



What (and Who) Will Emerge from the Crisis in Brazil?

EXECUTIVE SUMMARY

Until mid-May, positive economic growth and declining inflation in the first quarter of 2017 suggested that Brazil was finally beginning to recover, slowly, from the longest and deepest economic contraction in its history. The May 17th release of taped late-night conversations between President Michel Temer and Joesley Batista, an owner of Brazil's JBS (the world's largest meat processing company), threw the political sphere back into chaos with significant implications for the government's reform agenda. In the recording, Batista admitted to attempts to obstruct ongoing corruption investigations—and the president seemed to encourage Batista to continue these unquestionably illegal acts. Although President Temer has refused to resign, the recordings have largely destroyed his legitimacy as president and sunk further his already abysmal approval ratings. Yet the path forward is far from certain. Some analysts believe Temer will manage to survive by exhausting the judicial appeals process; others believe his presidency is doomed, although the nature of his exit is still to be determined. Yet whether Temer leaves in one month or after the 2018 presidential elections, his reform agenda has been badly damaged and no clear successor has emerged. Who can steer Brazil on a path toward fiscal sustainability and reunite a bitterly divided electorate?

Introduction: Paulo Sotero, Director, Brazil Institute

Panelists: Maurício Moura, Founder and Chief Executive Officer, Ideia Big Data
Sérgio Fausto, Executive Director, Fundação Fernando Henrique Cardoso
Monica de Bolle, Senior Fellow, Peterson Institute of International Economics
Cláudio Gonçalves Couto, Adjunct Professor, Fundação Getúlio Vargas
Matthew Taylor, Associate Professor, School of International Service, American University
Carlos Eduardo Lins da Silva, Global Fellow, Wilson Center; Senior Advisor, FAPESP
Juliano Basile, Washington Correspondent, *Valor Econômico*

Moderator: Anna C. Prusa, Program Associate, Brazil Institute

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6th Floor, Woodrow Wilson Center

In his opening remarks, *Paulo Sotero*, director of the Brazil Institute, underscored that the current crisis is decades in the making. Stemming from the exhaustion of a political and economic system built during the reinstatement of democracy in Brazil in the 1980s, the crisis, he said, cannot be blamed on anyone but ourselves [the Brazilian people].

Moreover, he noted that this latest episode surfaced due to Temer's inappropriate interactions with JBS's Joesley Batista, a businessman who, after entering plea bargain negotiations, surreptitiously taped his conversations with the president. Not once in their discussions, in which Batista disclosed he was committing crimes, did the president confront Batista over these illegal actions, which included bribing the former Speaker of the House and current inmate, Eduardo Cunha. Nor did Temer report Batista to the authorities, despite hearing a criminal confession.

Sotero argued that due to Brazil's heightened awareness of its own corruption, these conversations effectively marked the end of the Temer administration. Temer could prolong his stay in office, but his reform agenda as originally envisioned is now unattainable. Brazil's efforts to overcome the recession, account for fourteen million unemployed, and address social welfare have been compromised. Underscoring the gravity of the present moment, Sotero referred to a recent interview by former Wilson Center Fellow and acclaimed historian Boris Fausto, in which Fausto called the present situation the "largest and most dramatic crisis in Brazil's history."

Maurício Moura, Founder and Chief Executive Officer of Ideia Big Data, presented findings from a new national opinion poll his company conducted at the end of May.

The first conclusion was perhaps the starkest. With 92 percent consensus, Brazilians have little to no faith that Temer will be capable of pushing his agenda forward. Low approval ratings and skepticism have drained his political capital. In addition, despite the political debate surrounding reform efforts, the average Brazilian voter remains largely unfamiliar with the details of the proposals. Only 42 percent supported Temer's pension reform, yet 86 percent agreed that the pension system should treat all Brazilians equally (though Moura noted that this was not Temer's proposition).

On labor reform, however, 63 percent of those polled would like to see the government's reforms move forward; a signal that labor reform is more popular than pension reform, likely due to large informal sector and high unemployment.

However, 35 percent of respondents said political reform should be the top priority for Brazil, although opinions differ widely on what needs to be changed and how these changes will be accomplished. Tax reform ranked second at 25 percent of respondents, followed by labor reform at 22 percent, and lastly, pension reform at 18 percent. According to Moura, this low popularity can be attributed to people's fears that they will have to work more to earn their pension. In a country where the narrative is that corrupt politicians fill their own pockets, people have no trust in the system and have little desire to work longer.

Tellingly, 66 percent of respondents viewed solving corruption as at least as important as improving the economy. There is widespread popular support for corruption probes like the Lava Jato Operation.

Looking toward the future, Moura expressed concern that polarizing candidates will do well in the 2018 elections, including figures such as right-wing Congressman Jair Bolsonaro and former President Lula (who is himself currently under investigation). Polls indicate desire for a centrist option, yet also for someone who can run as an outsider, not a politician. The resurgence of conservatism and the spread of evangelism seem likely to create political opportunities for someone capable of presenting an outsider persona. Establishment politicians, on the other hand, may find it difficult to generate much enthusiasm.

Sérgio Fausto, the Executive Director of Fundação Fernando Henrique Cardoso, characterized the Temer administration as "withering" and "fatally wounded," though not yet dead. However, Fausto conceded that it is hard to predict what will happen with any reasonable accuracy.

The current delays in Temer's removal, in Fausto's view, come from the inability to find a replacement that meets three criteria: 1.) legitimacy in the public opinion, 2.) majority-backing in Congress, and 3.) political skill to further the reforms. Not only are good leaders scarce, but the political and economic elite have also yet to agree on a way forward. Fausto argued that Congress is not yet ready to pass unpopular reforms, and so a new government could be problematic for both the markets and the political elite. Moreover, the public wants an outsider: something that is impossible under the circumstances. According to the 1988 Constitution, should Temer resign or be forced out, Congress would choose his replacement through an indirect election.

Fausto suggested that, since the system seems unable to produce a solution from within, there will need to be an external push. It could be an economic shock, a judicial decision, or even new revelations from the Lava Jato investigation. The situation is precarious. Temer certainly faces huge legal challenges, and there is plausible evidence that the judges will not be able to turn a blind eye. The attorney general will likely press charges against Temer, at which point the Supreme Court (STF) could determine both his destiny and the rules under which he will be replaced, given that both the presiden-



Left-right: Paulo Sotero, Maurício Moura, Juliano Basile, Matthew Taylor, Cláudio Cuoto, Sérgio Fausto, & Carlos Eduardo Lins Da Silva

cy and the vice presidency would be vacant in that scenario. Obviously, there are procedural and legal complexities that are unknown. But Fausto contended that political costs are rising with election season approaching in 2018, and society has already passed its judgment on the administration. Once the tape was played, there was no way to rewind it.

Cláudio Gonçalves Couto, Adjunct Professor at Fundação Getúlio Vargas, noted that Temer is severely handicapped at the moment. Couto argued that it will be difficult for Temer to survive as president, especially as a president who hoped to pass reforms. But Couto insisted that Temer does have certain tools allowing him to resist or delay the actions of the legislative and judicial branches. For example, Temer did not resign, which was a unilateral decision.

Couto identified several potential paths. First, the Supreme Electoral Court (TSE) could decide to invalidate the 2014 victory of Rousseff and Temer, which Temer could appeal. Judges can also petition to revisit or revise the decision. By the start of 2018, it will be too late in the second term to remove the administration—so Temer merely needs to delay the process to avoid being ousted. Second, Temer could become a defendant in a corruption trial before the Supreme Court (STF), which would last even longer than the first scenario. Third, Congress could vote to impeach Temer (although this seems unlikely at the moment). Couto warned that if impeachment were to happen, like Dilma's, it would not be fast.

With no consensus on a replacement for Temer, the political system is gridlocked. Temer will bargain more with Congress, leading to more compromise but also more inaction. However, Couto noted that new surprises—such as the recordings—could surface and drastically alter the political situation.

Carlos Eduardo Lins da Silva, Brazil Institute Global Fellow, Editor at *Política Externa*, and Senior Advisor at the São Paulo Research Foundation, pointed out that throughout its history, Brazil has solved all its major problems through negotiation—including its independence from Portugal, the abolition of slavery, and the transition from dictatorship to democracy—which sets Brazil apart from other Latin American countries. This crisis is another key moment, and there is hope that another peacefully negotiated solution is possible.

In Lins da Silva's view, President Temer is not Brazil's first weak or delegitimized president. José Sarney, Hermes da Fonseca, and Itamar Franco all preceded him—however, it is not clear what will happen this time. Lins da Silva argued that it was easier to predict Rousseff's fate. Rousseff was more transparent, choosing to fight until the end; Temer is more enigmatic.

Independent of whether Temer stays or goes, however, the country will not fall apart before the 2018 election season. Lins da Silva said that investors have not left Brazil—in fact, foreign direct investment has increased recently. Yet he also argued that journalists and other commentators should exercise greater prudence in discussing Brazil to avoid giving the impression that the situation is worse than it is. He cited one recent headline reading "Brasília is in Flames," when it just part of a building was on fire because of the actions of 100 people at most. A less sensationalist and more moderate view is necessary.

Matthew Taylor, former Brazil Institute Global Fellow and Associate Professor in the School of International Service at American University, highlighted Temer's calculated decision to remove resignation from the table—allowing Temer to string out his removal from office. Although Temer's strategy may not prove successful, Taylor argued that time is on the president's side with general elections just sixteen months away.

Moreover, Taylor noted that removing Temer will not be easy, since the needed popular opposition is not there. The streets are active, but the protests do not match the scale of those in 2013. The economic elite, he said, is also not entirely opposed to Temer. What this means is that the current crisis will rely on the judiciary, which has been under enormous stress since the Lava Jato operation began.

As a result, Taylor argued that the situation will likely get worse before it gets better. The case before TSE on the legitimacy of the 2014 elections could potentially be appealed to the STF, placing an additional strain on the highest court. The TSE's judgement (due in the near future) is the next important step. Whether a judge will have the nerve to put the case on hold and the ultimate outcome remains uncertain. Alternatively, should Temer be criminally indicted, his case would be heard by the Supreme Court—again straining the capacity of

a judicial system already overwhelmed by the scope of the corruption investigations. Moreover, there has been increasing pressure on the Federal Police and prosecutors across Brazil. Rodrigo Janot, the prosecutor general of the Republic, is departing office in September, which seems likely to exacerbate the crisis, according to Taylor. Complex political maneuvering will ensue in the battle to name his replacement. The Supreme Court's outspokenness will complicate matters as well, especially because of the affinity between certain members of the Court and Congress.

Monica de Bolle, Senior Fellow at the Peterson Institute of International Economics, split the Temer administration into two periods: pre-Joesley and post-Joesley (referring to the release of Joesley Batista's audio recordings of his incriminating conversations with President Temer) and suggested that the two are fundamentally different environments. She noted that the numbers for Brazil's first quarter 2017 GDP, which come from the pre-Joesley period, showed 1 percent growth—although non-government analysts claim the figure was only half a percent. Bolle pointed out that the National Statistical Office, which published the 1 percent figure, changed its methodology recently, leaving most market analysts in disagreement. The difference is not a trivial one, especially considering that government officials used the news to preemptively declared that the country is no longer in a recession.

Regardless of whether it was half a percent or 1 percent, the sector behind the GDP growth was agriculture: a seasonal contribution to Brazil's output that positively impacts the first quarter each year, with a much smaller contribution in the other quarters. Every other sector saw a contraction, except for negligible growth in manufacturing. Even the demand-side, which showed increases in net exports, reflects sales in agriculture. Investment and consumption were decreasing even before the Joesley recordings.

Bolle argued that the recent political developments have generated significant economic uncertainty, worse even than that from Rousseff's impeachment. Before the latest revelations, there was a clear path forward with clear benchmarks. Now there are no comparable situations. Thus the announcement by government officials that the recession had ended was premature. There has been one quarter of growth, but a second consecutive quarter of growth seems unlikely, particularly given the political chaos. Under conventional definitions, there must be two consecutive quarters of growth before a recession is officially ended. So far, markets have only partially

factored in the current uncertainty, with some still in the private sector still optimistically expecting a swift resolution.

However, the government's reforms, particularly pension reform, have been watered down so there is no guarantee that fiscal sustainability will be restored in the medium-term. Raising the retirement age to 65 is important, but it is not a solution to the fiscal deficit. Even when he still had political capital, Temer failed to make significant progress on restoring fiscal sustainability. For example, his administration chose not to repeal Rousseff's tax breaks, which Bolle argued did nothing but diminish government revenue. The Brazilian Development Bank (BNDES) facilitated cheap subsidies from the public sector to private firms, which Bolle said needs to change. Yet no fiscal plan exists, and a sword hangs over the economy heading into the 2018 election. Rating agencies have put Brazil on negative credit watch. In her view, the country is not out of the woods.

Juliano Basile, Washington Correspondent with *Valor Econômico*, said that during his almost twenty years of covering the TSE, the one thing he has learned is that judges equivocate when making decisions without knowing how they will be enforced. Temer's removal would lead to a similar impasse, since it is unclear when and what type of elections would be held, who the candidates would be, and who would select the new president. His sense is that the judges will wait for negotiations between Temer and Congress to play out.

Waiting will happen regardless if the Minister of Justice (who serves essentially as Temer's lawyer) requests a *pedido de vista* (a request to revisit a ruling), which Basile said would be perfectly normal given the case. He noted that other important rulings, such the question of whether Rousseff and Temer should be tried separately, will set precedents going forward. Thus removing a president without knowing all the possible consequences is not something the courts will take lightly. There is a strong sense of institutional responsibility.

Towards the end of his remarks, Basile alluded to a phrase by Nelson Jobim: "judicial decisions will not be about our future. They are concerned with the past." The Lava Jato Operation is widely supported, but it deals with the past. Moving forward requires vigilance to safeguard the institutions of Brazilian democracy, especially if new leaders, particularly populists, might interfere with the country's ability to rebuild its political system.



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