

# Challenges for Growth with Social Justice in Brazil<sup>1</sup>

Paulo Paiva<sup>2</sup>

## Introduction

In January 2003, a new Brazilian administration took office headed by former union leader Luiz Inácio Lula da Silva, elected to the country's highest office in his fourth attempt. Lula was a founding member of the Worker's Party (PT)<sup>3</sup> at the start of the 1980s. Based on socialist principles, the PT grew over the years into a major voice for the opposition, proposing a new approach to governance, a new economic model, and new public policy choices with the emphasis on social policy, poverty reduction and economic development.<sup>4</sup> The new economic model would imply to break with the so-called Washington consensus and with IMF supervision. Lula won the election following eight years in office by President Fernando Henrique Cardoso who, at the head of a center-right alliance, brought inflation under control, achieved impressive results in important social services such as health and education.<sup>5</sup>

---

<sup>1</sup> This is a modified version of my paper Lula's Political Economy. I would like to thank all participants in Alcantara meeting for their useful comments and suggestion on my oral presentation.

<sup>2</sup> Visiting Professor at LBJ School of Public Affairs, University of Texas

<sup>3</sup> In Portuguese, Partido dos Trabalhadores (PT).

<sup>4</sup> This was not the first time that a leftist party rose to power in Latin America through the popular vote. Among others, two examples are the election of Allende in Chile at the beginning of the 1970s, and Alan García in Peru during the 80s. Both governments ended in political and economic crisis.

<sup>5</sup> Cardoso also assured Brazil a strong presence on the international stage, primarily through personal leadership in Latin America and the active role he has played in the group of world

Expectations for the Lula administration have been running high, both because of the strong majority he received at the polls - 45% in the first round and over 61% in the run off - and thanks to his promise to introduce changes and create a new economic model for the country.

In this paper, I should like to take up a few of the main challenges that his government will have to overcome to promote economic growth with social justice. My goal is to outline the main points of what I understand as the political economy of Lula's government, assessing his first and a half year in Office.

A section providing essential background information follows this introduction. The following sections deal with the main challenges to be faced, including how to: promote economic growth with stability, reconcile the need for macroeconomic stability with growing social demands, and maintain a balance between representative democracy and the new corporatism. Some remarks close the paper.

## **Background**

Brazil not only is Latin America's largest country, but also has one of its widest disparities in income distribution. With its continental-sized landmass and after a long history of colonial settlement, Brazil enjoys enormous ethnic diversity with a large proportion of African and European descendants living side by side with descendants of Asian immigrants and indigenous peoples. The Portuguese colonizers were able to maintain the country's territorial unity, thanks perhaps to the transferring of the royal family to Brazil in the early 19th century and the long period of imperial administration that followed.<sup>6</sup> The territorial and political unity

---

leaders known as the "third way" –a group which included former President Clinton of the United States and England's current Prime Minister Tony Blair.

<sup>6</sup> In 1808 the Portuguese royal family fled to Brazil to escape the Napoleonic invasion of Portugal. The court settled in Rio de Janeiro and Brazil was raised to a United Kingdom with the same status as Portugal and the Algarves. In 1821, the King, Dom Joao VI, returned to Portugal leaving his son, Dom Pedro I, as regent of Brazil. The Prince declared the Brazilian independence and

inherited from the empire period stands in sharp contrast to today's cultural diversity and uneven distribution of income. It is possible that these elements formed the basis for the country's present political system which is made up of political parties most of which are regional in nature with little cohesion at the national level. Even parties with a tight knit national organization (such as the Workers' Party) are led by predominantly regional leadership, in the case of the PT with a large presence of politicians from the state of São Paulo.

The economy is also fairly diversified, with sharp contrasts between regions. The southeast and southern regions are more developed than the northeast and northern part of the country. Construction of the federal capital in the midwestern region led to settlement further west in the country's interior and encouraged the development of commercial agriculture in this region, with an increase in grain and livestock production. Modernizing of agriculture has made this sector one of the most important elements in Brazil's economic growth.

The strong presence of the State in the country's economy was shaken by the deep crisis that occurred in the 1980s when the earlier development model based on import substitution came to an end. High rates of inflation, growing public deficits and external imbalances disrupted the economy, brought about a recession that lasted throughout the 1980s.

Despite the economic problems, the 1980s saw democracy consolidated in Brazil. The country managed without serious difficulty the transition from an authoritarian military regime to a democracy, first, with indirect election of a civilian president in 1984, second, with the approval of the new Constitution in 1988, and third, with the reestablishment of direct elections for the president of the republic. The incipient democracy was put to a major test when impeachment proceedings were brought against an elected president, Fernando Collor, within

---

was the new country first emperor from 1822 to 1831. He abdicated the throne for his son, Dom Pedro II, who reigned from 1831 to 1889.

the established institutional framework and without disturbance of any kind. During the interim administration of Vice-President Itamar Franco in 1993-94, then minister of finance Fernando Henrique Cardoso<sup>7</sup> carried out a macroeconomic adjustment program –the real plan—that succeeded in controlling inflation and laid the groundwork for transitioning the Brazilian economy into a more market oriented economy. Elected president in 1994 and reelected in 1998, Fernando Henrique Cardoso in eight years led an economic reform process that promoted greater integration with international markets, privatization of companies in the telecommunications and energy sectors, among others, and launched a broad government reform program in which sectors such as social security and public administration were overhauled. Annual inflation rates were brought down into the single digit range, the indexation of the economy was eliminated and, taking advantage of conditions on international markets, the flow of foreign capital into Brazil was allowed to rise and government spending on the social sectors was considerably increased. Among other improvements, this resulted in reaching 98% of elementary school enrolments, a drop in the infant mortality rate and the development of a program to combat AIDS which earned international recognition for its excellence.

Still, the rapid growth of Brazil's economy in the period 1994-1997 was slowed by external crises, primarily the Asian recession and Russian crisis in 1998, and later by the devaluation of the Real at the beginning of 1999. The unemployment rate rose during the decade and the gap in incomes failed to narrow.

Important changes on the macroeconomic side took place during the Cardoso administration. However, more permanent fiscal adjustments, which results would have signaled the market of the consolidation of a new fiscal regime, did not occur adequately. The advances in the reorganization of the states' fiscal accounts, the privatization of public banks and the implementation of the fiscal

---

<sup>7</sup> Under Itamar Franco, Cardoso first served as Minister of Foreign Affairs and subsequently as Minister of Finance. Until then, he was serving as senator from the State of Sao Paulo having

responsibility law were not complemented by a more effective control on federal spending levels. The federal government primary spending maintained a trend of real growth and the primary surplus achieved in the second term of Cardoso was basically due to revenue increases as for example the increase in the CPMF.<sup>8</sup> Between 1994 and 1998, the non-finance spending of the federal government grew by 7% in real terms compared to 2.6% GDP growth rate, and the discretionary spending increased by 12.3%. In the subsequent period, 1998-2002, the real growth of non-financial spending remained above the growth rate of GDP, 5.1% and 2.2%, respectively. In this period, however, the real growth rate of discretionary spending declined to 1.1% due to the adjustments in the federal budget of 1999. For the year 1999, discretionary spending experienced an 11% nominal decline, but the effects of the 1999 adjustments were partially eliminated in the following years as spending increased, to a certain extent, due to the new earmarking of revenues to specific spending lines such as those related to the health sector and to the “Fund Against Poverty” as well as the discontinuity of the activities of the Commission for Administration and Fiscal Control (Comissão de Gestão e Controle Fiscal – CCF).<sup>9</sup> Thus, the fiscal situation remained a central element in the vulnerability of the macroeconomic adjustment and, for sure, contributing to the exposure of the Brazilian economy to external and internal adverse shocks. There is no doubt that fiscal unbalances constraint the growth of domestic savings and contribute to the reliability of the

---

been elected for the PSDB, a center-left party. FHC is a social scientist with Marxist training who has been a strong influence on socialist thinking throughout Latin America.

<sup>8</sup> For an assessment of the fiscal policy of Fernando Henrique Cardoso government see Fabio Giambiagi, “Do Deficit de Metas às Metas de Déficit: A Política Fiscal do Governo Fernando Henrique Cardoso – 1995/2002”, Discussion Paper 93, BNDES, 2002.

<sup>9</sup> These fiscal numbers come from the Giambiagi’s article cited in the previous footnote. The 1999 federal budget was elaborated with the perspective of a new fiscal regime, including a primary surplus target. For the first time a disposition establishing a value for the primary surplus was included in the text of the budget law. In subsequent years the primary surplus target was indicated within the Lei de Diretrizes Orcamentarias (Budget Guidelines Act). For more details on the construction of a new fiscal regime starting in 1998 see the chapter “Por um novo regime fiscal no Brasil” (For a new fiscal regime in Brazil) in Paulo Paiva, *Sonho e Realidade (Dream and Reality)*, Editora Ensaio, Rio de Janeiro, 2001, where I discuss my experience as minister of planning and budget in the 1998-1999 period.

Brazilian economy on external savings and the resulting consequences of this dependency.

The stage for the electoral campaign of 2002 was set in a democratic country with freedom of expression, differing political parties with broad rights to organize and a president nearing the end of his second consecutive mandate (a first time for Brazil), plus an underachieving economy and gaping social inequalities.

At this juncture, with opinion polls indicating a possible victory for Lula in the election, the financial markets reacted by raising country risk and devaluing Brazil's currency. True, there was some level of contagion from the Argentine situation on foreign markets, as well as the adverse effects which the Enron debacle had on the economies of United States and Europe, but unquestionably the biggest problem at the time for Brazil was the adverse impact that the possibility of electing a socialist party candidate had on the country's financial indicators and its economy in general.

While on the one hand the expectations of the people were boosted with the possibility of electing someone promising to change the economic model, promoting growth, generating employment and reducing inequalities, on the other hand the markets were afraid that the reforms and stabilization program in progress might be scuttled. The rising expectations of the majority of the population for change had come up against the market's fear that the leftists would return to their populist past. One of Lula's campaign slogans captures this conflict perfectly: *A esperança vai vencer o medo* [Hope will triumph over fear].

### **Promote economic growth with stability**

The Lula team began looking after the economy and its risks even during the election campaign. Then President of the Workers' Party, José Dirceu (now minister serving as Chief of Staff for the president), paid a visit to the main market decision makers and the multilateral institutions in Washington and New York. A letter to the nation signed by Lula was published before the first round of the presidential election setting out his commitments to maintain macroeconomic policies. In it the candidate makes commitments regarding the four key elements of macroeconomic policy, namely commitments to maintain primary fiscal surplus, necessary for ensuring stability in the ratio of public debt to GDP; maintain an anti-inflationary policy by following an inflation targeting strategy; maintain the floating exchange rate policy; and respecting existing contracts.

Responding to a call from President Fernando Henrique Cardoso, the Workers' Party candidate also endorsed the agreement that Brazil was negotiating at that time with the IMF<sup>10</sup>. These measures established the basis for the macroeconomic policy of President Lula, should he be elected to the post. In effect, they established his commitment to continue the basic economic course set by the government of Fernando Henrique Cardoso. And it is a major departure from the so-called new economic model that PT had been proposed so for.

Once elected, the signals sent by the first actions of the future government were, in my opinion, very important for gaining the market's confidence. Let us look at a few of these. Critics of the left thought that Lula would begin by visiting

---

<sup>10</sup> In fact, President Cardoso got the endorsement from the major candidates.

presidents Chaves of Venezuela, and Fidel Castro of Cuba. This expectation was dashed, however, when he traveled south to Argentina and Chile instead, paying his first state visits to presidents Eduardo Duhalde and Ricardo Lagos. Next he traveled to Washington to visit President Bush, whose first impression was very favorable. In fact, the press came away with the impression that there was enormous empathy between the two leaders – a fact that was vital to the markets at the time. And it was while in Washington that Lula announced the appointment of his minister of finance, Antônio Palocci, a physician and Mayor of the city of Ribeirão Preto, a major regional center in São Paulo state, as well as a long-time member of the Workers' Party and coordinator of its platform during the election campaign.

While in the United States capital, Lula met with the presidents of the World Bank and the Inter-American Development Bank, but did not go to the International Monetary Fund. President-elect Lula waited for the General Manager of the IMF to visit him in Brazil later. Again, in terms of symbolism, Lula gave positive signs to the market by his visit to Washington while at the same time signaling a difference in his political relationship with the development banks and the Monetary Fund. This was clearly applauded by his more enlightened followers.

As to Brazil's Central Bank, Lula appointed a banker to serve as its president: Henrique Meireles, who was an executive of BankBoston in both Brazil and the United States. Lula maintained the other members of the *diretoria* (Central Bank board of directors) of the previous government, thus providing a gradual transition<sup>11</sup>. Even before the announcement of his appointment, Meireles accompanied the future minister of finance, Antonio Palocci, on his visits to bankers in New York, which took place soon after Lula's trip to Washington.

---

<sup>11</sup> The total change of the Central Bank was completed during 2004.

From the beginning of this administration, the basic macroeconomic policies of the previous administration have been maintained. At its first and second meetings, the Central Bank raised the prime rate 50 and 100 basis points to 25.5% and 26.5%, respectively. It stuck with this strategy leaving the rate unchanged in the next three meetings, allowing it to drive down the rate of inflation which was verging on 40% (annualized rate based on monthly inflation over the period October-December 2002), to around 7-9% in 2003, with a target of 5-7% in 2004.

Starting in June 16, 2003, base rates were dropping while inflation remained low and country risk was lowered thanks to the market's confidence in the way macroeconomic policy was being managed. By December 17, 2003, the prime rate was cut seven times, standing at 16.5%. This inflation targeting policy is still in place keeping inflation under control. A larger discussion is taking place in Brazil regarding to the level of interest rate. Some economists, businessmen and PT's supports would like to see a lower interest rate and blamed Central Bank for its conservative monetary policy. It seems to me that the level of interest rate in Brazil depends less on the Central Bank decision on the short run and more in its roots whether fiscal vulnerability (higher public debt and public deficit) or institutional context (jurisdictional uncertainty)<sup>12</sup> or yet the so-called original sin<sup>13</sup>. Anyway, Central bank decisions may move up or down interest rate up to one or two percent points but not to bring it to the international levels.

In the area of fiscal policy, the government has maintained its commitment to generate the fiscal surpluses needed to keep the public debt to GDP ratio stable. Management of the 2003 budget followed an austerity program, generating a

---

<sup>12</sup> On this point see the interesting paper by Persio Arida, Edmar Bacha and André Lara-Resende, "High Interest Rates in Brazil: Conjectures on the Jurisdictional Uncertainty", Núcleo de Estudos de Políticas Econômias, Casa das Garças, Rio de Janeiro, 2004 (mimeo).

<sup>13</sup> See Ricardo Hausmann, Ugo Panizza and Ernesto Stein, "Original Sin, Passthrough, and Fear of Floating". In: Blejer, Mario and Marko Skreb, Financial Policies in Emerging Markets, The MIT Press, Cambridge, Mass.

primary surplus equivalent to more than 4.3% of GDP, well above the 3.87% target in the agreement with the IMF. With regard to the next three years (2004-2006), the Budget Guidelines Act follows the same strategy establishing targets for the primary surpluses at 4.25% of GDP. In fact, the fiscal austerity of the Lula administration has so far exceeded that of Cardoso's second term.

The government also adopted the reform agenda set by the previous administration. Its first move in this direction was to approve, in the first months of the new administration, a constitutional amendment that opens the door for resubmitting draft legislation to the National Congress that would make the Central Bank more independent. This was followed by reform of the pension regime and the tax system, the two having been approved by both the Chamber of Deputies and the Federal Senate. The reforms to the pension regime have fairly sensitive political ramifications for the government's parliamentary base since it affects the interests of public servants (constituents of legislators from the Workers' Party). Nevertheless, the government and the party have taken this on as a government project and drew on the loyalty of their legislators in the voting to approve it. For example, PT's parliamentarians who publicly voice their opposition and voted against the reforms were expelled from the party. The tax reforms bring the government into direct conflict with mayors and governors since the changes may affect the distribution of tax revenues among the various levels of administration. The approved project represents an agreement reached with state governors and opposition parties.

Finally, early in December 2003, the Lula government reached agreement with the IMF for 2004 which maintains the fiscal austerity, inflation targets and the access to IMF financing. This was something unimaginable just one year ago.

Thus, the Lula government has established a macroeconomic policy which does not differ in essence from that of the Cardoso administration, and which is both essential to economic stability and a necessary condition for economic growth,

except on the budget administration with a more rigorous control over the federal discretionary spending. The government has shown its determination by choosing this road over the opposition of the economists and grassroots of its party. In 2003, the economy is still not performing to its potential and unemployment remains high, having risen steadily throughout the year.

But the first signs of growth have begun to appear in the economy. With the drop in country risk and the improvement in Brazil's status among risk rating agencies, the flow of foreign capital into the country is beginning to rise. Exports are increasing reaching levels never reached before and so having a positive impact on economic growth. The growth rate in 2003 was  $-0.2\%$ , and this figure is expected to rise to  $4\%$  to  $4.5\%$  in 2004. The same level is expected for 2005.

There is a consensus that Lula's macroeconomic policy brought the economy to the right track.

Although the macroeconomic policies of Lula's government have been sustained on solid basis, there are still many important challenges to consolidate a favorable domestic environment to increase private investments and to stimulate economic growth. For example, there is no perspective of reinitiating the privatization process, which was interrupted at the end of Cardoso's first term in office.<sup>14</sup> Similarly the risks of submitting the regulatory agencies to interferences by the executive branch remain and can jeopardize investment decisions in the infrastructure sector. The definition of adequate regulatory frameworks for investments, the consolidation of stable rules for respect of contracts, in summary the certainty of the prevalence of the rule of law are necessary internal conditions for a favorable growth environment that goes beyond 2004. The external sector also imposes challenge to the perspective of growth. In order to maintain higher trade surpluses, there is an urgent need to open markets to the Brazilian products, especially negotiating free trade agreements with relevant markets such as the United States, via FTAA, and with the Euro area. Perhaps a

more pragmatic and less ideological attitude in the conduction of the external policy could give a more significant contribution to macroeconomic stability and to a sustainable growth of the Brazilian economy.

But consolidating economic growth also depends on what happens outside Brazil: how far might economic woes spread from other economies such as those of Argentina and Venezuela, to name just two, if they encounter problems in coming years? And what would be the impact on Brazil of a possible adjustment of the United States economy needed to cope with the country's budget and current account deficits. At this point it is difficult to predict what is going to be the course of action that will be taken by the new administration in United States. If it will be the road of recession it might be difficult for the Brazilian economy to maintain a rapid growth rate in the years to come. However, the maintenance of the current macroeconomic policy and the deepening of the reforms are necessary conditions for the Brazilian economy to face future challenges. This is a major challenge that Brazil will then have to face.

Meanwhile, the year 2004 offers a window of opportunity --if economic growth continues-- that it may be easier to complete reforms to the pension and tax systems and provide a more solid environment for the economy. The positive expectations for 2004 could help in the implementation of microeconomic measures creating better conditions for an increase in investment, productivity, and competitiveness<sup>15</sup>. For example, to consolidate regulatory frameworks in the areas of telecommunication and energy, to conclude the process of Central Bank's independence, and to advance towards contract stability. In other words, these actions could help to consolidate a better business environment.

Perhaps then the proposed reform of Brazil's labor laws can be submitted to the National Congress as promised by President Lula in his inaugural address.

---

<sup>14</sup> The signal was when the privatization of Furnas (a very large energy mill) did not take place as in the case of Furnas.

<sup>15</sup> In the course of the discussion in the Alcantare meeting Emilio Fantella suggested that we should call mesoeconomic those reforms related to the institutional environment.

Unfortunately it seems that this window of opportunity has been missed. Reforms did not move in the Congress. It is more likely that the labor reform will be abandoned as well the tax reform. As 2005 approaches and the reelection agenda takes priority no controversial project will be sent to the Congress.

### **Reconcile the need for macroeconomic stability with growing social demands**

One of the greatest challenges for the government will be to simultaneously maintain macroeconomic stability while meeting the rising social demands of its citizens. The government of Fernando Henrique Cardoso had already increased social spending from 11 to 14% of GDP, representing a 39% increase under this budget heading. The rigidity of the budget left little room for further increases. For example, in the 2003 budget discretionary expenditures represented 2.1% of GDP, and of this total 72% were allocated for social development. To put it another way, under the proposed budget for 2004 and excepting constitutionally mandated transfer and social security, of every R\$100 in revenues, only R\$20 will be available to cover government programs including all sectors (social security, education, health, social assistance, transport, military activities, etc). Moreover, analysis of the government's budget proposal for 2004 shows that of every R\$100 in revenues, excluding constitutionally mandated transfers and social security funding, R\$34 will go to cover the social security deficit and primary surplus. In other words, this is the savings effort that the Brazilian population is making in order to carry a budget with a social welfare system in deficit while at the same time servicing the public debt. The savings in this case is nothing less than 6% of GDP. Given the rigidity of the budget and its imbalances, any further increases in social spending will be hard to come by.

In addition to these pressures on the budget, there are also calls from within the party for increasing the salaries of public servants given the expectations created by the longstanding support of the Workers' Party for their demands, especially during the Cardoso administration. Demands from the military sector are

unattended. And another potential friction point between the government and its supporters has to do with increasing the minimum wage. The Workers' Party has always advocated permanent real increases in the minimum level and Lula has promised to double the purchasing power of the minimum wage during his government. This is not consistent with balancing the social security accounts, however, because any rise in the minimum wage will directly impact social security spending since benefits under that system are indexed to minimum wage under Brazil's Constitution. These pressures may well grow even worse as the years go by. Adjustments to the minimum wage may become a major point of contention in the years to come between the government and its supporters in the National Congress since the Workers' Party has always pushed for sizeable increases in the minimum amount paid to workers.

It seems to me that the government has had more difficulty managing its social agenda than in any other area. First, because it began by launching the "Zero Hunger" program lacking a clear set of plans. The project appears to be more a label for a set of initiatives than a program itself, or an objective that social programs should aim for. There were no budgetary resources available to fund it, and the program lacked a clear focus.

Second, there is the question of its management style. On the one hand, the government created various secretaries with ministerial status and set them to formulating policy in a number of areas, including development of the Zero Hunger program and policies on women, race, fisheries, human rights and social assistance -- with virtually no means of execution, and yet their actions supercede those of the ministers themselves who have their budgets restricted in areas such as education, health, labor, social security, etc. This model has a very high potential for creating conflicts between authorities and over the "ownership" of programs. And on the other hand, there is a lack of coordination among the various ministries, each of which has its own set of activities. One positive decision was to compile a single registry of poor families so that the different

income transfer programs can be consolidated under a single organization. A risk inherent in this approach, however, is that concentrating social programs under a federal agency may very well undo the successful efforts of the previous government to decentralize its operations. Recent changes creating the Ministry of Social Development seem to follow the trend of centralization of actions which could result in lower levels of efficiency.

Third, some of the social resources are being misdirected in Brazil. It appears that the majority of the federal government's resources are not well targeted with respect to poverty reduction.<sup>16</sup>

Because of this, a review of social policy is necessary, perhaps with better targeting of social programs. This will be a tall order for the government for several reasons. For one thing, it will affect benefits that are clearly going to the middle class at present, including free college education and universal health care. The middle class wields a lot of influence over public opinion, and where the middle class goes, there go the government's approval ratings. Also, Brazil's middle class includes a large range of incomes so that there are even wide gaps between segments within the same class. Consequently, any change in the way public resources are directed may affect the living standards of a significant portion of the middle class. This is a very sensitive issue and will require great care on the part of the government. It is perhaps one of the greatest challenges that this government will face in carrying out its public policies.

Pressure to increase spending in the social sector is likely to increase in the next few years. If the efficiency of their social programs cannot be improved, the government will be faced with the choice of either not satisfying demand under

---

<sup>16</sup> See *Gasto Social do Governo Central: 2001 e 2002*, Ministério da Fazenda, Secretaria de Política Econômica, Brasília, DF, 2003. This paper, prepared by the Lula government's team of economists, asserts that *"Brazil is a country with relatively low per capita income levels compared to the per capita income of other industrialized countries that have achieved tax revenues equivalent to those of rich countries. However, unlike in those countries, Brazil has not been able to use the tax and social spending systems to substantially reduce income disparities in its economy"*.

social programs or not meeting their fiscal goals, and therefore placing their macroeconomic policy at risk.

There is a very real risk of frustrating the hopes of both the party's grassroots supporters and the electorate in general if major results are not forthcoming in the social sector<sup>17</sup>. Among other areas to be mentioned are the expectations of urban middle class; the land settlement and agrarian reform issues related to the *Movimento dos Sem Terra* [Landless People's Movement] (MST) and sectors of the Catholic Church; job creation; relations with the trade union movement, primarily through its umbrella association, the Central Única de Trabalhadores (CUT); and implementation of the Zero Hunger program.

I don't think that the administrative model of social policies will contribute to increase efficiency and efficacy. On the contrary, it can make them more inefficient. However, there is a need to review the whole complex system of the country social policies, their sources of financing, their redundancies and inefficiencies. It is also important to focus the attention of social policies on those most vulnerable segments of society if the goal is to reduce poverty and inequality.

There are two needs which, in my judgment, are the most important problems affecting the success of the social programs. One is the need to dismantle the old Welfare State that came from the "era Vargas",<sup>18</sup> replacing that model with another state better adapted to the market economy and the country's fiscal constraints; and the other is the need to begin tackling the enormous social and income inequalities that will not be fully solved within a single administration. Coping with these challenges without slipping into populist rhetoric is the most important task facing the Lula government.

---

<sup>17</sup> It seems that the results of local elections in 2004 support these fears. Opposition won on the larger cities in the more developed regions of South and Southeast. The cases of São Paulo and Porto Alegre are obvious examples.

## **A New Corporatism in Brazil**

Perhaps one of the main innovations of the Lula government was to reintroduce or, if you prefer, build a new corporatism in Brazil. The Estado Novo<sup>19</sup> was Brazil's first experience with a corporatist regime. With the presence --under the constitution of 1934-- in the legislature of corporatist representatives chosen by the country's professional associations, and the organization of trade unions and employers' associations, this regime formed a federative system within a unitary government and with compulsory taxation, inspired by the Fascist Italian *Carta del Lavoro*. In one way or another, this classical form of representation remained a part of Brazilian national politics over the years despite its gradual fading in importance. The National Congress dropped corporatist representation after the constitution of 1937. Since then, representatives have been elected by direct vote, which is not to say that industrial and professional corporations do not influence elections. One only has to note the number of congressional seats held by evangelicals, civil servants, business leaders, etc. that have no direct links to the political parties and that act in the Congress in accordance with their corporative interests, thus independent of party's orientation.

The new corporatism is not simply a direct copy of the corporativism of the past, but rather an alternative means of opening a dialogue between the government and organized society. The Workers' Party has a tradition of ongoing dialogue with the different segments of civil society and, in fact, has the roots of its organization not only in the social movement, but also in grassroots movements, community organizations, the church, professional associations, etc. In addition, the government understands that since the Workers' Party does not have the

---

<sup>18</sup> Era Vargas refers to the state organized under Getúlio Vargas dictatorship. See footnote 19.

<sup>19</sup> The New State is the name given to the regime installed in Brazil following the 1930 revolution, and lasting until 1945 when the dictatorship of Getúlio Vargas came to an end. This regime built an autonomous, authoritarian and corporatist state and helped to accelerate the industrialization of Brazil.

support of the majority of the population, the government must extend its base of support into other more organized population segments and built a consensus in order to advance its reform program. Analyzing the make-up of its cabinet<sup>20</sup>, regardless of political party affiliations, one can see the corporatist influence on the government. Heading the Ministry of Agriculture is a representative of modern capitalist agriculture, while an individual whose sympathies lie with landless farm movement leads the Agrarian Reform Ministry. A representative of the food industry, an important export sector for Brazilian industry head the Ministry of Industry, Trade and Development. The former head of a trade union leads the Ministry of Labor and Employment, and an individual dedicated to protecting the environment is the Ministry of the Environment. While the broader composition of the new cabinet may provide greater representation for the different segments of society, allowing such a wide diversity of interests to be represented, it also raises the potential for conflict in the very heart of the administration. And this is already occurring in debates surrounding the approval of the bill on genetically modified products, and discussion of agrarian reform and free trade agreements.

---

<sup>20</sup> Analyzing the composition of the cabinet of President Lula, one verifies the presence of a large number of members who participated in the leadership of unions and associations either on the labor or business side.

President Lula was the president of the metal workers union of Sao Bernardo do Campo and founder member of the Central Única dos Trabalhadores (CUT), one of labor confederations of Brazil. Vice-President José Alencar was the president of the Manufacturing Federation of Minas Gerais, an employers' union of Minas Gerais state.

The following ministers have also participated in the leadership of some association or union. Roberto Rodrigues was the president of the Brazilian Rural Association and he is the president of the Brazilian Association of Agrobusiness; Miguel Rosseto was president of the labor union of manufacturing workers of the petrochemical sector of Rio Grande do Sul and one of the national directors of CUT; Luiz Fernando Furlan was vice-president of the Manufacturing Federation of Sao Paulo and vice-president of the Brazilian Association of Foreign Trade; Marcio Thomaz Bastos was president of the Bar Association of Sao Paulo; Marina da Silva was a founder of CUT in the state of Acre; Luiz Dulci was a founder and first president of the Teacher's Union of Minas Gerais; Jacques Wagner was president of the union of petrochemical workers of Camaçari and one of the founders of CUT in Bahia; Humberto Lima was president of the Medical Doctors' Association of Pernambuco and secretary of the Medical Doctors' Union of that state; Ricardo Berzoini was president of the Union of Bank Workers of São Paulo; Walfrido Mares Guia was director of the Association of Private Schools of Minas Gerais; Luiz Gushiken was general secretary and president of the Union of Bank Workers of São Paulo; and Matilde Ribeiro was an adviser of the Metal workers Union of São Paulo.

Another dimension –and a more interesting expression-- of the new corporatism is the creation of the Social and Economic Development Council [*Conselho de desenvolvimento econômico e social* (CDES)] as a forum for discussion of the government's main policy measures and government reforms. Perhaps inspired by the experience of European countries, the CDES is made up of government officials, ministers, members of (mostly class-based) civil society organizations, representatives of workers and employers, individual business leaders selected by the government, and one secretary with the rank of minister. The proposals for reforming the pension and tax systems have been discussed in the Council, which has also submitted proposals for stimulating economic growth. A proposal to reform the labor system is being discussed in a special tripartite forum.

This may turn out to be a very positive development by allowing the Workers' Party to build a consensus within society on highly controversial issues and giving it greater legitimacy in dealing with issues on which it does not have the support of a clear majority of voters. It is analogous to a new attempt to build the so-called "National Pacts," which were never successful in Brazil. The CDES provides an important instrument for the democratic process by ensuring consultation and consensus building.

There are a few problems, however. First, there is a question of legitimacy of the system of representation in the building of the CDES. The majority of the population is made up of poor people, self-employed workers and members of the informal economy with no access to the representatives of the civil society.

Second, the class-based representatives, by their very definition, are bent on defending the interests of their constituencies. Since some segments of society are still not represented, the creation of the Council alone will not ensure that its results include the demands of the absent segments. Unequal income distribution is one of the major Brazilian problems. Reforms and policies which could impact the income distribution in favor of the poor will have many difficulties to be accepted by a council where those to receive the benefits have

no voice. It would be needed a certain degree of altruism of council members to propose and approve measures opposed to their corporative interests while benefiting others segments population. The same can happen with measures of fiscal austerity. It would be very difficult for the Council to approve proposals of tax increase, for instance. It is easier to propose and approve programs resulting in increased spending.<sup>21</sup>

Third, a council linked to the administration may not be the best means for building a consensus in society. The executive branch will always have the last word in decisions. The experience among European countries has shown that the independence of the council is an important factor. In Spain, the council is totally independent, and in Portugal it reports to the legislative branch. Linked to the executive branch, the council will end up more as a consultative group, rather than a body responsible for submitting proposals and even critiques of the government.

Fourth, there is a risk of conflict between an experiment in “direct democracy” conducted by the executive branch under the council, and the forces of representative democracy exercised through the political parties and their designated institutions which make up the National Congress. The National Congress could see the Council as a pressure tool used by the Executive to approve projects without negotiating with the “people representatives” elected through the political parties.<sup>22</sup>

The new corporatism has potential risks for civil society institutions. The experience of the European countries indicates that trade unions and other associations often lose their autonomy when asked to play a dual role by

---

<sup>21</sup> It is important to note as well that the composition of the Council does not reflect an equitable regional representation, as São Paulo is over-represented there.

<sup>22</sup> This point requires a more detailed discussion, but, in a society with weak political parties, a direct relationship between the Executive branch and the society can represent a threat to the independence of the legislative branch whose work depends on a party structure.

defending the interests of both their constituents and the government.<sup>23</sup> This is a very real risk to the CUT and MST. In the case of the CUT, the discussion of labor reforms may be an important test, along with the debates on policies governing the minimum wage, trade agreements, and macroeconomic policies which may impact unemployment rates. These institutions could be caught between the duality of defending their own interests and defending the government. It is possible that if they are connected to the government they can lose their autonomy and, by a certain degree, their own corporative representation legitimacy. In the past, during the Vargas' government, the union leaders experienced this type of situation and were even called "pelegos," an expression used to designate union leaders who supported the government.<sup>24</sup> This will be a big challenge for the CUT and the MST which were developed and gained strength as independent institutions in relation to the government.

Finally, this new corporatism may become a new means for consolidating democracy in Brazil by opening up new channels of communication and discussion between society at large and the government, and cooperating in the reorganization of the country's institutions to increase the efficiency and effectiveness of public policies aimed at achieving greater equity. In this sense, it can have a very important role in the building of a new welfare state consistent with a market economy and fiscal restrictions. But it could also become a step backwards if it helps to consolidate the corporate interests of those segments that already have the greatest power to influence public policy decisions, to the detriment of the large majority of the population, which lacks access to, or influence over public sector decision-making. It can also be an indication of a

---

<sup>23</sup> See for example, Christopher Candland and Rudra Sil (editors): *The Politics of Labor in a Global Age*, Oxford University Press, New York, 2001.

<sup>24</sup> Pelego is the sheepskin used between the horse and the saddle to reduce attrition. Thus, a union leader, who supports a government, and tries to reduce attrition between labor and government, is called "Pelego." Among other reasons, CUT was created to substitute the old-style leadership by new, more combative leadership.

new mixed-up between state and society.<sup>25</sup> In this case, it could stimulate populism and to obstruct any effort towards the reduction of the Brazil inequalities.

### **Final Remarks**

The largest economy in Latin America is also one of the most unequal. There are many striking contrasts in Brazil: in cities, the wealthy and affluent middle class live side-by-side with children squabbling over garbage in the streets; modern, high-technology industries have mushroomed, but so have poor, ramshackle rural settlements. Promoting sustainable economic growth with social inclusion is perhaps the greatest challenge for the country that is now governed by Luiz Inácio Lula da Silva, a former metalworker and leader of the socialist Workers' Party who won the presidential elections on his fourth try. In electing him, voters have placed a huge burden upon his shoulders: namely, to live up to the expectations he has raised. To do so he must launch a new Brazil with a growing economy that creates jobs and reduces poverty, putting an end to years of recession, unemployment, and poverty while the country bowed to the brutal winds of globalization.

Although the economy weakened in late 2002 when a Lula victory became increasingly possible, the new president has achieved impressive economic results so far. These include taming inflation, which, after peaking at an annualized rate of 40% by the end of 2002, dropped to an accrued rate of 7.67% for the period from January to December 2003,<sup>26</sup> and is projected to decline to an annual rate of 5-7% in 2004. The prime rate, after rising above 26% at the start of his administration, has since fallen, reaching a level of 16.5% by the end of 2003. To bring it to much lower level will depend on facing a more structural fiscal

---

<sup>25</sup> One example of this is the influence exerted by some members of the government in the election of the president of FIESP (The São Paulo institution that represent manufacturing businessmen). There is also a risk of promiscuity between government and political party as public jobs, at all levels, are taken by party militants.

<sup>26</sup> It refers to general price index [índice geral de preços (IGP-DI)] from Fundação Getúlio Vargas.

adjustment and/or some institutional reforms. Exports have reached unprecedented levels and the economy is growing at high speed.

But at the same time as the government has scored impressive victories in the economic sector by following an ultra-orthodox macroeconomic policy, its results in economic growth and in the social sector have been less than brilliant. To the contrary, there has been no significant change in relation to past performance, and the government has encountered difficulties with its management and coordination of this area. The difficulties with the government administration add to the lack of definitions in the microeconomic arena related to the regulatory framework, the privatization policy, the labor reform among other issues.

The government is now reaping the results of discontent shown among the disaffected in various sectors of society.

In short, economic gains have not come without a price to be paid in the social and political fields. Even within the party there is an increasing number of unhappy members and four parliamentarians, as mentioned before, have been expelled from PT.

In fact, the results from the first and a half year of the new administration appear to illustrate the complex dynamics of democratic societies, particularly in their consolidation phase the path of which is tortuous indeed.

One significant change introduced by the Lula government is the adoption of a new corporatism including increased consultation with civil society and the creation of a Social and Economic Development Council as a forum for discussing and building consensus on major national issues. Whether the CDES will provide a basis for consensus building, or be used simply to “legitimize” government proposals remains to be seen. If the first, it may usher in a new phase of Brazilian democracy; if the second, it will be doomed to failure.

Finally, the election of Lula has raised expectations at home and abroad. Within Brazil there is an opportunity to build a new economic development process with social justice. And the hope outside the country is that this new process will be

developed within a democratic and market-oriented framework. So far experience has shown that no great changes have taken place, except perhaps in the PT's manner of governing. For the moment, at least, this appears quite similar to that of earlier governments.

Austin,

November, 2004.