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**Institutional Development beyond the Crisis: The  
Public Decisions in Brazil**

**An Analysis from Within by  
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## INTRODUCTION

The grave context of the economic and political crisis of Brazil has caught the attention of many various media throughout the world. Economic imbalances are associated with political factors in a situation so dramatic and self-reinforcing that many national and international analysts came to believe in the complete paralysis of the country, given the profound institutional difficulties that have emerged since the end of 2014.

This article seeks, first, to consider the roots of the current crisis in order to then identify, through an analysis of the performance and activities of inspection and control institutions responsible for combating illicit practices in the public sphere, the extent to which important advances have been developed within this critical period. In summary, it attempts to answer whether, in fact, signs of paralysis do exist at the level of institutional dynamics, or whether it is possible to observe advances that will permit the country to emerge stronger at the end of this process.

Understanding the details of this context and its respective advances becomes essential for Brazil to be able to see, in the current crisis, opportunities to continue fostering important institutional developments such as those which have been presented during recent years.

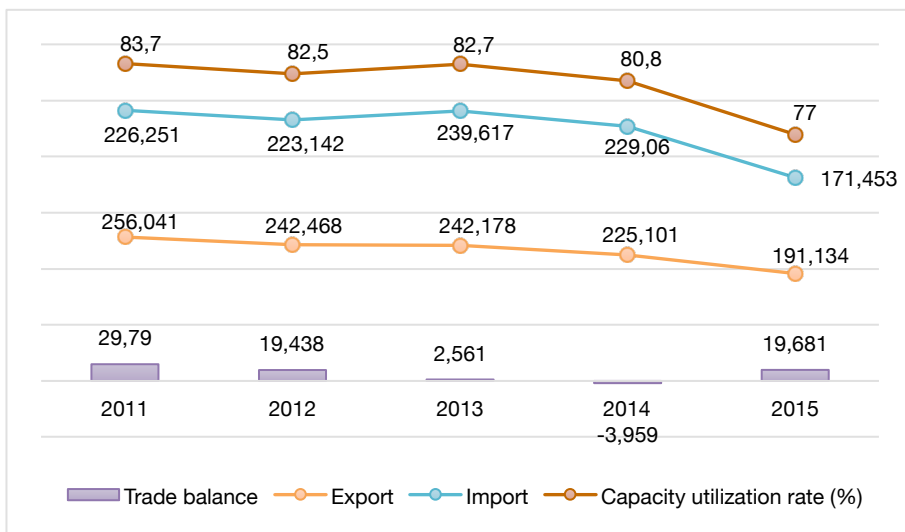
## THE ORIGINS OF THE CRISIS

To comprehend the situation of economic crisis currently under way in Brazil assumes the understanding of a number of political decisions taken in the face of unfavourable external and internal factors, such as the strong global economic downturn, the decline of international trade and the exhaustion of an internal consumption cycle based on the increase of employment, income and credit. These have resulted in the reversal of a fruitful and beneficial economic dynamic that was characterized by the strong growth of international prices of commodities along with the

adoption of important social policies,<sup>1</sup> especially during the period from 2004–11 (Figure 1).

### Figure 1 – Brazilian trade indicators (2011–15, US\$ billions).

Source: Based on data from the Ministry of Development, Industry and Foreign Trade (MDIC) (2016) and Trading Economics (2016)



In an effort to boost economic growth in the face of this cyclic slowdown, since 2012, the administration of President Dilma Rousseff has intensified the adoption of policies designed to stimulate private investment through the implementation of tax exemption measures and tax subsidies in specific economic sectors.<sup>2</sup>

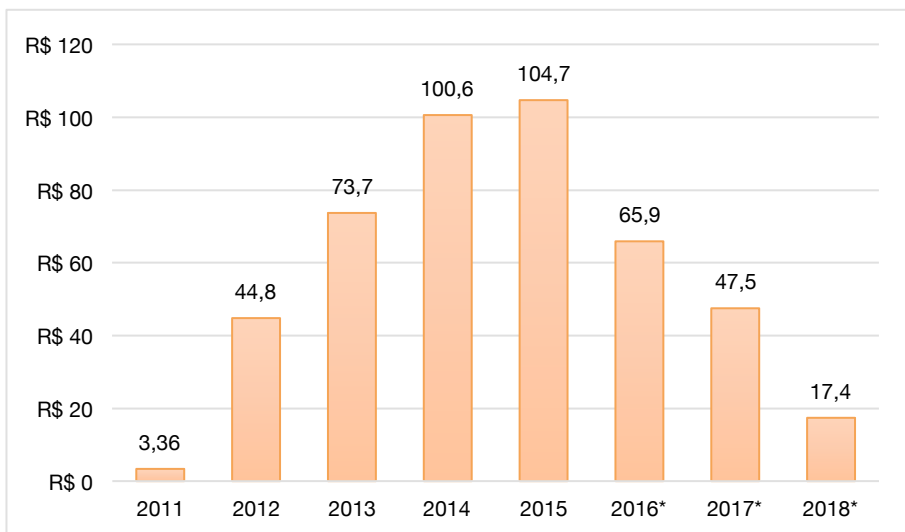
<sup>1</sup> For example the structuring of income transfer programs (Bolsa Família) and a policy of keeping increases to the minimum wage above those of inflation.

<sup>2</sup> Among such measures, we can highlight (i) reductions in payroll costs; (ii) reduction in the basic food basket tax; (iii) reduction of the tax on industrialized products; (iv) new tax levels for individual small businesses; (v) reduction of the tax on financial operations for individual credit operations; and (vi) tax reductions for exporting companies and for the capital goods industry.

Such tax incentives effectively began during the administration of President Luiz Inácio da Silva (2003–10) – more specifically as part of a broad strategy aimed at the need to stimulate the country’s economic development, thus compensating for the effects of the 2008 financial crisis. However, the intensification of tax relief measures and fiscal subsidies carried out during the Rousseff administration led to waiving the collection of taxes equivalent to R\$ 457.96 billion – an amount ten times larger than that of the Lula administration, estimated to have been R\$ 43.5 billion (Figure 2).

**Figure 2 – Tax waivers of the Dilma Rousseff administration<sup>3</sup> (R\$ billions).**

Source: Receita Federal (2016)



The combination of this fiscal policy with stagnation and the subsequent decline in economic activity and its negative impacts on tax collections,

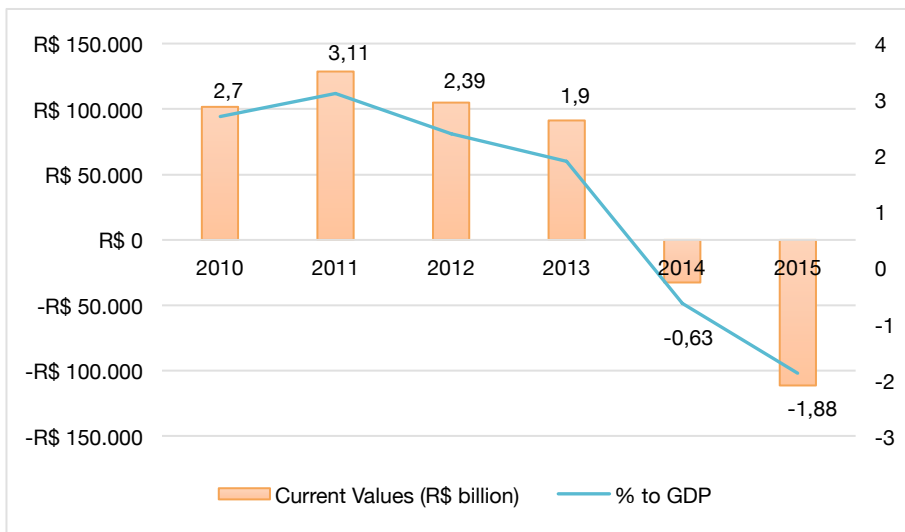
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<sup>3</sup> Tax waivers scheduled for 2016, 2017 and 2018 (\*) are estimates generated from the measures announced by the government since 2013, effective for the subsequent years.

coupled with a significant increase in real interest rates<sup>4</sup> – which went from 7.25 per cent, in 2013 to 14.25 per cent in 2015 – caused a substantial increase of public debt interest costs.<sup>5</sup> This contributed largely to the deterioration of public sector accounts, which in 2014 presented a primary deficit of R\$ 32.5 billion, the first negative result since 2001 (Figure 3).

### Figure 3 – Private sector primary result (2010–15).

Source: Banco Central do Brasil (2016).



This deterioration would lead the newly re-elected Rousseff administration to redirect its economic policy through execution of a fiscal adjustment put in place shortly after the completion of the most fiercely

<sup>4</sup> Seeking to combat inflationary pressures and to attract foreign capital.

<sup>5</sup> That totalled R\$ 368 billion in the year 2015, compared to R\$ 288.2 billion in 2014. Such interest costs weighed heaviest in the increase of public debt in 2015, with a total of R\$ 498 billion.

contested presidential election since the re-democratization of 1989.<sup>6</sup> This adjustment resulted in cutting 29 per cent of public investment<sup>7</sup> during 2015 – a cut that would total R\$177.4 billion, or 2.9 per cent of GDP – taking it to the lowest level since 2007.

Other characteristics of this pro-cyclic economic policy include the readjustment of frozen rates<sup>8</sup> and abrupt foreign exchange rate devaluation.<sup>9</sup> These measures, along with the significant reduction in public investment – which in itself has a strong multiplier effect on private investment – resulted in a strong acceleration of inflationary indices, a sharp decline of economic activity, a fall in GNP and a decline in confidence rates of entrepreneurs and consumers (Figure 4 and Figure 5). Given the subsequent impacts on tax collections resulting from the deceleration of the economy, the result of 2015, with a primary deficit of R\$ 111.2 billion, was even worse than that of 2014.

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<sup>6</sup> Dilma Rousseff, of the Workers Party (PT), would be re-elected in the second round with 51.64 per cent of votes compared to 48.36 per cent for Aécio Neves of the Brazilian Social Democracy Party (PSDB).

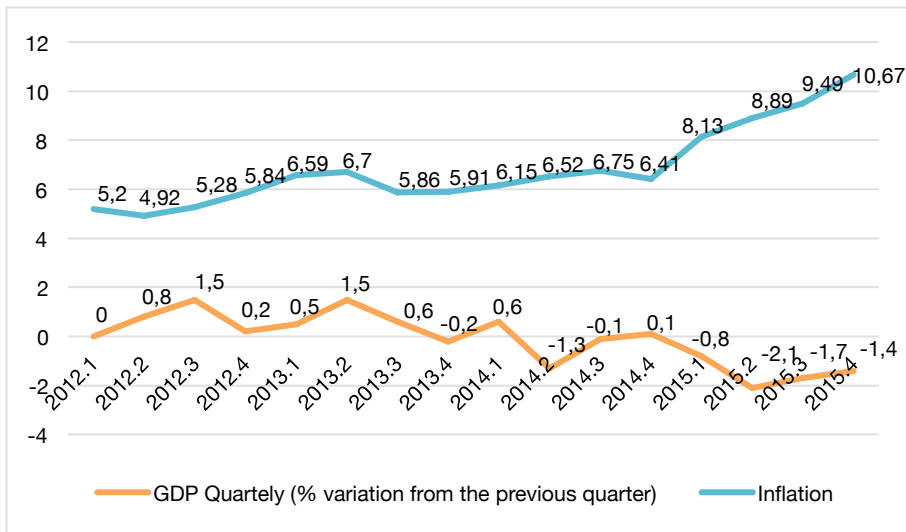
<sup>7</sup> This figure was arrived at by adding together all spheres of government and state-owned companies. Given that 90 per cent of government expenditures are mandatory – for example continued duration payments such as those for personnel, social programs, social security benefits, constitutional transfers to states and municipalities, etc., thus hindering the implementation of structural fiscal reforms, the tax cut decisions would focus on the remaining 10 per cent classified as ‘discretionary spending’, which includes the public investment.

<sup>8</sup> These consist of measures taken between 2013 and 2014 in order to contain inflationary surges. Included are a series of public utility rates, from water to electricity.

<sup>9</sup> This entailed a 32.9 percent drop against the dollar, the world’s second largest loss in 2015.

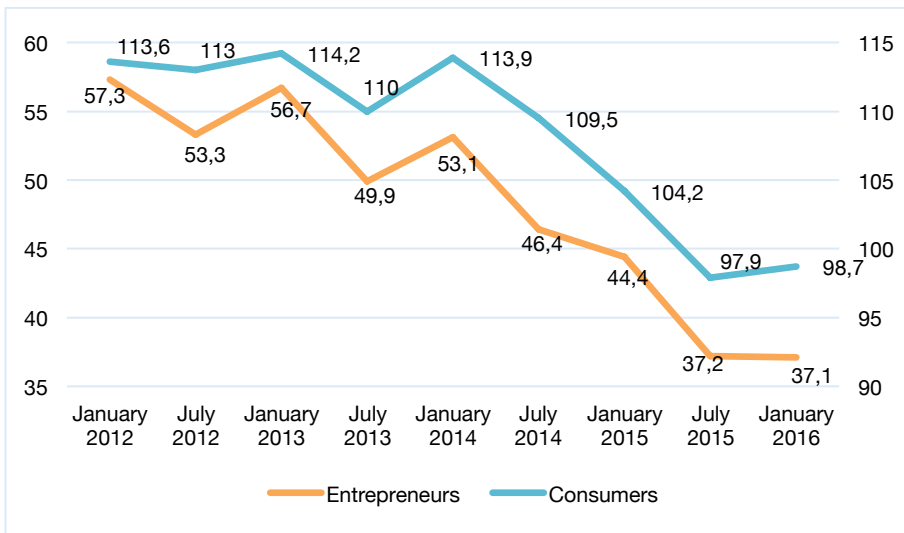
**Figure 4 – GDP and inflation (2012–15, % quarterly).**

Source: Formulated based on data available in Trading Economics.



### Figure 5 – Confidence index of entrepreneurs and consumers (2012–16).

Source: Formulated based on data available in Trading Economics



Therefore, the fiscal adjustment, instead of reversing the deterioration of public accounts, as it was promoted, resulted in an even greater decline in economic activity and of tax collections, accentuating the imbalance of the existing public accounts and opening the way to new rounds of contraction of consumer spending and investment. To this critical situation were added as well the perverse economic effects resulting from Operation Car Wash<sup>10</sup>

<sup>10</sup> This is an ongoing investigation carried out by the Federal Police of Brazil. Its first ostensive phase occurred on 17 March 2014, with the delivery of more than 100 warrants for search and seizure, temporary imprisonment, preventive imprisonment and bench warrants, with the purpose of unravelling an enormous scheme of money laundering and pay-offs. It is considered by the Federal Police as the largest federal corruption investigation in the history of the country, covering a large number of entrepreneurs and politicians from various parties.



that paralyzed large and dynamic sectors of total investment of the economy such as the chains of petroleum, gas and construction.<sup>11</sup>

We should point out, however, that the current crisis reveals structural problems that are not restricted merely to the imbalance of public accounts. The process of de-industrialization of Brazil had already started in the 1990s (Figure 6).<sup>12</sup> It made the Brazilian economy increasingly dependent on the commodity sector, and thus increasingly vulnerable to international price volatility (Bresser-Pereira, 2010). In this sense, the reversion of the favourable external situation in the period 2004–11, together with economic policy mistakes of the Rousseff administration, led to economic, trade and fiscal imbalances becoming even worse.

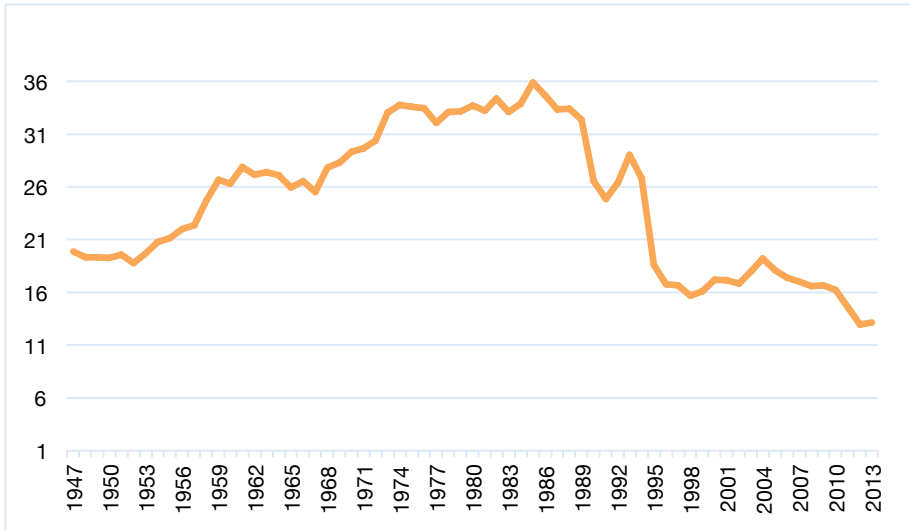
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<sup>11</sup> The total sum of investments in these sectors account for almost 5 per cent of GDP in a country where the overall level of gross fixed capital formation ranges in recent years between 15 and 18 per cent.

<sup>12</sup> De-industrialization occurred as a result of measures such as (i) low investment, (ii) strong increases in the foreign exchange rate, (iii) high interest rates, and (iv) unbraked trade liberalization implemented in the 1990s. The combination of these factors flooded the domestic market with imported goods, triggering the process of de-industrialisation of the Brazilian economy (Bresser-Pereira, 2010).

### Figure 6 – Participation of industry in GDP (1947–2013, %).

Source: IPEA (2016).



Beyond the bad economic results – a recession of 3.8 per cent in 2015, a trend which should persist also in 2016, two other problems deepened the crisis, transcending it to the political sphere. These were the outbreak of corruption scandals linked to the Workers Party and other members of its ruling base,<sup>13</sup> and the practice of ‘accounting masking’, through which the Rousseff administration delayed the transfer of funds to public banks responsible for the executive operation of social programs, with the alleged intention of softening the government's fiscal indicators.<sup>14</sup>

<sup>13</sup> These were the Progressive Party (PP) and the Brazilian Democratic Movement Party (PMDB). Such scandals relate to crimes such as money laundering, payment of bribes and illegal financing of political campaigns.

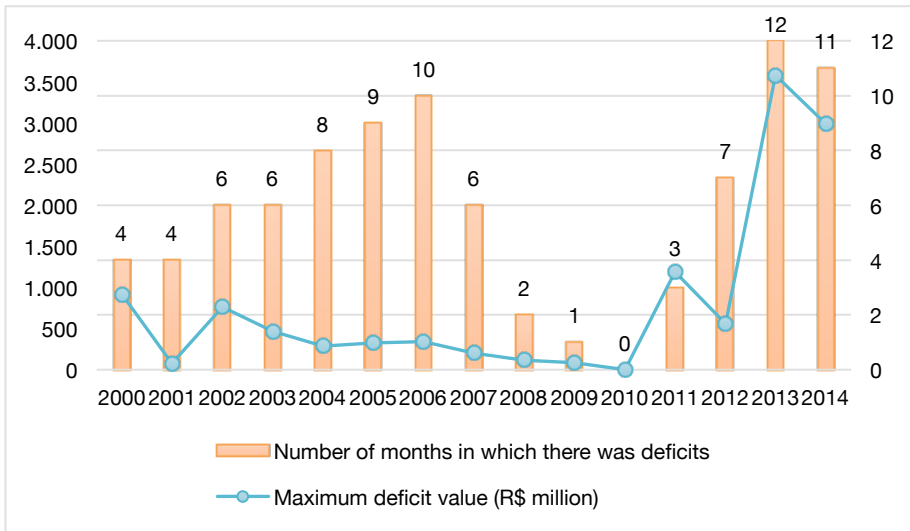
<sup>14</sup> This happens because although social spending effectively occurred, it had not yet been accounted for in the accounts of the federal government when it published its annual report. Thus, this artifice can be used to increase the primary surplus or, in this case, to prevent a larger primary deficit.

Such budgetary operations, not provided for in the constitution, have been criticized by sectors opposed to the government as a kind of federal government funding by public banks, a practice strictly forbidden by the Law of Fiscal Responsibility, and therefore used to justify the opening of the impeachment process currently in course in Congress. The administration, in turn, justified the implementation of these budgetary operations based on the argument that they had been used in previous administrations without any impediment.

Figure 7, restricted to the payment of unemployment insurance, confirms the indubitable recurrence of these accounting operations during the period 2000–14. On the other hand, it highlights as well the substantial increase in the amount also practised by the Rousseff administration, especially in the last two years of its first term. This trend would persist in 2015, when the practice of accounting masking totalled R\$ 40 billion, the same value occurring in the previous year (Cruz, 2015).

### Figure 7 – Accounting masking - unemployment insurance (2000-14).

Source: Caixa Econômica Federal (2015) and Amora (2015).



These accounting operations, associated with the opening of six additional credits in 2015 without proper authorization of the National Congress, strengthened the impeachment process currently underway. Despite the absence of unanimous agreement concerning the allegations found in the impeachment opinion, and even in relation to the impeachment itself, it is important to highlight that the opening of this process has strong social support: 68 per cent support the removal of the president (Datafolha, 2016).

## INSTITUTIONAL DEVELOPMENTS

Despite the political inconsistencies expressed in the course of the evolution of the process of impeachment of President Rousseff,<sup>15</sup> Brazil has shown important institutional progress related to the exercise of political control of citizens over the actions of the government. These are advances that can be verified from constitutional principles and complementary and ordinary legislation grounded in Constitution of 1988, and which have been widely implemented in the current scenario of economic and political crisis.

Such advances, upon instrumentalizing the concept by direct and indirect means of supervision, expose a complex relationship between society and public officials; that is to say, between 'principal' and 'agent', demonstrating the delegation of authority and responsibility from the first to the second, enabling the latter to act. Such action, however, must be strictly subject to accountability, *lato e stritu senso*, from the 'agent' to the 'principal', so that the latter benefits directly when the former performs its tasks with rigor (Posner, 2000). Such a relationship acts as a protection of the rights of the citizen against the uses and abuses of power by the government as a whole, by any individual vested with a public function.

Fundamental mechanisms were established for the control of government actions relating to aspects of the economy, efficiency and effectiveness, as they pertain to examining:

1. how public agencies and entities acquire, protect, and utilize their resources;
2. the causes of anti-economic and inefficient practices;
3. the fulfillment of foreseen goals; and

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<sup>15</sup> Eduardo Cunha (PMDB), president of the Chamber of Deputies and responsible for the acceptance of the request for impeachment in the Chamber, is accused by the Car Wash Operation of having committed crimes of corruption and money laundering; Antonio Anastasia (PSDB), rapporteur of the impeachment process in the Senate, have signed 972 decrees for supplementing the budget and increasing primary expenses when he was governor of the State of Minas Gerais, not complying with the fiscal targets set out in the Budget Guidelines Law; the opening of the impeachment process has confused important steps of the rite, such as the completion of the technical analysis by the Court of Auditors in relation to 2015 accounts and the consideration of this judgment by the National Congress.

4. the impact of governmental programs, projects and activities in the sense of seeking to discover the extent to which actions implemented are able to produce the effects intended by the administration.

Among such mechanisms are the activities of the Federal Accounting Tribunal, an institution defined within the Federal Constitution for carrying out national accounting, financial, budgetary, operational and asset control and of direct and indirect administration entities, to control the application of subsidies<sup>16</sup> and changes of use of fiscal resources, and to aid the National Congress in annual fiscal and budgetary planning.

Regarding the budget operations carried out during the first mandate of the Rousseff administration, it is valid to point out that the Federal Accounting Tribunal would have alerted the president about irregularities in the 2013 accounts (Amora, 2015). This is in compliance with its duties in regard to the control of public accounts for the sake of obtaining higher degrees of transparency and governability.

In turn, as regards to combating corruption within the federal executive branch, the Federal Comptroller General's Office has played an important role in fostering the defence of public assets. It was created in 2001 and has among its main functions internal control, public auditing, the formulation of policies for preventing and combating corruption, and increasing the transparency of management within the federal public administration. This institution has fulfilled its role with the opening of administrative and accountability processes against a number of companies related to corruption scandals under the Car Wash Operation.

Such processes can both prevent the signing of new contracts with the public sector, as well as result in the application of fines or other appropriate penalties, thus contributing to abolish the strongly rooted view in Brazilian society in regard to total impunity within the structures of government.

These efforts are reflected in the substantial number of expulsions of public servants during the period from 2003–15, including firing, seizure of

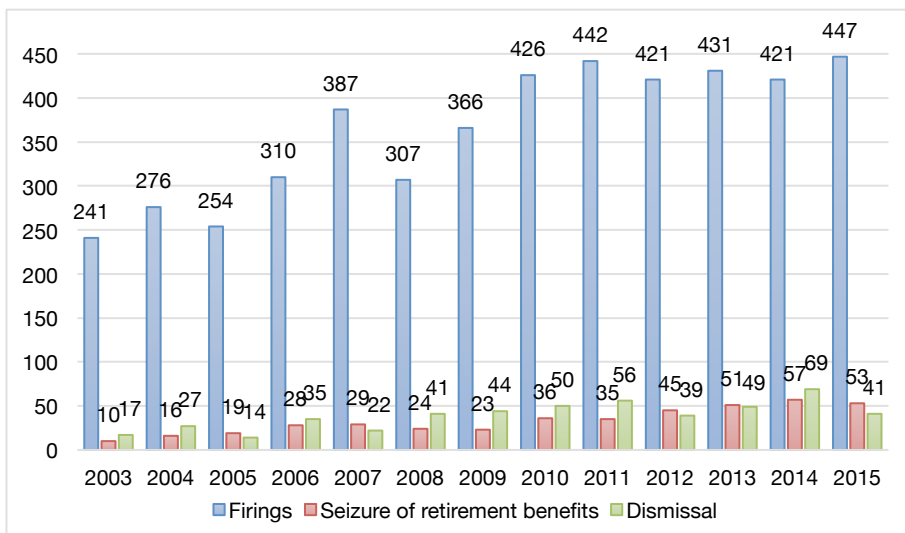
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<sup>16</sup> These subsidies constitute monetary aid, in general conceded by government.

retirement benefits and dismissal of appointed individuals in commissioned functions (Figure 8).

### Figure 8 – Federal Public Administration – expulsion penalties applied to public servants (2003-15)

Source: Controladoria Geral da União (2016).



Another significant initiative by the Federal Comptroller General's Office is the Transparency Portal,<sup>17</sup> a website launched in November 2004 with the aim of increasing the transparency of public administration and allowing citizens to monitor the use of public resources, thus contributing to its task of supervision in regard to their good and correct application.

Activities of the Federal Prosecutor Department, created in 1993 as a permanent institution essential to the jurisdictional function of the state, responsible for the defence of the judicial order and of the democratic regime, have been equally fundamental. Its broad attributions make it a key

<sup>17</sup> <http://www.portaltransparencia.gov.br/>.

institution for starting investigations of accounting practices committed by the Rousseff administration – and by state governments – within the purview of Operation Car Wash, in which it has denounced politicians and entrepreneurs for crimes of corruption, racketeering and money laundering.<sup>18</sup> As of December 2015, 1016 operations have been carried out, with 396 searches and seizures, 40 plea bargain agreements awarded individuals and five leniency agreements with companies (Ministério Público Federal, 2016).

The Federal Prosecutor Department also exercises the important role of promoting transparency and dissemination of information through the launching of a website about developments in Operation Car Wash.<sup>19</sup> It provides detailed data on the progress of the operation in course, as well as full texts of the complaints lodged, judgments handed down and news articles, among other documents, having already surpassed the mark of 1 million Internet hits.

Also related to combating corruption is the professional and institutional strengthening of the Federal Police. Its number of employees jumped from 7431 police in 2003 to 11,817 in 2014, an increase of 59 per cent over the period, while the institution's expenses have grown by 40 per cent since 2003, discounted for inflation. Its central role in the conduct of Operation Car Wash, through the blockage and seizure of goods totalling R\$ 2.4 billion, the repatriation of R\$ 659 million and the serving of more than 800 judicial orders – for search and seizure, coercive testimony and imprisonment – has contributed to raising important popular support for the operation and to combating corruption in Brazil (Polícia Federal, 2016; Souza and Onofre, 2016).

Operation Car Wash uncovered spurious relationships between private companies and the government through the private financing of election

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<sup>18</sup> These entailed 36 criminal accusations against 170 people for crimes of corruption, racketeering and asset laundering, among others. The crimes involve the payment of kickbacks of nearly R\$ 6.4 billion, R\$ 2.8 billion of which have been retrieved by federal prosecutors who also requested in courts the reimbursement of R\$ 14.5 billion (Ministério Público Federal, 2016).

<sup>19</sup> For more information, see <http://lavajato.mpf.mp.br/>.



campaigns, the payment of kickbacks and the granting of favours in public bidding. This resulted in the Federal Supreme Court declaring the private financing of candidates and political parties unconstitutional. In the future, they are only allowed to receive donations from private individuals, limited to up to 10 per cent of their income during the previous year.

The end of the private financing of campaigns, associated with increased inspection and control seeking to prevent illegal financing, will open the path toward diminishing the strict relation of influence between companies and politicians. Studies calculate that companies that financed Labour Party candidates to the Federal Chamber of Deputies during the 2006 elections received between 14 and 39 times the value donated through government contracts in subsequent years (Boas, Hidalgo and Richardson, 2014: 415). Similarly, this measure will bring greater balance between parties and candidates, including those who refuse to receive private funding from certain economic sectors, strengthening the functioning and the stability of the democratic regime.

An essential step for the stability of this system is free and transparent access to public information, a precondition for citizen engagement and of organized groups of society in political processes and in the management of public affairs. Asymmetries of information tend to lead to deficient social control, both in the dimension of choosing the best candidate as well as in the dimension of punishing conduct deviations. In this sense, important advances have been made from the promulgation in 2011 of the Information Access Law,<sup>20</sup> such as the initiatives for the release of official data by institutions such as the Comptroller General's Office and Federal Prosecutor Department. By these means, one expects greater citizen engagement in the successive cycles of public choice, based on information that nourishes decision-making processes in the common interest.

Thus, transparency assumes the role of an antidote against corruption, structuring itself as an inducement for public managers to act with

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<sup>20</sup> It seeks to guarantee Brazilian citizens broad access to official data of the executive, legislative and judicial branches.

responsibility, so that armed with information, society can collaborate in the control of the actions of its governors in order to verify the real application of public resources as well as the results achieved through their use.

## CONCLUSIONS

Although the serious context of the political crisis in Brazil undermines the ability to identify and execute proposals and reforms needed to resolve the economic crisis, and this, in turn, contributes directly to the worsening political crisis, it is also clear that the country is showing great institutional capacity to identify and punish misdeeds.

In doing so, it strengthens Brazilian structural and institutional dimensions: firstly, by reorienting the way of doing business and dealing with public-private partnerships, and secondly, by contributing to ensuring that the next governments should consider the fiscal and budgetary responsibility with a new – and even unprecedented – attention. Finally, it lays the foundation for a new way of doing politics in the country, one that is more transparent, accountable and focused on the common good.

It is necessary, however, to caution that no political inconsistencies block the progress expected and desired. Decisions taken in order to impede the autonomy and political independence of these control and punishment instruments in case of failure to execute legitimate guidelines will only lead to the weakening of the democratic ideal, exposing the whole society to the potential risks of its bureaucracy.

Although ensuring the autonomy and independence of these institutions is important, it is just as important to lay the foundation for economic and political reforms that allow Brazil to overcome its internal distortions, preparing the country for the challenges of the twenty-first century and for a new cycle of robust growth. Needed are reforms in taxes, budgetary, political and educational areas that contribute directly to the economic and social development.

Finally, we must keep in mind that the progress made and addressed above does not necessarily result from a particular government or political party, but mainly from dynamics between politics and society. This dynamic

has already been beneficial for the transformation of public administration in the country, which was forced to professionalize and to accept greater levels of control and pressure for results.

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