carbon emissions. In May 2007, President Lula launched an ambitious education development plan, which aims to redress Brazil's long-standing education deficit within 15 years. The plan establishes a results-based education system for the first time in Brazil's history.

History and Characteristics of Transformation

Democratic transformation in Brazil spanned a period of 16 years. The first steps toward liberalizing the authoritarian regime (1964 – 1985) were taken after General Ernesto Geisel assumed power in March 1974 and were continued under President João Baptista de Oliveira Figueiredo (1979 – 1985). Brazil experienced the most massive political mobilization in its history in connection with a campaign in early 1984 calling for direct election of a democratic president (“diretas já”). However, the armed forces insisted on indirect election of the first civil government since 1964. Tancredo Neves was elected president by an electoral assembly in January 1985. Due to his personal integrity and popularity, he found acceptance even among those opposed to the government, but died before he could take office. The office was assumed by the elected vice president, José Sarney (1985 – 1990). During the Constitutional Convention (1987 – 1988), the military prevented a far-reaching limitation of its institutional autonomy. The new constitution took effect in October 1988. The transition to democracy was consolidated in March 1990, when the first directly elected democratic president, Fernando Collor de Mello, assumed office. Implicated in a corruption scandal, Collor was removed from office by the National Congress in September 1992. Vice President Itamar Franco served out the remainder of his term. The internationally renowned sociologist Fernando Henrique Cardoso won the presidential elections in October 1994. In 1998, after the constitution was amended to allow his re-election, Cardoso became the first president in Brazilian history to be elected to a second term of office (1999 – 2002).

When Luiz Inacio Lula da Silva (popularly called “Lula”), a former union leader and Workers’ Party (Partido dos Trabalhadores, PT) chairman, was elected president on 27 October 2002, it was the first time in Brazilian history that the presidency had been filled by a representative of those classes that, to that point, had been largely excluded from positions of political or economic power. Thus, Lula’s inauguration in January 2003 not only symbolized a sociopolitical change, it was also linked to the hopes of millions of Brazilians that reforms needed to fight poverty and inequality would be implemented more systematically than in the past. In spite of various corruption scandals that weakened Lula’s government and especially the PT during 2005 and 2006, Lula was re-elected to a second term of office (2007 – 2010) in October 2006.

Brazil’s transformation toward a market economy began in the 1930s with a largely insulated local market. It was guided after the end of World War II by the concept of import substitution industrialization. This policy helped Brazil achieve high economic growth rates over several decades. However, it did not succeed in producing sufficient competitive pressure to maximize domestic economic efficiency, nor did it succeed in organizing a fully functional banking system or in reducing the risk of balance-of-payments crises. Industrialization was not self-sustaining. Existing economic, social and regional disparities increased further. The economic situation in the 1980s was characterized by growing unemployment, rapidly rising inflation rates, widely fluctuating gross domestic product growth rates, growing problems resulting from the large foreign debt and rising deficits in the national budget. After various heterodox economic plans had failed, comprehensive measures were taken, beginning in the early 1990s and with more intensity from the mid-1990s on, to stabilize economic development. As finance minister under President Franco and as president beginning in 1995, Fernando Henrique Cardoso instituted a stability and reform policy that yielded low inflation rates, a better managed and more fiscally responsible government, and more consistent macroeconomic conditions. However, it also brought growing government debt, extremely high nominal interest rates and only modest growth rates.

Although Lula and the PT attacked Cardoso as a neoliberal and insisted on an economic model with a stronger social component, Lula’s successful 2002 campaign (which followed three previously unsuccessful presidential bids, in 1990, 1994 and 1998) was founded on a platform of fundamental continuity with the course mapped out by Cardoso. In 2004, President Lula’s newly elected government faced several major challenges. There was deep concern on the part of the business actors as to how far a government led by a “socialist” party would be committed to fiscal stability. It was unclear how the government would develop programs to meet its election commitment of attacking inequality. However, Brazil’s progress in terms of meeting these challenges over the last six years has been impressive. The country’s macroeconomic situation, its fiscal outlook, debt situation and financial sector health are much better than they were six years ago. After his re-election for a second term of office (2007 – 2010), President Lula promised that the most important goal for his second term would be to accelerate growth. With 5.4% (2007) and 4.5% (2008) GDP real growth rates he managed to obtain this goal at least partially. Yet while progress in macroeconomic management was important, at least equally important was its combination with targeted social programs and policies that have brought poverty and inequality to historically low levels in recent years.

Transformation Status

I. Democracy

1 | Stateness

The state's monopoly on the use of force is established nationwide in principle, but does not function completely. Civilian authorities generally maintain effective control of the federal security forces, but there are reports that state-level security forces have committed numerous human rights abuses such as unlawful killings, use of excessive force, beatings, abuse, and torture of detainees and inmates. In February 2008, the government's National Human Rights Secretariat acknowledged that torture existed in the country. Federal, state, and military police often enjoy impunity in cases of torture, as in other cases of abuse. In several large cities the state is unable to completely guarantee private and public security. Reports of killings by Rio de Janeiro police decreased during the year 2008 under a new state security strategy. But there are still generalized problems related to the failure of security policies and persistent deficiencies in law enforcement.

Monopoly on the use of force

All citizens have the same civic rights, and the vast majority fundamentally acknowledges the state's constitution. Though discrimination persists, ethnic, religious and cultural minorities are not systematically excluded from political citizenship, on either a de jure or de facto basis.

State identity

In general, the state is defined as a secular entity. Religious dogmas have no noteworthy influence on politics or law.

No interference of religious dogmas

The state's basic infrastructure extends to the entire territory of the country, but its operation is deficient in some respects. The state apparatus operates efficiently and professionally in some regions, while others are still characterized by clientelism and patronage, demonstrating considerable need for reform. Further problems are caused by widespread corruption and organized crime and violence. A climate of lawlessness in certain remote parts of the country and in the slums of some large cities is aggravated by a weak judiciary and an often violent police apparatus.

Basic administration

2 | Political Participation

Free and fair elections take place without significant restraints.

Free and fair elections

Elected rulers have the effective power to govern. However, there are powerful landlords in some rural areas who effectively own the local judiciary and police and respond violently to attempts at agrarian reform and other legal actions.

Effective power to govern

The constitution guarantees unrestricted freedom of association and assembly, and the government generally respects these rights in practice.

Association / assembly rights

The freedoms of opinion and the press are unrestricted and generally respected. The national media are free from federal government pressures, but the economic pressure of government advertising and the use of regulatory power are important. The media provide vigorous reporting on controversial issues and government performance, but media ownership is highly concentrated and information is often biased by private power interests. While Brazil's national media enjoy unrestricted freedom, the media in some provinces are frequently subjected to violent attacks and abuses of power by local officials. In many states, there is only one local media conglomerate, often controlled by political groups.

Freedom of expression

3 | Rule of Law

There are almost no restraints on the basic functions involved in the separation of powers, with mutual checks and balances in place. Some problems of governability result from the electoral system, the fragmented character of the party system and the peculiar nature of Brazilian federalism.

Separation of powers

The judiciary is institutionally well differentiated and free from unconstitutional intervention by other institutions. However, it is heavily overburdened. There are vast disparities in citizens' access to legal counsel and the administration of justice, due to extreme inequalities in resources available to citizens, and in the distribution and availability of information. In following with its Roman law tradition, Brazilian law is heavily procedural. Despite repeated attempts at reform, Brazil's legal system still operates inefficiently. Judges have used their autonomy to impede court reform and often use highly formalistic legal decisions to overturn government efforts at modernization. Over the last two decades, the level of distrust in the Brazilian judiciary has increased, and judges have been repeatedly involved in instances of corruption. Brazil has one of the world's most crowded and contentious legal systems. A strong culture of confrontation in the courts and long delays caused by rules that allow generous rights of appeal have led to a backlog of about 20 million lawsuits. Only 2% to 10% of homicides even go to trial.

Independent judiciary

As a rule, corrupt officeholders are prosecuted under established laws, but some manage to slip through political, legal or procedural loopholes. During the first six years of President Lula's mandate, there have been more detentions for political corruption than in previous decades. In 2007, an estimated 2,800 people were detained, in the first half of 2008, 1,700 people were arrested. The government claims this is testament to increased transparency and accountability. In July 2008, the federal police arrested 24 people linked to the 2005 vote-buying scandal (the so-called mensalão or monthly payments scandal) involving President Lula's ruling Partido dos Trabalhadores.

Prosecution of
office abuse

The Brazilian constitution contains comprehensive guarantees for civil rights. It promises to promote the well-being of all citizens, without prejudice as to origin, race, sex, color, age or any other potential ground for discrimination. Men and women have equal rights and duties. The freedom of religion is guaranteed. However, in spite of these constitutional guarantees, violations exist in practice, particularly in rural areas and urban slums. Brazil has a very high firearms-related homicide rate. Most violent crime is related to the illegal drug trade. In many states, certain police groups, referred to as "death squads," terrorize shantytown dwellers and intimidate human rights activists. The prison system is anarchic, overcrowded and largely unfit for human habitation. Thousands of poor Brazilians work under conditions analogous to slavery. As a consequence of violent crime, corruption, mistrust of the police and highly centralized federal legal codes, many Brazilians do not feel that they are in a position to ensure their personal safety. Due to a 1979 amnesty law, violations of human rights by the Brazilian military under the authoritarian regime between 1964 and 1985 have never been prosecuted in court.

Civil rights

4 | Stability of Democratic Institutions

Democratic institutions operate essentially according to their allotted functions. Frictions between institutions have diminished, but specific structures of interaction between key institutions do create problems of governance and negatively affect the implementation of reforms. The 1988 constitution is characterized by a tendency toward overregulation. Consequently, nearly all major reforms require a constitutional amendment and are therefore difficult to achieve. The electoral system produces an overrepresentation of the sparsely populated and often disadvantaged northern and northeastern federal states in the Chamber of Deputies and the Federal Senate. In 2007, Congress rejected President Lula's proposal for political reform, which was expected to give parties more power to control their officeholder members, and to clarify campaign financing rules. In 2008, the government proposed a new package of long-discussed initiatives, including reforms to campaign finance rules, a proposal for closed electoral lists, measures to strengthen party loyalty and an introduction of proportional representation. At the

Performance of
democratic
institutions

beginning of 2009, it was not yet clear whether these repeatedly postponed reforms could be pushed through by years' end.

All relevant political and social players – with the possible exception of some powerful landlords – accept the legitimacy and authority of democratic institutions.

Commitment to
democratic
institutions

5 | Political and Social Integration

The political party system is characterized by a high level of fragmentation, moderate polarization, a poor social support base (with the PT as an exception) and high voter volatility. The reasons for this are partly historical, but are also connected with the electoral system. The Chamber of Deputies has an open-list system of proportional representation without a barring clause. The parties present regional lists of candidates, but voters may vote directly for individual candidates. Approximately 90% of voters in fact do so. This system makes it more difficult for national party leaderships to discipline elected representatives, and fosters a focus on personalities rather than institutions, particularly because political campaigns are planned and financed less by political parties than by candidates themselves. At the national level, most parties are organizationally weak. There is little party coordination or loyalty among congressional representatives. Until 2007, changes in party affiliation within Congress occurred with extreme frequency following elections, the switch usually being from opposition to governing parties, and often across ideological boundaries. The costs of party switching were minimal. In October 2007, the Supreme Court upheld an electoral court decision from February 2007, ruling that lower-house electoral mandates belonged to parties rather than to individuals. The court ordered that any officeholders switching party would lose their mandates. Some weeks later, the Supreme Court extended this requirement for party loyalty to senators, mayors, governors and even the country's president. The new situation made the political panorama more transparent, because the lineup of forces in Congress no longer changes from one week to the next. Some observers predict that Congress will want to soften this measure ahead of the 2010 vote, opening a temporary window to allow for some party switching before the polls.

Party system

Brazil's network of interest groups is relatively close-knit, but dominated by a few strong interests. Labor and capital associations dominate. Despite divergences among competing umbrella organizations, trade unions are strong political actors. Following democratization there was a gradual estrangement from traditional corporatist state models. Mobilization capabilities diminished during the 1990s and the level of trade union organization is on the decline, but trade unions are still important to many sectors of workers. President Lula has co-opted many trade union leaders by awarding them government positions, and by issuing a decree which grants labor federations 10% of the compulsory labor union tax.

Interest groups

Entrepreneurs have a national umbrella organization, with the National Confederation of Industries in São Paulo State wielding the greatest influence.

Consent to democracy is moderate at about 50%. In 2008, 47% of respondents (as compared to 46% in 2006) agreed that democracy was preferable to any other form of government. A larger percentage, or 57%, said democracy is indispensable to being a developed country. The degree of satisfaction with democracy continued to be moderate to low (2008: 38%), but at the same time 79% approved of President Lula's administration and 53% expressed confidence in the country's leadership. Political protests do not tend to question the constitutional framework.

Consent to democratic norms

There is a robust network of autonomous, self-organized groups and civic organizations in Brazil. In 2005, 338,000 private foundations and non-profit associations were registered, collectively employing 1.7 million persons across the country. One of the most important and controversial organizations is the Landless Workers Movement (Movimento dos Trabalhadores Rurais Sem Terra, MST), the largest social movement in Latin America with an estimated 1.5 million members. The MST aims for land reform and land distribution. The Lula administration has been much more responsive to the pleas of the landless than were previous governments. Under Lula, the government has more than tripled the disbursement of public funds to the MST in comparison with the previous government. In spite of this, the relationship between the government and an increasingly radical MST has worsened over the last several years.

Associational activities

II. Market Economy

6 | Level of Socioeconomic Development

Brazil's inequality levels remains among the highest in the world. Millions of people still live in poverty; social exclusion is quantitatively and qualitatively pronounced and structurally ingrained. But during the last several years, poverty reduction and income distribution indicators have dramatically improved. The full poverty rate fell from 34% of the population in 1995 to 25.6% in 2006. Millions of Brazilians have moved out of poverty in the last several years. The income inequality index value also came down a little bit, thanks to low inflation and economic growth, targeted transfer programs (including "Bolsa Familia," a conditional cash transfer program) and improvements in labor productivity due to improvements in the quality of schooling. But with a Gini coefficient of 0.57 (2008), Brazil still shows one of the worst values of income distribution worldwide.

Socioeconomic barriers

About 45% of the national wealth is concentrated in the upper 10% of the income pyramid, while the lower 20% control just over 2.4% of the wealth. Brazil exhibits a medium level of development according to key indicators, but national mean values mask the great disparities between the relatively developed southern and southeastern regions, where conditions resemble those in industrialized countries to some extent, and the socioeconomically disadvantaged northern and northeastern regions. Existing developmental imbalances between these regions have not lessened in recent years. With a Gender-related Development Index score of 0.789, Brazil occupies rank 55 in global comparison. The gender gap in terms of economic opportunity seems to be narrowing, but women remain at a substantial disadvantage. The rate of illiteracy among women was 8.1% in 2006 in urban areas, but 22.2% in rural areas. Although female students consistently show better results and school attendance than do their male counterparts, this does not translate into better salaries or higher-skilled jobs in the labor market, nor into lower levels of unemployment. Women have the highest levels of unemployment (11%). In 2006, men earned on average 885.6 reais per month, while women earned just 577 reais, or two-thirds of an average male salary.

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	663760.3	882185.3	1089061.1	1333270.5
Growth of GDP	%	5.7	3.2	4.0	5.7
Inflation (CPI)	%	6.6	6.9	4.2	3.6
Unemployment	%	8.9	9.3	8.4	8.2
Foreign direct investment	% of GDP	2.7	1.7	1.7	2.6
Export growth	%	15.3	9.3	5.0	6.7
Import growth	%	13.3	8.5	18.4	20.8
Current account balance	\$ mn.	11737.6	13984.7	13621.5	1550.4
Public debt	\$ mn.	96818.2	93933.0	84301.9	79956.9
External debt	\$ mn.	219499.4	187430.7	193515.7	237471.7
Total debt service	% of GNI	8.3	7.3	5.8	4.2

		2004	2005	2006	2007
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	19.2	19.9	20.0	19.9
Public expnd. on edu.	% of GDP	4.0	4.5	5.1	-
Public expnd. on health	% of GDP	3.3	3.5	3.6	-
R&D expenditure	% of GDP	0.8	1.0	1.0	-
Military expenditure	% of GDP	1.5	1.5	1.4	1.5

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

Market competition has a strong institutional framework, but the informal sector still generates more than a third of Brazil's GDP. Pricing is largely unrestricted. The use and transfer of profits is not regulated. The convertibility of the national currency, the real, is guaranteed, and there has been a floating exchange rate since January 1999. An ambitious law regulating private-public partnerships was established in 2004. The country's recent macroeconomic development has been impressive. The fiscal outlook, debt situation and financial sector's health are much better than they were five years ago. The government has consolidated the country's commitment to fiscal responsibility. In April 2008, Brazil was awarded an investment grade rating by one of the two main U.S. credit rating agencies. This opened the door for a massive inflow of foreign investment into Brazil, because certain investment and pension funds were subsequently legally allowed to invest in Brazil and in Brazilian bonds. A commitment to maintaining a primary surplus, to improvement of debt management and to reduction of the debt-to-GDP ratio has helped significantly reduce the vulnerability of public finances to adverse shocks. Exports and reserves are at their highest historic levels and inflation and country risk at their lowest. Critical areas where reforms are needed to ensure future sustainable economic growth include the high level of taxation, the low quality of public spending, relatively inflexible labor institutions and legislation, and high interest rates.

Market-based
competition

The main statute governing antitrust issues in Brazil is the Competition Act of 1994. The governmental agency responsible for the enforcement of anti-cartel policy is the Administrative Council for Economic Defense (CADE), an independent federal

Anti-monopoly
policy

agency linked to the Ministry of Justice. Three agencies – CADE, the Secretariat of Economic Law (SDE) from the Ministry of Justice and the Secretariat of Economic Surveillance (SEAE) from the Ministry of Finance – together constitute the Brazilian System of Economic Defense (SBDC). While the three agencies possess independence and technical skills, the Brazilian antitrust system has some deficiencies (including uncertainty concerning the date merger notifications must be made, and slow handling of cases under analysis). However, in recent years many practical improvements have been made.

Since the 1990s, Brazil has implemented a number of important trade policy changes. It carried out unilateral liberalization and also engaged in regional economic integration (through Mercosur). Even so, the country has retained significant vestiges of the foreign-trade policy paradigm inherited from the period of protectionist industrialization. Special exemptions and complicated registration formalities persist. Customs duties for imported goods change frequently, and imports from countries outside Mercosur member states are constrained by high tariff and non-tariff barriers. On various trade negotiation fronts, Brazil has adopted a rather defensive stance. Structural changes that have occurred during the last decade in the Brazilian economy, especially the consolidation of a highly competitive agribusiness, are pressuring the government to revise its trade policies and to deepen its integration with the international economy.

Liberalization of
foreign trade

The banking system and capital markets are well-differentiated, internationally competitive and aligned with international standards. There is also a functioning system of banking supervision. Capital markets are open to domestic and foreign capital. The financial sector is sophisticated and systemic risk is low. Access to banking services for the poor has increased and the granting of loans for private households has been substantially extended in recent years, but credit is still very expensive, especially for individuals and small enterprises. The ratio of bank lending to GDP remains low (25% of GDP) compared to other countries. A significant portion of financial activities are dedicated to financing the public sector through bonds. While Brazil today has a dynamic and growing financial sector, the challenge is to develop still greater competitiveness, efficiency and effective risk management practices, while maintaining stability.

Banking system

8 | Currency and Price Stability

Inflation and foreign-exchange policies are synchronized with other economic policy goals, and are institutionalized in a largely independent central bank. The central bank is broadly perceived as being independent in theory, even if it is not granted total operational autonomy in practice. The Lula government's policies of fiscal management and inflation targeting are well managed and well entrenched, providing a solid anchor to the economy. External vulnerability has been

Anti-inflation /
forex policy

substantially reduced, reserves are today at their highest historic levels, and inflation and country risk at their lowest. Inflation fell from 12.5% in 2002 to 5.7% in 2005 and 4.5% in 2007. The annual rate in 2008 was 5.8%. After the real's exchange rate was made fully convertible in January 1999, it repeatedly experienced massive devaluation pressure. Since 2003, however, the currency has strengthened significantly against the U.S. dollar (rising by 20% in 2007 alone). The abolition of the requirement that exporters repatriate all their foreign exchange earnings and demand for reais are major reasons for the strength of the real.

There is a consistent stability policy supported in part by institutional self-constraints. The 2000 Fiscal Responsibility Act (Lei de Responsabilidade Fiscal, LRF) subjected all levels of public administration to criteria of transparency and coordination and made them responsible for their fiscal performance. It set guidelines for primary surplus generation and debt limit maintenance, and limited salary increases for civil servants. When taking office in 2003, Lula's administration faced a crisis of investor confidence, but disciplined fiscal and monetary management and prudent macroeconomic policies paved the way for steady economic progress and the preservation of stability. In recent years, macroeconomic management has been exemplary, external vulnerability has been substantially reduced and economic stability has been consolidated. In December 2008, the Brazilian central bank reported that the fiscal deficit in the first 11 months of the year was just 0.4% of GDP, the lowest fiscal deficit since records began in 1991. The primary fiscal surplus in the first 11 months of 2008 was almost \$58 billion. The international financial crisis does not represent a major threat for macro stability given the excellent quality of Brazil's debt, monetary and fiscal management practices. The improvement of debt management along with reduction of the debt-to-GDP ratio has helped reduce the vulnerability of public finances to adverse shocks. The country's reserves have grown considerably in recent years. The external debt linked to foreign currency has been gradually substituted for debt denominated in local currency. Well over half of the government's total debt is now denominated in reais. Fiscal consolidation at the state level has also contributed to a stronger macroeconomic situation.

Macrostability

9 | Private Property

Private property rights are well defined and property acquisition is adequately regulated. Contracts are generally considered secure. Protection of intellectual property rights has improved. While some states in Brazil have started to simplify procedures for registering businesses, the overall process remains more costly and more time consuming than the Latin American average.

Property rights

For decades, state-owned corporations dominated nearly all economic sectors in Brazil. Privatization was initiated by President Collor (1990 – 1992), but was not

Private enterprise

continued by his successor, President Franco (1992 – 1994). President Cardoso (1995 – 2002) introduced and implemented a comprehensive process of privatization on the basis of several constitutional amendments. State monopolies in key sectors of the Brazilian economy such as energy and telecommunications were abolished, while other sectors were radically liberalized. Privatization is well-advanced in many areas, including the raw materials industries, transport and energy sectors and telecommunications. Regulation of liberalized economic sectors was arranged through framework legislation and in many cases assigned to newly established authorities that enjoy technical, financial and administrative autonomy. The Lula government has not implemented the privatization policies favored by its predecessors, as Lula advocates an active management role for the state in achieving both economic growth and social justice. Accordingly, no further sales of public enterprises have been carried out under Lula. The Lula government enacted a Public-Private Partnership (PPP) Law in December 2004, which is designed to attract private investment to supplement public infrastructural expenditures that are limited by tax or budgetary constraints. This program has been postponed a number of times, but several projects predate the statute's enactment, such as the Bolivia-Brazil natural Gas Pipeline. PPP projects have started in the Brazilian states of São Paulo, Bahia and Minas Gerais.

10 | Welfare Regime

Social welfare networks to compensate for old age, illness, unemployment and disability are somewhat developed, but do not cover all risks for all strata of the population. Over the past decade, Brazil carried out significant reforms to expand the coverage, quality and efficiency of its health system and strengthen its safety net. During this time, infant mortality fell by more than a third, maternal health improved, and mortality due to infectious diseases decreased substantially. Nevertheless, significant portions of the population still lead an existence on the margins of poverty and hunger. The infant mortality rate in Brazil is 20.4 per 1,000, the third-worst in South America, even though the rate fell by 65% in the decade between 1996 and 2006. Almost half (46%) of the country's children and youth live in conditions of poverty, compared to an overall poverty rate of 30% (defined as a family group living on two minimum wages). During its first term in office, the Lula administration launched several high-priority social initiatives, including efforts to eradicate hunger ("Fome Zero"), create youth employment ("Primeiro Emprego"), and unify conditional cash transfer programs for greater effectiveness in reducing poverty ("Bolsa Família"). The government also implemented an ambitious reform of the social security system. By the end of 2006, the Bolsa Família program was providing cash transfers – conditioned on children's school attendance and regular health visits – to 46 million people, covering close to 90% of the nation's poor. These programs have helped the country make remarkable gains

Social safety nets

in reducing inequality over the last four years. The poorest Brazilians are better off and less vulnerable than they were four years ago.

Brazilian society is markedly heterogeneous. Although compensation programs for those disadvantaged by extreme social disparities do exist, they are insufficient. A legal code approved in August 2001 made women equal to men under the law. But women still face a reality marked by inequality in both the domestic sphere and in professional life. Violence against women and children, forced child prostitution and child labor persist. In education, the gaps between men and women have narrowed greatly, and women on average possess higher educational qualifications, often attributed to more disciplined study habits. The visibility of women in public life, the media and politics is increasing, not least of all thanks to the activities of numerous women's organizations. The gender gap in terms of economic opportunity is also narrowing, but women still remain at a substantial disadvantage. While racial discrimination has long been officially denied as a problem in Brazil, the reality is that Afro-Brazilians earn less than 50% of the average earnings of other Brazilians, and even Afro-Brazilian university graduates earn less than other citizens who have only high school diplomas. The Lula administration has recognized this problem and taken some measures to combat racial discrimination, such as the Racial Equality Statute. There is also some evidence that services for indigenous populations have improved, as in the context of health care outcomes. During celebrations marking Indian Day in April 2005, the justice minister apologized on behalf of the government for the death of indigenous people throughout Brazilian history. This was the first time that any Brazilian government had publicly apologized for the crimes committed against the black and indigenous populations. Today there are 488 indigenous reservations in Brazil, making up 105.7 million hectares, or 12% of the national territory. The government's efforts have resulted in the creation of 22.3 million hectares of protected areas since 2000. According to the National Indian Foundation, 123 indigenous lands are still in the process of being demarcated.

Equal opportunity

11 | Economic Performance

Basic macroeconomic data have been very positive in recent years. The highest priority set by President Lula for his second term was to accelerate growth. The PAC (Accelerated Growth Program) was based on the assumption that more investment in growth-supporting infrastructure was needed to enhance growth. The PAC envisages increased public investment in infrastructure and increased public credit. Public infrastructure spending during 2007 – 2010 has been projected to reach over 500 billion reais. In recent years, Brazil achieved growth rates of 4% to 4.5% per year, and growth has been strongly beneficial to the poor. In the first nine months of 2008, annualized GDP growth was running at 6.4%, thanks to booming

Output strength

domestic demand and continued export growth. Brazil has performed better than many other economies in the face of the global economic crisis. In contrast to most developed economies, Brazil most likely will not suffer a recession in 2009. Although real GDP is projected to slow, GDP forecasts for 2009 remained at 2.5% as of this writing. The annualized rate of growth in industrial output fell from 6.8% in September 2008 to 3.1% in December. In December, industrial output fell by 12.4% month-on-month and by 14.5% compared with December 2007. By sectors, the auto sector (accounting for 5% of GDP) was one of the worst performers, falling 59.1% year-on-year. In January 2009, however, the vehicle industry saw a near doubling of output compared to December 2008. While in 2007 Brazil obtained a current account surplus of \$1.55 billion (0.12% of GDP), in 2008 it registered its first current account deficit in six years, due to a lower trade surplus and increased profit repatriations by foreign firms. The deficit on the current account was \$28.3 billion (1.78% of GDP). The trade surplus in 2008 was \$24.75 billion, down from \$40.03 billion in 2007. Foreign direct investment reached a new record of \$45 billion in 2008. Average real incomes rose by a year-to-year rate of 4% in November 2008 to 1,273.6 reais a month. In December 2008, the official rate of unemployment hit a new record low of 6.8%. In the first 11 months of 2008, the government ran a primary surplus of \$57.85 billion (5.08% of GDP). The overall fiscal deficit in the period was just 0.4% of GDP. In January 2009, the official inflation rate was 0.48% month-on-month, up from December's 0.28%. The annual rate was 5.8%. In February 2009, the minimum wage was increased by 12% to 465 reais a month.

12 | Sustainability

Ecologically sustainable development is an issue in some sectors of the economy, but often tends to be subordinated to economic growth targets. One of the greatest development challenges facing Brazil is how to develop the Amazon Basin in an environmentally sustainable manner. The boom in the Brazilian agro industry is pushing agricultural frontiers towards the Amazon region. The growth of extensive cattle and soya farming has had a significant environmental impact in the region. Huge tracts of land are being cleared of their original forest to make way for soya farms. Other factors contributing to deforestation include mining, oil and gas projects in the Amazon basin. In recent years, Brazil has developed many of the legal and institutional instruments necessary for reconciling development and environmental protection, including water management, forest protection and biodiversity regulations. But there remains a split in the government, with the environmental ministry on one side and the so-called development ministries on the other. In May 2008, Environment Minister Marina Silva, a well-known environmentalist with a very high international profile, resigned because she strongly disagreed with some of the infrastructure projects planned for the Amazon

Environmental
policy

region under the auspices of the national PAC development plan. She also disagreed with plans to allow increased commercial farming in the region. The president of Brazil's environmental protection agency and the president of the Chico Mendes Institute for the Conservation of Biodiversity also resigned at the same time as Silva. In 2008, the rate of deforestation increased for the first time after three years of decline. In December 2008, the environment ministry published an ambitious national Global Climate Change Plan to cut the rate of Amazon deforestation in half by 2017. The government promised to invest heavily in reforestation programs, and President Lula freed up \$550 million in funds to protect Brazil's forests over the next 12 years. With this plan Brazil has for the first time set concrete national goals for slowing deforestation and reducing its carbon emissions.

A few years ago, Brazil still had a fairly cost-ineffective education system, plagued by poor and inequitable academic achievement. Significant improvements have been achieved in recent years, but progress with respect to the quality of education at both the elementary and secondary levels is slow. Today Brazil spends 4.3% of GDP on education, but spending per student is low given the youthful population skew, the large amount of resources directed toward tertiary education and high spending on teacher's pensions. The educational system suffers from the highest repetition rate in Latin America and low education attainment. Individuals more than 15 years old have on average only 4.8 years of schooling. The situation is worse for the poor, who tend to enter the system late, leave early and repeat more grades. By age 15, poor youths have completed three years less schooling than the non-poor. The quality of education is a key issue: Over half of Brazil's 15-year-old students are functionally illiterate and close to 80% fail to perform at basic levels of mathematical competency. The situation is even worse considering that these tests don't include those who are not attending school.

The Lula administration has prioritized the democratization of access to education at all levels by means of the Literacy Brazil program. In 2006, the government implemented a reform which extended primary education from eight to nine years in an attempt to improve the accessibility of education for the poor. As a result, the total length of primary and secondary education in Brazil increased from 11 to 12 years. Additionally, the government established the Fund for the Maintenance and Development of Basic Education (FUNDEB) to close the gap between the quality of education in public and private schools. In May 2007, President Lula launched an ambitious education development plan (PED), which aims to redress Brazil's long-standing education deficit within 15 years. The plan establishes a results-based education system for the first time in Brazil's history. Schools have to achieve targets set by the government in order to receive more resources. The government introduced a basic education development index to measure the quality of education in state schools. The index is based on a school pass rate, and on the performance of pupils in a test of knowledge. The PED conditions the disbursement of public funds

Education policy /
R&D

to state schools on the schools' performance. The government set aside \$500 million for the PED in 2007 and a further \$3 billion for the 2008 – 2010 period. The PED is also aimed at high schools and continuing education.

Awareness of the importance of investment in R&D has increased during the past decade. R&D expenditures (both public and private) account for about 1% of GDP; research and development programs are carried out predominantly by the government and public universities. Most scientists work in public universities and research institutions, rather than in the business sector. Innovation performance is improving, and innovation policy is beginning to focus on the potential synergies between science and technology promotion, R&D support, and trade competitiveness. But Brazil's main challenge in innovation policy is to encourage the business sector to engage in innovative productivity-enhancing activities. The government must boost innovation in the private sector and encourage university-business ventures so as to convert knowledge into productivity gains at the enterprise level. It also must implement measures aimed at tackling the shortage of skills in the labor force, as new studies show a widening gap in tertiary educational attainment with respect to the OECD area.

Transformation Management

I. Level of Difficulty

Structural constraints on governance in Brazil range from moderate to high. The country exhibits an average level of development and educational standards. It is an ethnically heterogeneous and highly secular society. During the early 1990s, the full poverty rate was about 41%. It dropped to about 33% – 34% in 1995, and then persisted at about this rate until 2003. In 2006, the full poverty rate fell to 25.6%. Extreme poverty rates fell from 14.5% in 2003 to 9.1% in 2006. Brazil's poverty continues to be largely rural, and extreme poverty is concentrated in the largely semi-arid northeastern region of the country. Beginning in 2001, the income inequality index value (Gini coefficient) also began an historic decline, falling from 0.60 in 2002 to 0.54 in 2006. Nevertheless, poverty, inequality and significant regional disparities continue to represent major challenges for the country's future development. The youth literacy rate improved from 92% to 97% between 1990 and 2006. Child mortality has fallen, maternal health has improved, and efforts to combat HIV/AIDS, malaria and other diseases all have steadily strengthened. Immunization rates have risen and child mortality rates decreased from 53.7 per 1000 in 1990 to 20.4 in 2005. Brazil's AIDS program has had a significant impact both on attenuating the epidemic and improving quality of life for people living with HIV/AIDS. Indeed, Brazil's AIDS program is considered to be among the best in the world.

Structural
constraints

Brazil has moderate to strong traditions of civil society. The country's vibrant and increasingly influential civil society consists of NGOs, community-based organizations, social movements and professional associations. However, some of the interest organizations are rooted in old corporatist traditions (unions and professional associations, for example). Many NGOs replicate old patron-client networks, or else function as proto-bureaucracies used by the executive to bypass administrative rigidities.

Civil society
traditions

There are no irreconcilable ethnic, religious or social clashes, but there are extreme social and regional disparities. Social life in Brazil is characterized by the largely peaceful manner in which a multiplicity of ethnic groups lives together. However, several studies have demonstrated that racial inequality is still a serious problem in

Conflict intensity

Brazil. Racism is identified and recognized as an issue of concern by the Brazilian population. An opinion poll carried out in 2003 showed that 87% of Brazilians admitted there was racism in Brazil, but only 4% of them acknowledged themselves to be racists. Brazil is an extremely unequal country, and racism is an important element in understanding the dynamic of this framework of inequality. The high-income population is essentially white, while most Brazilians who live in poverty are black. The Lula administration initiated a variety of affirmative action programs and other measures with the objective of reducing racial inequalities. Another important constraint is widespread violence. Moreover, new studies show that violence is no longer purely an urban phenomenon in Brazil, but has spread to the countryside in recent years. The number of homicides in rural areas has increased considerably in the past decade. Meanwhile, the number of homicides in large cities has not declined. The Lula administration has not yet found a way to systematically reduce the endemic violence afflicting Brazilian society.

II. Management Performance

14 | Steering Capability

The Lula administration is committed to the goals of constitutional democracy and a socially responsible market economy. Its policies give these goals priority over short-term expediency. The role of external influence is modest. Brazil does not depend on foreign aid; net official development assistance (ODA) receipts in 2007 (\$297 million) are small in relation to the country's gross national income (GNI). The government's strategic priorities include fighting poverty and improving educational levels. President Lula was elected for his first term of office in October 2002 on a platform that emphasized increased social equity and faster growth. The government committed itself to tight fiscal policy, inflation targeting and the honoring of debt contracts. At the same time, it promised far-reaching improvements to the general public welfare, which were then carried out in the form of several high-priority social initiatives, including efforts to eradicate hunger, create youth employment and unify conditional cash transfer programs for greater effectiveness in reducing poverty. Indeed, Brazil experienced noticeable improvements in well-being during the past six years. The first Lula administration managed to combine mature macroeconomic management and policies aimed at enhancing social equity. The economy experienced steady, albeit moderate growth between 2003 and 2006. Inflation was low, the balance of payments recorded surpluses, and the country's debt vulnerability declined. Unemployment rates

Prioritization

declined, poverty was reduced and income inequality improved. In October 2006, President Lula was elected for a second four-year term. He promised faster economic growth, more efforts to enhance the educational system and strong action against the widespread incidents of violence plaguing the country. The government's efforts to accelerate growth and to enhance the educational system were implemented in effective reform programs and actually prospered in the past two years. Yet while the macro foundations of the Brazilian economy improved further and inequality decreased, advancements with respect to improved competitiveness, environmental sustainability and fighting endemic violence were humble.

The Lula government is committed to democracy, economic stability and social justice. Some of the reforms implemented since 2003 have been quite effective. The most important reforms implemented during the last two years have been the PAC (Accelerated Growth Program) and the education development plan (PED). Having said this, it must also be noted that many intended reforms could not be implemented. While President Lula initially seemed much more willing to push for controversial reforms in his second term than in his first, the government's problems with effective implementation of its reform policy were in part due to conflicting interests and policy goals inside the 11-party ruling coalition, and in part a consequence of formidable institutional barriers to reform, as well as a fragmented system of political parties. The federal government's organizational capabilities are also stretched to their limits by the provisions of Brazilian federalism, which grants considerable autonomy to individual states and municipalities. Over and over again, Brazilian congressmen have debated items associated with the long-awaited political reform, but to date the reform proposals have not prospered. Political reform is expected to give more powers to parties to control their members in office, and to clarify campaign financing rules. There are proposals to limit private donations to electoral campaigns and to establish "closed lists" in which voters would cast their votes for parties, rather than candidates, in elections for Congress and local assemblies. These items have been stuck in Congress for many years. In August 2008, the government submitted its latest political reform proposal to parliament, including reforms to campaign finance regulations; a proposal for closed electoral lists; measures to strengthen party loyalty and implement proportional representation; and the raising of the barrier for congressional representation to 10 federal deputies. But the reform package once again met with a recalcitrant Congress, in which political parties have proved unwilling to alter the status quo. Another important defeat for the government was the refusal of Brazil's Senate to approve the extension of the provisional tax on financial transactions (CPMF) in December 2007. The CPMF's extension was the most important piece of legislation in the government's 2007 agenda. In the end, it was lack of support from the government's own allies that led to the measure's failure. The 81 senators voted 45 to 34 in favor of extending the tax, four votes

Implementation

short of the necessary minimum of 49 votes to renew a constitutional amendment that would have extended the CPMF until 2011. In May 2008, a Chamber of Deputies commission rejected a proposed bill to legalize abortion in Brazil. The bill had been under discussion for 17 years. Another project discussed for well over a decade is tax reform. The government's latest tax reform proposal was presented to Congress in February 2008. The aim of the reform is to make the tax system simpler and less bureaucratic by standardizing the national tax on the trading of goods and services (ICMS) and unifying payments to two separate state welfare funds (PIS and Cofins). While the bill could boost production and formal employment by reducing the labor costs on companies from 20% to 14%, many commentators say the reform did not go far enough in simplifying taxation rules or to unburden Brazilians, who would still have to work for five months to pay their annual taxes. In November 2008, President Lula reached an agreement with Congress, and a congressional committee finally approved the bill. Following a disagreement with the opposition PSDB (Partido da Social Democracia Brasileira), however, the reform was put back to March 2009. As it is a constitutional amendment, the bill will need a two-thirds majority to be approved. Due to the difficulties in persuading Congress to pass reforms, the Lula government has issued a great number of presidential decrees (*medidas provisórias*). These decrees take preference over other legislation, but also delay the work of Congress and have caused growing irritation on the part of Congress members. Another factor damaging the prospects for important legislative reforms in 2009 is the growing antagonism between the two main government parties, the PMDB and the PT. In the light of the forthcoming presidential election campaign in 2010, it is unlikely that tensions between the two parties will be diminished in the near future.

The Lula government has repeatedly demonstrated its learning ability, and has reacted flexibly to new challenges. Even before taking office, former union leader Lula had demonstrated his sensitivity to political and economic realities, showing a great deal of pragmatism. His government's policies, even though faced with a "revolution of expectations" from a considerable proportion of Brazilian society with regard to reducing poverty and inequality, have proved to be based on the "art of the possible." This was due in large part to the leading executive officials' learning processes with regard to the functioning of the international economic system. The PT-led administration adopted macroeconomic policies that largely continued those of President Fernando Henrique Cardoso's previous government. At the same time, it successfully pursued its goals of reducing poverty and inequality while preserving stability. The Lula government can be compared and contrasted strongly with other recent left-wing experiences in the region, and particularly with the increasingly radical left-populist government of President Hugo Chávez in Venezuela. Learning processes also have occurred with respect to building and maintaining an 11-party coalition. Certainly the substantial political and ideological differences within the ruling coalition and the institutional barriers

Policy learning

to reform have impeded rapid implementation of several long-discussed reform projects. But if flexibility refers to political actors' ability to accurately appraise their own political leeway, and to recognize and utilize the developmental opportunities inherent to a given political situation, then it must be said that the Lula government has chosen its tools and strategies very carefully and successfully. Opinion polls demonstrate that Brazilians are very confident that their government is also doing the right things in the face of the current global economic crisis and local economic downturn. In January 2009, Lula's approval rating reached a new record-breaking 84%.

15 | Resource Efficiency

The Lula administration uses most available resources efficiently. Disciplined fiscal and monetary management enabled economic progress during the period under observation. The government has met or exceeded its annual primary fiscal surplus targets. Debt and external vulnerabilities have been substantially reduced. Primary fiscal surpluses and steady growth in real GDP have contributed to a decline in Brazil's total external debt stock to 12% of GDP at the end of 2008. Much progress has been made in strengthening the institutional framework for public debt management. The Fiscal Responsibility Law (FRL) approved in 2000 imposed order and accountability on spending by the states through a general framework of budgetary planning, execution and reporting that is applicable to all levels of government. With respect to revenues, the law mandates the withholding of discretionary federal transfers to states and municipalities that do not collect their own taxes effectively. The FRL requires that governments match any permanent spending decision with a corresponding increase in permanent revenues or a reduction in other permanent spending items. The FRL also weakens the power of governors to influence national policies, since it gives states more responsibility for their own fiscal problems, reducing their ability to hold the federal government hostage on fiscal grounds.

Efficient use of
assets

It is difficult to make general statements about the quality of administration in the country's 5,560 municipalities, given the sometimes very significant differences between them. Some municipalities have introduced a participatory budgeting procedure that allows civic organizations substantial opportunities for input in budgetary preparation and control. Other municipalities seem to prefer less process-oriented and more results-oriented measures of administrative modernization. However, client relationship patterns between administration and citizens have prevailed in a considerable proportion of the municipalities.

In theory, multi-year plans, yearly budget guidelines and the budget itself are all discussed and approved by Congress. In practice, the legislative branch is often sidestepped, since the constitution allows for the automatic spending of a share of

the previous year's budget if Congress has not approved the budget. Although the executive cannot perform unauthorized expenditures, a problem stems from the fact that the budget is not compulsory. This allows the executive to avoid fulfillment of the budget in its entirety, a tactic used politically to co-opt parliamentary support. Furthermore, deputies usually propose individual amendments to the executive's budget proposal. The approval of these amendments provides the opportunity for the president to use his powers of budgetary appropriation to obtain political support for his agenda from the members of the legislature and thus keep the coalition together, even in the context of a highly fragmented party system.

Regulations require an impartial, independent and fairly managed civil service. Most appointees are hired through public examinations. In some areas, civil servants must be hired according to professional evaluation criteria. In other areas, civil service positions are not regulated. Positions of responsibility are often filled by political appointees. In the federal sphere alone there are more than 23,000 such positions. The appointment of those is largely driven by political considerations, such as the imperative of holding together the legislative coalition.

International observers often criticize the high level of taxation and low quality of public spending in Brazil. They emphasize that the high tax burden provides strong disincentives to private investment, formal sector employment and economic growth. The quality of government spending in Brazil additionally suffers due to suboptimal public sector management, weaknesses in planning and budgeting, and rigid institutional arrangements (including inflexible labor legislation and complicated procedures for registering businesses). Brazil's public expenditures total more than 40% of GDP, while the composition of public spending has shifted toward government consumption and social security, and away from public investment.

The government tries to coordinate conflicting objectives and interests, but has had only limited success. Intragovernmental frictions are significant. After being re-elected to his second term in 2006, President Lula tried to form a broad government coalition in order to guarantee the passage of government-proposed legislation through Congress. He partly achieved this goal, building an 11-party ruling coalition. He received support for his strategy from his own Partido dos Trabalhadores (PT), and subsequently won the alliance of the catch-all Partido do Movimento Democrático Brasileiro (PMDB) and other minor parties. The PMDB is the largest party in the lower chamber of Congress, as well as in the Senate. Officially, it supports the government, but some sectors within the PMDB also oppose Lula. The PMDB does not have a unified ideology; its members are mostly positioned to the right of the political spectrum, and therefore hold positions conflicting with those of the left-wing PT. The successful formation of a broad but very heterogeneous ruling alliance, as well as President Lula's close cooperation with governors from all political parties, ensured that some important reforms could

Policy
coordination

be passed in 2007 and 2008. But the price for these successes was high, as coalition members had to be compensated with posts inside the government and the public administration. As an opposition party, the PT had repeatedly criticized the traditional spoils system of Brazilian politics, but once in power it acted in the same manner as its predecessors. With the goal of attaining a congressional majority, it established a clientelist policy grounded in the mutual exchange of favors. Tensions between the leadership of the PT and PMDB rose in the second half of 2008. Having won the highest number of local government seats in the 2008 municipal elections, the PMDB started to aim for an even more important role in national politics. In early 2009, the party achieved a double victory in Congress, electing presidents in both the upper and lower chambers. The PMDB's ambition has increasingly antagonized the PT. The growing resentment between the two parties is also undermining the prospects of important legislative reforms, as Brazil is approaching general elections in 2010. The subsequent difficulty in reaching policy consensus within the governing coalition was a key motivator in President Lula's decision to issue so many decrees.

Most integrity mechanisms are reasonably effective and are actively supported by the government. The Fiscal Responsibility Act subjects all levels of public administration to scrutiny based on how well they fulfill the criteria of transparency and discipline. The act makes each level responsible for its own fiscal performance and helps to check corrupt behavior. Regulations govern private contributions to political parties. Individuals can donate up to 10% of their declared income to candidates, while firms can donate up to 2% of their annual revenue to candidates. Donations to parties are not limited. All contributions are made public after the elections. Beginning in 2006, candidates were required to disclose donations received, but without identifying the donors. There are no limits on total political party expenditures. Candidates must declare how much they will spend in an election, but this amount may be adjusted. The media is able to report on corruption and has increased its coverage of corruption in recent years. Brazilian voters are increasingly aware of and educated about corruption. No journalists investigating corruption have been imprisoned or physically harmed. Citizens have a right of access to government information and basic government records. Whether access to information is effective depends on the institution. Federal organizations either respond quickly or state that the information does not exist. In states and municipalities, most organizations do not respond. Civil society organizations focused on anti-corruption issues are highly active in political councils at the legislative and executive levels. The judiciary can review the actions of the executive and the legislative branches. The heads of state and government, ministerial-level officials and members of the national legislature are required to file a regular asset disclosure form. Disclosure forms are published in the Official Gazette. Citizens can access this information. There are regulations governing gifts and hospitality offered to members of the executive branch. There are no

Anti-corruption
policy

restrictions preventing heads of state and government or ministers from entering the private sector after leaving the government. There are regulations addressing conflicts of interest for public procurement officials. All public procurements are widely advertised. The government is required to publicly announce the results of procurement decisions.

16 | Consensus-Building

All major political actors agree on the need to strengthen democracy, though they disagree on which path should be taken to reach this goal. Portions of the ruling Workers' Party (PT), as well as its allies in civil society advocate a more direct model of democracy. There are also conflicting positions as to the relevance of the market economy. While government officials follow a market oriented course, a considerable portion of the PT is critical of the Lula administration for pursuing these policies, in opposition to the party's original ideology.

Consensus on goals

While there are no clearly anti-democratic veto powers in Brazil, powerful landlords in some rural areas effectively own the local judiciary and police, and they respond violently to attempts at agrarian reform. Brazil's largest landless association, the Movimento dos Sem Terra (MST), has in recent years employed a more radical rhetoric and behavior. MST leaders have made it clear that, for them, land reform is not simply about the resettlement of peasants, but is rather a tool for wide-ranging social revolution. In early 2009, the Lula government came under heavy criticism after a wave of MST land invasions left four security guards dead in the northeastern state of Pernambuco. While conflict between the government and the MST has been on the rise, landless movements have long been linked to the ruling PT, and since President Lula came to power in 2002 they have been eligible for federal funds.

Anti-democratic
veto actors

The government has been able to prevent an escalation of social and racial conflicts within Brazilian society, which is still characterized by extreme social and regional disparities. During the period under review, it had considerable success in reducing poverty and social inequities.

Cleavage /
conflict
management

The participation of civil society, including the involvement of various councils and committees at the regional, state and municipal levels, is seen as important for developing effective public policy. The participation of organized civil society groups in Brazilian politics has intensified since the 1980s, when the process of redemocratization started after more than 20 years of military dictatorship. Since that time, several types of arrangements between the state and civil society organizations have evolved with respect to the implementation and co-management of public policies, particularly those of social character. The Lula administration conducted a process of consultation throughout the country, involving more than

Civil society
participation

2,000 civil society organizations representing labor, women's groups, environmentalists, consumer forums, indigenous peoples, Afro-Brazilians, the landless movement, religious communities and the handicapped. It also created and convened popular national councils and forums focusing on various aspects of the government's policies. President Lula opted to hold dialogue and negotiate directly with the Landless Workers' Movement (MST), with the National Conference of Bishops and with the Brazilian Association of NGOs. However, this kind of democratic inclusion in public policy does not produce sudden reversals in economic stagnation, unemployment, hunger, poverty, land concentration and social injustice. On the contrary, it can lead to growing frustration with the political system if the inclusionary policies do not show visible results along the way.

Brazil's military regime, which governed the country from 1964 to 1985, left behind fewer victims than did the dictatorships in neighboring countries. It is thought that more than 400 dissidents and guerrillas were killed during the dictatorship, and more than 160 disappeared. Thousands were tortured, jailed or exiled. President Lula's government includes survivors, and the president himself was imprisoned during the military regime for leading strikes. Brazil eased away from military rule without a final settling of accounts. Before returning to the barracks, the military declared a reciprocal amnesty, absolving both the regime and its opponents of their crimes. The armed forces never apologized, nor did the government investigate their crimes or imprison the generals responsible. The armed forces have gradually accepted democratic rule, but no process of national reconciliation has taken place. In December 2005, the Lula government released files on dissidents drawn up during the dictatorship, which contained secret documents, photographs, films and pamphlets from the intelligence service. In August 2007, the government released a 500-page report that outlined the fate of political opponents who were "disappeared" during the dictatorship.

Reconciliation

17 | International Cooperation

Political forces have applied international assistance directly to the intended target of the support, and have demonstrated their adaptability. In many areas, the Lula administration's reform policies are consistent with the programs of such international organizations as the World Bank, the UNDP and the Inter-American Development Bank, and are often implemented in close cooperation with these organizations. Conversely, international development organizations such as the World Bank appreciate the close collaboration with the Lula administration and concede that it is guided by a vision for a more equitable, sustainable and competitive Brazil. Brazil has also successfully sought intensified south-south development cooperation.

Effective use of support

International organizations, other states, foreign investors and international NGOs likewise consider the Brazilian government to be a credible and reliable partner. While Brazil's risk coefficient for the international financial markets skyrocketed to 2400 basis points before President Lula took office, it came down to 200 points at the end of 2006. In April 2008, Brazil even was awarded an investment-grade rating by one of the two main U.S. credit rating agencies. International organizations as well as consulting agencies have praised the government's budget discipline and its reform policies on the way to a market-based economy. President Lula has taken a leading role in seeking greater participation for countries such as Brazil, China, India and South Africa in multilateral bodies including the IMF and the G20, which was established in 1999 to strengthen the international financial architecture and foster sustainable economic growth and development. Lula was the first Latin American president to meet incoming U.S. President Barack Obama. The Obama administration has repeatedly demonstrated that it sees Brazil as its main strategic partner in Latin America.

Credibility

The Lula administration has made active and often successful efforts to establish and deepen as many cooperative international relationships as possible. Relations with neighboring states are constructive but have increasingly developed tension and particularly commercial disputes during the last years. Relations with Ecuador were affected after a Brazilian construction company was expelled from that country in 2008. There is also dissent over the terms of new oil concessions for the state-owned Brazilian oil company Petrobras in Ecuador. Relations with Bolivia have become more complicated following the Morales government's nationalization of the Bolivian gas industry. Bolivia provides Brazil with up to half of its natural gas supplies and there has been considerable conflict over the issue of gas contracts during the last several years. However, President Lula has repeatedly been closely involved in regional diplomatic efforts to bring about peaceful, negotiated settlements to the various political crises in Bolivia. Relations with Paraguay became more complicated in 2008 after Paraguay's new president, Fernando Lugo, made it clear that he wanted to renegotiate the treaties concerning the huge binational Itaipú hydroelectric project in order to achieve higher prices from Brazil for the power that Itaipú produces and Paraguay does not consume. Paraguay currently consumes only about 5% of the power Itaipú produces. Relations with Venezuela are good and trade links are growing, despite some obvious rivalries between President Lula and President Chávez over regional leadership issues. But the capacities of the two countries have recently started to diverge. While falling crude oil production and falling oil prices have eroded Chávez's petrodollar diplomacy and his opportunity to act as self-appointed spokesman for Latin America, Brazil since 2007 has discovered huge new oil and gas reserves and in the future might become a major oil exporter.

Regional cooperation

President Lula has consistently strengthened Brazil's role as a regional power in South America by means of an active foreign policy. Under U.N. command and supervision, the government committed military forces to Haiti to assist efforts to stem violence there. Brazil resumed a leading role in the Friends of Venezuela initiative, created to search for a peaceful solution of the country's internal conflicts. Since 2003, Brazil has been a driving force behind the G20 group. Brazil actively stimulated the establishment of a South American Community of Nations (CNS) in December 2004. In 2007, the CNS was renamed to the Union of South American Nations (Unasur), and in May 2008 Unasur was transformed into a new regional organization. In March 2009, representatives from the Unasur member countries set up a South American Defense Council. The council will meet on a regular basis to discuss defense issues. It is not intended to become a joint military organization, but rather a platform for cooperation. This is in line with Lula's vision, while Venezuelan President Chávez wanted to broaden the council's scope to become a South American version of the North Atlantic Treaty Organization.

The future of the formerly successful Mercosur trading bloc is far from clear. Relations between the five member states of Argentina, Brazil, Paraguay, Uruguay and Venezuela have become troubled for various reasons. Trade between the two main Mercosur partners Argentina and Brazil has generated considerable conflict, prompting calls for protectionist measures by businesses on both sides. The smaller members, Paraguay and Uruguay, are concerned by trade asymmetries within the bloc. Venezuela's petition to join Mercosur was given initial approval in 2006, but needs to be ratified by the parliaments of Argentina, Brazil, Paraguay and Uruguay. Although Brazil's Chamber of Deputies finally gave its approval in December 2008, the Brazilian Senate remains disinclined to follow suit. Venezuela's President Chávez has repeatedly made it clear that he wants to "rid Mercosur of neoliberalism" and push for political integration. While Mercosur will probably not break apart because the political costs of such a development would be very high, there seems to be little political will to overcome Mercosur's continuing crisis. For Brazil, Mercosur still has some political and diplomatic worth, but the bloc's importance for Brazil is clearly lower today than when Mercosur was founded 18 years ago.

Strategic Outlook

When starting his second term in January 2007, President Lula appeared to be in a more comfortable situation than four years ago, having obtained the support of the largest party in the lower chamber, the Brazilian Democratic Movement Party (PMDB). In total, the coalition government embraces 11 political parties, which collectively control 320 of the lower chamber's 513 seats. In spite of this apparent strength, institutional barriers and intergovernmental conflicts made it difficult for Lula to win congressional passage for his reforms. He reacted to this challenge by issuing a great number of presidential decrees. A precondition for change in this situation will be the realization of long overdue political reform, in such a way to make Brazilian politics more transparent and accountable. Brazil's fragmented party system and the lack of constitutional tools to force politicians to obey party directives are the main reasons why it is so difficult for the executive to pass legislation in Congress. Moreover, confusion surrounding campaign financing rules significantly increases corruption in Brazil. Lula's reform proposals have been waiting for congressional approval since 2008. If he does not succeed in getting these reforms passed until mid-2009, the growing antagonism between the two main government parties, the PMDB and the PT, and the upcoming 2010 election campaign make it unlikely that the reforms will be passed before the end of Lula's mandate.

Since the municipal elections in October 2008, the balance of power inside the ruling coalition government has shifted in favor of the PMDB, which now controls both houses of parliament and is demanding a greater role in national politics. President Lula must try to diffuse potential confrontations between the PMDB and his PT, not only to get key legislative reforms passed, but also to secure PMDB support for his preferred 2010 presidential candidate and current chief of staff, Dilma Rouseff. Lula himself is constitutionally barred from running for a third term, and in spite of his very high approval ratings he has made it very clear he has no intention of trying to change the constitution so as to run legally for a third term. In January 2009, the presidential candidate with the highest approval ratings in polls was José Serra, candidate for the Partido da Social Democracia Brasileira (PSDB). While 42.8% of respondents declared they would vote for Serra, only 13.5% were inclined to vote for Rouseff (PT). The PMDB did not present a candidate of its own in the last presidential election, and at the close of the review period it remained unclear whether it would present a candidate in 2010. It is also possible that the PMDB will support the PSDB presidential candidacy in 2010. The two parties are ideologically closer than are the PMDB and the PT.

Brazil continues to face a number of challenges with respect to poverty reduction and economic management. The country's current tax burden is very high, and presents disincentives to private investment, formal sector employment and economic growth. Furthermore, the structure of taxation is very complex, with various levels of direct and indirect taxation. As with the political reform proposals, tax reform is awaiting congressional approval. What is true for the political

reforms is also true for the tax reform: If Congress does not accept the reforms before mid-2009, it is unlikely that the Lula government will win their passage at all.

A further challenge for the Lula government during its last two years in office is related to the global economic crisis. Industrial production virtually collapsed in late 2008, and unemployment rates might rise. While Brazil, thanks to its strong fundamentals, is much better placed than many other countries to recover in the near future, the year 2009 might also become quite complicated for South America's biggest economy.

Last but not least, there are challenges related to Brazil's international role. The country has successfully participated in many regional and global organizations and negotiation processes, and has increasingly been accepted as a global player. But even as Brazil has sought reform of international organizations such as the IMF or the United Nations, it has been unable to overcome the crisis of the Mercosur at its own door. This is related not only to structural asymmetries between the organization's member countries and to the fact that Brazil has in some ways outgrown the organization in the last 15 years, but also to the country's reluctance to pay the (political and financial) leadership costs that a role as regional power demands.