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Brazil in the Crucible of Crisis

MATTHEW M. TAYLOR

Brazil's outlook has dramatically deteriorated. After nearly a decade of solid growth that contributed to four consecutive presidential election victories for the Workers' Party (PT), the country faces a period of “lean cows,” as a somber President Dilma Rousseff acknowledged to a meeting of mayors in April 2015. Gross domestic product was on track to shrink by more than 3 percent in 2015, and looks set to repeat this dismal performance again in 2016, even as inflation running above 10 percent and the deterioration of government finances hamper an effective policy response to the recession.

Brasília, meanwhile, has been paralyzed by a series of interconnected scandals that cast a shadow over many leading players on the national stage. In December, the storms on the horizon grew even more menacing and unpredictable, as the president of the Chamber of Deputies filed impeachment proceedings against Rousseff, sparking Brazil's most dangerous political crisis since the impeachment and resignation of President Fernando Collor in 1992. As the country looks ahead to the impeachment process in the first half of 2016, municipal elections in the second half, and a presidential election in 2018, the intertwined crises raise questions about the future of economic policy, the rule of law, and the coalitional system that has governed Brazil since the end of military rule in 1985.

The political and economic crises share a common origin in the seven good years that followed the 2002 election of Luis Inácio Lula da Silva as president. The discovery of offshore oil, a China-propelled commodities boom, and the initially prudent macroeconomic policies of

Lula's pragmatic PT administration contributed to the most sustained economic growth of any period since the return to democracy. The bonanza enabled the government to undertake a series of impressive projects, including an expansion of social policies that helped move 40 million citizens into the middle class and massive infrastructure projects in the shipbuilding and energy industries.

The combination of market-friendly macroeconomic policies and strong growth strengthened the hand of “developmentalist” economists within the government (most notably Guido Mantega, who served as minister of planning, president of the national development bank, and then finance minister between 2006 and 2015). It seemed to have set Brazil on a unique path of state capitalism that combined moderately neoliberal macroeconomic prescriptions with a leading role for the state in promoting industrial development. The government's reaction to the discovery of major new offshore oil fields exemplified this mix: It gave state-owned oil company Petrobras the leading role in exploration, financed local shipbuilding and refinery firms, and favored domestic companies through local content requirements and targeted credit.

Lula's 2003–10 presidency was triumphal, and Brazil at last seemed to have found its way after the lost decade of the 1980s and the turbulent 1990s. Lula thrived despite a corruption scandal in 2005, dubbed the *mensalão* after the monthly under-the-table payments the government made to legislators to ensure their support. Brazil rode out the global financial crisis of 2008–9 with hardly a hiccup, and the combination of strong growth and Lula's enthusiastic backing ensured that the previously little-known Rousseff won the 2010 election by a margin of more than 12 percentage points. But the boom years also laid the stage for

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the corruption and loose fiscal policies that have since cast a pall over Brazil.

Falling commodity prices, slowing growth in the world economy, and the exhaustion of the government's stimulus efforts all took an inevitable toll during Rousseff's first term. The force of the ebbing tide was magnified by massive, if rudderless, street protests against corruption, overspending on the 2014 World Cup soccer tournament, and lackluster government services. The uncharismatic Rousseff persevered to win reelection, however, with help from Lula and the large share of the electorate that had benefited from declining inequality and rising economic prospects. She managed to scrape by in the second round of the October 2014 election, prevailing by a 3-point margin over opposition leader Aécio Neves of the Brazilian Social Democratic Party (PSDB).

SPATTERING SCANDAL

As the country headed into the 2014 electoral season, police and prosecutors on the trail of political corruption in the state of Paraná wiretapped a conversation that suggested a black-market money dealer (*doleiro*) had given a Land Rover to a top executive at Petrobras. The ensuing investigation, given the code name *Lava Jato* (Car Wash) turned up questionable payments to the *doleiro* from the winners of a contract to build the massive \$18 billion Abreu e Lima oil refinery in Pernambuco state, which was plagued by cost overruns and delays.

Plea bargains by nearly three dozen defendants led to 75 convictions, pending charges against nearly 200 others, and the recovery of nearly \$500 million in bribes. The nightly news has seen a regular parade of defendants being flown to Paraná's capital, Curitiba. No part of Brazil's traditionally prison-immune elite has been spared: *doleiros*, politicians, Petrobras executives, lawyers, construction magnates, and a powerful banker have all been jailed.

The scandal has spattered thick and fast across the political landscape. Petrobras, the crown jewel of Brazil's state capitalist model, has been laid low. Rousseff, who served as Lula's minister of mines and energy and also chaired the Petrobras board at the time of the alleged wrongdoing, has claimed absolute ignorance of the scheme. Rousseff's

handpicked president of Petrobras, Maria das Graças Foster, was forced to resign along with most of the top corporate leadership only a month after Rousseff's second inauguration, as it became clear that a combination of bad management decisions and failure to curb wrongdoing would severely undercut the company's performance. Petrobras' market capitalization has fallen more than 90 percent, from a high of \$380 billion in 2011 to \$30 billion by late 2015.

Even more troubling has been proof that political operators from across the spectrum were involved. As *Lava Jato* reached critical mass by early 2015, prosecutors alleged that the proceeds of corruption were funneled to three parties in the governing coalition: Rousseff's PT and its largest ally, the Brazilian Democratic Movement Party (PMDB), as well as the smaller Progressive Party (PP), whose late leader, José Janene, was an original target of the Paraná investigation.

The PT's treasurer, João Vaccari Neto, was sentenced to 15 years in prison for funneling bribe

money to the party coffers. Lula's former chief of staff, José Dirceu, found himself back in jail less than a year after his seven-year sentence in the *mensalão* scandal was commuted to house arrest. They were joined behind bars by executives of Brazil's largest

construction firms, including heirs and top executives of the Odebrecht, Camargo Corrêa, and Andrade Gutierrez empires, whose ties to Brasília have been tight for decades. Meanwhile, a retired admiral and principal architect of Brazil's nuclear program has been arrested for bribery in the construction of an electric plant.

The rapidly evolving corruption story is not limited to Petrobras or construction firms. Another major investigation, code-named Operation *Zelotes*, has been looking into allegations that an obscure regulatory board within the finance ministry, the Administrative Council of the Revenue Service (CARF), has systematically voided multimillion-dollar fines for tax evasion. There were more than \$4.5 billion in suspicious exemptions for large corporations between 2005 and 2013. Investigators became suspicious of the many lawyers who sought to join the CARF, even though the positions offered no salary. Anonymous accusations pushed the case into overdrive.

The investigation has targeted one of Lula's sons; the father of the PP leader in the Chamber;

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former federal revenue secretary Otacilio Cartaxo; and a prominent minister on the federal audit court, Augusto Nardes. On a parallel track, a congressional committee of inquiry hauled in a series of business executives, primarily from auto manufacturers and large dealerships, to testify about their lobbyists' and lawyers' dealings with the CARF. More recent evidence suggests that provisional laws granting tax exemptions to particular business sectors may have been up for sale.

IMPEACHMENT INTRIGUE

In the bewildering chain of events that consumed Brasília during 2015, the most fateful was the filing of ethics charges against Eduardo Cunha, the president of the Chamber of Deputies. In February 2015, Cunha had defeated the government's candidate in an election for that post, promising to represent members of Congress who felt underappreciated by Rousseff, with her notably insular governing style. A member of a dissident faction of the PMDB, Cunha mixes commitment to conservative evangelical Christian causes with the taint of a litany of corruption allegations that date back to his appointment as president of a state-owned firm under Collor. One prominent *doleiro* alleged that bribes from a Petrobras ship contract were paid as contributions to an evangelical church, presumably at Cunha's behest.

By the middle of 2015, Cunha had broken completely with the government. The final straw came when accusations by five defendants in the *Lava Jato* case pointed to him as the mastermind of corruption in Petrobras' international operations department. They said he had opened a Swiss bank account to receive \$5 million in bribes from the company's contracts in Africa. Cunha saw the government's hand behind the allegations, and quickly retaliated by launching committees of inquiry to probe corruption in the national development bank and state-controlled pension funds.

Cunha and Rousseff spent much of the second half of 2015 in a standoff, with each threatening to move forward on charges against the other, but neither actually pulling the trigger for fear of mutual destruction. Records from the Swiss government showing that Cunha indeed held

accounts in that country, which he had denied under oath, tipped the balance. By early December, despite intense procedural maneuvering by Cunha, the congressional ethics committee met to consider his expulsion. When behind-the-scenes negotiations between the president's staff and a Cunha ally fell apart, and the three PT members of the ethics committee announced that they would vote against Cunha, he exercised his prerogative as the chamber's president to push forward one of nearly thirty pending motions to impeach Rousseff.

The request was drafted by Hélio Bicudo, a nonagenarian former PT member and congressman; Janaina Conceição Paschoal, a criminal lawyer; and Miguel Reale Jr., a lawyer who served as justice minister in the PSDB government of President Fernando Henrique Cardoso, which preceded Lula's. In the choreographed delivery of the impeachment petition to Cunha's office, leaders of opposition parties and dissident members of the PMDB pointedly expressed their disgust with the

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PT and the corruption tainting it. They were accompanied by representatives of movements involved in orchestrating the street protests that have repeatedly been held in major Brazilian cities since June 2013.

But the irony is that even though the past year has been dominated by scandal, the impeachment petition has little to do with corruption. It is premised largely on the fact that Rousseff flouted budget laws by delaying government payments and used state-owned banks to cover up unauthorized debt issuance. Although the impeachment request includes many rhetorical flourishes about the corruption allegations surrounding the president and her predecessor, the legal basis for the request is that Rousseff violated the constitution and the Fiscal Responsibility Law of 2000 by permitting so-called fiscal *pedaladas* (delayed and disguised payments) in 2014. Such budgetary shenanigans, while illegal and much reduced since 2000, have been routine for decades. Rousseff's fiscal maneuvers, however, were unanimously rejected by the federal audit court in August 2015.

Rousseff's defenders complain that impeachment requires a proven case of wrongdoing during the president's current term (which began in January 2015), and that no sitting president has ever before been held

responsible for fiscal mismanagement. But needless to say, impeachment is an inherently political process and will not be decided by legal niceties. The danger to Rousseff is real.

Partly as a result of an October cabinet overhaul, the government appears to have built a defensive bloc of about 200 deputies in the 513-seat Chamber of Deputies. But the PT accounts for only 59 of the 171 votes needed to block impeachment, so Rousseff must ensure rock-solid support from her own party. Early-morning police raids on the homes of PMDB leaders, including Cunha, further undermined that party's support for Rousseff two weeks before Christmas. Other allies will be highly sensitive to the winds of public opinion, and polls suggest that at least three-fifths of Brazilians support impeachment.

DILMA'S DANGERS

Rousseff also faces dangers from two unexpected flanks. Lula has been faithful to Rousseff in public, calling Cunha's moves "insanity." This public loyalty makes sense, given that Rousseff was Lula's chief of staff and handpicked successor. But pundits note that Lula's sagging chances of making a comeback in the 2018 presidential election might be buoyed by impeachment: Not only would it make a martyr of the PT, but it would remove the party from the difficult position of implementing the kind of austerity policies that it has traditionally criticized. More directly, it would free Lula from being forced to defend the policies of a government that he has suggested is on the wrong track.

The weaker flank is Vice President Michel Temer, an old fox who would be next in line for Rousseff's position if she were to be impeached or resigns. As the PMDB's leader, Temer has spent much of the last year subtly undermining Rousseff, an effort that culminated in a private letter to the president complaining that he had been mistreated, which dominated news coverage when it was leaked to reporters in early December. It is unclear whether Temer is vying for greater influence in the government for his party, a game that the PMDB plays better than anyone else in Brasília, or whether he actually seeks to break with the government. Either way, Temer's role highlights the complexity of Brazilian coalition politics, particularly in times of crisis, and is a further indication of the rapidly shifting terrain under Rousseff's feet.

To make matters even less predictable, the impeachment petition is not the only imminent

threat facing her; a minefield of dangers lies ahead. Even if Cunha is expelled from the Chamber of Deputies on ethics charges, it is far from certain that he will be succeeded by a Rousseff ally. Prosecutors remain focused on potential bribes behind the purchase of the Pasadena refinery in Texas, which Petrobras bought in 2006 for \$360 million, one year after the refinery was acquired by Astra Oil for only \$43 million. Delcídio do Amaral, the former government leader in the Senate, agreed to a plea bargain after being expelled from the PT when a wiretap revealed his efforts to help a witness in the Petrobras case flee the country. And the Supreme Electoral Court in August reopened an investigation of Rousseff's 2014 campaign finances in light of the *Lava Jato* revelations.

Although street protests shrank during 2015 and leaned toward a political conservatism that does not represent the Brazilian mainstream, new demonstrations are being planned. If they draw large crowds, they could tip teetering government allies into the pro-impeachment camp. In today's volatile and angry climate, Brazilians might take to the streets if there are further revelations of corruption involving the Pasadena purchase, or in congressional testimony against Lula's family. There is very little good news that the Rousseff administration can offer as part of a counter-narrative to the "Pixuleco," a 12-meter-high inflatable doll of Lula dressed in prison garb that has been making the rounds at protests in various cities.

UNDERWHELMING FOES

The best things that Rousseff has going for her are the underwhelming opposition and lingering public perceptions that perhaps there is something not entirely legitimate about impeachment. The opposition, led by the PSDB and the conservative Democrats, controls only about one-fifth of the lower house, and has none of the appointment and revenue powers that traditionally hold together Brazilian coalitions. Moreover, the opposition does not speak with one voice; the PSDB is split into three rival camps of presidential contenders (José Serra, Geraldo Alckmin, and Aécio Neves). Internal consensus on whether to proceed with impeachment was slow in coming, partly because the better strategy seemed to be slowly bleeding Rousseff until the 2018 election.

The opposition fails to offer a compelling governing alternative, not least because its governors have also been accused of corruption, as

in the pending Minas Gerais state-level *mensalão* case. Many are confronting severe crises of their own, including water shortages, massive teacher and student protests, and budget cuts. With the possible exception of former President Cardoso, who is in his eighties and has no pretensions of returning to politics, there is an absence of a clear voice promoting a coherent policy alternative. The opposition still has not gained voters' confidence that it will preserve the social policies that have done so much to buoy the poor, or that it can do any better at avoiding the corruption that seems so integral to coalition politics in Brazil's multiparty system.

Rousseff supporters have argued that impeachment represents the worst of *golpismo*, or coup-mongering, and is a constitutional overreach that threatens to undermine democracy. Supreme Court President Ricardo Lewandowski, a Lula appointee, went on the record in November to argue that the country should be "patient" and avoid an "institutional *golpe*." This perspective finds some justification in the uglier facets of the opposition to Rousseff. A general was reassigned in October after criticizing the corruption of the political class and then planning a celebration for one of the most infamous torturers under military rule, Brilhante Ustra, who oversaw the garrison where Rousseff was imprisoned and tortured in her youth.

Equally important is public suspicion that an interim government led by Temer and the clientelistic PMDB would not bring greater probity or better economic policies. With this hesitancy in mind, Rousseff backers are pushing for the impeachment vote to be brought forward as quickly as possible. They aim to ensure that a vote takes place before public sentiment shifts or new allegations arise.

DEMOCRATIC FISSURES

This year will be dramatic and unpredictable. Impeachment, on balance, still seems unlikely. Convincing two-thirds of the Chamber to vote against Rousseff, and then the same proportion in the Senate trial, appears to be an uphill battle. But Congress will extract its pound of flesh in the form of spending and appointments, making it all the harder to achieve progress on desperately needed fiscal reforms.

The longer-term impact is potentially more significant. Whichever way the impeachment train rolls, the survivors will find that the crucible of crisis has opened new fissures in a democratic system that has been in place only since 1985. One of the few bright spots of the current situation is that Brazilian democracy is not under threat: This is a crisis of the government, not of the regime. But the underlying structure of the regime is likely to emerge in a new form in its aftermath.

The first challenge is economic. Two of three leading rating agencies cut Brazilian debt from investment grade to junk status in 2015. Corporate credit is tightening. Unemployment has risen from under 7 percent a year ago to nearly 10 percent, and is forecast to reach 12 percent by the end of 2016.

Fiscally conservative Finance Minister Joaquim Levy, appointed in January 2015 to stem the crisis, was caught in the crossfire between government supporters who oppose austerity and opponents who reject any policy put forth by Rousseff. He

failed in his efforts to obtain a primary fiscal surplus (before interest payments) during 2015, and most of the heavy lifting will have to happen this year. The primary budget balance fell from a surplus of 1.9 percent of GDP in 2013 to an expected

deficit of more than 1 percent in 2015. With no support in Congress, and little backing from Rousseff, Levy resigned in December, handing the reins over to his developmentalist colleague, Nelson Barbosa.

In the longer term, the structural imbalance of federal finances remains the central governance challenge. Very little spending is truly discretionary at the federal level: Only about one-fifth of it is free from constitutional or legislative mandates, and much of what is labeled discretionary is politically untouchable, such as the Bolsa Família program for low income families. The consequences of this will challenge Brazil's idiosyncratic state capitalist system.

Hard choices need to be made, but it is unclear who will be left standing to make them. Some change is already under way in the breach. Declining investment and tight budgets have pushed some states and state-owned companies to open new concessions and permit greater private-sector investment. São Paulo's powerful industrial federation has declared its support for

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impeachment, signaling that the private sector's patience with the status quo has worn thin.

The second challenge is political. Regardless of what may happen in the impeachment battle, the party system that has governed Brazil since the return to democracy has been turned upside down. Although there is not yet much polling to rely on, all indications are that the PT will face a bloodletting in the 2016 municipal elections. While he is the front-runner according to voting intentions for the 2018 presidential contest, Lula, the PT's once ironclad standard-bearer, also has the highest rejection rate of any potential candidate, at 55 percent, and polls suggest he would lose to any of the opposition leaders. Lula's declining poll numbers and the prosecutors doggedly nipping at his ankles suggest that the PT may be forced to find a new candidate, though there is no heir apparent.

The PMDB, for its part, is being torn asunder by the impeachment process. It has revealed an enormous regional divide between representatives from the poorer north and northeast regions, which benefited from heady growth and social spending under the PT, and the richer south and southwest, where the party's association with Rousseff's government is a heavy burden. The PSDB has been an ineffective opposition, in part because it fears being tagged as neoliberal or *golpista*, but also because each of the party's three major candidates is rejected by 45 percent or more of surveyed voters.

While the 2018 presidential election is too far away to call, the odds still favor a candidate from one of the three big parties, given their geographical reach and historical appeal. But the anti-establishment sentiment stirred by the dual crises could generate support for a relative outsider, such as two-time presidential candidate Marina Silva, or the soccer star and senator Romário. The other possibility might be a lesser-known candidate, such as Rio Mayor Eduardo Paes, a Rousseff backer in the PMDB whose city will host one of the few appealing events in an otherwise grim year, the 2016 Summer Olympics. Even before the 2018 elections arrive, however, legislative coalitions will need to be reassembled. The crisis is causing rumblings for a structural reform of the political system.

ENDING IMPUNITY

The third challenge for Brazilian democracy comes from the preeminent role that the courts and prosecutors have played in the recent tumult.

Many analysts (myself included) have pointed out that the current corruption scandal demonstrates that democratic checks and balances are working. Independent prosecutors have tackled the long-standing tradition of impunity for elites, better investigative tools have permitted more efficacious tracking of wrongdoing such as money laundering, new laws have facilitated plea bargains and other legal instruments that help to ensure witness cooperation, and judges—who have historically been timid and even biased toward elites—have forcefully supported prosecutorial efforts. The improvements are significant, and the shift has been remarkably quick.

A joke making the rounds on social media captures Brazilians' astonishment at the change. A defendant being led to a police squad car asks the officer to call his lawyer. The officer responds, "Don't worry, he's in the squad car ahead of you." "Can I call my bank to get some money for bail?" "Don't worry, your banker is in the car behind you." "I demand to see my representative!" "Yes, sir, your senator is waiting in your jail cell!"

The pressures of the *Lava Jato* scandal will force reckonings by the judiciary. Courts are increasingly treading on political turf. Government supporters complain that the treatment the PT has received is harsher than that faced by any previous ruling party, despite similarly convincing evidence of wrongdoing. In response, opponents note that the Supreme Federal Tribunal (STF), the nation's high court, has intervened in the impeachment drama on multiple occasions, including with an injunction that halted the process for review in mid-December. Eight of the STF's eleven justices were appointed by the PT, so the court will need to maneuver carefully to avoid accusations of partisan bias.

Corruption cases are increasingly putting the spotlight on the courts themselves, which are notoriously inefficient and costly, not least because of the enormous perks doled out to judges. Associated with this is corruption involving the courts: In the *Lava Jato* case, suspect decisions by the second-highest court in the land, the Superior Tribunal of Justice, led prosecutors to create an oversight group to monitor judges' rulings. A number of federal trial court judges have been reassigned after questionable decisions, and allegations of influence peddling on the STF have emerged.

There has been considerable pushback against the courts' active role. Rousseff unflatteringly

compared the plea-bargaining witnesses in *Lava Jato* to political prisoners who betrayed their comrades under torture by the military. Criminal defense lawyers have campaigned against the hard-nosed attitudes of prosecutors and judges in the *Lava Jato* case. While this must be chalked up to zealous advocacy, it also reflects an unresolved tension in Brazilian law between the strong rights protections established in the wake of authoritarian rule and the increasingly powerful anticorruption statutes implemented over the past thirty years.

Lava Jato serves as a bellwether for a new way of fighting corruption. The degree to which it has succeeded has a great deal to do with the skill and discipline of the judges and prosecutors involved. It is not a coincidence that the leading expert on Brazil's new anti-money laundering statutes is presiding in the *Lava Jato* case: Judge Sérgio Moro learned much of his craft from the

pitfalls prosecutors encountered in the 2002 Banestado public-sector banking scandal and as an adviser to the STF in the *mensalão* case. But there is no guarantee that his interpretation of the law, or the use of new prosecutorial instruments, will percolate up or through the judicial ranks.

The newfound proactivity of prosecutors and judges is largely welcomed by Brazilians, but it is putting pressure on three enduring patterns of the country's democratic governance: a fluid party system in which coalitions have been held together by horsetrading and worse; a state capitalist system in which the government plays the central role in coordinating business decisions; and a judiciary that has been permissive and timid in the political sphere. This is a decisive moment, but the crucible of crisis is still hot, and the resulting economic, political, and legal alloys are as yet inchoate and uncertain. ■