

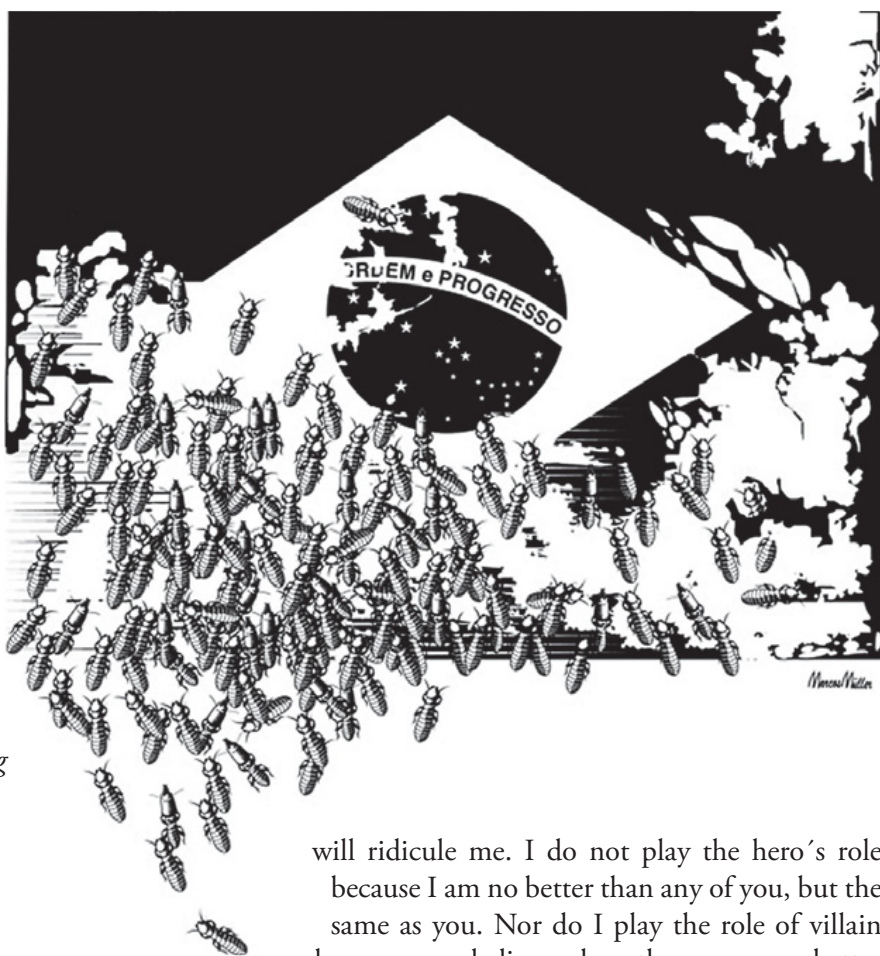


Democracy 4: Brazil needs a new strategy

Lula and Mephistopheles

Norman Gall

This essay is being written during one of Brazil's worst political crises since the collapse of democratic rule in the early 1960s, with unprecedented disclosures of corruption in both Congress and the Executive branch of government. While democratic institutions and the economy are much stronger today and the prospects of a return to military rule are remote, the current troubles expose flagrant defects in the system of political representation that tend to weaken belief in democracy. The outcome of these troubles is still in doubt. Nevertheless, the Fernand Braudel Institute of World Economics believes that it may be useful at this time to analyze the general contours of these difficulties as well as the long-term issues embedded in them. We divide this essay into three parts: (1) the facts and causes of the present crisis; (2) analysis of Brazil's viability and strategic advantages, and (3) proposals for overcoming Brazil's institutional weaknesses.



1. War of the Termites

“Hear me, citizens of Brazil, senators and deputies,” Mephistopheles began, at a nationally televised Congressional investigation of corruption. “I ask your permission to say that, although we are in a theater of struggles and ideas, a political theater, I came here not to play the role of an artist. If I am so judged, I would apologize so I can try to make my arguments personally, leaving aside any artistic propensity that I or any of you may have. I came here not to beg to keep my seat in Congress. I am now beyond such things. Nobody will force me to my knees with a tail between my legs. Nobody

will ridicule me. I do not play the hero's role because I am no better than any of you, but the same as you. Nor do I play the role of villain because you, ladies and gentlemen, are no better than I.”

Mephistopheles, archangel of corruption, ended the session at 2 a.m. with a hellish laugh. Mephistopheles has assumed many forms and identities over the centuries. In this incarnation, he took the identity of a 52-year-old Congressman from Rio de Janeiro, Roberto

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Corruption and crisis in Brazil

Rubens Ricupero

The essay by Norman Gall in this issue of *Braudel Papers*, "Lula and Mephistopheles," is the best and most complete study available of Brazil's current crisis. Its title suggests the growth of a demonic culture of power and corruption that has surfaced in recent months.

The first part is an admirable chronicle of the fascinating series of revelations of systematic corruption, which read like a high-quality crime novel. The second illustrates Brazil's evolution, over a broader expanse of time and space, with all its promise and deficiencies. The third part offers what the Workers Party (PT) and President Lula lack: a program of government, not merely for continuing in power, but a specific agenda of intelligent proposals that will allow Brazil to emerge from this crisis and chart its future course.

This agenda of strategic measures, originally conceived as a "Letter to Lula" before the unfolding of Roberto Jefferson's accusations, dives deeply beneath the surface of today's scandals to search for the roots of the problems that threaten to destroy Lula's government.

We have witnessed scenes like this before in the impeachment of President Fernando Collor in 1992 and the scandal of the "dwarfs" in Congress that in 1993 revealed the corrupt allocation of budget amendments. We ask now: Why are our institutions paralyzed once more in a way that shakes the confidence of citizens in our democratic regime?

For Norman, the explanation is that we still have not learned how to manage an increasingly complex society. Our leadership, among the wealthiest 20% of the population who are the planters, industrialists and entrepreneurs, controlling government at all levels, on average have only 10 years of

schooling, much less than leaders in advanced democracies. Thus our elites are incapable of designing and managing a complex society. Our imperfect institutions lack the leaders and managers who know how to make them function well.

Learning how to deal with complexity is a gradual process. History provides us with examples of failure such as the South Sea Bubble of 1720 or of the Dutch in the Golden Age of the 17th Century, when corruption was widespread and systematic before declining with the advent of transformations brought by the Industrial Revolution.

Comparisons with similar or worse problems affecting Russia, China and India shed light on another feature of Brazilian life. In continental nations, with giant and heterogeneous populations, the "monster countries" described by George Kennan in his book, *Around the Cragged Hill*, it is harder to establish effective democracy because of the difficulty of adopting laws and uniform practices that can apply equally across heterogeneous regions and populations.

In the case of the "emergent monsters," there is another complicating factor. That is material wealth and the opportunities for illegal enrichment grow much faster than the improvement of regulation and the mechanisms for managing complexity.

Brazil fits well into the explanation that complexity and wealth expand much faster than the capacity to manage this abundance in an efficient and honest way. Thus Norman Gall is right in assigning priority to the quality of education as the crucial element for establishing a basic consensus against corruption. Apart from education, which needs time for us to appreciate its benefits, there is a chance to attempt to improve, more

immediately, our way of dealing with the more immediate causes of corruption.

Of all that I have read about these depressing scandals, a commentary in *The Economist* impressed me greatly and was cited in this issue of *Braudel Papers*. *The Economist* observed that, after Collor's impeachment, Brazil adopted several laws and regulations to impede repetition of those criminal practices. Apart from the new laws, mechanisms and institutions of fiscal control were created to prevent money-laundering such as the Finance Ministry's Council for Control of Financial Activities (COAF).

In this way, Brazil became one of the few developing countries equipped with an apparently complete arsenal of legal tools to reduce corruption in public life. However, neither the COAF, the Central Bank, federal prosecutors, the press nor the Accounts Tribunal had detected what was happening in the current scandals.

If it were not for a fight, a settling of accounts among gangsters, the scandal never might have been revealed. How can we explain the cumulative and complete failure of these expensive institutions? Can we blame guilty complicity, subservience to authority, incompetence, lack of human and financial resources to do the job or deficiencies in the legislation? There must have been some of all these ingredients in this indigestible brew.

The scandal probably is best explained from another angle. We could imagine that, after the spectacular adventures of Collor and of the budget dwarfs in Congress, repetition of these crimes would be immediately

detected by these defense mechanisms and that it would be much harder to commit these crimes. But what we saw was the amazing ease with which the PT and its allies managed to organize a vast and systemic network of corruption involving ministries, banks, state corporations, public service concessionaires and advertising agencies. And all this within two years!

Brilliant articles by ex-PT leaders like César Benjamin and Chico de Oliveira explain how a party inspired by leftist ideals allowed itself to be putrefied by greed born of the corrupting temptations in managing the Workers Relief Fund (FAT) and the huge resources of

How can we explain that our safeguards against corruption and looting the public treasury were of no use?

pension funds. All this is fascinating but leaves us without an answer to the basic question: How was it so easy to commit these crimes once the decision is taken to overlook the means to an end? How can we explain that the panoply of safeguards and defenses to protect the public treasury were of no use?

Little is spoken of these questions, although it is that we investigate with rigor where the faults and lapses are located in order to prevent this happening again. Some think that the cause of corruption lies in the financing of parties and in other defects of the political system. The truth is that

political campaign financing is a problem in nearly all democracies, yet what is not common is corruption in the degree and scope that prevails here. Party financing may be one but not the only motive for which politicians want money. But it does explain the ease and impunity with which these crimes are committed.

The general explanatory framework that seems broadest and most penetrating is the backwardness in learning how to manage complex societies. But we must understand now, without waiting for the long-term benefits of more and better education, why Brazilian laws and institutions designed to prevent corruption are not working well. Why is corruption not fought quickly and effectively?

The process of investigation is still work in progress, not having yet revealed crucial enigmas such as the origin of all the money that fed this machine for winning elections and approving bills in Congress. Until we detect these mechanisms, we never will understand how some pieces fit to give meaning to the design of this puzzle. It is for this reason that Norman Gall should construct a research agenda that, in the coming months, would enable the Fernand Braudel Institute of World Economics to continue this effort to create an action agenda of specific solutions for the problems of Brazil's political system.

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Exchange rates: Brazil's real gained in value since Lula's inauguration, from more than R\$3 to R\$2.30 to US\$1. Dollar equivalents cited here are estimates of value at the time of payments.

Jefferson Monteiro Francisco, a former gun-toting TV presenter and amateur singer of opera arias and Neapolitan songs whose accusations, embellished with theatrical flourishes and pauses, launched a political scandal that has nearly destroyed the government of President Luiz Inácio Lula da Silva and his Workers Party (PT). As if to prove his authenticity, Jefferson, as president of the right-wing Brazilian Labor Party (PTB), confessed that he had negotiated payments from PT leaders totaling 20 million reais (roughly US\$6 million) on behalf of the PTB, but indignantly added that he only had received R\$4 million in cash in two suitcase deliveries.

A master of both grandiloquent and gutter Portuguese, Mephistopheles later stressed, with theatrical gestures, the code of honor in politics, announcing that if the government had kept its bargain he would have kept silent. As it turned out, his disclosure led to cascading revelations of fraud, international money-laundering, illegal funding of election campaigns, bribing Congressmen for their votes, illicit government contracts and the stealing of large sums from municipal authorities and from banks, corporations and insurance companies owned by the federal government, as well as illicit investments by public sector pensions funds.

The essence of the old Faust legend is the failure to perceive limitations. Each such failure pays its price. As the old story is told, Faust was a magician and charlatan who bargained with the Devil to gain superhuman powers for 24 years. Then Mephistopheles, one of the seven princes of Hell, claims Faust's soul for damnation. The legend evolved over the past five centuries in popular storybooks, puppet shows, tragic dramas, poems, operas, symphonies and modern films and novels.

In Goethe's classic poem, Mephistopheles asks Faust:

Why do you enter into a bond with us if you cannot see it through? Did we force ourselves on you or you on us?

In its latest Brazilian version, the Faust legend is revealing itself in Congressional investigations and press disclosures as sordid bargains for heightened powers by Lula and the PT. These scandals threaten to end a spectacular career as well as dreams of establishing a hegemony for the PT akin to the seven decades of rule in Mexico by the Institutional Revolutionary Party (PRI). The means for achieving this hegemony was a reckless scheme of bribes and siphoning away of state funds through fraudulent and unsecured bank loans and government contracts. Like termites, politicians ate away at the structure and legitimacy of Brazil's democracy.

The hopes inspired by Lula have collapsed into a pageant of corruption, buffoonery and degradation. The mastermind of this pageant was said to be José Dirceu de Oliveira e Silva, the former strongman of Lula's government. Also changing identities like the original Mephistopheles, Dirceu was revolutionary student leader in the "generation of 1968" resisting military dictatorship, Cuban intelligence agent after undergoing plastic surgery while in exile in Havana, a clandestine career as owner of a men's clothing shop in a small town in Paraná and, from 1995 to 2005, the president of the PT and later Lula's chief minister whom Lula called "the captain of my team." A dour, tense, authoritarian firebrand who built the party organization and then assumed the day-to-day running of government, Dirceu developed the failed strategy of bribing small, corrupt right-wing parties to guarantee a working majority in Congress.

The Marx Brothers

The results were so disastrous that, according to one observer,

"perhaps the Marxism defended by José Dirceu was based on the works of the Marx Brothers and not Karl Marx." At televised hearings of the House Ethics Committee on June 14, Roberto Jefferson accused Dirceu of commanding the corruption schemes and peremptorily told him: "Get out quickly, Zé" to save Lula from disgrace. Two days later Dirceu resigned. Two months later, at another CPI hearing, Dirceu denied Roberto Jefferson's disclosure that the chief minister authorized agents of the PT and PTB to travel to Lisbon to organize a bribery scheme with Portugal Telecom. Mephistopheles/Jefferson responded melodramatically: "I am afraid of Your Excellency. Because Your Excellency provokes in me the most primitive instincts. I fear the consequences."

Day after day, week after week, the pageant of corruption and buffoonery, with its many ramifications, impacted the self-esteem of Brazilian society. The pounding of the media has been incessant. TV Globo's *Jornal Nacional*, the main news program of Brazil's leading network, reached 30 million homes throughout the country with a half-hour of scandal details every night. The big newspapers of São Paulo and Rio de Janeiro devoted 10 or 12 pages to the scandals every morning. The three weekly news magazines competed furiously for scoops. "You win readers with exclusive information and there aren't that many readers," said one editor. "So this is all becoming quite feverish and it has its own dynamic."

The key figures of the Congressional inquiry (CPI) – Roberto Jefferson, the greedy ad man who became banker to the PT and corrupt members of Congress; the ex-secretary who told all, political hacks, bureaucrats, intelligence agents, government contractors-became as famous as soap opera stars. The phones in the trading rooms of big banks fell silent as Mephistopheles launched his accusations in the CPI hearings.

People in big cities compulsively listened to the hearings on portable radios in crowded buses. This is Brazil's first political crisis of the digital age, with Internet blogs, email chain letters and sites such as www.e-indignacao.com.br that so far signed up 503,000 people for a "virtual" protest march on Brasília. The disbelief and indignation among the 53 million people who voted for Lula yielded to frustration at the lack of a political solution.

"We, the Brazilian people, are deeply shaken and indignant," wrote the Cardinal-Archbishop of São Paulo, Cláudio Hummes, who in the 1970s as bishop of the industrial suburb of São Bernardo had promoted young Lula's career as a union and political leader and the formation of the PT. "We [the Church] wish to contribute so as the people will not lose hope nor lapse into cynicism in this moment of disenchantment and indignation at corrupt politicians who threaten a government so much awaited and celebrated by the majority of the population that took pride, with reason, at having brought to presidential power a metal worker, a lathe operator, someone from the ranks of the common people."

Prodded by media revelations, three committees of Congress are conducting hearings and are being swamped by documentary evidence from subpoenaed bank and telephone records, tax authorities and investigations by the Federal Police and several prosecutors. They lack their own staff and budget to process all this information, relying instead on specialists seconded from the Central Bank and government agencies.

A Brazilian CPI, televised nationally, is very different from parliamentary inquiries in other democracies. The chairman and the rapporteur sit at a head table with the witness and his lawyer, facing a noisy crowd of senators and deputies talking to each other and on cell phones and

clamoring to appear on television in what often resembles an unruly classroom. Each committee includes representatives of the 18 parties in Congress and their alternates, some 70 in all. The hearings often last from 10 to 12 hours because of repetitive questioning and the insistence of legislators on using their 10 or 15 minutes of allotted time to make speeches.

All this would have dissolved into chaos if not for the pressures of public opinion and the dedication of a few key deputies, especially young former prosecutors who in televised hearings rose to prominence in Brazilian politics. Osmar Serraglio, the patient and meticulous rapporteur who formulated charges against 18 deputies involved in the bribery scandals, said that their expulsion depended on "circumstances of the moment when the charges are voted on by the full Chamber. Something happening on that day can change things. Historically, the expulsion of 18 deputies never happened before. But those accused are only a few if you believe that 150 got money," which only would be revealed "if a new fact occurred, another Roberto Jefferson."

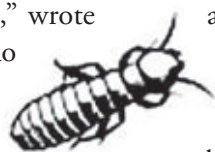
Public indignation feeds on the fear that the scandals will end in "pizza," a Brazilian codeword signifying political deals to absolve the guilty and leave things as they are. Deputies are applying pressure to escape expulsion from Congress, which also means an eight-year ban on participating in elections. Individual leaders facing expulsion threaten to "tell all" if they are not absolved, implicating dozens of others with them. Expulsion of deputies by the full Chamber is decided in secret balloting, which creates space for inter-party deals and for escaping accountability. But many politicians are reluctant to deal with the public rage that would be provoked by "pizza".

A lightning rod for this rage was

Severino Cavalcanti, a 74 year-old conservative from a small town of João Alfredo in the interior of Pernambuco. He unexpectedly was elected president of the Chamber of Deputies in February 2005 in the confusion created by the government's mismanagement of its relations with Congress, losing key votes despite having bribed several deputies. Controlling the Chamber's agenda, Severino maneuvered to delay processing of corruption charges and, in a newspaper interview appearing on August 30, suggested that bribed deputies facing expulsion might suffer lighter sanctions, such as censure or warning, if they could show that they used illegal money to pay campaign debts. Three days later Severino himself was threatened with expulsion after being accused of receiving monthly bribes of R\$10,000 from a concessionaire operating some of the restaurants in Congress. He resigned from Congress on September 21 in order to avoid expulsion.

In writing this essay, I have thought often of Serenus Zeitblom, the humble schoolteacher who narrates the tragedy of Thomas Mann's novel *Dr. Faustus*, witnessing the fate of Nazi Germany, having "failed, failed horribly in their last and uttermost attempt to find the political form suited to their particular needs."

Brazil is different from Germany and has had many chances. Yet most of us share the view of Mann/Zeitblom that democracy, despite anachronistic institutions, "is after all essentially in the line of human progress, of goodwill to the improvement of society and its renewal, alteration, rejuvenation; it shows that western democracy is after all capable, by its own nature, of a transition into conditions more justified of life." Brazil's own struggle with political form involves the quality of representation and education, which we will discuss more fully later in this essay.



“Watch with me!”

“Watch with me!”, Faust cried in his moment of greatest danger. “Forsake me not! Be about me at my hour!” Lula is now a lonely figure, neither feared nor respected, who may be saved by pity and by the caution of those concerned with the future of Brazil’s political system. People who believed in him, poor people, his people, are anguished and mystified by the sickening stories appearing almost daily in the press and televised Congressional hearings, stories of PT apparatchiks and their henchmen traveling with suitcases of cash to bribe politicians in the foolish presumption that these bizarre and childish schemes would never be discovered.

The essence of human tragedy is self destruction, an option of the privileged, involving contemplation and choice. Lula had his choices. What he did with those choices reflects a very complex personality whose spectacular ascendancy bred an arrogance that made him lose his moral compass.

Lula rose to the Presidency as a symbol of hope, a symbol of the changes achieved by Brazil with its new democracy. What moved us all was the spectacle of Lula’s inauguration in Brasília on January 1, 2003, with an adoring crowd swarming around the presidential Rolls-Royce, hysterical with joy and hope and solidarity with a man who began life as one of them, in the poorest conditions, and became a symbol of what the poorest Brazilians can achieve. And then Lula told them: “When I think back to the time when my family fled the droughts of the Northeast, when I sold peanuts and oranges as a boy on the wharfs of Santos and then became a lathe operator in factories and then a union leader who founded the Workers Party (PT), I see and know clearly and with conviction, as I now become Commander-in Chief of the nation, that we can do much more.”

He bathed in fame and

international adulation. According to *The New York Times*, “Luiz Inácio Lula da Silva, 59, “is the genuine article, a walking fable, democracy’s classic story, the poor boy who grew up to be president.” Shortly after he took office, the Bolivian newspaper *La Razón* called Lula “the new Latin American political star.” When he spoke at a conference on progressive governance at the London School of Economics, outshining the other participating presidents and prime ministers, the eminent sociologist Anthony Giddens proclaimed: “Lula wants to change Brazil, but I seriously think that he can change the world.”

With only fifth-grade schooling, Lula ran for president four times. He is a highly intelligent improviser with a talent for listening who has lived all his life with reading difficulties. A close associate says it is painful to see Lula, as president, struggle for an hour to read a single printed page. Lula likes to ridicule intellectuals, which at first may seem strange, since there are so many in the PT. “I say that politics has no secrets,” he said in Brasília a few days before his London speech. “If there’s one thing that nobody needs to know about politics, it’s a university degree.” Lula’s lack of effort to overcome his reading problem may be a matter of choice.

Another choice was his indifference to corruption. This involved an even more fateful choice: He handed over the reins of government to others while devoting himself to public relations, state visits around the world and barnstorming throughout Brazil making improvised speeches.

One of Brazil’s wisest and most respected senators, Jefferson Peres of the state of Amazonas, observed: “I voted for Lula and now think, contrary to what I thought then, that he was not prepared to be President. He lacks the notion that the Presidency of the Republic is the country’s most important institution. Lula likes the external side of things, the lighted stage, the state visits, inaugurating

public works, giving speeches, posing as a statesman. But he has an absolute inaptitude for the habit and routine of governing.”

Nevertheless, Lula’s record in office contains some achievements. Even before financial markets panicked at the prospect of his election in 2002, he had the wisdom to understand that the people of Brazil would not accept a revival of chronic inflation. He understood that the main thrust of government policy would have to be the maintenance of stability, upon which his political survival depended.

Brazil has been engaged in a long struggle, over the past 25 years during six presidential administrations, to achieve political and economic stability. Lula’s electoral triumph was the fruit of a long process of democratic consolidation and economic stabilization in Brazil, often opposed by the PT on ideological grounds, which nevertheless created conditions for access to power by a leftist party with a revolutionary program. When the Real Plan was announced, Lula warned: “On the face of it, the workers could lose 30% of their purchasing power.” As it turned out, poor people gained purchasing power with the end of chronic inflation.

The consolidation of stability and the revival of economic growth should have given Lula a decisive advantage in seeking reelection in October 2006. The decency and the sympathy he radiated led people to forgive the failure of his Zero Hunger program, touted throughout the world, and other social programs plagued by disorganization and corruption. Nor was efficiency enhanced by Lula’s tripling the staff of the Presidency and doubling the number of ministers to accommodate allied parties and PT candidates defeated in the 2002 elections.

Among his legislative victories are reforms of social security, the judiciary, bankruptcy laws and creation of Public-Private Partnerships (PPPs) to

finance infrastructure and banning of firearms possession by civilians, still to be confirmed in a referendum. He provided more access for poor students in private universities. Rapid growth in the world economy enabled Brazil to earn record trade and current account surpluses over the past two years. Some of these successes carried forward the work of previous governments. But Lula's victories were tarnished by disclosures of large cash payments to Congressmen coinciding with key votes.

“Moral patrimony”

Before Lula took office in 2003, the PT was admired for advocating ethics in public life, denouncing real and imagined scandals in previous governments. The PT's success contrasted with the decline of mass parties in most western democracies. It is the only Brazilian party that holds direct elections for party posts among its registered members, who doubled in number to 850,000 since Lula's election. The PT conducted internal elections in September 2005 in 4,600 municipalities with 120,000 candidates competing for 83,000 party posts. It built the strongest party machinery ever seen in Brazilian politics, which was very expensive. By comparison, other Brazilian parties were weakly organized. The cost of maintaining its organization was far more than what the PT could raise from the 10% tax it imposed on salaries of its office-holders. Moreover, PT sources said that Lula's 2002 presidential campaign cost roughly R\$200 million, 10 times more than was reported to election authorities and four times more than was spent by his closest rival.

While off-the-books payments and illegal transfers to and from clandestine foreign accounts long have been tolerated in Brazilian politics, the scale of these operations and the massive bribing of legislators with cash payments were new. The

many millions of dollars in illegal political payments shocked a nation with a monthly minimum wage of roughly US\$100 and where US\$500 a month is considered a lower middleclass income. Toninho de Barcelona, a leading black market dealer now serving a 25-years prison term, said that the PT has been laundering money overseas since 1989, the year of Lula's first presidential campaign.

During the 1990s, to finance its bureaucracy, the PT built a system of siphoning away funds from municipalities in São Paulo State that it governed, including the giant city of São Paulo, mainly through kickbacks on inflated contracts for consulting, garbage collection and bus service. The *mensalão* in Lula's government was basically an enlargement of the bribery scheme to control the City Council of São Paulo under its PT mayor, Marta Suplicy (2001-04). The PT also was funded by kickbacks from operators of the state lotteries in Rio de Janeiro and Rio Grande do Sul.

One of the first disclosures of this system was made by Paulo de Tarso Venceslau, a former student leader and urban guerrilla who participated in the kidnapping of U.S. Ambassador Burke Elbrick in 1969. In 1995, as finance secretary of the city of São José dos Campos, Venceslau warned Lula, then the party president, that the PT was accumulating secret funds (called *caixa 2*) from these municipalities through a consulting firm owned by his close friend, Roberto Teixeira, a lawyer whose apartment and weekend cottage Lula occupied rent-free for eight years. An internal PT inquiry found “alarming irregularities.” However, Lula protected his friend. Venceslau was fired from his city job and later expelled from the PT. “In this episode Lula was consecrated as a *caudillo* and the party fell on its knees before him,” Venceslau said. “This was mortal for the PT.”

Meanwhile, the PT is struggling to deal with the effects of the kidnap-

murder in January 2002 of Celso Daniel, the PT mayor of the São Paulo suburb of Santo André, who was slated to be Lula's election campaign manager. Daniel's murder has haunted the PT ever since. It was allegedly linked to disputes over siphoning of campaign funds from Santo André to the PT, involving senior party leaders who now are key members of Lula's presidential staff in Brasília. The medical examiner told prosecutors recently that his superiors had censored him from disclosing his autopsy finding that the mayor was savagely tortured before he was shot and dumped on an isolated road. Three years after his murder, Daniel's housekeeper told prosecutors that she accidentally found shopping bags full of cash in the service area of his apartment. João Francisco Daniel, the mayor's brother, testified before Congress and prosecutors that Gilberto Carvalho, then the mayor's chief secretary and now Lula's private secretary in Brasília, had told him and two other witnesses he had delivered R\$1.2 million in cash kickbacks from Santo André to José Dirceu at PT headquarters in São Paulo. Also unsolved is the murder in September 2001 of the PT mayor of Campinas, a city of 1 million people in São Paulo State, Antonio Costa Santos (“Toninho do PT”), an architect and city planner who was fighting garbage and bingo rackets and met resistance from drug dealers while trying to clear a crime-ridden favela.

The scandals caught up with Finance Minister Antonio Palocci, the former Trotskyite physician whose remarkable transformation made him the pillar of Lula's cautious economic policy. He was implicated in the ongoing investigation into corruption in the city of Riberão Preto, which Palocci ran as mayor in 1993-96 and 2001-02 before managing Lula's campaign. *O Estado de S. Paulo* observed that “it was just a matter of time before the Finance Minister's entry on stage to demonstrate the

process of putrefaction of the party that claimed a monopoly of ethics in politics.”

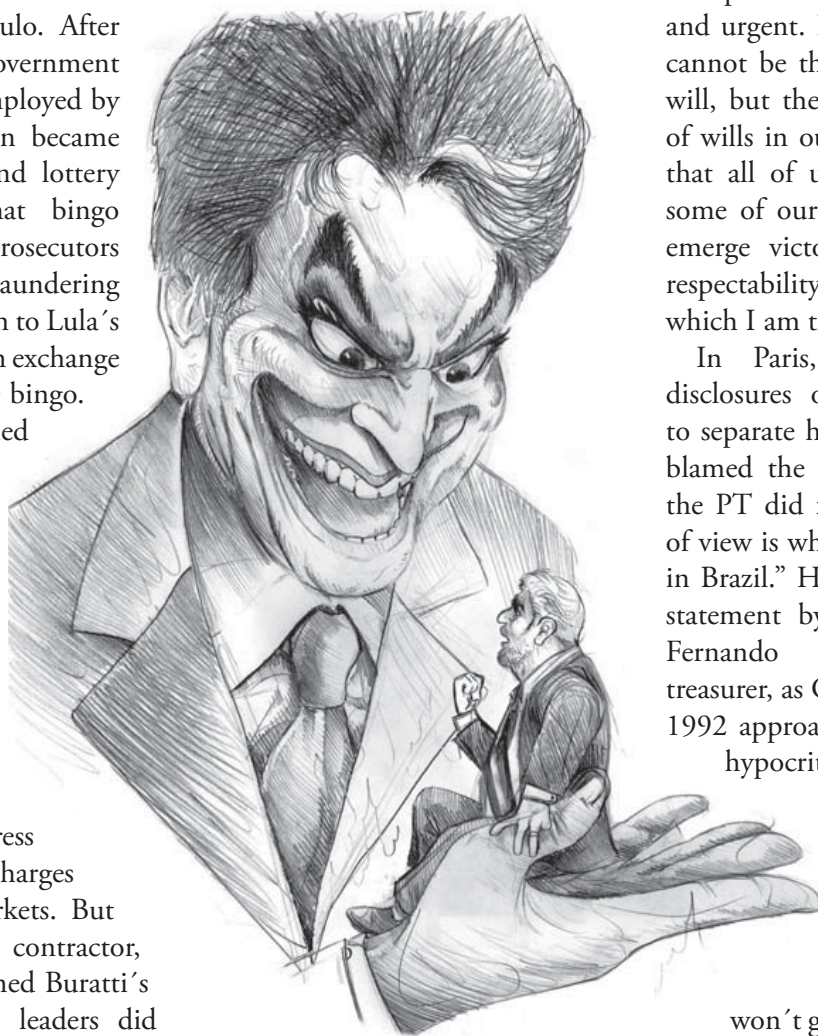
Rogério Tadeu Buratti, formerly Palocci’s righthand man in the city government, was indicted for defrauding garbage contracts, money-laundering and tax evasion. In a plea-bargaining session, Buratti told prosecutors that Palocci received R\$50,000 monthly from a garbage contractor to be forwarded to the PT treasury in São Paulo. After resigning from the city government in 1994, Buratti was employed by the contractor and then became a lobbyist for bingo and lottery interests. He said that bingo operators, linked by prosecutors to drug and money-laundering rackets, gave R\$1 million to Lula’s campaign in São Paulo in exchange for a promise to legalize bingo.

This never happened because José Dirceu’s chief legislative aide, Waldomiro Diniz, was filmed demanding a bribe from Rio’s leading numbers racket operator.

On August 22, two days after Buratti’s testimony, Palocci called a dramatic Sunday press conference to deny all charges and calm financial markets. But bank records of the contractor, Leão Leão, later confirmed Buratti’s allegations. Opposition leaders did not call for Palocci’s resignation, fearing the possible impact on Brazil’s financial stability.

In Paris, Lula told a TV interviewer that the PT had leadership problems “because there was a time when the best cadres of Brazil’s left were PT leaders. After we won elections as mayors, state governors, for Congress and the Presidency, many of our leaders went into government. So the PT leadership was weakened. Possibly for this reason we committed errors that we would not have committed

in the past.” Earlier, Lula privately expressed contempt for the PT and its internal feuds. “My party is shit,” Lula told a stranger on the eve of his triumphal 2002 election campaign. “The PT is made up of too many factions and classes of people that are always fighting with each other: labor leaders, ex-guerrillas, socialist university professors, public employees, professional politicians,



radical Catholics and Trotskyites. I don’t get involved in these fights and try to keep the PT together. I deserve better than this. I deserve to be the candidate of a broad front of parties. I never was ideological. I never read a book on Marxism in my life. You know, I never read any book in my life.”

Reelection?

Lula’s chances for reelection in 2006 were damaged by these

scandals, but the president pledged renewed efforts to overcome these difficulties. “I have a biography to preserve, a moral patrimony, a history of decades in defense of ethics in politics,” he told the Fourth Global Forum on Combating Corruption, speaking with reddened eyes, his coarse voice resonant with emotion. “It is evident that our institutions must be strengthened. It is evident that political reform is indispensable and urgent. It is evident that reform cannot be the work of one person’s will, but the product of a gathering of wills in our republic. It is evident that all of us will have to yield in some of our positions, for Brazil to emerge victorious. At stake is the respectability of our institutions, of which I am the principal guardian.”

In Paris, pressured by more disclosures of corruption, he tried to separate himself from the PT and blamed the political system: “What the PT did from the electoral point of view is what is done systematically in Brazil.” He thus echoed an earlier statement by P.C. Farias, President Fernando Collor’s campaign treasurer, as Collor’s impeachment in 1992 approached. “We are all being hypocrites here,” Farias testified in Congress. “Nobody complies with the campaign financing law.”

Inside the palace Lula told his advisers: “I won’t go to the slaughterhouse.” He became more belligerent as he traveled around the country, making speech after speech appealing for support from labor unions: “In this country of 180 million Brazilians, there may be equals, but don’t think that there is a man or woman that has the courage to give me a lesson in ethics, morality or honesty. In this country there is no one born yet who can give me lessons in ethics.” He told union leaders of pensioners that he would not “negotiate with the Devil for reelection... I will not stand

for reelection if it means auctioning ministries and not being able to improve the economy and distribute more income. If it means running a government the same or worse as this one, I won't be a candidate." But Lula was on the campaign trail the next day, wearing a leather helmet of a back country cowboy (*cangaceiro*) and weeping about his mother, telling a crowd in his home town in Pernambuco that, if he decided to run, "they [the elites] will have to swallow me again, because the Brazilian people will want me."

Lula often spoke of a conspiracy of elites trying to overthrow his government. But business, banking and opposition politicians almost unanimously oppose Lula's impeachment, although many say there are ample legal grounds for it. By removing the threat of impeachment, the opposition renounced use of the main lever of pressure against Lula. Meanwhile, the economy is doing well. Inflation is falling. Public finances are improving and international accounts show growing surpluses. Banks and foreign suppliers of hot money make huge profits lending to the government at the world's highest real interest rates, 14% above inflation. The money men fear that the fall of Lula also would mean the fall of Finance Minister Antonio Palocci, called "the pole that holds up the circus" by Delfim Netto, the cynical economic czar of the military regime (1964-85).

Brazil's political system seems to lack the self confidence to face the trauma of an impeachment like the one leading to the resignation in 1992 of Fernando Collor, who became the first elected president in Latin America's history to be impeached after discovery of a vast bribery and kickback scheme.

There are big differences between then and now. First, in 1992 widespread corruption had not yet been discovered in Congress, while today many members of Congress

benefited from the PT's much more ambitious payoff scheme, depriving Congress of the moral authority to impeach Lula on grounds of corruption. Second, the street demonstrations and rallies that orchestrated Collor's fall were organized by the PT and other major parties as well as PT-controlled unions, all of whom until now, for different reasons, have not mobilized their militants. Third, while Collor's scandals occurred during resurgent inflation as his shock therapy policy failed, Lula kept inflation low and could boast of resuming economic growth. Indeed, as the political crisis deepened, the economic news improved, with rising levels of private investment, formal employment and wages. Also, many politicians fear a backlash by what they see as a hard core of support for Lula among poor people. But Lula's "they will have to swallow me" speech in Garanhuns provoked a swift reaction. Senator Tasso Jereissati, twice governor of the Northeastern state of Ceará, voiced the indignation of the opposition Brazilian Social Democratic Party (PSDB):

We of the opposition have done what is possible to preserve the figure of the President of the Republic, a man whose political history merits the respect of all Brazilians. But the President, in his speeches, has exceeded the limits of what we can endure. It seems that the President of the Republic still has not understood the gravity of the facts involving his government that have led to a state of perplexity and stupefaction, nationally and internationally.

"Lulinha, paz e amor"

A few days later, two surprises worsened Lula's troubles. The biggest cash transfer revealed so far was R\$15.5 million to the political marketing firm of Duda Mendonça, who created the "Lulinha, paz e amor" media campaign for the 2002 election.

Lula had refused to be a candidate again, after losing three previous elections, unless the PT hired Duda as his marketeer. But after the election Duda had trouble getting paid. His partner, Zilmar Fernandes Silveira, signed receipts for cash after long delays and was summoned to testify at the CPI on August 11. But Duda himself made a surprise appearance at the CPI beside his partner, flying to Brasília in a private jet at 6 a.m. after several hours of grilling by the Federal Police in Salvador that ended at 4 a.m. A lover of cock fights and carnivals who became Brazil's most expensive political marketeer, Duda revealed that R\$10.5 million of his R\$25 million bill for Lula's media campaign was paid illegally in a money-laundering scheme using hidden funds in other countries, saying that, to get the money owed him, he was told to open an account under the name of Dusseldorf at BankBoston in the Bahamas. "We knew the money was *caixa 2*," Duda said. "We are not fools. We had to get it this way or we wouldn't get paid. We had no bargaining power, once the campaign ended."

The lavish payments to Duda from both leftist and conservative politicians reflect the huge cost of Brazilian election campaigns. Nearly one-third of the cost is for lavish television productions, some of which are never used. Brazil's 1994 campaigns for president, state governors and Congress was said to have cost US\$3.5-US\$4.5 billion, against US\$3 billion for the 1996 election in the United States, even though Brazil is a poorer country and a much smaller political market. Since then, over the past decade, the cost of Brazilian campaigns has increased enormously.

These huge election costs are bred by a chaotic and fragmented system of political representation. Brazil is one of the world's most decentralized federations. Large revenue transfers go to state and local governments

enjoying broad autonomy. Thinly-populated poor states are over-represented in Congress. An “open list” system of proportional representation in huge multi-seat districts forces candidates of the same party to compete with each other for funds and votes, raising the cost of elections and eroding party loyalties.

A new president usually assumes office with his party holding less than 20% of seats in Congress. The PT won 91 seats in the Chamber of Deputies, forming the largest bloc, but Lula’s nine-party coalition at first held only 220 of 513 seats. Election laws favor proliferation of small parties and frequent switching of allegiances. In the first two years of Lula’s administration, roughly one third of the members of the Chamber switched parties, several of them two or three times. Much of this switching of parties was encouraged by the PT to swell the ranks of allied parties. After a deal was made with the catch-all Brazilian Democratic Movement Party (PMDB), the government’s nominal support swelled to 341 deputies. But this support proved fragile, even though Lula gave thousands of jobs to the PT and its allies, because of the escalating claims of other parties and the failure of the PT to keep its promises, as in the case of Roberto Jefferson.

“I feel betrayed.”

As the scandals developed, Lula insisted that he knew nothing of the illegal payments. The day after Duda’s

bombshell testimony, under pressure to make a public statement, Lula made a short televised address, saying “with all frankness, I feel betrayed, betrayed by unacceptable practices of which I never had knowledge.” But on the same day the magazine *Época* published an interview with Valdemar Costa Neto, leader of the small Liberal Party (PL), who resigned from Congress after Roberto Jefferson accused him of receiving bribes from the PT to lead the PL into Lula’s coalition. Valdemar said Lula was present at a meeting on June 19, 2002 at the home of José Dirceu in Brasília to help settle an impasse over money.

“I began asking for R\$20 million in order to settle for R\$15 million,” Valdemar said. “Lula was in the next room. He knew we were negotiating numbers. I said: ‘Let’s settle for R\$10 million.’ Then Lula came in to authorize the operation. [Later] Zé Dirceu chose to operate with Roberto Jefferson. Jefferson always was with them, in Lula’s company. They got into this trouble because they wanted it. Jefferson is a character known in this market, with bad intentions, dangerous.”

Roberto Jefferson still wears some of the baggy suits he bought when he weighed 360 lbs. (170 kg.), before he underwent surgery to remove part of his stomach. Nevertheless, according to a TV audience survey, “the supposed villain stole the show and charmed the people. A criminal lawyer who takes singing lessons and has unlimited acting ability, the former fat man with horn-rimmed glasses seems to have emerged from the reality show, ‘Extreme Makeover,’

straight into the theater of televised Congressional investigations.”

A decade ago Roberto Jefferson won notoriety by leading the defense in Congress of President Collor against impeachment. He is one of those exotic personalities that occasionally rise to fame in Brazil’s political culture. Wearing a bracelet of *candomblé*, the Afro-Brazilian folk religion, he brilliantly defended himself with caustic humor at the televised hearings as he unveiled the system of bribes to Congressmen by the PT, known as the *mensalão*, that involved cash payments adding up to many millions of dollars. “It’s cheaper to pay an army of mercenaries than to share power,” he observed. “It’s easier to rent a deputy than to discuss a government proposal with him. He who is paid doesn’t think.” The main justification for these payoffs was the financing of campaign expenses. He said that he suffered “brutal pressure” from deputies of his own party who wanted more money.

Although his appetite for food shrunk, Roberto Jefferson’s hunger for influence was undiminished. First elected in 1983, after gaining popularity as “lawyer for the poor” on a daily TV program, Jefferson is one of the longest serving members of Congress, with an intimate knowledge of the political system. The PTB supported virtually every federal government over the past two decades while initiating little legislation. Half of its deputies have been indicted or tried for tax evasion, embezzlement or fraud. In the same election that brought Lula and the PT to power in 2002, the PTB elected only 26 members to the Chamber of Deputies. Within a few months, the PTB’s bloc doubled, in the promiscuous switching of parties endemic in Brazilian politics. In this way, the PT seduced deputies of minor parties to join those allied to the new government in order to form a Congressional majority. Less interested in ministerial posts



for himself or other PTB members, Jefferson concentrated on obtaining key executive positions in quasi-autonomous state corporations with large budgets subject to little supervision. These included the state reinsurance monopoly controlling \$800 million in deposits abroad, state electricity companies and the federal highway police in Rio de Janeiro, where PTB appointees got bribes for freeing confiscated truck cargoes. Other PTB appointments were in the postal service, where the troubles started.

In mid-May 2005, the magazine *Veja* published and posted on its website a videotaped interview on a hidden camera with a minor post office bureaucrat who casually pocketed a R\$3,000 (\$1,200) bribe. "There are three of us and we work together," the official, Maurício Marinho, said on tape. "We three are designated by Roberto Jefferson. It's a deal with the government. We name the director, an adviser and a department chief. I'm the department chief. The party knows about all the deals we close." Marinho provided more details to prosecutors on Roberto Jefferson's involvement in inflated contracts and fixed bidding in the post office and other agencies.

As the video clip was aired over and over on TV, Lula tried to defend his new ally, saying: "We must show solidarity with our partners." Lula and the PT failed in frantic efforts to block a CPI and then tried to distance themselves from Jefferson and the PTB by launching a police investigation. Then Jefferson gave a long interview to *Folha de S. Paulo*, outlining the huge payoff scheme, the *mensalão*, to bribe dozens of Congressmen. "I saw that the government acted to isolate the PTB," he said. "They'll have to cut off someone's head at the guillotine and throw blood and meat to the jackals. *Veja* said that I'm a human bomb. So what do you do with a bomb? You have to deactivate it or explode it. I see that they're

evacuating the vicinity to isolate the PTB to be exploded." Jefferson was ousted from Congress on September 14, with deputies voting in a two-to-one majority for his expulsion, despite the praise he received for exposing the deepening scandals.

Valério and Delúbio

The audacity of the schemes hatched by these men is stranger than fiction. The main bag man and fixer was Marcos Valério de Souza, 44, a tense, soft-spoken skinhead who dresses in black suits and ran 18 companies and 150 bank accounts. Valério's clutch of advertising agencies in the inland city of Belo Horizonte served as a conduit for money laundering and bribes to scores of politicians. Among the sources of funds was Lula's old friend and Secretary for Social Communications of the Presidency, Luiz Gushiken, a former bank employees' union leader, who tightly controlled the federal advertising budget and influenced pension fund investments.

Among other offshore operations, Valério sent R\$6 million to a Uruguayan front company, Garanhuns Empreendimentos, accused by U.S. drug authorities of laundering money for Mexico's Ciudad Juarez drug cartel. Although Valério was a little-known figure in Belo Horizonte before Lula's election, he grew rich so fast that he bought 13 thoroughbred horses for his teenage daughter and imported two Olympic riding champions from Switzerland and Belgium to train her for competitions. Valério's services to the PT included financing Lula's inaugural ball in January 2003 to paying the legal fees of a former federal chief prosecutor, Aristides Junqueira, to defend the PT in the investigation of the kidnap murder of Celso Daniel, the PT mayor of Santo André. Valério won an advertising contract for the Chamber of Deputies a week after making a cash payment of R\$50,000 to João

Paulo Cunha, the Chamber's PT president. His schemes were funded in different ways: (1) by "loans" from two politically-connected banks; (2) from inflated advertising contracts with government agencies; (3) by kickbacks from political influence in channeling deposits from Brazil's corrupt public sector pension funds into favored banks in Belo Horizonte, Banco Rural and BMG. These banks supplied funds to Valério for distribution to political clients under instructions from Delúbio Soares, the PT's treasurer who, Valério said, exhibited a "canine fidelity" to Lula and Dirceu. As the scandals multiplied, Lula let it be known that he had been "betrayed" by Delúbio.

Delúbio Soares is the kind of man who, like Lula and many others, rose from poverty through the apparatus of the labor movement and the PT to become an important political actor as the PT gained ascendancy. Delúbio was born in 1955 of a family of poor farmers in the municipality of Buriti Alegre in Goiás, the heartland of Brazil's vast Central Plateau. He showed a talent for numbers that compensated for childhood speech difficulties. At age 15 he went to study in Goiania, the state capital, at the Colégio Lyceu and the Catholic University, where he specialized in mathematics before becoming a school teacher. Delúbio soon became a leader of the teachers' union, freeing him of his teaching duties under Brazilian labor law. He then moved to São Paulo in 1984 to become finance secretary of CUT, the national labor confederation linked to the PT. He became Lula's constant companion and, in 2002, his campaign treasurer. Delúbio aroused suspicions when he paid R\$150,000 in cash to buy land near his family's home in Goiás. Childless and married to Mônica Valente, a PT staff officer, Delúbio is said to have devoted his life to the PT but now faces expulsion in light of the scandals. He proved the most recalcitrant of witnesses at the

televised CPI hearings investigating corruption.

Under Delúbio's guidance, Valério made cash payments of at least R\$75 million (roughly US\$30 million), mainly to politicians, from his accounts at the Banco Rural, a small institution where he had an advertising contract since 1995. Banco Rural has been almost continually in trouble with the Central Bank since it gained notoriety in 1992, when it hosted "phantom" accounts under false names as part of the bribery and kickback scheme operated by President Fernando Collor's campaign treasurer, P.C. Farias, that was said to have raised some \$350 million, never recovered. Valério assisted the Banco Rural in its successful appeals for reduced penalties at the Central Bank at hearings accompanied by National Treasury Attorney Glênio Guedes, who resigned soon after disclosure that he received payments totaling R\$2.5 million from one of Valério's firms. Another \$2.6 million went to a Rio de Janeiro politician, Manoel Severino dos Santos, president of the Casa da Moeda, which prints Brazil's currency. In 1984 Banco Rural opened the Trade Link Bank in the Cayman Islands and became heavily involved in a US\$30 billion money laundering racket, involving organized crime and hundreds of politicians of different parties, operated through the New York branch of Banestado [State Bank of Paraná] and an account under the name of Beacon Hill at J.P. Morgan. An investigation by Manhattan District Attorney Robert Morgenthau and the Brazilian Federal Police was reaching a climax in April 2003 when, shortly after Lula's inauguration, the Federal Police agent in charge of the inquiry in New York was suddenly withdrawn and sent to an obscure provincial post in southern Brazil. The agent, José Francisco de Castilho Neto, recently told *O Estado de S. Paulo* that the Banestado scheme "involved people from the highest ranks of the two governments [of Presidents Fernando

Henrique Cardoso (1995-2002) and Lula]. Today, I am convinced that this whole money-laundering scheme that we were so close to revealing was mounted mainly to send away from Brazil secret funds of the two parties."

Meanwhile, Congress was investigating Banestado, with a PT deputy, José Mentor, as rapporteur, who had played a leading role in organizing the mensalão in the São Paulo City Council. Mentor helped to smother the Banco Rural's role in the scheme, as well as the cases of other



Delúbio

Loredano / *O Estado de S. Paulo*

key figures, including Paulo Maluf, former governor and mayor of São Paulo who was indicted for holding at least US\$400 million in offshore accounts as the fruit of corruption, which prosecutors say may total US\$1.8 billion. The investigation also involved Ronan Maria Pinto, a bus company owner named in the corruption schemes in Santo André, whose PT mayor, Celso Daniel, was murdered in January 2002. During the Banestado inquiry, Mentor phoned Valério with a tip that led to

the hasty shredding of 25 folders of documents, according to Valério's former secretary. Payments totaling R\$120,000 were made to Mentor from the R\$50 million in transfers made from Valério's accounts in the Bank of Brazil. On May 14, as federal prosecutors revived the investigation, Mentor proposed an amnesty law in Congress for illegal transfers of funds.

Follow the money

The origins of all the money, estimated at R\$2 billion (US\$800 million), are still unclear. We must go far back into history to find a scandal embracing such scale and complexity, perhaps as far back as the fraud and bribery revealed after the collapse of the fevered speculation that drove the South Sea Bubble of 1711-20 in England, one of the biggest swindles of all time, compromising the royal family, several ministers and members of Parliament, leading merchants and stockbrokers. Or in Latin America, we must go back to the corruption in Cuba under President Carlos Prío Socorrás (1948-52), which paved the way for the rise of Fidel Castro. In Prío's cabinet were idealistic student leaders of the previous generation, like some of Lula's associates today, who had fallen into what the historian Hugh Thomas described as "the gangsterism and corruption which pervaded legislature and executive." The previous elected Cuban government of President Ramón Grau San Martín (1944-48) also awakened great hopes but proved just as bad. Grau's Minister of Education arrived in Miami after leaving office with US\$20 million in cash (roughly US\$180 million in today's money) in his suitcase.

Suitcases full of cash

Suitcases full of cash became all the rage in Brazil. Valério's ex-secretary, Fernanda Karina Ramos Somaggio, said that Marcos Valério was sending suitcases full of cash on private planes to be given to politicians in Brasília.

“At times they withdrew R\$1 million in cash from the Banco Rural,” Karina recalled. The cash withdrawals came, she said, on the eve of Marcos Valério’s meetings in Brasília and São Paulo with Delúbio and Sílvio Pereira, the PT’s secretary-general, in clownish schemes resembling creations of Cartoon Network.

Karina said that the advertising agency’s finance director, Simone Vasconcellos, had complained to her of getting tired counting money and handing cash to politicians in hotel rooms in Brasília. “On three occasions I carried the cash for Valério, twice to the Hotel Blue Tree Park, once in a taxi parked at a shopping center in Brasília,” Simone later told police. “I was worried about being identified by strangers and handing them large amounts of cash without knowing who they were.”

More shipments of cash in suitcases went to politicians in other states. On July 8, Federal Police at a São Paulo airport found R\$200,000 in a suitcase and US\$100,000 in cash in the underpants of an aide to the president of the State Assembly of Ceará, a brother of José Genoíno, national president of the PT, who quickly resigned. Police later learned that cash carried by the mule, or courier, was a kickback from a construction company for a R\$500 million contract it had won to build a high voltage electricity transmission line financed by the federal Bank of the Northeast. Three days later police at the airport in Brasília arrested João Batista Ramos da Silva, deputy from the conservative Liberal Front Party (PFL) and a bishop of the Universal Church of the Kingdom of God, who was trying to load suitcases full of R\$10.4 million in cash (US\$4 million) into a private plane. João Batista was expelled from the PFL the next day.

Shocks and reforms

At the time of the South Sea Bubble, British politics probably was

no less corrupt than Brazilian politics today. At the same time, England was desperate to achieve financial stability and consolidate its credit to pay for its many wars of the 18th Century. England then needed to lower interest rates and convert short term debt into long-term debt, just as Brazil has been trying to do since the foreign debt crisis of the 1980s and the surges of hyperinflation in the early 1990s. So England conducted a series of piecemeal reforms to modernize public finance and administration that lasted a century, enabling the Crown to borrow huge sums at low interest. In *The Sinews of Power: War, Money and the English State, 1688-1783*, John Brewer observed that “the shock of the South Sea Bubble and of the painful financial reconstruction that followed helped secure a high level of financial probity thereafter.”

In the same way, Brazil has taken a series of important steps since the foreign debt crisis of 1982 to modernize its public finance and administration. Over two decades, successive governments abolished open-end funding of the Bank of Brazil (*conta de movimento*) that was an engine of inflation. They fused monetary and fiscal outlays into a unified budget. They raised

the professional efficiency of tax collection and created the office of Secretary of the Treasury to manage public debt. They prohibited the Central Bank from lending to the government. They privatized corrupt and money-losing state banks. They established the office of independent public prosecutor and a Council for Control of Financial Activities (COAF) to detect money-laundering and other illicit financial transactions. In 2000 Congress passed a Fiscal Responsibility Law that establishes spending and credit limits on all levels of government. These innovations

still are incomplete and should continue. But they already make less likely a return to the chronic inflation of the 20th Century. Detection of the current wave of Brazil’s scandals was helped by a sophisticated financial system that easily tracks money movements. Banks are no longer allowed to honor checks made out to cash. So crooks were forced to carry large volumes of cash in suitcases and in their underpants. Most office buildings in Brazil’s big cities photograph and register all visitors. Surveillance cameras in public places, from airports to hotel corridors, record the movements of people. So it was easy to trace the comings and goings of politicians and their aides and relatives withdrawing cash from Valério’s accounts at the Banco Rural branch in a shopping center in Brasília.

But these mechanisms were activated only after the crimes were discovered. The bureaucracies produced few whistle-blowers. Public-sector auditors are overworked and beholden to their political masters. “This scandal came to light not because of Congress, Central Bank auditors or the efforts of the Federal Police,” said Gilberto Amaral, a tax consultant. “We know because someone involved in the corruption scheme talked. These are gangsters settling scores.”

This tragedy is still unfolding and its outcome is still subject to choice. *The Economist* blamed the current troubles on “the arrogant naivety of a party whose acceptance of democracy and capitalism was all too recent. Several of Lula’s fallen lieutenants appear to have carried into government two Marxist notions: that a self righteous end justifies unholy means, and that the party is superior to the state.” With all that said, the evolution of Brazil’s institutions in recent decades gives hope that this episode may drive further advances.





Rondonia, 1976 (Norman Gall)

2. The Happy Land

Despite all these troubles, Brazil remains a country of aspiration. Brazilians judge themselves by the political standards of advanced western democracies. However, their view of their own country oscillates, with wild mood swings, between triumphalism and despair. Lula complained often that Brazil suffers from a *herança maldita*, an accursed heritage, referring to the preceding government and also to an economy and society historically rooted in slavery and precarious settlement. Pessimism about Brazil coexists tenuously with the idea of Brazil as a happy land, the country of the future, a cornucopia of natural resources and many individual talents, with the wailing, throbbing pulses of a native popular music that reaches many lands, a world power for the 21st Century, the *patria* of Pelé and the only country to win the World Cup in soccer five times, a continental archipelago of communities speaking the same language and flying the same flag, untouched by great

wars, blending 180 million people of African, European, Asian and Amerindian stock without major outbursts of ethnic conflict.

Many people get few chances in life, while some get many chances. Brazil is a happy land because it has had many chances. Despite distortions and injustices institutionalized in chronic inflation, Brazil led all major economies in growth from 1870 to around 1980. Yet high rates of economic expansion have foundered since 1980 on institutional weaknesses leading to surging urban violence, recurrent debt crises and hyperinflation.

The list of Brazil's other institutional weaknesses is awesome. In education, barely half of pupils entering the first grade finish primary school and only 37% complete a secondary education, with functional illiteracy common in the higher grades. In São Paulo, the world's third-largest metropolis with 17 million people, 40% of all heads of households did not study beyond the fourth grade. One-fifth of all

births in Brazil are to adolescent mothers ages 15 to 19. According to the World Bank, the richest 20% of Brazilians, including the middle class, gets 65% of all income, against 2% for the poorest 20%. The concentration is so extreme that the top tenth takes 47% of all earnings. While the poorest fifth of adults average only 3.4 years of schooling, the dispersion of education among income groups is less shocking than the fact that the richest 20% of adults have completed only 10.3 years of school. It is hard to operate a complex society with an elite invested with so little education.

Nevertheless, it is hard for us today to recognize the Brazil of the past. In 1900, Brazil had only 17 million inhabitants, 90% of them in rural areas, with a life-expectancy at birth of 31 years and per capita income of US\$678 (1990 dollars). More than 80% were illiterate, against 11% today, which still is too high. Today there are 180 million Brazilians, 82% of them in towns and cities, with life-expectancy of 71 years and real per

capita income growing 10-fold to roughly US\$6,000.

“The first time I ate rice...”

The poverty of Lula’s childhood has become a living legend. The little boy of five with quick, glistening eyes who, many years later as a famous politician, looked back on his early life in the dusty village of Garanhuns in the back country of Pernambuco: “I remember that the first time I ate rice was when I was sick. I had a stomach ache so my mother bought rice for me as a kind of remedy. In those days, rice was a rare thing in our house. We lived on manioc and beans.” By today this kind of poverty has been greatly reduced. In 2003, seven million pensions were distributed to rural families, reaching 24 million people, or three-fourths of the rural population. Lula’s mother, dona Lindu, was a brave and resolute woman, illiterate all her life, who gave birth to 11 children, four of whom died in infancy. In those years, of every 1,000 children born in Brazil, roughly 200 died before their fifth birthday. Today only 34 such children die. Brazil still has many more child deaths than in rich countries, but far fewer than in the past. When Lula was a boy, only six million children were enrolled in primary and secondary schools, against nearly 40 million today, although the quality of schooling still is terrible.

The political system also developed. In 1872, only one million of nine million Brazilians were eligible to vote and only 20,000 did so. According to Richard Graham, “elections and violence often went together. While the result of elections often could be easily predicted at the national level, local struggles for certain men were of desperate importance.” Control of judges and police chiefs decided elections. Losers often were persecuted and winners gained patronage and influence. The total of federal, state and local jobs in 1920 was about 200,000, which equaled the votes

needed to win the 1919 presidential election. Since 1945, when Lula was born, Brazil’s electorate grew 19-fold, from 5.9 million to 119 million. But fiscal parasitism also expanded with the growth of the political system.

Today Brazil’s economy is 10 times as big as when Lula was a child. In 1950, when he was five years old, Brazil’s shortage of petroleum products was so desperate that even asphalt had to be imported to pave the country’s few highways. In those days, Brazil had only 3,000 kilometers of paved roads, against roughly 160,000 today, most of which, alas, are potholed and eroded for lack of maintenance and investment. Not only is Brazil now self-sufficient in petroleum but soon will be exporting from its new offshore discoveries of oil and gas. With its huge expanse of cheap arable land and sophisticated technology, Brazil has become an agricultural superpower. It has built the biggest and most productive industrial base in the Southern Hemisphere, with a talented entrepreneurial class absorbing new technologies, management and marketing techniques. Leading exports include jet airplanes, compressors, cars, buses and automotive parts. Today, Brazil is a rich, productive country, but it still has too many poor citizens.

Yet Brazil is a happy land because it continues to develop. Not only is Brazil the world’s 12th largest economy, but it is a crucible of longterm processes of modernization. Its dismal social statistics hide centers of excellence in both public and private life. Chronic inflation in the 1980s and early 1990s drove Brazil’s banks into pioneering development of a continental computerized payments system. This was adapted in creating electronic elections and vote-processing systems. The federal tax administration now receives 95% of returns via the Internet. These nodes of communication keep reaching deep into its heartland, animated by a fantasy of infinite expansion

peculiar to the frontier societies of the Americas.

The frontier mystique took shape in a precariously organized political structure, surviving behind barriers of distance, culture and law that isolated its vast interior from the rest of the world economy. Longterm economic growth came from rapidly expanding inputs of labor and land, fed by a virgin resource base of continental proportions. The frontier is expanding today in the *cerrados*, the enormous scrub forest spread over savannas the size of the Great Plains of the United States, which modern farming is transforming into the world’s most dynamic agricultural frontier, growing soybeans, cotton, rice, corn and cacao. Overcoming huge inland transportation difficulties, farm products now are being shipped to overseas markets on a new railroad to the São Paulo port of Santos and on a new high-tech barge system down the Madeira and Amazon rivers. The frontier made Brazil an ambitious country. Former President Fernando Henrique Cardoso (1995-2003) once voiced Brazil’s hope: “We are far from being a developed country, but we have something positive: the aspiration to be one of the developed countries. That’s what drives us, isn’t it?”

Three decades ago I published an essay, “The Rise of Brazil” (*Commentary*, January 1977), when I observed that “in a relatively short period of time, Brazil has become a new political force in the Western Hemisphere.” Since then, Brazil has gone through several difficulties and transformations: a foreign debt crisis, economic stagnation, transition from military rule to democracy, hyperinflation, gradual restructuring of public finances lasting two decades that helped to end chronic inflation, a huge increase in social spending to overcome poverty and injustice and an opening of the economy to more trade and investment. Over the past decade, Brazil has achieved political

and economic stability, confirming my belief of three decades ago that “the rise of Brazil has provided mankind with many challenges, not the least of which is preserving the character of the New World as a region of hope.”

In 2003 Goldman Sachs, a New York investment bank, boldly speculated that Brazil, Russia, India and China, together called the BRICs, “could become a much larger force in the world economy. If things go right, in less than 40 years, the BRICs economies could be larger than the G6 [France, Germany, Italy, Japan, Britain and the United States] in U.S. dollar terms. The big assumption underlying all these projections is that the BRICs maintain growth-supporting policy settings.”

Brazil, China, India, Russia

We may gain perspective by comparing Brazil’s assets with those of Russia, India and China, the other big “emerging” economies. One clear difference is that Brazil’s population, concentrated on a mainly flat and geologically stable land mass, suffers less from extreme weather and natural disasters, such as earthquakes, hurricanes, tsunamis and floods, than the other continental nations, where these disasters historically have killed tens or hundreds of thousands of people in a single event. Brazil is not plagued by the kind of ethnic, religious and linguistic tensions that afflict Russia, India and China. Those countries have educated more numerous scientific and technological elites than Brazil has, yet Brazil’s productivity per worker is much higher, because Russia, India and China have larger and more backward rural populations, less personal freedom than in Brazil and less access to natural resources. Although further progress is retarded by its wasteful and backward public institutions, Brazil has an extensive and efficient distribution system for goods, food and most services,

reaching the remotest parts of its huge territory.

Brazil is the world’s largest supplier of iron ore. Its alcohol program has pioneered large-scale production of fuels from biomass. Brazil’s huge forest plantations feed one of the world’s largest and lowest-cost paper pulp industries. Yet its population exerts less pressure on natural resources than in India and China. Brazil’s rivers, with enormous potential for generating cheap hydroelectric power, contain 13% of the world’s fresh water supply on a planet facing severe water shortages in coming decades. In per capita terms, Brazil’s fresh water supply is four times greater than in the United States and 20 times that of China or India. India suffers endemic electricity shortages because its politicized power sector is run by state governments that distribute electricity so cheaply or for free that they cannot invest in expanding capacity. Water shortages afflict more than 400 of China’s 600 cities, notoriously Beijing, with 110 of them suffering from serious shortages. Reduced river flows have cut hydropower output. Paper mills, petrochemical plants and smelters lack the water they need to operate continuously. Droughts, more common in northern China, have spread to the south as well. The Chinese and Russian people are aging faster. Russia is losing population, with mortality rising, because of declines in the quality of life over the past two decades. Brazil has been much more effective than Russia, India and China in controlling the AIDS pandemic. Its energy sources are more accessible and are larger than those of India and China, which are desperate for fuels to sustain their rapidly growing economies

Brazil’s financial system is much stronger than those of Russia, India and China. Brazil’s private banks developed agility and new technologies while adapting to chronic inflation and absorbed

windfall profits by investing in public debt at high interest rates. In a painful and expensive effort, Brazil privatized its money-losing state banks and either sold or refinanced failed private banks in the 1990s. While government banks make only 35% of all loans in Brazil, they dominate the economies of Russia, India and China. China’s giant banking system generates 9% of the world’s financial assets, fed by savings of 40% of GDP, double Brazil’s low savings rate. But China’s banking system is almost all government-owned, with 60% of its assets concentrated in just four state banks, while in Brazil they are spread more evenly among government banks (30%), private Brazilian banks (40%) and foreign banks (25%). In China, non-performing loans are variously estimated at up to 60% of all bank assets, while at Brazilian banks they are only 5% of the total. These comparisons show the strengths of Brazil’s financial system. However, this system is being weakened by persistence of the world’s highest real interest rates, benefiting banks and depositors, but impoverishing the rest of the country as two-thirds of bank credit invested in public debt, with the government paying as much as 9% of GDP in interest in recent years.

Over the past decade, Brazil may have been more successful than Russia, India and China in combating corruption, but that is not saying much. Corruption is a big problem in all four countries, independently of the level of democracy. Criminal elements penetrate public institutions. For example, of the 541 members of the Indian parliament elected in 2004, nearly one-fourth had faced criminal charges. While Brazil and India have developed strong democracies, the fragmentation of their political party systems weakens them, as politicians compete to distribute public goods among political interest groups while neglecting investments in human capital and productive capacity.



3. Brazil Needs a New Strategy

With all its assets and achievements, why is Brazil's political life so plagued by mediocrity and corruption?

As we have seen, Brazil has developed rapidly, but it still lacks the institutional capacity to manage problems of scale and complexity that only can be handled efficiently by an educated population. The failure to develop human capital is one of the legacies of slavery which is gradually being overcome. One sad aspect of the failure to develop human capital is seen in the response of the political class to the corruption crisis of Lula's government, generating many accusations but few proposals on how to overcome these difficulties. This is especially true of the opposition parties, who seem to think that they will benefit from the PT's disgrace without producing ideas or solutions of their own regarding the institutional problems that we have been discussing.

Corruption thrives on the opportunities provided by the failure to manage scale and complexity successfully. Belying the myth of their dedication to Carnival and football, Brazilians are a hard-working people that, unfortunately, still lack the skills to manage the complex systems spontaneously created by

a population that has multiplied tenfold over the past century, urbanizing fast and continuously incorporating a vast array of new technologies. Brazil now has 13 cities of at least a million people each and 32 cities with populations 500,000 or more within its huge territory. There are inefficiencies and injustices in all societies and political systems, but higher levels of education tend to reduce these institutional failures. Education tends not only to reduce corruption but also strengthens cooperation and endows people with capacities to develop other opportunities for themselves.

Brazil would have a brilliant future if its institutional blockages can be overcome. To be successful, a new strategy must mobilize support over a long period, sustained by a series of elected governments. It must provide credibility for a long-term program for strengthening public institutions and for realizing Brazil's potential. Some of these ideas were proposed by Felipe González, that great democratic leader of Spain and a new member of our Institute, who told us at a seminar in São Paulo last November:

In Latin America and especially in Brazil, we lack consensus, a

strategic consensus, to define a sustainable strategy that lasts beyond changes of government, beyond the constitutional terms of a legislature or a president. This cannot be a consensus on too many issues, for that would be too complicated. But a consensus on three or four issues could mobilize everyone's efforts. All developed countries have this kind of consensus on issues that unite people and remain outside the arena of debate. These elements of consensus enjoy a kind of permanence that strengthens countries. This kind of consensus is especially important for development of human capital. The failure to develop human capital is a source of great anguish. Even in countries with abundant natural resources such as petroleum, there is no possibility of development, there is no future, if the nurturing of human capital is neglected.

A long-term consensus is needed because it takes decades to consolidate progress in key areas such as education, infrastructure and political reform. To avoid political fragmentation and disorder, a stronger democratic center must emerge with a coherent and credible program of innovation in both policy and process. An alliance

focused on this program might support these ideas:

1. A strategic consensus to develop high quality education and infrastructure as longterm government priorities.

2. Break the impasse in social policy that blocks more investment in education and infrastructure.

3. Congress enjoys broad powers with few responsibilities. Its sense of responsibility would be reinforced with Senate confirmation of all cabinet-level presidential appointments. Today in Brazil, only ambassadors, Central Bank presidents directors and heads of regulatory agencies require senatorial approval. Senate confirmation would provide closer scrutiny of political nominees, inhibiting both scandals and rapid turnover in sensitive positions. All these appointees should be free to name their own subordinates at the policy level. The pacting parties should agree on naming qualified professionals to head technical ministries such as Energy, Transport, Social Security, Health, Education and Justice.

4. Broad political reform. After more than a decade of deliberation, the Political Reform Commission of Congress recently proposed legislation providing for public financing of election campaigns and strengthening party discipline. A system of primary elections should decide contested party candidacies. Election districts, now statewide and citywide, should be reduced in size to uniform population units, making legislators responsible to a specific and coherent body of voters. Under present law, no such responsibility exists. In the City of São Paulo, for example, all 55 members of the City Council are elected at large by seven million voters choosing among several hundred candidates who have no clear constituencies. Budget amendments favoring individual constituencies and members of Congress should be made illegal, restricting perverse

incentives that corrupt the behavior of Congress and the Executive. A threshold of 5% of the national vote in at least onethird of the states should be required for representation of any party in Congress, as mandated in new legislation for the elections to be held in 2006.

5. Financing of election campaigns has been cited many times as the motive for corruption, in Brazil as in many other democracies. There is no single solution to this problem, but some partial solutions would help to reduce the level of chronic corruption. The Political Reform Commission of Congress has proposed public financing of election campaigns. But this is not enough. All parties and candidates should publish their accounts on the Internet to enable the political system to police itself. Also, the staff and budget of election authorities should be expanded to permit more effective supervision and review of the thousands of campaigns conducted every two years.

Enactment of reforms like these depends on how shamed Brazilians have become as a result of the recent scandals and how desperate they are to secure their long-term future. As Machiavelli wrote five centuries ago:

...such reforms are never effected without danger, for the majority of men never willingly adopt any new law tending to change the constitution of the state, unless the necessity of change is clearly demonstrated; and as such a necessity cannot make itself felt without being accompanied with danger, the republic may be destroyed before having perfected its constitution.

Impasse in social policy

Development of a strategy for the future of Brazil is blocked by the *herança maldita* of the impasse in social policy. Because of spending rules mandated by the 1988 constitution soon after the end of military rule, Brazil generated one of the biggest

short-term surges in social spending of any nation in history. Brazil spends one-fourth of its GDP on social programs, a higher share than in richer countries like Spain, Canada, Japan, Australia and the United States. These programs absorb two-thirds of federal spending, excluding interest payments. Between 1987 and 2002, transfers to individuals grew by 344%. However, this social spending tends to elude the poor. Most researchers agree that the end of chronic inflation in 1994-95 was more effective in reducing poverty than any social program. A study by specialists at IPEA, a government research institute, found that spending on social programs since 1995 has failed to reduce the portion of Brazilians living in poverty and extreme poverty. Deaths of children under age five have been at the same level since 1990. Ricardo Paes de Barros of IPEA caustically observed: "If all the money spent on social policies in Brazil were simply thrown out of a helicopter, the poor would have a better chance of benefiting than by the way it is spent today."

How productive has this huge increase in social spending in Brazil been when compared with other Latin American countries? In 2000-01, Brazil spent about as much per capita as Chile on education, health, social security and housing, five times as much as Peru and the Dominican Republic, three times as much as Colombia and twice as much as Mexico. However, advances since 1990 in social indicators such as infant mortality, educational achievement, life-expectancy, housing and sanitary conditions and household income have been no better than in countries spending much less on social programs.

Why has this surge in social spending been so unproductive? According to the Finance Ministry, spending on pensions, representing 73% of all monetary transfers by the central government in 2002, has a

regressive profile, with most resources appropriated by the wealthiest households. Over the past decade, Brazil gradually increased taxation from 24% to 37% of GDP to maintain stability, equaling the tax burden of much richer countries. Of all taxes, 45% support social programs, mainly social security, with no impact on reducing poverty or inequality. Of all employed people, 60% are not covered by social security, remaining in the informal sector. Taxes to support unproductive social programs are so onerous (35% of payrolls) that employers are reluctant to hire.

“Brazil is an exception to international trends, by which a high tax burden is associated with more equal income distribution,” the Finance Ministry observed. “In other words, Brazil is a country with relatively low per capita income that has achieved a level of taxation as high as rich countries. Nevertheless, contrary to what happens in rich countries, Brazil has not been able to use its tax system and social spending to affect its extreme income inequalities.” Minimum income transfers to the poor amounted to only 1.7% of all transfers, which raised their incomes on average by only 0.4%. The richest fifth of Brazil’s population gets 61% of pension spending, against 26% in the United States. Brazil spends 12% of GDP on pensions, more than Britain, the Netherlands, Spain, Japan and the United States, although those countries have much older populations.

Comparison with Spain is especially revealing. While in Spain 45% of pensions go to people over 70, in Brazil the largest share (40%) goes to pensioners between ages 40 and 60. Taxes and transfers reduce inequality by only 14% in Brazil, against 50% in Europe. Without these redistribution policies, inequalities in Europe would be nearly as severe as in Brazil. While only 6.5% of Brazilians are over age 65, social programs and policies favor old people over the young, who are

deprived of a decent education.

According to the World Bank: “Social security is the single most important fiscal issue facing the federal government and subnational governments in Brazil today.” A young country, Brazil spends more on its 24 million retirees than on the 50 million attending primary and secondary schools and universities. Of the 24 million retirees, roughly 40% of the pension spending goes to only three million former public employees. Between 1993 and 1998, the number of private sector retirees receiving government pensions rose by 90%, increasing at an 11% annual rate, a surge without precedent in international experience, while the average retirement age fell from 54

Improvement of public education is the best way to promote social justice

to 49 years. In no advanced country are people allowed to retire so young and at full salary. When the rules changed to limit this growth, the number of new retirees on disability pensions more than doubled from 1999 to 2003, a symptom of the corruption that has plagued the social security system. If present trends continue, social security deficits will grow from 5% of GDP today to 10% by 2030, excluding badly needed investments in infrastructure and education. Explained in another way, the accumulated social security deficits from 1995 to 2005 amount to roughly R\$1 trillion, including interest payments, a sum equal to the whole public debt.

None of these problems of social policy are easy to solve. All specialists agree that social programs to sustain

the very poor are necessary and sustainable. The main problem is that the pension system puts Brazil on the path of collective suicide, draining the country of resources needed for investment for its future development. Since passage of the 1988 constitution, which greatly expanded social spending, public investment has fallen from 4% to 1.5% of GDP with the added burden of large interest payments on the public debt. Solutions probably will be gradual and applied over time. They are simple, obvious, widely discussed and always meet ferocious political resistance.

1. Raise the retirement age. Because of improving health and life-expectancy of the population, the fiscal problem of social security can be overcome by raising the retirement age to 65 and eliminating special provisions, such as allowing women to retire five years earlier than men.

2. Decoupling pensions from the minimum wage would reduce the fiscal burden created every time Congress approves a big raise in the minimum wage, as it did this year. Pensions could be adjusted by the consumer price index or according to trends in average wages throughout the economy.

3. Provide more resources and manpower for the social security system to combat fraud and corruption. These resources have been cut in recent years, reducing the system’s investigative capacity, which had produced promising results in earlier times.

Education

Shortly after the 2002 election, I published an article in *O Estado de S. Paulo*, “Lula, the educator,” voicing this hope: “The terrible performance of Brazil’s public schools threatens the country’s future. Lula, who only finished five years of primary school, became a symbol of social mobility who could become our great educational president. Improvement

of public education is the best way to promote social justice.”

There is no way for Brazil to manage a complex society efficiently without a dedicated strategy for strengthening the quality of education. To operate an increasingly complex society, we need more and better specialists and professionals: engineers, teachers, managers, doctors, nurses, accountants, policemen, machine operators and software programmers that only better education can provide. Brazil spends 12% of its GDP on pensions, what European countries pay for pensions for much older and richer populations. If pension spending could be cut by only 1% of GDP, spending per pupil in primary and secondary education could increase by more than 25%. Today Brazil spends only US\$150 per year for each pupil in the Northeast and US\$400-\$500 in Rio de Janeiro and São Paulo. It is very hard to improve schools and teaching with so little money.

In Brazil, because of very generous pensions, poverty tends to be concentrated in children rather than old people. Children have less chance to develop their capacities so that they can earn a better living in the future. In 1950s Korea was seen as a hopelessly poor country, much poorer than Brazil, but today Korea is much richer, developing and exporting advanced products that are beyond Brazil's capacity. One reason why Korea is richer is that it spends only one fourth on pensions than it spends on education, while Brazil's pension spending is double its education investment. More than the money Korea spends on education, its effort is driven by family motivation and attention to quality and diligence at all levels. Brazil's failure to invest in primary and secondary education is reflected in the results on nation-wide and international examinations that show how little pupils are learning in school.

Over the past decade, there

have been big advances in school enrollments, but the poor quality of instruction condemns millions of young people to a life without useful access to the printed word. Brazilian students ended in last place in reading and mathematics among 15 year-olds in 32 countries tested by the Paris-based Organization for Economic Cooperation and Development (OECD). Reading below Level 1, the lowest performance standard, were 56% of students in Brazil, 50% in Chile, and 44% in Argentina and Mexico. A Brazilian supervisor of the exam found that many Brazilian students could not even read the questions. The Education Ministry's National System for Evaluating Primary Education (SAEB) found no gains in pupil learning since 1991. Despite all these deficiencies, Brazil is a country of aspirations. Brazilian 15 year-olds ranked highest among students of 31 countries in their levels of occupational ambition, aspirations undermined by the quality of their schooling.

In our Institute's work in organizing Reading Circles in the public schools of São Paulo's periphery, we found that many schools are plagued by chronic disorganization. Schools commonly change principals every year, several of them two or three times a year. The endemic absences of teachers leave idle pupils to congregate and play in the corridors, creating an infernal noise that impedes work in classrooms where a teacher is present. Most teachers are too busy to learn their pupils' names, calling attendance by numbers assigned to each child. Most teaching is done with the teacher's back to the class, writing at the blackboard for pupils to copy mechanically without any explanation or discussion. These behavioral patterns are accepted as norms. Parents often feel impotent as their children remain illiterate through the fifth or sixth grade. Episodes of parental pressure for improvement are rare because they lack access to school

authorities. Most work long hours. Many only have two or three years of study in rural schools, so it is hard for them to evaluate how their children learn in school. There are some good public schools, but they are a small minority.

Brazil needs a new strategy, supported by a national consensus for improving primary and secondary schools. Here are some ideas:

1. Create a national corps of master teachers, earning salaries equivalent to senior federal bureaucrats, chosen by competitive examination and independent evaluation of their classroom practice. These master teachers would undergo special training for one or two years in groups of 1,000 at a new National Teaching Institute, where they would take intensive courses in methods of teaching reading, mathematics and social studies, seeking to improve the quality of content. Because of the large public investment in their high salaries and special training, these master teachers normally would be eligible for retirement only at age 65.

2. The numbers of master teachers would grow over several years. They would concentrate their efforts on improving teaching in poor communities through special courses for teachers and continuous evaluation. They would be supported by funds for libraries and special teaching materials. They could advise state and municipal education departments but could not accept bureaucratic positions. They would be subject to continuous evaluation and would return to the National Teaching Institute every five years for further training.

3. Establish a national teacher accreditation program with high standards and salary premiums for those who qualify.

4. Establish a federal program for public schools in metropolitan regions, developing new methods to improve school security, changing laws and regulations to reduce teacher

absenteeism and creating financial incentives to attract qualified teachers to schools in poor neighborhoods.

5. Tens of thousands of promising Brazilian high school graduates and university students are too poor to continue their education. This potential talent could be mobilized in a scholarship program under which, with special training, carefully selected candidates could teach in primary schools in poor communities for a minimum of two years. Every year of satisfactory teaching would earn the right to two years of university scholarship, including living and travel expenses.

6. Expanding the system of technical training schools and creating two-year community colleges for high school graduates.

7. Evaluation of learning results is traditionally opposed by teachers' unions and administrators in many countries because it may reflect badly on their job performance. Good performance should earn rewards. In the 1990s an ambitious program of testing of primary, secondary and university students began. However, results are not published for individual schools, teachers and pupils. Consumers of education, mainly parents and students, need to know these results for self-evaluation and to stimulate emulation among teachers and schools.

8. Declining fertility trends in recent decades have reduced demographic pressures, creating opportunities to extend and improve education of young children. A large body of research shows that pre-school education improves the learning achievement of children in later years. In pre-school they learn cooperation and adaptation to a classroom environment and start climbing the ladder of literacy. After pre-school, children should begin primary schooling at age six instead of age seven, as now required.

9. Reduce the imbalance in funding per student between primary and



secondary schools and universities. Calculated in constant purchasing power dollars by the OECD, Brazil spends only one fifth as much for primary school pupil/year and one-sixth as much per secondary pupil as Britain, but spends nearly 50% more per student/year than Britain at universities. However, 40% of the budget of Brazil's federal universities goes for pensions.

Infrastructure

Advanced levels of education and infrastructure are the two basic needs for efficiently managing complex societies to ensure the fair distribution of benefits at reasonable costs. Highly trained and well-paid specialists are needed to achieve fairness and efficiency in production and distribution of public goods such as transport facilities and electricity, especially in a complex democracy like Brazil, that embraces a continental territory with hundreds of cities and remote production sites. Creating and managing modern infrastructure means mastering

complex legal, financial, engineering, regulatory and accounting issues in the public interest.

Brazil needs big advances in the development of human capital to avoid scandals and waste that degrade rather than improve living conditions. Only a democratic consensus on reallocating resources can make the investments and create regulatory and legal structures needed to achieve these advances.

Brazil's infrastructure needs more investment and better regulation to modernize and expand networks of transportation, communications, public sanitation and energy supplies. The government estimated that US\$100 billion in infrastructure investments would be needed in 2000-07 to support yearly economic growth of 4%.

Brazil is endangering future development by failing to invest enough, both in public works and, given budget restrictions, project concessions to private investors. Partial privatization of ports, railroads and highways, as well as ending the commercial air transport cartel, has led to progress over the past decade. But in recent years this progress has stalled under the weight of political disputes, lack of public investment funds and absence of a clear legal and regulatory framework for private investors. President Fernando Henrique Cardoso lamented:

The potholes make life difficult for motorists, increase fuel consumption, wear out cars, delay freight deliveries and, this part is dramatic, cause accidents and deaths..... The federal government cannot care for all its highways. It has been proven that private enterprise can maintain part of the system. This is happening on roads linking Rio de Janeiro and São Paulo, Rio de Janeiro and Teresópolis, Rio and Juiz de Fora, Osório and Porto Alegre in Rio Grande do Sul and the Rio Niterói

bridge. And you who have driven on these stretches can testify to the fact that the toll paid guarantees better roads. We will continue to privatize and to transfer stretches of road to the states.

However, in the eight years of FHC's administration, no new highway concessions were made to private operators, with 98% of the network still in government hands. While private operators improved the internal efficiency of the ports, despite featherbedding by unions, long lines of trucks, bringing exports from thousands of kilometers away in Amazônia and the *cerrados*, wait for days outside the port of Santos, Latin America's largest, for lack of rail and road capacity entering the port. And the stability of electricity supplies for a growing economy has been jeopardized by the legal and institutional quagmire that prevents new investment.

The cost of logistics absorbs 20% of GDP in Brazil, twice as much as in advanced countries. These costs can be divided in several ways. Inefficient logistics means higher costs for inventories and warehousing throughout the economy. Domestic freight transportation is largely in the hands of unregulated and largely informal truckers providing low-quality service, plagued by cargo theft and overcapacity, with empty return trips over long distances preventing them from making a decent profit. The poor condition of the 55,000 km. of federal highways delays deliveries and raises trucking costs by up to 30%.

Paved roads are crushed by overweight trucks that cause cracks in the pavement into which water seeps over time until the pavement collapses. The Transport Ministry calculates that excess truck cargo of 20% to 30% can reduce the useful life of a road by 60%. The federal highway system is equipped with 70 scales to weigh truck loads, but only



six of them are working. The federal highway network could be improved and maintained at an annual cost of \$300 million over four years, reducing vehicle operating costs by \$500 million yearly, which in practical terms only can be done with more private road operation and maintenance concessions. The World Bank estimates that solving these transportation problems could raise GDP by 2%. In other words, Brazil's economic growth could have been 7% in 2004 instead of 5%, creating more jobs and other opportunities.

Solving infrastructure shortages and bottlenecks involves overcoming legal and technical issues in different areas. But there institutional solutions available that gradually could meet some of the most pressing needs over time:

1. One of the most pressing needs is for highly skilled, politically independent specialists to staff regulatory agencies. To overcome this shortage, Brazil should establish an Institute for Regulatory Studies in Brasília providing courses of one or two years for engineers, accountants, lawyers and economists to acquire the specialized knowledge needed to staff regulatory agencies.

Graduates of this Institute should receive premium salaries, equivalent to those of members of Congress. The Institute should help to build regulatory agencies capable of developing and enforcing effective regulations. This could include designing and enforcing concession contracts and increasing regulatory transparency and credibility, defining vague legal concepts like "financial equilibrium" that cause uncertainty among investors. The Institute could help regulatory agencies develop accounting and information standards, cost and financial models for setting tariffs and benchmarks to compare productivity and efficiency among concessionaires in Brazil and in other countries.

2. Without regulatory agencies that are independent from political influence, improving staff quality will not work. Directors of these agencies should continue to hold staggered terms of office separate from the electoral calendar.

3. Consolidate land transport regulation into a single agency with a mandate to issue new concessions to private operators of ports and highways. This agency could operate successfully only under clear statutes and rules, with swift and impartial

mechanisms for appeals to prevent extended court litigation.

4. Privatization should be accelerated in the energy sector to avoid the political influence and corruption exposed in the recent scandals.

5. Ensure that the gasoline tax (CIDE) is used for investment in road maintenance, the statutory purpose from which it has been diverted by politicians in recent years.

6. Establish an Infrastructure Investment Fund, following a master plan approved by Congress every five years, financed by the national development bank (BNDES) and international agencies recycling debt

repayments, under joint control of Brazilian and international funding agencies.

* * *

“Brazil does not deserve all that is happening,” Lula said in Paris, inaugurating the “Year of Brazil in France” as the scandals were multiplying. “It deserves much more.” Many people would agree. But institutional innovations are needed to avoid ordeals like this in the future. By focusing on the long-term priorities of education and infrastructure, Brazil could achieve the efficiencies that would enable us to advance faster toward

better managing its complex society, gradually solving other institutional problems not mentioned in this essay, such as public security, health care, the judiciary and the devastation of Amazônia, as well as the plague of corruption. Brazilian society can gain self-confidence only by investing in its future instead of its past, in capacity-building strategies like education and infrastructure instead of in the fiscal parasitism bred by an archaic political system. Only by pursuing new institutional strategies based on broad political consensus can Brazil overcome the traumas and failures that have afflicted us over the past few months.■

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