

# Brazil's Political and Economic Future

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### Alex Vines

Good evening, everybody. My name is Alex Vines. I'm one of the research directors here at Chatham House and I'm really pleased that tonight we're hosting this meeting here at the Institute on Brazil's political and economic future. This is such an exciting time for Brazil. I was in Brasilia not many weeks ago, and all the predictions that Brazilians were telling me and diplomats were all proven wrong. Everybody has been caught by surprise with the way the election is going at the moment. Which is why I think this is very timely and to understand what's going on and that actually Brazilian politics is extremely exciting and can be unpredictable. We have three speakers here today who are going to help us.

So on my far right, we have Dr Timothy Power. He's an associate fellow of the Americas Programme here at Chatham House and he's also currently a lecturer in Brazilian Studies at the University of Oxford and associate editor of the Journal of Politics in Latin America. He's a regular visitor to Brazil. I was luckily involved in a meeting with him over the summer where he was educating me on the intricacies of Brazilian politics. So I was certainly impressed by the insights that he provided me in the meeting that I attended with him. I hope you will too.

What we're going to do is start with Dr Timothy Power, and secondly, next to me, we have Professor Anthony Pereira. He's director King's Brazil Institute, King's College London. He's previously undertaken teaching positions in the Department of Political Science at Tulane University, the Graduate Faculty of the New School for Social Research in New York City, and was a visiting professor at Harvard University. He has written a lot on citizenship, human rights, public security and state coercion in Brazil.

Finally, we're going to have Mahrukh Doctor. She's a senior lecturer at the School of Politics, Philosophy and International Studies at the University of Hull. Welcome back to Chatham House. Her research interests are in the field of political economy, with a special interest in development, industrial trade and infrastructure investment policies in Latin America. She has been involved in the research for a number of projects, particularly also on Brazil.

This meeting is not under the Chatham House rule. We are live streaming the event, so I will give you in a moment the, for those who are watching through live stream, the details of how you can ask questions, but I'll need to find that. Without more ado, I'm going to invite Tim to make some stage setting remarks about Brazil and set the context of the conversation that we're going to have. Thank you.

### Dr Timothy Power

Thank you. As Alex said, my remarks will be stage setting and I think we could get into specifics in the Q&A, but I'd just like to say more or less where I think we stand today, two weeks before the second round.

The results of the first round of the election confirmed a duopoly, which has been emerging in Brazil since 1994, between the PSDB (Brazilian Social Democracy Party) and its allies and the PT (Workers' Party) and its allies, which have followed each other

sequentially in power. There has been a consensus in Brazil around certain points at which the two coalitions are not very different, not very far apart on macroeconomic policy, social policy, on federal inter-governmental relations, on the method of coalitional presidentialism as power sharing in Brazil and on a renewed international projection for the country.

The results of the election show once again that the country does not reject this duopoly, essentially. The PT and the PSDB together, the two party share of the vote has ranged from 70 to 90 per cent in the last six elections in a row. This year, the PT and PSDB picked up 75 per cent of the first round vote for the presidency, again, and a quarter of the vote for the congress again.

The two candidates that we have, Dilma Rousseff and Aécio Neves, are heirs or legatees of that duopoly. There's no doubt about that. Dilma is running on a legacy of Lula [Luiz Inácio Lula da Silva] and the PT. Aécio is running on the legacy of Cardoso [Fernando Henrique Cardoso] and the PSDB. That may seem terribly obvious to say, but I think it's worth exploring because I think it does set the context. It's very easy to stereotype those two governmental experiences. Eight years of Cardoso, eight years of Lula, on which these two candidates are running.

You could say it like this – you could say that the legacy of Cardoso was economic stabilization; the legacy of Lula was social inclusion. Or you could say that Cardoso was reform without redistribution and Lula was redistribution without reform, which would also work. Or you could say that Cardoso was a government of reforms while Lula was a government of programmes. That would also work.

Cardoso chose to reform the constitution, change the macro-economy. This required three fifths majorities in congress, versus the Lula style of empowering small teams and ministries to execute popular social programmes, such as the small team in the Ministry of Social Development, which administers Bolsa Familia, which covers 14 million Brazilian families with fewer people than we have in this room running the programme.

Cardoso's approach was very costly in terms of political capital and it produced very diffuse benefits for Brazil, for the nation. It did not yield major electoral payoffs for him or for his party. Whereas Lula's approach was very inexpensive in terms of spending political capital, but it produced concrete benefits for targeted constituencies and it produced a very visible electoral pay-off in 2006 and 2010. Any map I could show you or any poll I could show you would show that the beneficiaries of these social programmes have become reliable PT voters in presidential elections.

So these legacies are important because the PSDB sort of owns the issue of inflation control in Brazil and the PT sort of owns the issue of social inclusion. In the last two election cycles, if you stacked up social inclusion versus inflation control, social inclusion easily won the day, first of all, because of the novelty of poverty reduction.

But in 2014, the two issues are more evenly matched this time, actually, firstly because the novelty of redistribution has begun to wear off a bit, and the aspiring new middle class in Brazil is becoming more critical of services, becoming more critical citizens. Secondly,

because the inflation targets espoused by the Central Bank have become less credible and have been exceeded in the last 30 days, for example.

So the two legacies are giving us a real race in 2014, because the two legacies are more evenly matched by the current context. That was not the case in the previous two elections at all. This explains in part why Aécio Neves has been much more willing than his predecessors, José Serra or Geraldo Alckmin to run on the legacy of Cardoso.

It was astonishing in the last debate before the first round on Thursday night that Cardoso was present in the audience and Aécio Neves recognized him on national television. That's something that Serra would never have done, or Alckmin would never have done. So Aécio has been able to hitch his wagon to Cardoso because the moment is right to do that.

Although the PSDB owns inflation control and the PT owns poverty alleviation, there's a big question that pervades the election, and Mahrukh will talk about it, which is who owns growth, right? That wasn't a relevant question in 2010 because Brazil was growing at 7.5 per cent that year. Lula's eight years produced 4.5 per cent annual, Cardoso's 2.5 per cent annual, so it was no contest. The PT in the last election had a better growth record than the PSDB did.

But the Dilma experience has reduced the margin between the two legacies, let's say it that way, euphemistically. Dilma has squandered that PT advantage on the growth issue, and it's not clear however to me that Aécio is able to provide any real specifics on this either. This is a problem, which I say it's a question mark hanging over the election. Of course, Dilma will try to link Aécio to the slow growth and high unemployment of Cardoso's second term, which she's already begun to do in last night's debate.

So legacies matter, and whether we like it or not, this has turned into a very backward looking election. It's basically a dual by proxy between two guys who aren't even on the ballot, which is Cardoso and Lula. But this is how Dilma and Aécio are framing it. They are the ones framing it as a battle between these two legacies, not me, not us. So that's their prerogative as candidates. That's why these legacies are again important.

If we look at Brazil over the past two years, there's a major puzzle that needs explaining. How did we get from the Brazil of 2013 to the Brazil of 2014? They seem like very, very different places, right? 2013 Brazil, a country of protests, civil unrest, an attack on politics as usual. 2014, ratification of the two main parties. The party system throws up the same two options that we've had in the six previous elections or the five previous elections. The candidates are running as insider candidates on easily visible legacies.

In Sao Paulo, which was the epicentre of the protest last year, you had the re-election of the governor in the first round. You had José Serra elected to the senate. You had Mario Covas's son leading the race for Congress, etc. It was a ratification of the machine in Sao Paulo which a year ago seemed to be quite criticised by the general public.

So there seemed to be, going into the end of last year, a segment of potential protest votes that could not find expression in the party system. For a short period of time, Marina Silva seemed to be channelling that sentiment. But she could not sustain it. For a time,

she drove down the indicators of alienation, which was like voting blank or voting null or saying that you're undecided. But by mid-September, what she had done in that regard had eroded.

Why? Marina Silva did not make any catastrophic missteps, just a series of small missteps and over time, this was complicated by the fact that she had no ground level party organisation to speak of. I think there were clues to that from the past. Marina Silva in 2010 borrowed the label of the Green Party to run. The Green Party was a tiny party which then she moved on from.

She tried to form her own party called Rede in 2013, but she failed to get the signatures to register it. She then moved to PSB as a kind of borrowed vice presidential candidate and was very reluctant to follow through on the party agreements that the PSB had already set up.

So Marina's posture was anti-party and you need a party to win. So this was, I think, a problem for her. She did not have the support networks in the states. Aécio did. In the early part of September, Marina's support was a mile wide and an inch deep. By the end of September, it was fairly well dissipated in October. He actually didn't pass her until about 96 hours before the election or something like that in the polls, but he finished ahead of her by a mile on election day, by 11 percentage points, which is a huge achievement for Aécio or a huge disaster for Marina, depending on how you would like to interpret that.

But one third of Aécio's votes came from a single state, which is Sao Paulo. Again, the machine of the PSDB. The PSDB showed a capacity to organise at the local level. The PSDB actually had more party line votes. In Brazil this is called [indiscernible]. They had more party line votes than the PT had this year, and they actually were the second most voted for party in congress. The PMDB won more seats than the PSDB, but the PSDB actually won more votes than the PMDB. So the PSDB is the number two force for congress as well.

This year Marina's voters were much more clearly opposition voters than they had been in 2010. They were very much an anti-Dilma, anti-PT constituency and over time, they shifted to the person who offered the more credible historical opposition to the PT. Aécio Neves had consistently posed himself as the anti-PT candidate in the election, and as Marina's sheen wore off, those voters gravitated quickly back to him in the final week of the campaign.

I think one of the lessons of the first round is the party matters and party organisation matters, which is somewhat surprising given the anti-party sentiments that we saw on display in Brazil in 2013.

Just to conclude, I would say actually, my personal view is that Brazil has been given a very interesting and very user friendly choice in the run-off, because these are two candidates for programmatic parties, with long experience in government, that have very transparent and very judgeable records which would not have been the case had Marina been one of the two finalists.

## Alex Vines

Thank you very much. Just a reminder, if you've joined us late in the room here or through live streaming, this is a meeting on the record and we've just had Tim Power, an associate fellow of the Americas Programme at Chatham House speaking.

Our next speaker is going to be Professor Anthony Pereira, director of King's Brazil Institute, King's College London.

## Professor Anthony Pereira

Thanks, Alex. Well, I was one of those people writing about Marina and Dilma in the second round a few days ago, so I look a bit silly now, but this is an election I think where...

## Alex Vines

It could change in 96 hours from what we hear.

## Professor Anthony Pereira

Yes, I wish I'd anticipated that. But if you look at blank and spoiled votes, and abstentions, in most of the gubernatorial races, that was actually the third place candidate, it was people who didn't want to vote for any of the above. If you look at, there's one survey of young people from 16 to 30 that says 59 per cent of them would prefer that Brazil had no political parties at all.

I feel odd as an outsider spending so much time following Brazilian politics when a lot of Brazilians are trying to get away from politics. That's just my own personal position.

But I wanted to say something about what this election looks like from the long historical view, because if you had to ask me what is the Brazilian state? I would say that three really important characteristics of the Brazilian state are one, that it's a neo-developmental state, still, even though it's become more open in terms of the economy.

It's a social democratic state in that it represents a strong consensus for a Brazilian style of social democracy in which social rights are strongly respected. It's still, I think, a violent state. It's one where the police in a lot of places use quite a bit of violence to maintain social order.

I think if you think of that as a sort of long durée, I think these have all been elements of the Brazilian state for quite a long time, this election has been more about the developmental issue than it has been about the other two characteristics of the state. I think Aécio is trying to signal very clearly, and all of these characteristics of the state I think have tensions in that for example, when you come to – and I say neo-developmental because you have a... You can see both in the constitution and the institutions of Brazil a

commitment to use of the state to guide the economy, the idea that national sovereignty has to be expressed in the economic realm, the use of state banks to supply credit in various sectors – housing, infrastructure and the like.

Because Brazil is an open economy and it needs foreign capital, it tends to have a sort of zig zag process, so it moves closer to the neo-developmental ideal types and farther away. I think Aécio was definitely signalling, with his platform for example talking about Arminio Fraga, talking about a fiscal shock so that you cut federal spending, that he was signalling that he would be the candidate that would move Brazil away from the developmental pathway of the PT, especially since the second term of Lula, and create economic policies that are more favourable to investors and especially business sector outside of the industrial sector.

Having said that, I don't think the – I think Tim is right, that the area of convergence is quite big. We're not talking about a huge fundamental philosophical divide, because I do see the pathway of the Brazilian state as staying on that neo-developmental line. I use that neo term, because I want to signal that it's not import substitutes industrialisation. It's not what we had from 1930 to 1980. It is something different. It is more around markets. So I don't think there's a huge variation. I think either government, a government of Aécio or Dilma, would have to look at these structural constraints.

Another thing that's good to keep in mind is that something near 80 per cent of federal spending is non-discretionary. So it's servicing the debt, it's paying pensions and it's transferring money in an obligatory fashion to municipal and state authorities. So there's not a lot of wiggle room for someone coming in to drastically alter the pattern of federal spending.

A lot of it is allocated, which again means that the constraints are very great for whichever of these two candidates gets into the presidency, and at this point, I don't want to hazard a guess as to which one of the two it will be. I've done that before in the first round, so I'm going to avoid it this time.

With social democracy, what I mean by that is that there's a strong consensus that the social rights that have been won over the past few decades have to be preserved. If you look at the letter that many prominent academics and former government officials signed recently in support of Aécio Neves, they said, 'We support Aécio Neves because stability and economic growth are indispensable conditions for the reduction of inequality to be effective and for the resumption of development to be sustainable.'

This is not a Tea Party-esque protest about Bolsa Familia, that we don't want tax and transfer policies to help the poor. That's not what they're saying. They're disagreeing about means and not on ends. So there does seem to be a consensus at least ideologically across the party spectrum that what I call social democracy should be preserved.

I think the protests of 2013, although they were also about representation, were fundamentally about social [indiscernible] as well, because they were about the quality of state services in education, health, transportation and public security.

I think what's striking to me... Tim and I wrote a piece about the Lula election in 2002, that's going back a ways, isn't it? I think we sort of were trying to speculate about what that meant. Despite the convergence, despite the fact that I think these two candidates are arguing about a fairly small policy space, and fairly minor differences of direction that either one of them would implement as president.

The level of vitriol is really high. The sort of animosity, and I'm not sure what that's about. I thought mistakenly that Dilma, being from a different class background from Lula, being more upper middle class, might actually diminish that vitriol and might lead to a sort of mellowing of the feelings on both sides. But that's not been the case.

Maybe it's because the PSDB has been out of power now for three successive presidential elections. The economy is not doing well, and maybe there's a sense that if they can't win this election, when are they going to win a presidential election? So there's an urgency on their side and of course there's an urgency now on the PT to hang onto power, because they're the establishment. That's a very uneasy feeling, I think, for a lot of long-term PTistas, because they're not comfortable with being the establishment.

You do see interesting dissidence on the left, of people who don't feel that the Dilma presidency has been imaginative enough, that it would be better for the PT to lose, to sort of find its way again, to find coherence as a party of the left, and that what they've done in power hasn't really been enough.

I do wonder if Bresser-Pereira is right, the economist Bresser-Pereira had an interview recently where he argued that as the PT moved to the centre and became a social democratic party in its 12 years in power, the PSDB has moved to the right. I wanted to throw that out there as a possibility, and I did want to say too that the questions that the PT is raising about social programmes under an ASU presidency, I don't think it's entirely electoral scare mongering.

I mean, they are engaging in electoral scare mongering, but there is I think a legitimate question to ask, is if there's going to be a fiscal shock and there's going to be a return to orthodoxy and a return to some introduction of austerity at the federal level, where are the cuts going to fall? As I said, there isn't a lot of discretionary spending that you can cut.

I think the final thing I wanted to say was Brazil has been sold short in the past on a number of occasions. If you're a market analyst and you're negative over time, those negative appraisals don't bear out, you kind of get hit by the markets or investors. They will criticise you for doing that.

When it comes to Brazilian politics, I think you can be negative consistently over a long time and you can get away with it. There's a prominent economist who wrote in 2006 that in the short term, the orthodox policies pursued in Brazil have not favoured redistribution. In other words, you can't redistribute and impose orthodoxy as Lula did when he first came in in 2003.

He wrote that in 2006, fair enough. He repeated it in the seventh edition of his book in 2014, which I thought was just very odd. So my own instinct about this impasse that



Brazil is in, this low growth moment, that they will surmount it somehow. That's going to be task number 1 for either Aecio or Dilma, come the first of January.

It's clear that Dilma is making signals that are similar to Aecio. She's saying, 'I'm not going to appoint Guido Mantega as minister of [indiscernible],' and Aecio is saying, 'It's going to be Arminio.' Maybe that tells you a little bit about what you're going to get with these two governments. I wanted to stop there. Thanks.

### Alex Vines

Thank you very much. Well, we've heard from Tim Power. We've now heard from Anthony Pereira. Finally, we have Mahrukh Doctor, who's senior lecturer at the School of Politics, Philosophy and International Studies. Mahrukh, over to you.

### Dr Mahrukh Doctor

Very good. We've already heard a lot about the big scene, and today I thought, I was asked to speak about the economic situation and specifically the possible economic priorities of the next government. Thinking about the setting, to go into the specifics and specifically issues that are of concern to international investors, but also of course to the domestic business community.

The presidential election itself has been a bit of a... The whole process has been a bit of a roller coaster. I think for the polling organizations it's been up and down, for politicians themselves, they seem to be flavour of the moment one minute and then completely ignored the next. And of course, for the financial markets. I mean, it's been very volatile in the last couple of months. In some ways, you could argue this is speculation, but in other ways, I think it's a genuine question of market sentiment and uncertainty about what will happen next.

Now, the voters in Brazil in general, I would argue are not looking for change. They're looking for improvements from government and public services and so on. Who is looking for change, however, are the business community. The business community has been quite disappointed in the Dilma government. They have felt increasingly frustrated, sometimes even side-lined from the policy-making process.

They are frustrated with the very low growth. It will be less than, or it will be around 0.3 per cent this year and the average for the Dilma government will be about 1.5 per cent. The stubborn inflation, in fact inflation 12 months running, accumulated inflation has gone above the margin of tolerance to about 6.75 per cent. There is increasing current account deficit. There are all kinds of problems with fiscal policy, the primary surplus is going to barely make one per cent, when in fact the target is already lower than the 1.9 per cent.

I can mention hundreds of specific issues and niggling problems, but of course, it is much bigger than that. It is the trend that is also a problem. The easy years of the consumption boom, helped along by the commodity boom, have now given way to the next step, to make the next step in terms of competitiveness, increases in productivity, etc., you're

going to need appreciable change in the way the country is run as well as the way in which structural reform issues are tackled in some kind of sensible manner.

In other words, long-standing issues of systemic competitiveness from taxes to bureaucracy to infrastructure to logistics and labour markets and what have you, all need to be addressed and the government instead of actually dealing with them, sort of coming back to Tim's point on reform or a government without reform, but lots of packages. I think in Dilma's first two years in office, she announced nine different economic packages. I've lost count after that, quite frankly. But none of these packages really delivers its stated objectives.

So business argues urgent change is required. On the one hand, a macroeconomic adjustment is absolutely essential, and this is the point where I think both Tony and Tim seem to think there is more or less a consensus about this on both sides. However, the way it is going to be tackled is going to be quite different, depending on who wins. The PSDB candidate, potential government, would address the issue of removing distortions, while the PT would probably try to think about how it can manoeuvre around the situation in terms of adjustments within the rules of the fiscal context.

We also have a great need for microeconomic reform. This, I should say, from my research going back 20 years, is the problem. The first PSDB government was obsessed with the macro-economy and micro-economy was always left aside. It will be dealt with later. The PT said, 'We are the workers' party. We're actually worried about the micro-economy,' but in fact Lula was equally obsessed with the macro-economy.

Now we have Dilma, who does meddle with the micro-economy, but not in a systematic way, rather in an ad hoc way, specific groups being perhaps favoured for sometimes quite un-understandable reasons and other times very understandable reasons, but perhaps not necessarily legitimate reasons.

Then we have of course the third demand from business which is better external economic relations, real frustration with the fact that the next step of globalization, which basically is further integration into global value chains and especially higher up in those global value chains, and Brazil has simply been left behind.

So who is to blame for this odd mix of what some are calling job-full stagflation? I mean, the word in itself is a mouthful. What are the options that these two candidates are offering to deal with it? Now, who is to blame? The government blames external factors, it's been forced to fire fight since 2008 and the opposition argues the problem lies with poor domestic economic management and policy decisions – too interventionist, too protectionist, too inefficient, not to mention lack of transparency, creative accounting and corruption.

So here we have all the blame being put wherever it suits each candidate, and what are going to be the results after the election? They're going to have to actually do something about it. What are the policy priorities going to be?

If Dilma wins, we will see her economic team change. She's already said Mantega will go out. There will be a gradual fiscal adjustment because there is no other way out. She has

been however rather cagey about the details of what she plans to do. One can expect that she will make an adjustment to her version of what she calls, or what economists call 'the new economic matrix'. So tax rebates, subsidies, protectionism, heavy use of public banks, will all be rethought a little bit.

But the important progressive aspect will be more resources for education and training and infrastructure investment. This we are already seeing. In the last two years there's been uptakes here.

Dilma will certainly not consider central bank independence. In her view, that would be what one economist in Brazil put it as 'fur on an eggshell'. What does that mean? He means it's completely unnecessary. So she thinks the system is working well, what is the point of it? To be fair, Aécio and PSDB have not said too much about this either. It was Marina's sort of special bell that we're going to have a central bank independence.

What happens then with her, with Dilma, would be Brazil would just muddle along as always. There would be no disasters, but nothing especially new.

If Aécio wins, there will be a marked change in style and discourse almost immediately, but in actions, I'm not so sure. There will of course be some changes in the next two years or so, in what they would call a responsible manner, avoiding any sort of fiscal shock or that kind of thing. Aécio has already said, Arminio Fraga, very well respected banker, will be his financial minister.

He has also said that Brazil needs to go beyond the first, the legacy, Cardoso economic, macro-economic tripod. In other words, inflation targeting, primary surplus and floating currency. He has said they need to go beyond this, and he is in other words saying, 'We're going to start finally looking at the micro-economy.'

What are the three economic axes of the new government going to be in his words, if they should get elected? First, of course, restore the macro-economic equilibrium, fiscal policy, better transparency and create conditions that would be better for growth. This process would take around two years.

The next target will be to increase the investment rate to about 24 per cent. 24 per cent is calculated to be the rate of investment required, gross fixed capital formation in other words, required to have growth potential at four per cent. What do we have today? We have the investment rate at around 16.75 per cent, so very well below. If I would compare to China, China's investment rate is over 40 per cent. So you see where we're talking.

The third axis of his policy would be increasing productivity – education, innovation, labour market reform, all these sort of issues. Just a point on productivity, I recently read a report by a Brazilian academic economist and he said that, he calculated that since 1980, productivity of the average worker in China has increased by 895 per cent. Would you like to even guess by how much productivity for the Brazilian worker has increased in the last 30 years? It is six per cent.

I mean, what do you say to this? But what lies at the heart of that figure, it's not that the worker is useless. It's not that the business community is useless. It is the way that the structural conditions for business have been hampered.

The biggest change I think Aecio will introduce is on the external front. He's already said he's not going to put up with any more nonsense from Mercosur. They are either going to have to get their act together, move forward, have a deep reform and actually follow the rules, otherwise Brazil is just going to get out and leave. Brave words. I'm not sure how much he will actually do this. But okay, it's something exciting to think about.

A backwards looking election, yes, in many sense. The old issues are there. The same solutions are being produced. Will any action happen? Not so sure. Can the two candidates deliver on their promises? Yes, I think Brazilian presidents have considerable powers, if they want to do it, they can do it. Sure, they face some restraints so an eventual PSDB government for example would have to deal with the very strong PT presence in congress.

Finally though, to conclude, whoever wins, they know there is that legacy issue, but more importantly also the future issue. A key concern is how to overcome these structural obstacles to kick start growth without sacrificing the social policy gains of the past 15 years.