

BTI 2008 | Brazil Country Report

Status Index	1-10	7.90	# 20 of 125	
Democracy	1-10	7.95	# 24 of 125	➔
Market Economy	1-10	7.86	# 18 of 125	➔
Management Index	1-10	6.70	# 17 of 125	

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

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

The BTI is a joint project of the Bertelsmann Stiftung and the Center for Applied Policy Research (C•A•P) at Munich University.

More on the BTI at <http://www.bertelsmann-transformation-index.de/>

Please cite as follows: Bertelsmann Stiftung, *BTI 2008 – Brazil Country Report*. Gütersloh: Bertelsmann Stiftung, 2007.

Key Indicators

Population	mn.	186.4	HDI	0.79	GDP p.c.	\$	7,475
Pop. growth ¹	% p.a.	1.3	HDI rank of 177	69	Gini Index		57.0
Life expectancy	years	71	UN Education Index	0.88	Poverty ³	%	21.2
Urban population	%	84.2	Gender equality ²	0.49	Aid per capita	\$	1.0

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Brazil meets the minimum requirements for a democracy under the rule of law. During the second half of President Luiz Inacio Lula da Silva's ("Lula") first term of office, standards of stateness and the rule of law have remained unchanged. The quality of political participation has improved slightly during recent years, due to the Lula administration's efforts to open decision-making processes at all levels of the political system to civil society participation. The level of democratic consolidation has not changed significantly. Further progress toward consolidation would require political reforms in order to reduce corruption, limit the number of parliamentary parties, reduce the number of legislators who switch parties for personal convenience, and create more transparent and solid political alliances. As in years past, there were virtually no successes of note in these respects. During the period under review, the level of satisfaction with democracy, democratic convictions and interpersonal trust within Brazilian society improved slightly, but still remains very low.

The country's level of development has not changed significantly in the last two years. Brazil continues to have one of the highest levels of income inequality in the world. However, after initial problems, the reforms initiated recently by the Lula administration have yielded some effects. Benefiting from favorable external conditions and a growing economy, unemployment has declined, poverty has been reduced, income inequality is improving, as has the poor's access to an increasingly efficient social safety net. The institutional framework for market-based economic action has made further improvements in recent years. The Lula administration continued its commitment to macroeconomic stability, and macroeconomic indicators have shown noticeable improvement as a result. Debt as a proportion of GDP fell from 57% at the end of 2003 to 50% at the end of 2006, though Brazil still spends much more than other developing countries in debt servicing. There remain several

challenges for the next years, as Brazil still has the highest real interest rates in the world. Though growth in 2006 was slightly higher than in 2005, it is nonetheless the slowest growth rate in South America and is not high enough for Brazil to meet its development needs. Experts say that Brazil would need annual growth rates of at least 5% to overcome the country's social problems and shortages in infrastructure. Awareness of the importance of investment in research and development (R&D) has increased, but R&D expenditures (both public and private) still account for only 1% of GDP. It should be noted that this figure is low in comparison to other expenditures. R&D in Brazil is carried out predominantly by the government and public universities. Brazil's main challenge in innovation policy is to encourage the business sector to engage in productivity-enhancing innovative activities.

From an ethical point of view, the years 2005 and 2006 were disastrous for the Lula administration. Evidence cited for the first time in May 2005 that the ruling Workers' Party (PT) used illegal funds to finance its campaigns and bribed allied congressmen to win support for the government caused the gravest political crisis the country had seen in recent years. The corruption scandals brought into question the PT's ethical conduct, which it had claimed as a distinguishing feature from other mainstream parties, and forced President Lula to replace some of his senior important staff members. This scandal dominated the public and the political agenda for more than a year. The government suffered various defeats in Congress. In spite of this, Lula managed to recover much of the support he had lost as a result of the corruption scandals, and won re-election in October 2006. Following a run-off vote, Lula won 61% of the total valid votes. His rival, the center-right Geraldo Alckmin, won 39%. Though Lula had won the 2002 election in almost all parts of the country, in 2006 he received overwhelming support from low-income voters, especially in Brazil's poorest states, while in the more wealthy states, a majority opted for his opponent. During his second term of office, President Lula's main challenges include avoiding further polarization between poor and rich Brazilians, boosting economic growth, strengthening the path towards a more equal and just social and economic policy, renewing society's trust in the country's political class, and implementing the political reforms imperative to consolidating Brazilian democracy.

History and Characteristics of Transformation

Democratic transformation in Brazil spanned a period of 16 years. The first steps toward liberalizing the authoritarian regime (1964 – 1985) were taken after General Geisel assumed power in March 1974 and were continued under President Figueiredo (1979 – 1985). Brazil experienced the most massive political mobilization in its history in connection with a campaign in early 1984 to institute direct election of a democratic president (“diretas já”). The armed forces, however, insisted on indirect election of the

first civil government since 1964. Tancredo Neves was elected president by an electoral assembly in January 1985. Due to his personal integrity and popularity, he found acceptance even among those opposed to the government, but he died before he could take office. The office was assumed by the elected vice president, José Sarney (1985 – 1990). During the Constitutional Convention (1987 – 1988), the military prevented a far-reaching limitation of its institutional autonomy. The new constitution took effect in October 1988.

The transition to democracy was consolidated in March 1990, when the first directly elected democratic president, Fernando Collor de Mello, assumed office. Implicated in a corruption scandal, Collor was removed from office by Congress in September 1992. Vice President Itamar Franco served out the remainder of his term. The internationally renowned sociologist Fernando Henrique Cardoso won the presidential elections in October 1994. In 1998, after the constitution was amended to allow his re-election, Cardoso became the first president in Brazilian history to be elected to a second term of office (1999 – 2002). Democracy as a form of state and government became more firmly established under Cardoso.

When Lula, a former union leader and Workers' Party (PT) chairman, was elected president on 27 October 2002, it was the first time in Brazil's history that the presidency had been filled by a representative of those classes that, until then, had been largely excluded from positions of political or economic power. Thus Lula's inauguration in January 2003 not only symbolized a sociopolitical change, it was also linked to the hopes of millions of Brazilians that reforms needed to fight poverty and inequality would be implemented more systematically than they had been in the past.

Brazil's transformation toward a market economy began in the 1930s with a largely insulated local market. It was guided after the end of World War II by the concept of import substitution industrialization. This policy helped Brazil achieve high economic growth rates over several decades. However, it did not succeed in producing sufficient competitive pressure to maximize domestic economic efficiency, nor did it succeed in organizing a fully functional banking system or in reducing the risk of balance-of-payments crises. Industrialization was not self-sustaining. Existing economic, social and regional disparities increased further.

The economic situation in the 1980s was characterized by growing unemployment, rapidly rising inflation rates, widely fluctuating gross domestic product growth rates, growing problems resulting from the large foreign debt and rising deficits in the national budget. After various heterodox economic plans had failed, comprehensive measures were taken, beginning in the early 1990s and with more intensity from the mid-1990s on, to stabilize economic development. As finance minister under President Franco and as president from 1995, Fernando Henrique Cardoso (1993 – 1994) instituted a stability and reform policy that yielded low inflation rates, a better-managed and more fiscally responsible government, and more consistent

macroeconomic conditions. However, it also brought growing government debt, extremely high nominal interest rates and only modest growth rates. During Cardoso's time in office (1995 – 2002), Lula and his party contested many of the reforms the Cardoso administration put into effect. They attacked Cardoso as a neoliberal and insisted on an economic model with a stronger social component, a stronger focus on the needs of the Brazilian people at large than those of the banks and corporations. But as time went on during the Cardoso administration, even the PT had to admit that many of Cardoso's policies had produced better results than the opposition had expected. Lula was elected president in 2002 only after three failed attempts (in 1990, 1994 and 1998), in which he ran on a platform of fundamental continuity with the course mapped out by Cardoso, and after having presented himself as substantially more moderate than before.

During his first term of office (2003 – 2006), President Lula strengthened the country's macroeconomic stability. After initial problems, the reforms initiated by his government also have shown some positive effects in the social realm: unemployment has declined, poverty has been reduced, income inequality is improving, as has the poor's access to an increasingly efficient social safety net. In spite of various corruption scandals that weakened Lula's government and especially the PT during 2005 and 2006, Lula was re-elected for a second term of office (2007 – 2010) in October 2006.

Transformation Status

I. Democracy

1 | Stateness

The state's monopoly on the use of force is established nationwide in principle, but does not function completely. There are reports of torture, extra-judicial executions and excessive use of force at the hands of security forces. There are also reports of killings by death squads, including members of the security forces. In several large cities the state is unable to completely guarantee private and public security. In May 2006, over 150 people were killed following simultaneous riots in prisons in the state of São Paulo, the worst wave of organized crime in the history of the country. In sum, there are generalized problems related to the failure of security policies, huge deficiencies in law enforcement, and rising homicide rates, particularly among young males.

Monopoly on the use of force

All citizens have the same civic rights and the vast majority fundamentally acknowledge the state's constitution.

State identity

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

No interference of religious dogmas

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

Basic administration

2 | Political Participation

Free and fair elections take place without restraints.

Free and fair elections

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

Effective power to govern

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

Association / assembly rights

Freedoms of opinion and the press are unrestricted and generally respected. The media provide vigorous reporting on controversial issues and government performance, but media ownership is highly concentrated and information is often biased by private power interests.

Freedom of expression

3 | Rule of Law

There are almost no restraints on the basic functions involved in the separation of powers, with mutual checks and balances in place.

Separation of powers

The judiciary is institutionally well differentiated and free from unconstitutional intervention by other institutions. However, it is heavily overburdened. There are vast disparities in citizens' access to legal counsel and the administration of justice, due to extreme inequalities in the distribution and availability of information and resources to all citizens. In following with the Roman law tradition, Brazilian law is heavily procedural. Judges have used their autonomy to impede court reform and often use their highly formalistic legal decisions to overturn government modernization efforts. High court justices are appointed by the president and subject to approval by the Senate. This process has been subject to increasing criticism. In December 2004, a National Council of Justice was created by constitutional amendment. Most members are appointed by courts or by the public prosecution. Two members are lawyers, and two are citizens, appointed by the parliament. The creation of the Council was controversial. Before the Council, all matters regarding the conduct of judges and courts were examined by judges only; it became a consensus that judges were being too corporative in handling these matters. The creation of the Council has been a major improvement over the previous system.

Independent judiciary

As a rule, corrupt officeholders are generally prosecuted under established laws, but some manage to slip through political, legal or procedural loopholes.

Prosecution of office abuse

While civil liberties are guaranteed in theory, violations exist in practice, particularly in rural areas and urban slums. Brazil has a very high firearms-related homicide rate. Most violent crime is related to the illegal drug trade, which is said to employ an estimated 200,000 people. In Rio de Janeiro alone, at least 5,000 heavily armed gang members are working for various drug-trafficking gangs. In many states, certain police groups, referred to as “death squads,” terrorize shanty-town dwellers and intimidate human rights activists. The prison system is anarchic, overcrowded and largely unfit for human habitation. Thousands of poor Brazilians work under conditions analogous to slavery. As a consequence of violent crime, corruption, mistrust of the police and highly centralized federal legal codes, many Brazilians do not feel that they are in a position to ensure their personal safety.

Civil rights

4 | Stability of Democratic Institutions

Democratic institutions operate essentially according to their allotted functions, but specific structures of interaction between key institutions create problems of governance and negatively affect the implementation of reforms. The constitution of 1988 is characterized by a tendency toward over-regulation. Consequently, nearly all major reforms require a constitutional amendment and are therefore difficult to achieve. The electoral system produces a clear over-representation of the sparsely populated and often disadvantaged northern and north-eastern federal states in the Chamber of Deputies and the Federal Senate. This allows traditional local and regional elites to more easily insulate themselves from modernization.

Performance of democratic institutions

All relevant political and social players accept the legitimacy and authority of democratic institutions.

Commitment to democratic institutions

5 | Political and Social Integration

The political party system is characterized by a high level of fragmentation, moderate polarization, most parties having a poor social support base (an exception being the PT) and high voter volatility. The reasons for this are partly historical, but they are also connected with the electoral system. The Chamber of Deputies has a system of proportional representation with open lists without a barring clause. The parties present regional lists of candidates, but voters may vote directly for individual candidates, as do approximately 90% of voters. This system makes it more difficult for national party leaderships to discipline elected representatives, and it fosters a focus on personalities over institutions, particularly because political campaigns are planned and financed less by political parties than by the candidates themselves. At the national level, most parties are organizationally weak. There is little party coordination or loyalty among

Party system

congressional representatives. Changes in party affiliations within Congress occur with extreme frequency following elections, the switch being usually from opposition to governing parties and often across ideological boundaries. The costs of a party switch are minimal. The loose and weak structure of political parties makes it difficult to predict the outcome of congressional decision-making processes. Even numerical majorities of the governing parties cannot guarantee that the executive branch will be able to implement its reform plans.

The network of interest groups is relatively close-knit, but dominated by a few strong interests. Labor and capital associations dominate. Despite divergences among competing umbrella organizations, trade unions are strong political actors. Following democratization there was a gradual estrangement from traditional corporatist state models. Mobilization capabilities diminished during the 1990s and the level of trade union organization is on the decline, but trade unions are still important to many sectors of workers. Entrepreneurs have a national umbrella organization, with the National Confederation of Industries in São Paulo State wielding the greatest influence.

Interest groups

Consent to democracy is low (2006: 46%), as is the degree of satisfaction with democracy (2006: 36%), but political protests do not tend to question the constitutional framework. This data must be interpreted in light of the Brazilian experience with authoritarianism, which from the mid-1970s was less repressive than those in many other Latin American countries. Political parties, elections and legislatures had certain significance even under autocratic rule, and the economic balance under the rule of the armed forces was not entirely negative.

Consent to democratic norms

Interpersonal trust is very low (2006: 5%). There is, nevertheless, a robust network of autonomous, self-organized groups and civic organizations. There are at least 500,000 civil society organizations in Brazil, possibly as many as 750,000. Among these is a growing number of nongovernmental organizations. Traditional social movements are also active, most notably a movement of the landless founded in the mid-1980s that mounts high-profile protests against the neoliberal economic policies and social injustice, and organizes land occupation.

Associational activities

II. Market Economy

6 | Level of Socioeconomic Development

Social exclusion is quantitatively and qualitatively pronounced and structurally ingrained. Although Brazil exhibits a medium level of development according to key indicators, national mean values mask the great disparities between a relatively developed southern and southeastern region where conditions resemble those in industrialized countries to some extent, and the socioeconomically disadvantaged northern and northeastern regions. Existing developmental imbalances between these regions have not lessened in recent years. Evidence shows that the high levels of inequality one finds between regions exist within individual regions and large metropolitan centers. This indicates that social inequality is pervasive throughout the country and not a phenomenon explained by regional disparities. In spite of the Lula administration's partially successful fight against poverty, with a Gini index value of 58.0, Brazil still has one of the most inequitable income distributions in the world. The poorest one-fifth of Brazil's population controls only a 2.4% share of the national income. With a Gender-related Development Index of 0.789, Brazil occupies rank 55 in global comparison.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	460,787	505,747	603,973	796,055
Growth of GDP	%	1.9	0.5	4.9	2.3
Inflation (CPI)	%	8.4	14.7	6.6	6.9
Unemployment	%	9.1	9.7	-	-
Foreign direct investment	% of GDP	3.6	2.0	3.0	1.9
Export growth	%	7.9	8.9	18	11.6
Import growth	%	-12.3	-1.7	14.3	9.4
Current account balance	\$ mn.	-7636.6	4177.3	11737.6	14199.3

		2002	2003	2004	2005
Public debt	\$ mn.	101,337.0	101,277.0	97,700.5	94,496.6
External debt	\$ mn.	233,106.7	236,587.4	220,381.6	187,994.3
External debt service	% of GNI	11.8	12.1	9.2	8.1
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	20.1	19.9	18.8	19.6
Public expnd. on edu.	% of GDP	4.2	-	-	-
Public expnd. on health	% of GDP	4.1	4.6	4.8	-
R&D expenditure	% of GDP	1.0	1.0	-	-
Military expenditure	% of GDP	2.1	1.6	1.5	1.6

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Market competition has a strong institutional framework, but the informal sector generates about 40% of Brazil's GDP. Pricing is largely unrestricted. The use and transfer of profits is not regulated. The convertibility of the national currency, the real, is guaranteed, and there has been a floating exchange rate since January 1999. An ambitious law regulating private-public partnerships was established in 2004.

Market-based competition

Since the Competition Act went into effect in mid-1994, a coherent anti-monopoly and anti-cartel policy has evolved. A bankruptcy law was approved in 2004, an anti-trust law was sent to Congress in 2006, and rationalization of the business registry was underway as of January 2007.

Anti-monopoly policy

Foreign trade has been liberalized in the course of the past decade, and economic openness has increased, though special exemptions and complicated registration formalities continue. Customs duties for imported goods change frequently. Imports from countries outside Mercosur member states (Argentina, Brazil, Paraguay, Uruguay and Venezuela) are constrained by high tariff and non-tariff barriers. There have been some improvements in customs effectiveness during recent years.

Liberalization of foreign trade

The banking system and capital markets are well-differentiated, internationally competitive and aligned with international standards. There is also a functioning system of banking supervision. Capital markets are open to domestic and foreign capital. The financial sector is sophisticated and systemic risk is low. Brazil's public banks hold more than 40% of financial sector assets, but even with the large role of public banks, access to financial services is unevenly distributed, to the disadvantage of the poorest. Access to banking services for the poor has increased in recent years, but small entrepreneurs still have little access to finance options. Financial services to small-scale entrepreneurs as well as microfinancing and non-bank financial services must be expanded in order to further encourage growth and employment. In order to curb inflation, the central bank raised the base interest rate to as much as 19.75% annually. Although the bank has gradually reduced rates to 13% since September 2005, Brazil still has the highest real interest rates in the world. Correspondingly, the risk spreads charged by banks continue to be among the highest in the world, impeding access to credit for investment.

Banking system

8 | Currency and Price Stability

Inflation and foreign-exchange policies are synchronized with other goals of economic policy and are institutionalized in a largely independent central bank. The central bank is broadly perceived as being independent in theory, even if it is not granted total operational autonomy in practice. Governments have repeatedly shown a commitment to an inflation targeting regime, and the central bank takes responsibility for observing it. Inflation fell from 12.5% in 2002 to 3.1% by the end of 2006. Reduced prospects of inflation allowed the central bank to cut the headline interest rate from a peak of about 19.7% in mid-2005 to 17.3% in January 2006. After the real's exchange rate was made fully convertible in January 1999, it repeatedly experienced massive devaluation pressure. Since 2003, however, the currency has strengthened significantly against the U.S. Dollar.

Anti-inflation /
forex policy

The government has consistently pursued policies geared to ensure macroeconomic stability. The May 2000 Fiscal Responsibility Act (Lei de Responsabilidade Fiscal, LRF) subjected all levels of public administration to criteria of transparency and coordination and made them responsible for their fiscal performance. It set guidelines for primary surplus generation and debt limit maintenance, and also limited salary increases for civil servants. When it took office in 2003, the administration of President Lula da Silva faced a crisis in investor confidence, but disciplined fiscal and monetary management, and prudent macroeconomic policies have produced an impressive turnaround, paving the way for both steady economic progress and the preservation of stability.

Macrostability

9 | Private Property

Private property rights are well defined and property acquisition is adequately regulated.

Property rights

For decades, state-owned corporations had dominated nearly all economic sectors in Brazil. Privatization was initiated by President Collor (1990 – 1992), but was not continued by his successor, President Franco (1992 – 1994). President Cardoso (1995 – 2002) introduced and implemented a comprehensive process of privatization on the basis of several constitutional amendments. State monopolies in key sectors of the Brazilian economy such as energy and telecommunications were abolished, while other sectors were radically liberalized. The privatizations carried out during the Cardoso government have been the subject of much controversy. Critics maintain that many of these transactions were harmful to the public interest, either because the prices paid were too low, or because the Brazilian Development Bank financed them under unfavorable circumstances. Those who defend these privatizations hold that they freed the state of a heavy burden and enabled the affected sectors to develop. Privatization is well-advanced in many areas, including the raw materials industries, transport and energy sectors and telecommunications. Regulation of liberalized economic sectors was arranged through framework legislation and in many cases assigned to newly established authorities that enjoy technical, financial and administrative autonomy. The Lula government has not implemented the privatization policies favored by its predecessors, as Lula advocates an active management role for the state in achieving both economic growth and social justice. Accordingly, no further sales of public enterprises have been carried out under Lula. Instead, the government launched an ambitious law regulating public-private partnerships, which is designed to attract private investment to supplement those public expenditures for infrastructure limited by tax and budgetary constraints.

Private
enterprise

10 | Welfare Regime

Social welfare networks to compensate for old age, illness, unemployment and disability are somewhat developed, but do not cover all risks for all strata of the population. Over the past decade, Brazil carried out significant reforms to expand the coverage, quality and efficiency of its health system and strengthen its safety net. During this time, infant mortality fell by more than a third, maternal health improved, and mortality from infectious diseases decreased substantially. Nevertheless, significant portions of the population still lead an existence on the margins of poverty and hunger. During its first term in office, the Lula administration launched several high priority social initiatives, including efforts to eradicate hunger (“Fome Zero”), create youth employment (“Primeiro

Social safety nets

Emprego”), and unify conditional cash transfer programs for greater effectiveness in reducing poverty (“Bolsa Família”). The government also implemented an ambitious reform of the social security system, with far-reaching fiscal and equity effects, bringing generous public employee benefits more in line with the private sector while introducing a complementary, providing a fully-funded pension plan for civil servants. After initial problems, the reforms have shown some effects in recent years. Benefiting from favorable external conditions and a growing economy, unemployment has declined, poverty has been reduced, income inequality is improving, and those in need increasingly have access to a more efficient social safety net.

Brazilian society is markedly heterogeneous. Although compensation schemes for those disadvantaged by extreme social disparities do exist, they are insufficient. A legal code approved in August 2001 made women equal to men under the law. But women still face a reality marked by inequality in both the domestic sphere and professional life. Violence against women and children, forced prostitution of children and child labor persist. In education, the gaps between men and women have narrowed greatly, and women on average possess higher educational qualifications, often attributed to more disciplined study habits. The visibility of women in public life, the media and politics is increasing, not least of all thanks to the activities of numerous women’s organizations. While racial discrimination has long been officially denied as a problem in Brazil, the reality is that Afro-Brazilians earn less than 50 percent of the average earnings of other Brazilians, and Afro-Brazilian university graduates earn less than other citizens with only high school diplomas. The Lula administration has recognized the problem and taken some measures to combat racial discrimination such as the Racial Equality Statute.

Equal opportunity

11 | Economic Performance

Long-term growth of per capita GDP is moderate, with the annual growth rate between 1990 and 2004 averaging 1.2%. In 2004, the per capita GDP was \$8,197 (PPP). Basic macroeconomic data have been positive in recent years. Though growth in 2006 was slightly higher than in 2005, it is nonetheless the slowest growth rate in South America and is not high enough for Brazil to meet its development needs. The average for Latin America in 2006 was 5%. Experts say that Brazil would need annual growth rates of at least 5% to overcome social problems and shortages in infrastructure. The central bank has projected a growth rate of 3.8% in 2007. The inflation rate in 2006 was 3.1%, and is expected to rise to 4.1% in 2007. After managing to bring the unemployment rate down to 9.8% of the working population in 2005, the average unemployment rate in Brazil’s six largest cities rose to 10% in 2006. The number of legal workers increased by

Output strength

5.2% between 2005 and 2006. Also, the average salary paid to Brazilians in urban areas increased by 4.3% in the same time period, to \$486 per month. Brazil again achieved a primary fiscal surplus in 2006, but when taking into account the cost of interest and debt payments, a net deficit of 3.6% of GDP remained. Public sector spending has been running very high in recent years, accounting for 46.6% of GDP. Tax rates are also very high. Debt as a proportion of GDP fell from 57% at the end of 2003 to 50% at the end of 2006, but Brazil still is spending much more than other developing countries in debt servicing. While Brazil spends the equivalent of 8.2% of GDP on servicing its public debt, the average spent by developing countries in debt servicing is 3.9%. Exports increased by 16.2% and imports by 24.2% in 2006, resulting in a 3.1% increase of the country's trade surplus. Foreign direct investment increased by 24.7% in 2006 to \$18.8 billion.

12 | Sustainability

Ecologically sustainable development is an issue in some sectors of the economy, but often tends to be subordinated to economic growth targets. One of the greatest development challenges facing Brazil is how to develop the Amazon Basin in an environmentally sustainable manner. The recent boom in the Brazilian agro-industry is pushing agricultural frontiers towards the Amazon region. The growth of extensive cattle and soya farming has had a significant environmental impact in the region. The number of cattle in the Amazon has increased by 144% in the last ten years. Some 12% of the area originally covered by rainforest has become pasture. Huge tracts of land are being cleared of their original forest to make way for soya farms. Other factors contributing to deforestation include mining, and oil and gas projects in the Amazon basin. A total of 26,130 sq km of virgin forest was lost in 2003 and 2004, 6.2% more than in the previous two-year-period. According to the environment ministry, the rate of destruction has been almost halved in the last two years, due to a multi-agency plan promoted by the government. After 14 years of talks between the government, Congress and environmentalists, the government passed a bill placing an area of the Amazon rainforest the size of Uruguay under permanent protection at the end of 2006. In recent years, Brazil has developed many of the legal and institutional instruments necessary for reconciling development and environmental protection, including water management, forest protection, and biodiversity. But there remains a split in the government, with the environmental ministry on one side and the so-called "development ministries" on the other. According to a recent study, the Brazilian economy will not grow at the desired 5% annual rate if the government does not step up investments in infrastructure, particularly in new power stations. But the environmental ministry has requested thorough environmental-impact assessments before granting concessions, and has halted several infrastructure projects proposed for the Amazon in recent years. The mines and energy ministry,

Environmental
policy

however, wants to speed up environmental concessions granting. The recently announced Programa de Aceleração do Crescimento (PAC) is to include a law regulating the responsibilities of each level of government regarding environmental protection. The law will give the environmental ministry and regional agencies more power to control infrastructure projects, allowing them to have a say in various stages of their development, from conception to implementation.

A few years ago, Brazil still had a fairly cost-ineffective education system, plagued by poor and inequitable academic achievement. Significant improvements have been achieved in recent years. The Lula administration has prioritized the democratization of access to education at all levels through the Literacy Brazil program, by creating laws aimed at implementing university reform, and through its creation of the Fund for the Maintenance and Development of Basic Education (FUNDEB). The latter is a fund for education that has been approved by the Senate but has yet to be approved by the lower house. In the case of primary education, legislation establishing registration for basic education at six years of age stimulated greater access to schooling. Improvements were also made to education levels for children of eight and nine years of age. While education indicators show primary school attendance nearing 100%, pre-primary and secondary school attendance remains low compared with other middle income countries. The quality of government and private educational and training facilities is improving, albeit very slowly. Between 2002 and 2004, public expenditure on education accounted for 4.1% of GDP and 10.9% of total government expenditure. In 2004, the government created the University Program for All (PRO-UNI). PRO-UNI placed students from public schools whose family income amounted to less than the minimum wage and elementary school teachers with no advanced degree into a portion of the 550,000 openings in private institutions of higher education. The Special System of Reserved Seats provides that 50% of openings in public universities be assigned to students who have attended middle school in public schools. Through this quota, seats to Brazilians of African and indigenous descent are provided in accordance to their proportion in each state. However, while there has been considerable effort to democratize access to education, government officers, and President Lula himself, publicly admit that the quality of public education at elementary and secondary levels is rather poor. There have been well-intentioned statements in favor of policies to enhance quality but as yet there are no clear signs of effective improvements. Awareness of the importance of investment in R&D has increased during the past decade. R&D expenditures (both public and private) today account for about 1.5% of GDP; research and development are carried out predominantly by the government and public universities. Most scientists work in public universities and research institutions, rather than in the business sector. Innovation performance is improving, and innovation policy is

Education policy
/ R&D

beginning to focus on the potential synergies among science and technology promotion, R&D support, and trade competitiveness. But Brazil's main challenge in innovation policy is to encourage the business sector to engage in productivity-enhancing innovative activities. The government must boost innovation in the private sector and encourage university-business ventures so as to convert knowledge into productivity gains at the enterprise level. It also must implement measures aimed at tackling the shortage of skills in the labor force, because new studies show a widening gap in tertiary educational attainment with respect to the OECD area.

Transformation Management

I. Level of Difficulty

The structural constraints on governance in Brazil range from moderate to high. The country exhibits an average level of development and educational standards. It is an ethnically heterogeneous and highly secular society. The overall poverty rate refers to 22% of the population. Extreme poverty (population living below \$1 a day) amounted to 7.5% of the population from 1990 to 2004. During the Cardoso government (1995 – 2002), poverty levels remained relatively stable but the poverty profile changed significantly. High unemployment and a permanent reduction of labor income in the industrial sector resulted in the increase of urban poverty. Conversely, rural areas were less affected by slowing growth and the macroeconomic volatility. Nevertheless, Brazil's poverty continued to be largely rural, and extreme poverty is concentrated in the largely semi-arid northeastern region of the country. During the first Lula administration, poverty has been slightly reduced, income inequality lessened, and those in need increasingly gained access to a more efficient social safety net. The health of Brazilians has also improved significantly. Infant mortality has fallen by more than a third. Brazil has a policy of distributing free antiretroviral medication to HIV/AIDS patients, which has been noted around the world. But although the number of new HIV infections has declined, the total number of AIDS cases has increased, because effective treatment reduces the number of AIDS patients who die.

Structural
constraints

Brazil has strong civic traditions. The country's vibrant and increasingly influential civil society consists of NGOs, community-based organizations, social movements and professional associations. There are no irreconcilable ethnic, religious or social clashes, but there are extreme social and regional disparities.

Civil society
traditions

Social life in Brazil is characterized by the largely peaceful manner in which a multiplicity of ethnic groups lives together. However, several studies have demonstrated that racial inequality is still a serious problem in Brazil. In recent years, Brazil has experienced an intense debate about racism in all of its public spheres. The Lula administration initiated a variety of affirmative action

Conflict intensity

programs and other measures with the objective of reducing racial inequalities. Another important constraint is widespread violence. Moreover, new studies show that violence is no longer purely an urban phenomenon in Brazil, but has spread to the countryside in recent years. The number of homicides in rural areas has increased considerably in the past decade. Meanwhile, the number of homicides in large cities has not declined. The Lula administration has not yet found a way to reduce systematically the endemic violence that afflicts Brazilian society.

II. Management Performance

14 | Steering Capability

The Lula administration is committed to the goals of constitutional democracy and a socially responsible market economy. Its policies give these goals priority over short-term expediency. The role of external influence is modest. Brazil does not depend on foreign aid; net Official Development Assistance (ODA) receipts in 2005 (\$192 million) are barely even worth mentioning in relation to the country's GNI. Strategic priorities of the government include fighting poverty and improving educational levels. President Lula was elected for his first term of office in October 2002 on a platform that emphasized increased social equity and faster growth. The government committed itself to tight fiscal policy, inflation targeting, and the honoring of debt contracts. At the same time, it promised far-reaching improvements to the general welfare of the public, which were then carried out by several high-priority social initiatives, including efforts to eradicate hunger, create youth employment, and unify conditional cash transfer programs for greater effectiveness in reducing poverty. Indeed, Brazil experienced measurable improvements in well-being during the past four years. Building on policies of fiscal and monetary discipline that started in the mid 1990s, the first Lula administration managed to combine mature macroeconomic management and policies aimed at enhancing social equity. Benefiting from favorable external conditions, the economy experienced steady, albeit moderate growth between 2003 and 2006. Inflation was low, the balance of payments recorded surpluses, and the country's debt vulnerability declined. At the same time, unemployment declined, poverty was reduced and income inequality improved. In October 2006, President Lula was elected for a second four-year term. When he was inaugurated on 1 January 2007, Lula promised faster economic growth, more efforts to enhance the educational system, and strong action against the widespread incidents of violence plaguing the country.

Prioritization

The government is committed to democracy, economic stability and social justice, but during the last two years has shown very limited success in enforcing and implementing its stated reform goals. An ambitious pension reform with far-reaching fiscal and equity effects was instituted in 2003. The government has also been successful in getting its tax reforms through Congress during its first year and establishing new social assistance programs, such as those under the umbrella of the “Bolsa Família” initiative, which aims at reducing poverty.

Other reform projects such as judicial reform, educational reform and agrarian reform have shown limited progress at best. The long-overdue political reform (concerning above all electoral and party legislation) that many experts regard as a precondition for efficient governing, has once more been postponed. Minor reforms of electoral laws were implemented in 2006, forbidding the publication of opinion polls within 15 days of the election, forbidding candidates from distributing gifts and souvenirs, and prohibiting campaigners from hiring celebrities to front campaign events. Furthermore, the reforms compelled parties and candidates to publish monthly reports of their campaign expenses. Yet the electoral rule that obliges parties to reflect their national alliances all the way down to the local level (called *verticalização*) was maintained for the 2006 elections. A further electoral reform – which had required that a party attain at least 5% of the national vote in order to receive public funding – was ruled unconstitutional by the Supreme Court following elections. This decision saved 22 of Brazil’s 29 registered political parties from virtual extinction. According to the Supreme Court, the rule would have led to “a massacre of the minorities” and would “undermine political pluralism.” The threshold was meant to make politics more transparent to voters, give parties more power over their representatives and prevent politicians expelled from main parties to run on the ticket of smaller parties despite having no real ideological connection with them.

The government’s problems in effectively implementing its reform policy are in part due to conflicting interests and policy goals inside the ruling coalition, and in part a consequence of formidable institutional barriers to reform, as well as a fragmented system of political parties. The federal government’s organizational capabilities are also stretched to their limits in the provisions of Brazilian federalism, which grants considerable autonomy to individual states and municipalities. The dominance of electoral campaigns throughout 2006 for the October 2006 election also played a role in limiting implementation. Last, but not least, political decision-making in Brazil was paralyzed by several corruption scandals detected during the second half of President Lula’s first term of office that dominated the public and political agenda for over a year. Evidence presented in May 2005 showing that the ruling PT used illegal funds to finance its campaigns and bribed allied congressmen to win support for the government set off Brazil’s gravest political crisis in recent years. Embroiled in corruption

scandals, the PT and its integrity were called into question, forcing President Lula to replace some of his most important staff members, including his former chief-of-staff, José Dirceu, and his former finance Minister, Antonio Palocci. The government suffered various defeats in Congress.

The political leadership responds to mistakes and failed policies with changes. Learning processes occur. The leadership sometimes demonstrates its capacity for complex learning and acts flexibly, but at other times its policies remain stuck in long-established routines. Even before taking office, former union leader Lula had demonstrated his sensitivity to political and economic realities and showed a great deal of pragmatism. His government's policies, even though faced with a "revolution of expectations" with regard to reducing poverty and inequality from a considerable proportion of Brazilian society, have proved to be based on the "art of the possible." This was due not least to learning processes on the part of leading members of the executive with regard to the functioning of the international economic system. Nevertheless, the government has been criticized for not pursuing consistent and reasonable policies. One good example of a meaningful reform that neither the Cardoso nor the Lula administration has been able to enforce is the reform of the political system. Many experts and parliamentarians consider such a reform necessary, in order to equalize the representation of the regions inside the parliament, to reduce the number of parties, to increase the efficiency of parliament, and to discourage widespread party switching. Above all, the smaller parties inside the government coalition profit from the current situation, which is why the executive would jeopardize the cohesion of its own alliance in pushing ahead with such political reforms.

Policy learning

15 | Resource Efficiency

The Lula administration uses most available resources efficiently. Disciplined fiscal and monetary management enabled progress in economic outcomes during the period under observation. When he took office in 2003, Lula faced a crisis in investor confidence, reflected in high sovereign spreads, currency depreciation, and the resulting negative spiral of economic implications. Prudent macroeconomic policies, including primary fiscal surpluses, wise debt management, consistent pursuit of enhanced credibility in the inflation targeting regime, and maintenance of the floating exchange rate led to a turnaround in this situation. Brazil's risk coefficient for the international financial markets fell from 2400 basis points in 2003 to about 200 basis points by December 2006. Inflation fell from 12.5 % in 2002 to 3.1% by the end of 2006. Debt and external vulnerabilities have been substantially reduced. Primary fiscal surpluses, steady growth in real GDP, and the recent decline in interest rates have contributed to a decline in Brazil's net public debt ratio (from about 57% of GDP in 2003 to

Efficient use of assets

around 50% percent of GDP at the end of 2006). The government has met or exceeded its annual primary fiscal surplus targets, making this an effective device to demonstrate policy credibility. Fiscal policy has allowed Brazil to reduce its external public debt stock. Much progress has been made in strengthening the institutional framework for public debt management.

While improvements in the economy owed much to the government's reliable and consistent macroeconomic policies and to the individual qualifications of its main protagonists, they were equally the result of the strengthening of institutions during the Cardoso years, which helped maintain macroeconomic discipline. The Fiscal Responsibility Law (FRL) approved in 2000 imposed order and accountability on spending by the states through a general framework of budgetary planning, execution and reporting that was applicable to all levels of government. On revenues, the law mandates the withholding of discretionary federal transfers to states and municipalities that do not collect their own taxes effectively. The FRL requires that governments match any permanent spending decision with a corresponding increase in permanent revenues or a reduction in other permanent spending items. The FRL also weakens the power of governors to influence national policies, since it gives states more responsibility for their own fiscal problems, reducing their ability to hold the federal government hostage on fiscal grounds.

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

In theory, multi-year plans, yearly budget guidelines and the budget itself are all discussed and approved by Congress. In practice, the legislative branch is often sidestepped, since the constitution allows for the automatic spending of a share of the previous year's budget if Congress has not approved the budget. Although the executive cannot perform unauthorized expenditures, a problem stems from the fact that the budget is not compulsory. This allows the executive to not fulfill the budget in its entirety and is used politically to co-opt parliamentary support. Furthermore, deputies usually propose individual amendments to the budget proposal that comes from the executive. The approval of these amendments provides the opportunity for the president to use his powers of budgetary appropriation to obtain political support for his agenda from the members of the legislature and thus keep the coalition together, even in the context of a highly fragmented party system. There are regulations requiring an impartial,

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

In October 2002, representatives of 19 political parties were elected to the lower house of Congress. Although President Lula's party received only 17.7% of the vote, it was able to construct a broad parliamentary alliance composed of seven political parties. The most significant step in the construction of this alliance was the de facto integration of the conservative Brazilian Democratic Movement Party (PMDB) into the governing coalition. The successful forging of a broad but very heterogeneous ruling alliance as well as President Lula's close cooperation with governors from all political parties ensured that important reforms could be passed in 2003 and 2004. But the price for these successes was high, as coalition members had to be compensated with posts inside the government and the public administration. As an opposition party, the PT had repeatedly criticized the traditional spoils system of Brazilian politics, but once in power it acted in the same manner as its predecessors. With the goal of attaining a congressional majority, it established a give-and-take, clientelist policy of exchange of favors that started to backfire during its second year in office, turning the executive somewhat into dependents of old political bosses in the lower house and in the Senate. Even worse, the PT used secret funds to finance PT campaigns and paid bribes to lawmakers in exchange for their support. The disclosure of these scandals in 2005 caused a serious political crisis that made governing even more difficult. The president's coalition strategy led to growing dissatisfaction within the PT. Intra-party frictions increased considerably during Lula's second year in office. While the government's policies were strongly focused on preserving macroeconomic stability, elements in the PT and former allies in civil society demanded more distributive justice and a major push in the struggle against poverty and social disparities.

Policy coordination

Most integrity mechanisms are reasonably effective and are actively supported by the government. The Fiscal Responsibility Act subjects all levels of public administration to scrutiny based on how well they fulfill the criteria of transparency and discipline. The act makes them responsible for their fiscal performance and puts a check on corrupt behavior. There are regulations governing private contributions to political parties. Individuals can donate up to 10% of their declared income to candidates, while firms can donate up to 2% of their annual revenue to candidates. Donations to parties are not limited. All contributions are made public after the elections. Beginning in 2006, candidates

Anti-corruption
policy

are required to report on the donations they received, without identifying the donors. There are no limits on total political party expenditures. Candidates must declare how much they will spend in an election, but this amount may be adjusted. The media is able to report on corruption and increased its coverage of corruption in recent years, even to the point that some now think that corruption, not the disparate concentration of wealth, is Brazil's worst problem. Brazilian voters are increasingly aware of and educated about corruption. The national media are free from the federal government's pressures, but the economic pressure of government advertising and the use of regulatory power is important. In many states, there is only one local media conglomerate, often controlled by political groups. No journalists investigating corruption have been imprisoned or physically harmed. Citizens have a right of access to government information and basic government records. Whether access to information is effective depends on the institution. Federal organizations either respond immediately or respond that the information does not exist. In states and municipalities, most organizations do not respond. Anti-corruption civil society organizations are highly active in political councils at the legislative and executive levels. The judiciary can review the actions of the executive and the legislative branches. The heads of state and government, ministerial-level officials and members of the national legislature are required to file a regular asset disclosure form. Disclosure forms are published in the Official Gazette. Citizens can access this information. There are regulations governing gifts and hospitality offered to members of the executive branch. There are no restrictions on heads of state and government and ministers entering the private sector after leaving the government. Legislation was passed a few years ago during the Cardoso administration preventing ministers and top officers from entering the private sectors immediately after leaving office, but there are many loopholes. Sometimes ministers are not only employed but continue to run their own firms while in power. There are regulations addressing conflicts of interest for public procurement officials. All public procurements are widely advertised. The government is required to publicly announce the results of procurement decisions.

16 | Consensus-Building

All major political actors agree on the need to strengthen democracy, though they disagree on which path should be taken to reach this goal. Sections of the ruling Workers' Party (PT) and its allies in civil society advocate a relatively direct model of democracy. There are also conflicting positions on the relevance of the market economy. While government officials follow a market oriented course, a considerable section of the PT is critical of the Lula administration for pursuing the very same policies in opposition to the party was once launched.

Consensus on goals

While the government itself claims to have moved away from the “neoliberalism of the Cardoso years,” its internal adversaries complain about a “continuity of the neoliberal adjustment.” In this process, the PT leadership has not always acted prudently toward its critics. Some noted party activists have been expelled because as Congress members they did not vote for the government’s social security reform. Others have left the party. In September 2005, only a tight vote kept the PT’s national presidency in the hands of the party’s main faction Campo Majoritário, to which Lula belongs. The Campo Majoritário’s candidate managed to win with 51% support in the runoff vote. This, however, was the first time in the PT’s history that no candidate had managed to win majority support in the first round, a clear sign of the increasing divisions within the PT. Support for the Campo Majoritário faction, whose leaders have been implicated in corruption scandals, has dwindled. The party’s leadership contest result prompted the defection of some 400 grassroots members, including several prominent figures. President Lula’s relationship with Congress has also been difficult. In February 2005 he suffered a significant defeat when his candidate for the presidency of the chamber of deputies was defeated. It was only on 28 September 2005 that the communist Aldo Rebelo, a former member of Lula’s cabinet, was elected the new president of the lower chamber of Congress. The government and its allies in Congress rallied behind Rebelo in order to regain control of the lower chamber of Congress. Negotiations to win support for Rebelo’s candidacy, however, involved courting the same parties involved in the corruption charges with the PT. The government paid more than R\$500m (US\$217m) to allied congressmen for them to carry out pet projects back in their constituencies in exchange for giving support to Rebelo. The government also freed resources worth BRL1 billion (\$534m) to the ministries controlled by the allied Partido Liberal (PL), the Partido Trabalhista Brasileiro (PTB) and Partido Progressista (PP).

While there are no clearly anti-democratic veto powers in Brazil, powerful landlords in some rural areas effectively own the local judiciary and police, and they respond violently to attempts at agrarian reform.

Anti-democratic veto actors

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

Cleavage / conflict management

The participation of civil society, including the role of various councils and committees at regional, state and municipal levels, is seen as important for instituting effective public policy. The Lula administration conducted consultations throughout the country, involving more than two thousand civil society organizations representing labor, women’s groups, environmentalists, consumer fora, indigenous peoples, Afro-Brazilians, the landless movement,

Civil society participation

religious communities and the handicapped. It also created and convened popular national councils and fora, embracing different aspects of its policies. President Lula opted to dialogue and negotiate directly with the Landless Workers' Movement MST (Movimento dos Trabalhadores Rurais Sem Terra), with the National Conference of Bishops, and with the Brazilian Association of NGOs. However, this kind of democratic inclusion in public policy does not produce sudden reversals of economic stagnation, unemployment, hunger, poverty, land concentration and social injustice. On the contrary, it can lead to growing frustration toward the political system if the inclusionary policies do not show visible results along the way.

Brazil's military regime, which governed the country from 1964 to 1985, left behind fewer victims than did the dictatorships in neighboring countries. Some 300 people were murdered, compared with 3,000 in Chile and at least 10,000 in Argentina, much smaller countries. However, in Brazil, thousands were tortured, jailed or exiled. Survivors make up President Lula's government, and the president himself was imprisoned during the military regime for leading strikes. Brazil eased away from military rule without a final settling of accounts. Before returning to the barracks, the military declared a reciprocal amnesty, absolving both the regime and its opponents of their crimes. The armed forces never apologized, nor did the government investigate their crimes or imprison the generals responsible. The armed forces have gradually accepted democratic rules, but a process of national reconciliation has not taken place. Brazil's previous president, Fernando Henrique Cardoso, decreed a doubling of the secrecy period for classified documents. However, increasingly, victims are pressing for the access to secret archives.

Reconciliation

17 | International Cooperation

The political forces have applied international assistance directly to the requirements of their transformation and have demonstrated their adaptability. In many areas, the Lula administration's reform policies are consistent with the programs of such international organizations as the IMF, the World Bank, UNDP and the Inter-American Development Bank, and are often implemented in close cooperation with these organizations. Conversely, organizations like the World Bank appreciate the close collaboration with the Lula administration and concede that it is guided by a vision for a more equitable, sustainable, and competitive Brazil.

Effective use of support

The government is considered credible and reliable by the international community. While Brazil's risk coefficient for the international financial markets skyrocketed to 2400 points before President Lula took office, it came down to 200 basis points at the end of 2006. International organizations as well

Credibility

as consulting agencies praise the government's budget discipline and its reform policies on the way to a market-based economy.

The Lula administration is making active and successful efforts to establish and deepen as many cooperative international relationships as possible. Relations with neighboring states are constructive but have increasingly run into dissent and disputes during the last two years. During president Lula's first two years in office, Brazil strengthened its role as a regional power in South America through a more active foreign policy. Under U.N. command and supervision, the government committed military forces to Haiti to assist the efforts to stem violence. Brazil resumed a leading role in the Friends of Venezuela initiative, created to search for a peaceful solution of the country's internal conflicts. At the WTO summit in Cancún, Mexico, in September 2003, Brazil constituted a driving force behind the G20 group of developing nations from Latin America, Asia and Africa which prevented the Doha round of WTO negotiations from succeeding in protest at the agricultural policies of the world's economic superpowers, notably the United States and the European Union.

Regional cooperation

While Brazil actively stimulated the establishment of a South American Community of Nations in December 2004, differences regarding the nature of the endeavor between Brazil and some of its neighboring countries have quickly become obvious. In 2005, Brazil's bid for a seat on the UN Security Council faded, not least because of a lack of support from neighboring Argentina. After the "nationalization" of Bolivia's gas and oil fields in May 2006, relations with Bolivia deteriorated. The decision affected the Brazilian government-controlled Petrobras, but it was above all the aggressiveness with which it was announced that angered the Lula administration. Since then, diplomatic relations between Brazil and Bolivia have been dominated by controversial negotiations over the price of natural gas the former imports from the latter. The agreement reached between the two countries in January 2007 allowed both governments to save face. In future, the price paid by Petrobras for Bolivian gas will be nearly quadrupled. This is less than the Bolivian government had claimed. For the Brazilian press, however, the new terms of the contract were just short of total humiliation.

Relations between the five member states of Mercosur (Argentina, Brazil, Paraguay, Uruguay and Venezuela) have also become troublesome. While South American leaders still aspire to deeper integration, national interests and conflicting political opinions are limiting the possibilities of firm agreements which could implement these aspirations. The smaller members, Paraguay and Uruguay, are bothered by trade asymmetries within the customs union. The Brazilian government recently presented a number of proposals to reduce asymmetries in Mercosur and make it more attractive to Paraguay and Uruguay, but its proposals ended up being blocked by the Argentine government. In Brazil

there is also rising concern that Mercosur's new member Venezuela might be using the integration body to satisfy its own political goals. President Chávez repeatedly made it clear that he wants to "rid Mercosur of neo-liberalism" and push for integration on political grounds. Brazil has welcomed Venezuela's Mercosur membership from an economic and commercial point of view. At the same time, the Lula administration has become aware that Brazil's influence in Latin America at least partially has been called into question in recent times, while Venezuela's President Hugo Chávez has taken a lead role in the region, acting as self-appointed spokesman for Latin America.

Strategic Outlook

When starting his second term in January 2007, President Lula appeared to be in a more comfortable situation than four years ago, having obtained the support of the largest party in the lower chamber, the Brazilian Democratic Movement Party PMDB. Altogether, the new coalition government forged by Lula embraces 12 political parties that control 320 of the lower chamber's 513 seats in. This means that the government theoretically has the two-thirds majority in the lower chamber needed to pass the most controversial legislation. In the Senate, Lula has secured the backing of 42 senators out of a total of 81. Because the government has only a simple majority in the Senate, extra-coalition negotiation is necessary to pass more contentious items in the government's legislative agenda.

It remains to be seen whether Lula will be able to establish a functioning relationship with the PMDB and with his own party, the PT. Lula started his first term of office with the PMDB on his side, but ended up losing the party's support halfway through it. The PMDB was split on whether it should support Lula or be more active in its role as an opposition party. In recent years, a pro-government PMDB grouping was represented by three cabinet members, the heads of the health, communications and mines and energy ministries. Aside from these figures, a large faction of the PMDB was in opposition. After gaining control of five ministries in Lula's second term, it has been able to pacify infighting between its factions.

Although Lula's own party pledged total support for him, during his second term of office, the PT has continued to be divided into internal factions which are not expected to vote with the government in all instances. The PT already has signaled that it will not give up its strong position in Lula's second administration. The party wants to keep the control of key ministries and institutions, particularly those with more influence over economic policy. The PMDB has also signaled an interest in increasing its influence in the government. On 1 February 2007, both parties agreed to support each other during the contest for congressional leadership resulting in the re-election of a PMDB senator for the Senate presidency and the election of a PT deputy for the presidency of the lower chamber. Lula seems to have no other option but to find positions in the government for all the PT and the PMDB factions if he is to avoid a repetition of conflicts that undermined his first term. This, however, will create problems with the smaller parties within his coalition, which will be forced to give up the control of their ministries.

President Lula will face various challenges in the upcoming years. First, investigations into the corruption scandals are still ongoing. If these investigations ever focus in on the executive branch, he will have great difficulty in maintaining his positive image. The second challenge consists of boosting economic growth rates. During the run-off campaign, Lula promised to bring economic growth rates up to 5% or more annually after 2007. Five percent is considered the minimum rate necessary to further improve Brazil's welfare system, fund the government apparatus and service debt without increasing taxes. On 22 January 2007, the government launched a package to accelerate growth called the Programa de Aceleração do Crescimento 2007 – 2010 (PAC). The measures introduced by the PAC aim to increase growth to 4.5% in 2007 and then 5% for the rest of President Lula's four-year term. The PAC calls for the government to invest \$236.6 billion over the next four years. The government will provide about 10% of the total PAC commitment. The rest of the money will come from state-owned companies and the private sector. The government target for infrastructural development includes improving 42,000 km of roads, and 10,000 km of railways, enlarging 12 ports and 20 airports, and building 13,800 km of high-voltage electricity transmission lines. Besides this, the gas transport business will be opened up to private sector companies. Furthermore, the government promised to cut as much as \$3.1 billion in taxes in 2007 and a further \$5.34 billion in 2008. These tax cuts are intended to prompt the private sector investment in essential infrastructure and boost economic growth. The PAC proposal was scheduled to be voted on in March 2007, but because the opposition has been able to delay this process, it is still pending.

A third challenge for Lula's government is the realization of the past-due political reform to make Brazilian politics more transparent and accountable. Brazil's fragmented party system and the lack of constitutional tools to force politicians to obey party directives are the main reasons why it is so difficult for the executive to pass legislation in Congress. Moreover, the confusion surrounding campaign financing rules significantly increases corruption in Brazil. A fourth challenge will be to contain the increasing violence in the country. President Lula's inauguration for a second term on 1 January was overshadowed by a recurrence of violence by drug gangs in Rio de Janeiro, resulting in 25 deaths. Lula declared the attacks acts of terrorism and promised that his government would combat violence with a strong policy and with the firm hand of the Brazilian state. But he has yet to present a comprehensive concept to fight not only the symptoms but also the causes of this violence.