CHAPTER 2

Democracy and Reform in Cardoso’s Brazil: Caught Between Clientelism and Global Markets?

WILLIAM C. SMITH AND NIZAR MESSARI

This chapter explores President Fernando Henrique Cardoso’s record during his first term in office (1995-1999) and his successful reelection in October 1998 over the challenge of Luiz Inácio Lula da Silva, candidate of the Workers’ Party (Partido dos Trabalhadores — PT) and the left. These events are examined in the context of a central, inescapable dilemma of contemporary Brazilian politics: how to reconcile the exigencies of the market and globalization with the equally compelling needs to promote democracy while combating poverty, violence, and social exclusion. The chapter concludes with analyses of the first year of Cardoso’s second term and of various alternative politico-economic scenarios for Brazil during the period before the next presidential elections in 2002.

INTRODUCTION

Brazil is a mosaic of contrasts and contradictions. It is the third most populous democracy after India and the United States. It ranks fifth in the world in the size of its national territory, fifth in population (nearly 170 million), and eighth in gross national product, surpassing China. Brazil is wealthy, but it is also a country of tremendous poverty and inequality saddled with the legacy of an authoritarian past. Confronting these contradictions, President Fernando Henrique Cardoso (FHC) has attempted simultaneously to democratize Brazilian politics and society and make Brazilian capitalism more competitive in a volatile world economy. Many Brazilian and international observers praise Cardoso for abandoning an earlier flirtation with anachronistic, if not dangerous, leftist ideas. Meanwhile, erstwhile Cardoso admirers interpret his policies as Brazil’s leader as the capitulation of a former radical to the blandishments of the global market and Washington orthodoxy. Despite containing elements of truth, the Manichean polarities of such facile ideological formulas fail to capture adequately the complex realities of Brazil at the beginning of the twenty-first century.
In the 1970s, FHC attained international acclaim as a sociologist for his seminal work on dependency theory (Cardoso and Faletto 1979) and his role as one of the most influential critics of the post-1964 military dictatorship and its model of "associated-dependent" development (Cardoso 1973, 1975, 1979). Important elements of the basic worldview he forged during this period remain intact. Cardoso's protestation that he continues to be a "man of the left" and has "never been a neoliberal" rings true (Cardoso 1996c; Esquerda 1996; Folha de São Paulo 1996). In the early 1990s, shortly before he assumed the post of finance minister in Itamar Franco's government (1992-1994), FHC spelled out his vision of Latin American social democracy. He wrote that, in contrast to "populism, national-statism and renovated liberalism," social democracy must assume "responsible positions concerning the necessity of accumulation and economic growth, added to the qualities of a moral and concrete political force in favor of income redistribution and social welfare policies." Cardoso then added that

the real goal for contemporary social democracy concerns knowing how to increase economic competitiveness — leading to increases in productivity and the rationalization of the economy — and how to make the vital decisions concerning investments and consumption increasingly public ones, that is, how to make them transparent and controllable in society by consumers, producers, managers, workers and public opinion in general, not only by impersonal bureaucracies of the state and the private sector (Cardoso 1993: 286, 287).

Once in the presidency, however, FHC has seen this social democratic goal of combining capital accumulation with a thorough democratization of Brazil’s state, political regime, and civil society thwarted by the rigors of economic restructuring made worse by governability problems and the institutional constraints of the Brazilian political system, for example, an unrepresentative electoral system, weak parties, and a dysfunctional federal system. In fact, the difficulty of securing passage of reform legislation he considered crucial led FHC to believe that his own reelection to the presidency was the best guarantor of the continuity of market reform.

This conviction led him to downplay the need for social change in favor of strengthening ties with both the local and transnational business communities and his political allies from the center-right and right. FHC’s rationale rested on the optimistic premise that a second four-year term would be the most practical route to the delayed but still very important social and political transformations he has always advocated. It made sense, then, that he resorted to the old-fashioned politics of clientelism, patronage, and elite conciliation, although these practices ran counter to his earlier insistence that the democratic reform of Brazil’s arcaic political institutions was required if capitalist development were to serve the interests of the country’s poor majority. Thus, FHC’s intellectual and political commitment to deepening democracy had to accommodate the enduring realities of elite privilege and domination. This accommodation resulted in a limited program of modest social reforms conditioned by the realities of globalization and subordinated to the twin imperatives of economic stabilization and Cardoso’s own reelection.
Would this scenario, in which democratic social reform took a back seat to the economy, be reversed following FHC’s successful October 1998 reelection to a second four-year term? Having defeated his leftist rival, Luiz Inácio Lula da Silva, the candidate of the Workers’ Party (Partido dos Trabalhadores — PT), could FHC refurbish his somewhat tarnished social democratic credentials? To address these questions and to speculate on possible future developments, this chapter examines a central, inescapable dilemma of contemporary Brazilian politics: how to reconcile the exigencies of the market and globalization with the equally compelling need to promote democracy while combating poverty, violence, and social exclusion? Probing these issues, we find that Cardoso the sociologist is often the best critic (and adviser) of Cardoso the president.

THE PLANO REAL AND THE SOCIAL AGENDA IN AN “UNJUST SOCIETY”

Stabilization and Economic Growth

Fernando Henrique Cardoso won the presidency in 1994 with 54 percent of the vote, defeating Lula, the PT candidate. Cardoso’s victory was largely due to the optimism generated by the Plano Real, designed under his tutelage as finance minister during the government of Itamar Franco. During the 12 months before the Plano Real’s advent in July 1994, inflation had skyrocketed to a stunning 5,200 percent, yet, the Plano Real very rapidly brought mega-inflation under control, with prices rising during the rest of the decade at the slowest pace since the early 1950s. As Figure 1 shows, the Plano Real’s success contrasted favorably with previous stabilization plans.

Figure 1. Plano Real Versus Previous Stabilization Efforts
(Monthly Inflation Rate in %)

Source: Consumer price index (CPI) compiled by the Fundação Instituto de Pesquisas Econômicas (FIPE) from January 1985 to May 1998. See SECOM 1998a.
Table 1.
Selected Economic Indicators for Brazil

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Notes: a) GDP at market prices. Sector of Origin at factor cost; b) Excludes monetary and exchange correction; c) Minimum wage; d) Real$/US$; End of Period; Index 1990=100.
Table 1.—continued
Selected Economic Indicators for Brazil

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<td>149,857</td>
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A more stable economy reversed the stagnation of the early 1990s. The four years preceding the Plano Real had witnessed an average negative growth rate of 0.2 percent. Between 1994 and 1997, the gross domestic product (GDP) grew 17 percent at an average rate of 4 percent a year. Including 1998, Brazil achieved six consecutive years of economic expansion, something not seen since the late 1970s. Moreover, GDP per capita increased at an average annual rate of 2.6 percent, rising above $5,000 (all data is expressed in US dollars unless otherwise noted) in 1997 (SECOM 1998a).

The macroeconomic stability facilitated by the Plano Real also encouraged domestic investment, which, though still significantly lower than in Argentina or Chile, stood at approximately 18 percent of GDP in 1998, after floating around 15 percent since the beginning of the decade. Net foreign investment has been particularly dynamic, rising to $17 billion in 1997 and $26 billion in 1998, a more than tenfold increase since 1993 (SECOM 1998a). Spurred by liberalization policies enacted by Fernando Collor de Mello (1990-1992), Brazil’s international trade has grown by 140 percent since 1990, from $50 billion to a peak of about $110 billion in 1997. A substantial increase in imported capital goods (currently about 27 percent of total imports) is a sign of a vigorous industrial modernization process, which is reflected in data on productivity gains and the competitiveness of manufacturing exports (SECOM 1998a; LARR: Brazil 1997a, 1998d). Table 1 presents the relevant macroeconomic indicators for the 1990s.

However, what about social reform? During the 1994 presidential campaign, Cardoso spoke eloquently about Brazil’s “social debt” and the urgent need to attack the gaping inequalities between the wealthy elite and the privileged upper-middle classes and the urban and rural poor. Have stabilization and structural adjustment policies diffused prosperity broadly? Alternatively, have market-oriented reforms resulted in greater social exclusion? Here it is necessary to distinguish between poverty, which tends to decline with economic growth, and redistribution of income and wealth, which requires more fundamental transformations in the political economy and the class structure.

**Poverty and Equity**

The major achievement of the first Cardoso government on behalf of social justice was the Plano Real’s effective repeal of the “inflation tax” (see Figure 2), a repeal that allowed millions of Brazilians to increase their consumption. In mid-1994, the minimum wage could purchase only 60 percent of the basket of basic goods required for a family of four; by 1995, the same minimum wage purchased 90 percent of this basket; and, by 1998, a family might even have a little extra left over after meeting its basic food needs. According to the Brazilian Institute for Geography and Statistics (Instituto Brasileiro de Geografia e Estatística — IBGE), food consumption has increased across the board. Since 1994, chicken consumption jumped 40 percent, beef consumption 27 percent, and soft drinks 71 percent. Consumption of durable consumer goods also increased, with refrigerator sales up 55 percent, washing machines 69 percent, and color televisions 57 percent; in addition, sales of “popular” cars (less than 1,000 cubic centimeters) doubled. According to Cardoso’s economic team, millions of Brazilians, for the first time,
gained access to piped water, electricity, garbage collection, and telephone service. Reflecting these trends, official statistics show that extreme poverty (an income of less than about $50 per month) declined from approximately 35 percent of the population in 1994 to 25 percent in 1997 (SECOM 1998a).5

**Figure 2. Inflation Versus Poverty**

![Graph showing inflation versus poverty with years from 1991 to 1997 and percentage of poor and annual inflation](image)

Sources: Instituto de Pesquisas Econômicas Aplicadas (IPEA) and Fundação Instituto de Pesquisas Econômicas (FIPE). See SECOM 1998a.

President Cardoso trumpeted these gains on July 1, 1998, the fourth anniversary of the Plano Real, when he announced that, according to the most recent data compiled by the United Nations Development Program (UNDP), Brazil ranked for the first time among the top 50 countries as measured by the "human development index" (Jornal do Brasil 1998d; O Globo 1998). Brazilians’ prosperity is a welcome achievement, but due to other factors highly impervious to short-term amelioration — concentration of land ownership, an elitist educational system, racial and gender discrimination, and a huge informal economy — the reduction of extreme poverty does not necessarily translate into redressed inequalities. In fact, available data indicates that the post-1994 economy recovery left the deeply rooted structural inequities unchanged.

Household surveys confirm that the Gini coefficient, which measures inequality, has improved only slightly (0.614 in 1995, 0.58 in 1996, and 0.575 in 1998) in recent years, thus explaining the basic stability of income distribution. In fact, Brazil is one of the most unequal societies in the world: the richest 10 percent continue to appropriate around 46 percent of the nation’s wealth, the poorest half of the population makes do with only 14 percent, and the most impoverished 20 percent receive only about 2 percent of national wealth (Londoño and Székely 1997; Lustig and Deutsch 1998; Barros, Mendonça, and Rocha 1995; Brazil Focus:
Weekly Report 1999d). Thus, measured against the magnitude of the problem, the progress achieved so far has been of the *ma non troppo* variety. As FHC observed in his 1994 campaign, "Brazil is no longer an undeveloped country, it is an unjust country" (New York Times 1998b).

**Industrial Restructuring, Unemployment, and Urban Violence**

Disturbingly, examination of the impact of the Cardoso government's economic modernization policies reveals new manifestations of social exclusion. Reflecting, in part, strong import competition due to trade liberalization, industrial output increased only 6.3 percent in the first seven years of the decade. Despite this sluggish growth, intensive technological innovation and vigorous industrial reconversion significantly boosted labor productivity but did little to raise real wages. Moreover, considerable job loss and a proportionately steep rise in unemployment have also been reported. According to official IBGE statistics, from 1990 to 1997, the number of manufacturing jobs has declined by a whopping 38.1 percent. Consonant with trends throughout the region (Tardanico and Menjivar Larín 1997), this led to a rapid restructuring of the labor market: the combination of rising unemployment in the formal sector, fewer workers in regular employment, and multiplication of those employed in the burgeoning informal economy, who are without legal protections or benefits (Veja 1998a).

These trends have been devastating for the welfare of urban workers and their families. Survey data collected by the Inter Trade Union Department of Statistics and Socio-Economic Studies (Departamento Intersindical de Estatística e Estudos Socio-Econômicos — DIEESE), a well-known labor-affiliated research center, revealed that unemployment in greater São Paulo, Brazil's largest, most developed, and wealthiest metropolitan area, rose from 10.2 percent in 1990 to an unprecedented 18.9 percent in April 1998. Using a different methodology, the IBGE reported an average unemployment rate above 8 percent throughout 1998, up from 4.6 percent in 1995 (SECOM 1998a). Similar increases in joblessness are seen in the other major metropolitan areas of Rio de Janeiro, Belo Horizonte, Porto Alegre, and Salvador.

Urban violence and criminality have also risen sharply in recent years. Brazil ranks third among Latin American countries in homicides, with a rate of 19.7 per 100,000 inhabitants, roughly twice the U.S. rate and eight times the rate for Western European countries. Homicides are the number one cause (58 percent) of early death in Brazil, far surpassing auto accidents. Moreover, other forms of violence and criminality — drug trafficking, gunrunning, bank robbery, and kidnappings — have increased dramatically. Civil and military police are frequently perpetrators of the violence, particularly against shantytown dwellers, Afro-Brazilians, and street children (Pinheiro 1997; U.S. Department of State 1998). Although it would be a mistake to attribute violence and criminality solely or directly to market restructuring, there is little doubt that some of the consequences of economic reform, particularly high and rising unemployment, are linked to these problems. As recent studies (Ayers 1998; Morrison, Buvinic, and Shifter 1999) suggest, failing judicial systems, urban poverty, restricted employment opportunities, and inadequate
housing, education, and social infrastructure are among the main causes of the rise in violence and the general erosion of citizen security in Latin America.

**Agrarian Reform and the Sem-Terra Movement**

These transformations and their consequences in the urban areas of Brazil have noteworthy parallels in the countryside. The expansion of modern, export-oriented agro-industry has generated pockets of impressive prosperity, but living conditions for many of the rural poor continue to deteriorate. This deterioration has given rise to an unexpected "ruralization" of national politics, whose most salient expression is the revival of agrarian reform as a hotly contested issue.

Land tenure in Brazil is becoming progressively more concentrated in fewer large units. According to recent studies, some 44,000 large landholdings (about 1.6 percent of the total) encompass about 155 million hectares, or 50 percent of all Brazil’s farmland, an area roughly the size of Venezuela and Colombia combined. A middle group, consisting of about 394,000 farms (12 percent of the total), controls 32.1 percent of the arable land. In contrast, approximately 2.75 million small farmers (85 percent) eke out a living on only 18.9 percent of the nation's arable land. Another 4.5 million rural families (comprising as many as 30 million persons) are squatters (posseiros), renters, sharecroppers, and rural salaried workers who enjoy little legal access to land ownership (Fernández Franco 1997; SECOM 1998a, 1998c).

These highly skewed patterns of land tenure help explain the political influence of militant social movements seeking the democratization of access to land and the improvement of wages and rural working conditions (Pereira 1997a, 1997b). The Landless Workers' Movement (Movimento dos Trabalhadores Rurais Sem-Terra — MST), which claims 5,200 full-time "professional militants" and 300,000 active participants, is the most politically visible of these groups and one of the most powerful grassroots social movements in Latin America. The MST has carried out hundreds of illegal occupations and, according to the newsmagazine *Veja*, has taken over 7.2 million hectares of land, settling 130,000 people and creating 55 small rural cooperatives (FBIS 1998). Other important organizations include the National Confederation of Agricultural Workers (Confederação Nacional dos Trabalhadores na Agricultura — CONTAG), Brazil's oldest and largest rural labor movement; the Struggle for Land Movement (Movimento de Luta pela Terra — MLT); and the Pastoral Land Commission (Comissão Pastoral da Terra — CPT), a group with ties to the National Bishops Conference of the Catholic Church (Fernández Franco 1997; *El Mercurio* 1998a, 1998b; FBIS 1998).

Although land invasions have taken place in virtually every corner of Brazil, the focal points, in what sometimes resemble battlefields in a low-intensity civil war, are in the Pontal do Paranapanema region in the far west of the state of São Paulo and in the northern state of Pará. Land invasions in these regions often are violently repressed by police and, with increasing frequency, by private armed militias of modern-day jangueiros, thugs hired by landowner organizations such as the Democratic Rural Union (União Democrática Ruralista — UDR) and the National Association of Rural Producers (Associação Nacional dos Produtores Rurais — ANPRU). More than 1,100 labor leaders and peasant activists involved
in rural mobilizations have been assassinated since 1985 as a result of these confrontations. The partial collapse of state authority evidenced in the failure of law enforcement and the judicial system (Pinheiro 1997; U.S. Department of State 1998; Holston and Caldeira 1998; Pereira 2000) to punish human rights violations in the countryside means that perpetrators of these crimes, whether police or hired guns, normally enjoy total impunity.

The conflict, moreover, has taken on a radical political tone. The MST's principal leader, João Pedro Stédile, announced in 1997 that the movement's ultimate aim is to "finish off the neoliberal model" advocated by the government; he also warned that Cardoso's reelection would mean the "Colombianization" of Brazil, suggesting that uncontrolled violence and perhaps even armed conflict could engulf the countryside (LARR: Brazil 1997c; MST 1996). For his part, the then agrarian reform minister, Raúl Jungmann, who claimed that the "latifúndio is politically dead at the national level, though it still retains some power at the local level," charged that MST leaders "have three motives: politics, politics, and elections" (LARR: Brazil 1998a). Rhetoric aside, the government's response has been to make pragmatic concessions in an attempt to isolate the more radical MST leadership from its followers. Many land occupations have been legalized as the pace of agrarian reform has accelerated. However, although surveys by the National Colonization and Land Reform Institute (Instituto Nacional de Colonização e Reforma Agrária — INCRA) reveal many unproductive estates of up to 1.2 million hectares in size, only a handful of these large fazendas have been expropriated (Folha de São Paulo 1998a). The Cardoso government claims that in its first three years it has settled 190,000 families, exceeding the agrarian reform efforts of all previous governments combined (INCRA 1998). Land purchases are expensive, as is the provision of credit assistance to the families granted parcels. The government allocated $4 billion to reach the official goal of settling 100,000 families in 1998, with plans announced to spend more than $16 billion for this purpose by 2002 (SECOM 1998a; INCRA 1998).

Nevertheless, the Cardoso government's efforts to placate the landless have backfired politically. As the government itself has recognized, state attempts to address the crisis in the rural sector have set off a spiral of rising expectations fueling new demands as the growing supply of land made available stimulates competitive mobilization by the MST and other rival organizations such as CONTAG, which the government had cultivated in the past as a counterweight to MST (LARR: Brazil 1998c). Although they do not condone the use of violent methods and would lose nothing by the expropriation of large fazendas, a majority of middle-class Brazilians in urban areas support the goal of agrarian reform and tell pollsters they view the Sem-Terra movement sympathetically. It remains to be seen how this diffused support will play out, but it is clear that rural social movements supporting agrarian reform are likely to play a key role in efforts to overcome poverty and construct a more participatory civil society (Cadjı 2000; Navarro 2000).
FISCAL HYPERACTIVITY VERSUS GLOBAL FINANCIAL MARKETS

The success of the Plano Real hinged on a delicate balance among fiscal restraint, tight monetary policy, and access to adequate inflows of foreign capital. The goal of this strategy was to control inflation and prepare Brazil for a more competitive integration with the world economy. The consequence was that Brazil’s external vulnerability to global market forces, particularly its vulnerability to the vagaries of short-term flows of “hot money” in volatile financial markets, significantly increased. The “tequila effect” of 1995 that followed the Mexican meltdown in late 1994 presented the first challenge to the strategy of embracing globalization. The effects of the Asian financial crisis in October 1997 posed a second major test. A third challenge came in August 1998, when the economic meltdown and political crisis in Russia foreshadowed the need for modifications in the Plano Real to reduce Brazil’s exposure to the contagion effects of international financial instability.

The response of Cardoso’s economic team on these three occasions was to cling tenaciously to its “dirty” float policy within broad exchange rate “bands,” which allowed the real to gradually devalue in relation to the U.S. dollar. Reacting to the Asian crisis, for example, the Central Bank quickly boosted interest rates to 43.4 percent and reaffirmed the no-devaluation policy by spending $10 billion from its abundant international reserves to shore up the currency. These actions were followed, in November 1997, by an emergency austerity package of higher taxes and spending cuts equivalent to 2.3 percent of GDP (Jornal do Brasil 1997a; Latin American Monitor: Brazil 1997b; LARR: Brazil 1997e). Although many of these measures were never effectively implemented, the response worked, at least in the short-term: markets stabilized, and investors trusted Brazil again, thus allowing the Central Bank to gradually lower interest rates to their pre-crisis level and to rebuild international reserves, which soon rebounded too an all-time high of $74.9 billion in July 1998. However, the Central Bank’s intervention in currency markets in response to the Russian crisis, a plunge of 40 percent in local stock markets, and the downturn on Wall Street provoked a net loss of more than $10 billion in reserves during August 1998.

Although the Plano Real’s basic premises emerged intact, these episodes nevertheless highlighted the risks of the government’s strategy in a world of globalized markets (Folha de São Paulo 1997b, 1998d). Since Thailand’s devaluation of the baht, Brazil has been buffeted by successive bouts of skittishness of foreign investors, international bankers, and pension fund managers fearful of a new “contagion.” In this environment, the Achilles heel of the Plano Real’s hard-won macroeconomic stability is the “fiscal hyperactivity” of the Brazilian state, whose public sector, at 31.2 percent of GDP, is one of the largest of Latin America.10

The net public sector debt doubled during Cardoso’s first government, surpassing $300 billion (or about 36 percent of GDP) in early 1998 (Folha de São Paulo 1998f, 1998h; Estado de São Paulo 1998c). Not only was the debt huge, but, under the impact of the Asian crisis, its average maturity declined from nearly 11 months to less than eight months (Jornal do Brasil 1998i). The cancellation of
several debt auctions, when the government authorities refused to pay the interest rates demanded by investors, underscored the seriousness of this problem. The Central Bank was forced to roll over expiring debt by issuing bonds indexed to the overnight interest rate, a practice not widely used since the late 1980s, an era of economic uncertainty and rampant inflation. Naturally, the Central Bank’s accumulation of dollars — necessary to bolster reserves, maintain the exchange rate, and ward off speculative attacks against the currency — increased the money supply. This move left the economic team two unpalatable options: either accept higher inflation (threatening stability) or issue government bonds to soak up the extra liquidity, thus boosting interest rates and choking off growth (Folha de São Paulo 1998d, 1998g; Economist Intelligence Unit 1998; New York Times 1998a).

The vicious circle set in motion by the state’s fiscal hyperactivity also aggravated the public sector’s deficit. Although government revenues were at an all-time high in 1997, government spending rose even faster. By the end of 1998, Central Bank data revealed that the nominal fiscal deficit of the consolidated public sector (federal government, plus the states, municipalities, and state enterprises) had reached 8 percent of GDP. A primary cause of the deficit, of course, was the need to make high, at times astronomical, interest payments on the public debt. The postponement of reforms of the social security system and the public administration (together responsible for 11 percent of GDP) also exacerbated the fiscal deficit. A related problem was that the revenue the state governments received from the privatization of public enterprises, which was to have been used to reduce their debt, has been spent (some say squandered) on high-profile public works projects, payrolls, and other current expenditures (Folha de São Paulo 1998g, 1998j; Estado de São Paulo 1998b; Jornal do Brasil 1998a).

The perverse feedback loop between the state’s fiscal hyperactivity and volatile global financial markets had serious negative implications for economic growth as well. According to Central Bank data, because of growing deficits, the public sector’s share of the country’s financial savings jumped from 62 percent of the total in December 1995 to 85 percent in April 1998. Conversely, the private sector’s share declined from 38 percent to only 15 percent in the same period (Folha de São Paulo 1998g). In theory, the public sector’s voracious appetite for capital could be due to massive investments in education or infrastructure, which would result in both better equity and more rapid economic growth. However, in practice, financial resources have been used for interest payments, salaries, and to shore up the social security system. The private sector has been partially crowded out, obliging firms to resort to foreign loans, which increases Brazil’s international reserves but potentially creates other problems. The reality is that the basic economic model has changed: rather than the state, the model now looks to the private sector to engender economic growth. But the government’s inability to rein in a lax fiscal policy means that monetary policy has to be tighter, thus putting companies in a bind and making it hard for them to invest. This combination, of course, fuels problems, such as an overvalued currency and imbalances in the trade and current accounts, not to mention sluggish economic growth.

Against this background, the government’s partial shift to relying on floating-rate bonds and dollar-linked debt was an intelligent response to the challenge of
rolling over debt in a reluctant market. However, this tactic raised concerns of repeating the Mexican teso bonos debacle, when the buildup in foreign currency debt provoked a liquidity crisis after the Mexican government devalued. The risks of floating-rate bonds have always been severe, but, in the 1990s, these risks worsened due to the greater volatility of exchange markets and the dramatic global upswing in speculative attacks against currencies in emerging markets.

Many economists, such as MIT’s Rudiger Dornbusch, insisted that, by the outbreak of the Asian crisis, the real was overvalued by at least 15 percent vis-à-vis the dollar (Miami Herald 1997), explaining, in part, why the growth in imports outstripped that of exports. After 1995, the trade deficit rose by more than 140 percent, and the current account deficit ($33.6 billion in 1998) jumped by more than 150 percent, surpassing the International Monetary Fund’s (IMF) benchmark threshold of 4 percent of GDP. Concomitantly, economic growth slowed gradually. After a healthy rate of 6 percent in 1994, GDP growth was 4.2 percent in 1995, 3 percent in 1996, and 3 percent in 1997 (see Table 1 above). The loss of dynamism was even more pronounced in 1998, when the economy stagnated badly and per capita income dropped sharply.11

The continued volatility of international financial markets served as a reminder that, although Brazil successfully defended its currency during the worst of the Asian crisis, the huge fiscal deficit still left the economy extremely vulnerable to external shocks. In this context, the 1998 electoral campaign introduced new elements of uncertainty, thereby underscoring that the interaction among several key factors — global financial market volatility, rising fiscal deficit, the current account deficit, and political contingencies — could once again force Cardoso’s economic team to sacrifice growth — and progress on equity issues — in favor of defending the currency and protecting monetary stability. All this highlighted the urgency of major fiscal reform, which would allow both a looser monetary policy and a less rigid exchange-rate regime without triggering fears of a return to inflation. In fact, eventually, just such a fiscal adjustment was probably inevitable. The danger was that the more time passed, the riskier the Cardoso government’s postponement of reforms became.

CONSTITUTIONAL REFORMS AND THE COSTS OF THEIR DELAY

For President Cardoso and his economic team, these risks to macroeconomic stability and long-term growth were of paramount concern as the 1998 elections neared. To address the need for improvements in democratic governability and to provide a permanent solution to the fiscal crisis, four main sets of constitutional reforms were proposed: social security reform, administrative reform, fiscal/tax reform, and political and institutional reforms. The following section presents a very schematic and simplified summary of an extremely complex set of reform proposals with highly Byzantine legislative histories.12

* Social Security Reform. The social security system (previdência social) operates with chronic deficits, forcing the government into the unsustainable use of tax revenues to pay for the benefits of retired public employees. Reform is needed to impose a reduction in benefits, to introduce tax
deductible private pension plans, and to substitute time of contribution for
time in service, with the introduction of a minimum age of retirement (55
for women and 60 for men). The two latter modifications were part of the
government reform project but were rejected by Congress. However, a cap
was instituted on monthly retirement paychecks for public employees
(about $1,050). Some special retirement regimes were suppressed, al-
though some officials, such as politicians and judges, continue to receive
special perks. Reforms enacted prior to the October 1998 elections were
considered a good start but fell far short of the government’s initial
proposals.

- *Administrative Reform.* Although the bloated federal and state adminis-
trative apparatus has shrunk somewhat since 1995, the government’s efforts
to modify constitutional protections in order to reduce the number of
employees, curtail waste and corruption, and improve the quality of public
services met stiff resistance from politicians, many of whom accumulate
various public salaries and retirement pensions, as well as from the unions,
especially those affiliated with the National Labor Central (Central Única
dos Trabalhadores — CUT). The 1995 Camata Law mandates that public
payrolls not exceed 60 percent of revenues, but it was never enforced (22
states were out of compliance by early 1998). Watered-down legislation
approved in January 1998 ended guarantees of lifetime employment,
imposed a cap of about $10,400 on monthly payments by the state
(accumulation of salary and pension), prohibited receipt of more than two
governmental paychecks, and eliminated some special privileges enjoyed
by public officials.

- *Fiscal/Tax Reform.* The roots of Brazil’s intractable fiscal problems lie in
its system of “incomplete federalism.” The 1988 Constitution mandates
revenue sharing with the state and municipal governments but not a
commensurate shift in responsibilities for major programs. Unable to pass
constitutional amendments or to make fundamental changes in the tax
system, FHC resorted to partial fixes, chief among them the creation of the
Fiscal Stabilization Fund (Fundo de Estabilização Fiscal — FEF), which
allows the federal government to retain transfers to states and municipalities
in an attempt to rein in ballooning deficits. Other ad hoc measures to
bolster tax receipts included the special tax (Imposto Provisório sobre
Movimentação Financeira — IPMF) on checks and other financial trans-
actions approved in 1994 when Cardoso was finance minister and the
Temporary Tax on Financial Transactions (Contribuição Provisória sobre
a Movimentação Financeira — CPMF) approved in 1996, with revenues
earmarked exclusively for the Health Ministry.

- *Political Reforms.* Academics and legal experts have long called for
wholesale changes in Brazil’s political system, including strengthening of
party fidelity to enhance party discipline; one-person, one-vote measures
to redress unequal regional representation; changing from an open to a
closed-list proportional representation system; adopting a “mixed” elec-
toral system, similar to the German model; establishing threshold barriers
of 3 to 5 percent to reduce the number of parties in Congress; beefing up controls on contributions to electoral campaigns; tightening criteria for the creation of new municipalities; and enacting judicial reforms to reduce case loads, eliminate nepotism, and increase public confidence. With the exception of a few minor reforms approved in 1995 that dealt with party fidelity and campaign finances, virtually none of these proposals has been enacted. The only significant political reform was enacted in June 1997, when the government pulled out all the stops to secure passage of a constitutional amendment permitting Cardoso’s own reelection, along with that of governors and some mayors.

The government and business interests claimed that passage of these reforms promised substantial rewards. For example, the government calculated that administrative and social security reforms would together trim nearly $34 billion from the fiscal deficit within three years. Government economists also warned that failure to act would leave the government with no options but either to print money (thereby risking higher inflation) or raise taxes. However, if the reforms were approved, government economists estimated the economy could grow 6 to 7 percent per year. For its part, the powerful Federation of Industries of the State of São Paulo (Federação das Indústrias do Estado de São Paulo — FIESP) argued that a delay in approving the government’s tax, administrative, and social security reforms would reduce potential annual GDP growth by 3.7 percentage points. FIESP economists insisted that passing these reforms was the only way to boost the investment rate up to 25 percent of GDP and to achieve annual growth of 6 percent, increases that are needed to keep pace with the growth of the economically active population (Latin American Monitor: Brazil 1997a; LARR: Brazil 1998b).

**POLITICO-INSTITUTIONAL DEADLOCK**

Given the stakes, why did the Cardoso government make such scant progress in winning approval for these fundamental reforms? Although the reforms involved complex and controversial economic issues, the problem did not stem from a lack of technical expertise in the Cardoso government. Nor does an alleged lack of political will in the administration or Congress explain the situation very much. FHC the sociologist would agree that the obstacles to reform are systemic and that they raise fundamental questions regarding institutional design and the rules of the game in Brazil’s postauthoritarian political system.

When FHC came into office, he enjoyed considerable enthusiasm in the general population and had broad support among the members of the political class. As Figure 3 demonstrates, Cardoso’s original congressional coalition, made up of his own center-left Brazilian Social Democratic Party (Partido da Social Democracia Brasileira — PSDB); the conservative Liberal Front Party (Partido da Frente Liberal — PFL); and the center-right Brazilian Labor Party (Partido Trabalhista Brasileiro — PTB) could only marshal a maximum of 182 votes out of 513 in the Chamber of Deputies. Soon, however, the attractions of power brought new allies to the Cardoso camp: the catch-all Party of the Brazilian Democratic Movement (Partido do Movimento Democrático Brasileiro — PMDB) and the rightist Brazil-
ian Progressive Party (Partido Progressista Brasileiro — PPB) led by ex-São Paulo Mayor Paulo Maluf.

On paper, this broad coalition gave the government an ample majority of more than 75 percent of the votes in Congress and should have guaranteed easy sailing for the proposed constitutional amendments. Instead, Cardoso’s reform agenda stalled badly. Major responsibility for this failure must be laid at the doorstep of the federal system, electoral legislation, and the lawmaking procedures consecrated in the Constitution of 1988 (Rosenn 1990; Zaverucha 1997; Reich 1998).

Brazil is one of the most politically and fiscally decentralized of all developing countries. Modifications introduced in 1988 oblige Brasilia to transfer a large share of tax revenues to the 26 governments, the Federal District in Brasilia, and more than 5,500 municipalities, without a commensurate transfer of programs, thus leaving the national government with the same or expanded responsibilities but with fewer resources (Selcher 1998; Montero 2000). Paradoxically, this devolution of power and resources simultaneously holds out the promise of grassroots democratization while also strengthening local oligarchies and the forces of parochialism, clientelism, and patronimialism. In fact, in a modern-day variant of Brazil’s “politics of the governors,” state and local political machines and their constituencies operate as veto players in constant struggles over scarce resources with national authorities. While tempering possible abuses of centralized power, this system of
"state ultrapresidentialism" (Abrúcio 1994; Selcher 1998), in which governors wield extraordinary power, erodes democratic governability by undermining the national government's management of the macroeconomy (Bonfim and Shah 1994).

Governability is further challenged by constitutional rules that seriously distort congressional representation. The Chamber of Deputies has 513 members, with a minimum of eight seats and a maximum of 70 per state. Because of the tremendous regional variations in demographics, six of the least populous states (with less than 6.5 percent of the national electorate) send 72 deputies to Brasília, while the state of São Paulo, Brazil's economic powerhouse with 22 percent of the electorate, sends only 70 deputies. Thus, a vote for federal deputy in the sparsely populated Amazonian state of Amapá is "worth" 14.5 times the vote of a citizen of São Paulo. Similarly, each state sends three representatives to the Senate, which permits the smaller, more rural, and more traditional states to overpower the larger, wealthier states. The distortion is so massive that only 40 percent of Brazil's population elects a majority of the Chamber of Deputies, and half the Senate is elected by less than 10 percent of all Brazilians (Sola 1994; Dos Santos and Schmitt 1995; Selcher 1998; Souza 1997).

The national electoral system of open-list proportional representation with statewide electoral districts introduces additional complications. Voters cast their ballots for a specific party or an electoral coalition or for a particular candidate affiliated with a party. Large districts make it easier for small parties to elect deputies, thus encouraging a multiplicity of parties and making it all but impossible for voters to hold their representatives accountable (Ames 1995a, 1995b, 2000). Regarding their offices as personal prizes rather than public trusts, deputies enjoy maximum freedom to switch allegiance from one party to another; this facilitates the formation of interparty alliances while undermining party coherence and discipline.

The combination of geographical distortions and electoral rules systematically favors politicians from less populated rural areas belonging to amorphous, catch-all centrist and rightist parties. Conversely, politicians belonging to the more modern or ideological parties of the center-left and the left, with urban constituencies, are strongly disadvantaged (Mainwaring 1992-1993, 1995a, 1995b, 1999; Power 2000a, 2000b). This gives rise to regional voting blocs organized along a north-south (poor-rich) cleavage in which alliances of conservative deputies and senators from the north, center-west, and northeast with rent-seeking, special-interest agendas have the upper hand over rivals from the more industrialized states of the south and southeast (Selcher 1998).

In addition, hard-to-meet requirements for the passage of constitutional amendments constitute a final institutional arrangement with far-reaching consequences. The main problem is that the 1988 Constitution is replete with provisions usually handled in most countries by ordinary legislation. Therefore, virtually all the reforms needed to assure democratic governability of the macroeconomy require constitutional amendments. Such amendments must be approved in two separate sessions by three-fifths super majorities of the full membership of both the Senate and the Chamber of Deputies. Moreover, because the mechanism of a U.S.-
style conference committee to resolve differences does not exist, even minor changes in constitutional amendments made by one chamber require the other’s agreement before final passage.

A weak and fragmented party system makes congressional initiatives on broad social or economic questions virtually impossible; such initiatives can originate only with the executive branch (Abraches 1993; Mainwaring 1995a, 1995b, 1997, 1999; Weyland 1996a, 1996b). Nevertheless, their ability to delay and obstruct executive initiatives permits politicians to reap tremendous benefits in the game of “physiological politics” (política fisiológica). In the Brazilian version of pork and patronage, politicians use their bargaining leverage with the executive by exchanging their vote for jobs for family members, friends, and supporters and for special federal projects benefiting narrow interests in their states, municipalities, or specific constituencies (Diniz 1982, Hagopian 1996, Weyland 1996a, 1996b; Power 2000a). This perverse practice forces presidents to grant concessions to state, regional, and local elites, and it forces governments to forge cumbersome, constantly shifting ad hoc congressional coalitions in order to pursue agendas on key national issues (Weyland 1998; Power 2000a, 2000b).

The institutional arrangements emerging from these rules, reinforced by political patronage, resemble a huge collective action dilemma in a complex game involving numerous players: governors, clientelistic politicians, entrepreneurs, and other influential interest groups. Maneuvering in this game, Cardoso eschewed frontal assault in favor of advancing his reforms in sequential fashion. Cardoso’s strategy has been to exploit the players’ conflicting interests, supporting those whose demands overlap with his own agenda, and compensating the losses of those whose demands conflict with his project. Playing off clientelistic politicians’ short-term interests against their long-term goals, FHC and his political operatives want to win maximum immediate patronage while guaranteeing their access to future patronage. Because of the highly uncertain nature of their careers in electoral politics, politicians discount future benefits and focus almost exclusively on obtaining short-term rewards. Cardoso’s gamble has been to offer patronage up front in exchange for votes for constitutional changes he hopes to use to strengthen state capacity and reinforce governability, while also advancing a project of democratization and institutional modernization that will sharply limit patronage in the future (Weyland 1998).

How has this game played out to date? Cardoso’s strategy achieved some initial victories during his first year in office, when Congress was persuaded to pass several “economic order” amendments to the Constitution, including beginning the privatization of state enterprises in telecommunications, coastal shipping, gas distribution, and a limited “flexibilization” of the Petrobrás petroleum monopoly. Foreign firms were also put on an equal legal footing with national companies (Fleischer 1998). However, the initial success of the Plano Real in rapidly bringing mega-inflation under control dissipated the impetus for further reform.

Since early 1996, the main proposals for constitutional change — social security reform, administrative reform, fiscal/tax reform, and political reform — have fallen victim to legislative gridlock as escalating demands for costly concessions produce paralysis and repeated congressional postponement of final approval.
For all his intellectual and leadership skills, many of Cardoso's reform ambitions have been effectively gutted by the veto players, who have successfully minimized most costs to themselves and their constituencies while extracting an exorbitant price in patronage in exchange. In Brazil, although legislative proposals of presidents usually prevail, at least in formal terms (Figueiredo and Limongi 1997a), this may mean that the executive branch simply decides not to insist on a vote or is obliged to accept substantially watered-down legislation. In the case at hand, more permanent solutions to the state’s fiscal crisis were stymied, forcing the government to forego constitutional reforms and to continually resort to executive decree powers (medidas provisórias — MPs) to pass “important and urgent” stop-gap legislation (Figueiredo and Limongi 1997b; Power 1998). Ad hoc partial remedies (such as the Fiscal Stabilization Fund and taxes on financial transactions) managed to stave off collapse but at high economic and political cost. Therefore, even Cardoso’s great victory, his passage of the reelection amendment in May 1997, was marred by allegations of widespread payoffs to special interests and rent-seeking politicians.\[15\]

The reaction of Brazilian society to the political experiment represented by Cardoso’s reelection bid was illuminating. Abuses were emphasized not only by those facing incumbent candidates but also by the press and the courts. These abuses were generally worse in the smaller states. The costs to Brazilian democracy of allowing the reelection of the president, governors, and mayors must be weighed against the eventual advantages of longer terms without reelection. More important, the 1998 election certainly gave new ammunition to those who, like Cardoso before he became president, have always defended parliamentarism.\[16\]

THE 1998 ELECTORAL CAMPAIGN

On October 4, 1998 Brazil’s huge electorate of 106 million eligible voters would not only decide on Cardoso’s reelection but would choose a new Congress (all 513 seats in the Chamber of Deputies and a third of the 81 Senate seats) as well as 27 governorships and 1,059 state legislators. Was Cardoso unbeatable and his reelection inevitable? Did the government’s concessions to clientelistic politicians alienate the electorate and undermine FHC’s capacity to govern? If reelected, would the president have any coattails that would strengthen his hand in passing reform legislation?

In the run-up to the October elections, Brazilians still credited FHC with taming inflation and also liked and admired the president for his personal characteristics; according to polling data, although Cardoso was seen as distant from the “real” people, he was considered to be honest, courageous, elegant, cultured, and intelligent, as well as a good family man. In one area, however, polls reported in Veja (1998b) detected vulnerability: specifically, voter dissatisfaction with high unemployment, low wages, and poor public health care. The public considered the Cardoso government’s social policies to be “center-right” measures that hurt the interests of public employees, workers, the landless, and the poor in general, while favoring the rich, bankers, industrialists, and politicians. In short, although public opinion of FHC was positive for his record on stabilizing the economy and his
personal qualities but negative for his performance on distributive questions and social issues, which meant that, in theory, the president was not unbeatable at the polls. Moreover, focus groups and simulation exercises revealed that if a credible opposition candidate could convince voters that he could maintain economic stability and, besides that, improve the lot of the majority, he might compete effectively against Cardoso (Veja 1998c; Istoté 1998c). Although this was precisely the strategy attempted by his opponents, the odds still heavily favored a Cardoso victory.

Electoral demographics and geography worked strongly to Cardoso’s advantage. The recently published Atlas Eleitoral do Brasil reveals that Collor’s victory in 1989 came from the hefty margin he racked up in smaller municipalities where low education levels and high social inequality prevail; politics in such regions generally remain dominated by local oligarchs and clientelistic party machines (Jornal do Brasil 1997c). Cardoso’s 1994 victory was similar, except that, in addition to winning large majorities in smaller municipalities, he also won by smaller margins in the more competitive urban areas. In contrast, the highest returns for Lula were in large metropolitan areas and more industrialized municipalities where voters tend to be better educated. These regions are precisely where the PT, unions (especially those grouping public employees) affiliated with the more militant labor confederation (Central Única dos Trabalhadores — CUT); and grassroots social movements are best organized. Exceptions to Lula’s generally poor showing in the countryside came only in regions (for example, in Rio Grande do Sul, Santa Catarina, and Paraná) where the MST first emerged and is most consolidated.

In short, while voters in “archaic” Brazil favor candidates like Collor and Cardoso who present themselves as symbols of “modernity,” citizens in the most developed, industrialized, and sophisticated regions of Brazil are disproportionately more inclined to vote for Lula, who is often denigrated by his critics as “the candidate of backwardness.” The main difference between archaic and modern Brazil is that the former has always been reliably pro-government, whereas the developed urban centers are more likely to be oppositionist. Paradoxes aside, 1998 was the first time a sitting president had ever sought reelection, and the odds were that the votes of those states, politicians, and voters most dependent on the federal government’s largesse would favor the incumbent.

Large disparities in political, organizational, and financial resources had a similar effect on the probable outcome of elections. Taking full advantage of his incumbency, FHC cobbled together a broad coalition comprising his own PSDB and the conservative PFL, along with other centrist to rightist parties, including Maluf’s PPB, the PTB, and the small Social Democratic Party (Partido Social Democrático — PSD) (See Figure 3). Although not a formal member of the coalition, the large PMDB did not field its own candidate, and the majority of its leaders supported the president. Finally, the Cardoso campaign was fueled by a planned budget of more than $60 million, most of its contributions coming from corporations and wealthy individuals (Jornal do Brasil 1998f).

In contrast, Lula’s coalition, the “Popular Unity/Change Brazil” (União do Povo-Muda Brasil), consisted of his own PT plus the Democratic Labor Party
(Partido Democrático Trabalhista — PDT) headed by his vice-presidential running mate, populist war-horse Leonel Brizola, along with the small but growing Brazilian Socialist Party (Partido Socialista Brasileiro — PSB) led by Pernambuco Governor Miguel Arraes, and the remnants of the two minuscule Marxist parties, the Brazilian Communist Party (Partido Comunista Brasileiro — PCB) and the Communist Party of Brazil (Partido Comunista do Brasil — PC do B). The PT was rent by internal conflicts pitting dogmatic intransigents versus “renovators” of a more social democratic cast (Nylen 1997, 2000). In addition, the PT’s electoral strategy conflicted on many points with the union strategy of the CUT as well as with the militant tactics of the MST and some other grassroots social movements (Martin 1997; Hochstetler forthcoming). Moreover, Lula’s coalition did not have the huge cadres of elected or appointed officials of its opponent coalition. Nor could Lula’s electoral front’s organizational weakness be compensated for with expensive tactics because of the paltry funds raised by the Lula campaign (Jornal do Brasil 1998f; El País 1998a). Ciro Gomes, the third-place candidate in public opinion surveys and ex-governor of Ceará who briefly served as Itamar Franco’s last finance minister, was backed by a weak coalition of small parties, including the Popular Socialist Party (Partido Popular Socialista — PPS) led by ex-communist Roberto Freire and the small Liberal Party (Partido Liberal — PL). However, the Gomes campaign was relatively well financed and spent considerably more than Lula’s coalition (Jornal do Brasil 1998f).

Cardoso’s final advantage during the campaign was the access to free radio and TV time. Brazilian legislation allocates free air time to candidates according to the size of their party or coalition’s congressional representation, thus introducing a huge bias favoring a large multiparty coalition such as the one supporting Cardoso. Therefore, Cardoso’s campaign had about one-half of all the free time divided among the 14 candidates (Estado de São Paulo 1998d).

Nevertheless, despite multiple handicaps, in May-June 1998, the Lula campaign managed to jolt the president’s camp by scoring an empate técnico, or technical tie, with FHC in several opinion surveys. In various polls, the difference between the two candidates approached the margin of statistical error. One of the main causes of the narrowing gap was a sharp drop in support for Cardoso in the cities. Polls showed public irritation with several unfortunate extemporaneous remarks by FHC (for example, he called people who retire before age 50 “lazy bums”). Moreover, the public was increasingly critical of rising unemployment and the government’s failure to respond effectively to the huge fires raging in the northern state of Rondônia and the drought affecting millions in the Northeast (Jornal do Brasil 1998b; Istoé 1998a).

The Cardoso campaign demonstrated quick reflexes, however, and mounted an effective, two-pronged counterattack. First, Lula’s opposition to the Plano Real and hints that a sizable currency devaluation might be necessary, together with his strong opposition to the privatization of state enterprises (particularly the 1997 sale of the Vale do Rio Doce mining giant and the July 1998 breakup and sale of the Telebras telecommunications conglomerate), were used to paint him as a dangerous, irresponsible radical — the “candidate of chaos” who would scare away investors and bring back hyperinflation (Jornal do Brasil 1998c). Lula’s platform
calling for massive job creation, speeding up of agrarian reform, and a “pact of production” to assure 5 to 7 percent annual growth, while safeguarding stability, did not win large numbers of new recruits from among entrepreneurs or the middle classes (Jornal do Brasil 1998e). Many analysts argued that Lula’s electoral support was nearing its maximum ceiling of approximately 30 percent of the electorate.

The second tactic of the Cardoso campaign’s anti-Lula offensive was more positive: to project a confident, optimistic image of a take-charge president promising a better future for all Brazilians. Resembling U.S. president Bill Clinton’s “bridge to the twenty-first century” and British prime minister Tony Blair’s “New Labour” and the “Third Way,” Cardoso’s strategy was innovative for Brazil. FHC did not deny the problems facing his government in areas such as poverty, unemployment, or the crisis in public health. Rather, he talked about these issues and sought to politicize them to his advantage. The rationale was to “educate” people about the underlying causes of unemployment, for example, technology, industrial modernization, and globalization, in order to deflect blame away from the president, who represented himself as offering positive solutions for intractable problems (Jornal do Brasil 1998i, 1998j; Estado de Sào Paulo 1998a).19

Cardoso’s economic team assisted the public relations strategy by announcing a series of major spending initiatives, including offering subsidies for reduced interest rates for middle-class mortgages, selling government stocks of rice and beans to force prices down, and expanding the National Program for Family Agriculture (Programa Nacional de Fortalecimento da Agricultura—PRONAF) to provide assistance for 500,000 family farmers. The centerpiece of this effort was the highly publicized “Brazil in Action” program, which was launched in 1997. This program projected spending more than $70 billion for 42 infrastructure projects in transportation, electricity, water, housing, and food production. The emphasis was on job creation, “social action,” and future-oriented plans to “redesign the country” (SECOM 1998b).

Cardoso’s campaign skillfully frustrated Lula’s efforts to capitalize on the government’s perceived weaknesses on potent social issues, including jobs, agrarian reform, and inadequate education, among others, by appropriating the left’s reform agenda as his own. In the final months before the elections, Cardoso renounced some of his earlier austerity measures as “unnecessary evils.” Instead of laying off public sector workers or pursuing cost-cutting measures such as cracking down on fraudulent pensions, for example, the president skillfully turned a court order forcing the government to give civilian employees the same pay increase earlier received by the military to raise civil service wages; this popular measure cost more than $400 million in 1998, plus an estimated $2 billion in future years. He also inaugurated spending projects of more than $5 billion for low-cost housing, promised billions of dollars for rural credits, and announced a minimum income scheme for poor families with children in school (New York Times 1998c; El País, 1998b).

Through such initiatives, Cardoso’s main success in his first government, the Plano Real and economic stability, was skillfully linked to an optimistic vision of the marvelous things Cardoso could do if given a second, four-year mandate. All this was accompanied by a massive advertising campaign extolling the victories of the
Plano Real and promising much more. In fact, at the rhetorical level, a subtle inversion of priorities seemed to have taken place in Cardoso’s platform: democracy first, followed by the “social question,” with the economy in third place. In the 1994 elections, macroeconomic stabilization had been the absolute priority.

This offensive rapidly permitted Cardoso to recoup his popularity with voters and fueled his hopes for a first-round victory. By late September 1998, a *Datafolha* poll showed that he had reestablished his earlier lead: 40 percent supported FHC versus 25 percent who favored Lula; 9 percent backed Ciro Gomes; 3 percent favored Enéas Carneiro, the eccentric leader of the extreme right nationalist party (Partido de Reединificação da Ordem Nacional — PRONA); 6 percent said they would cast a blank or null vote; and the remaining 9 percent were undecided (Fleischer 1999, Table 1). Troubling for the president, however, was Lula’s margin in the large states of Rio de Janeiro and Rio Grande do Sul and the way he had cut into the president’s lead in the crucial state of São Paulo. The FHC camp found comfort in the fact that early polls systematically underestimate center-right votes that usually go to the incumbent (less educated persons define their vote late and are more susceptible to last-minute government patronage).

With a first-round victory within striking distance, Cardoso’s ultimate win and his second term were not at serious risk. The real stakes on October 4, 1998 was whether FHC could win a majority or be forced to confront Lula in a second-round runoff. More in doubt than his victory was whether the president’s showing at the polls would garner him the strong mandate he would need in 1999 and beyond to push his controversial package of constitutional changes through a reluctant Congress.

**AFTER THE ELECTIONS: POLITICO-ECONOMIC SCENARIOS**

Let us pause here quite literally to revisit our own perceptions on the eve of the 1998 elections. As the elections approached, our analysis placed strong emphasis on the nature of the interaction between domestic politics and economics and the global economy — particularly the upturns and downturns in global financial markets — and the peculiarities of Brazil’s politico-institutional arrangements. Assuming Cardoso’s successful reelection, we envisaged three broad scenarios: 1) a worst-case outcome characterized by an adverse international environment, erratic economic performance, and rising domestic conflicts; 2) a “muddling through” path similar to Cardoso’s first term but crucially lacking the earlier confidence that conditions would improve shortly; and 3) an optimistic trajectory in which major constitutional reforms, together with favorable international circumstances, might permit Cardoso to initiate a phase of renewed economic growth and deepening democracy. Let us recapitulate each of these possibilities in turn.

*Not Apocalypse Now, Maybe Tomorrow?*

A Cardoso victory over Lula would not mean easy sailing for the next Brazilian government. Even with an FHC victory, a worst-case scenario could possibly erupt at any moment, triggered by, for example, a total collapse of markets
in Asia and Russia, which could touch off a speculative run against the real. Brazil’s national accounts might not be able to withstand this type of contagion effect, especially as the current accounts balance had shown cumulative deficits since 1995, with the gap in 1997 and 1998 exceeding $30 billion.21 The primary fiscal deficit was about twice the 3-percent level considered acceptable by the IMF. In addition, the exchange rate remained significantly overvalued. Though high interest rates and other measures taken in late August 1998 to prevent capital flight demonstrated the government’s readiness to defend the real at any cost, they also exacerbated the already onerous domestic debt burden. The need to maintain high international reserves to ward off speculators inflated the money supply and, in a vicious circle, required large emissions of treasury bonds, further adding to the debt and leaving the economy vulnerable to new international financial shocks.22

To counter the effects of an “Indonesian” or “Russian” scenario, the new government might be forced to announce a surprise economic package right after the elections. Such a package might be accompanied by urgent appeals to the IMF and the Clinton administration for an emergency bailout. The desire to avoid this ominous scenario was one of the reasons Cardoso hoped to win reelection outright in the first round of voting: uncertainty and the risk of a misstep would be high during the interregnum before the runoff. This, then, would strengthen old-line politicians, as Cardoso would need their support and the help of their electoral machines at almost any price. This, then, would certainly frighten investors and Brazilian holders of liquid assets. Consequently, the longer that necessary corrective measures were postponed, the tougher any surprise pacotazo (big package) of austerity measures would have to be to shore up Brazil’s credibility in global markets.

In this worst-case scenario, given Brazil’s lethargic growth rates, tough austerity measures could well provoke a recession, and unemployment rates — already high — could climb. Depending on the depth of the crisis, social unrest and political instability could increase, given the absence of the social safety nets that cushion downturns in the United States and Europe. The reverberations of the crisis in the countryside might strengthen the MST and could stimulate a wave of new land invasions and rural violence. In this negative chain of events, FHC’s hopes for advancing a democratic reform agenda would quickly vanish.

More of the Same, or Back to the Future?

After the elections, a second scenario was that of the Cardoso government muddling through, with conditions continuing more or less as they were or perhaps even improving to some extent. A speculative attack on the real might not occur. Even though the social security and administrative reforms approved in Cardoso’s first term were greatly diluted, they did improve national accounts somewhat and sent the encouraging message to global financial markets and domestic investors that Brazil was serious about reforms. The subtext of this message was that investors should be patient, given that there were limits to what Cardoso could accomplish within the constraints of Brazil’s cumbersome institutional arrangements.

Several developments prior to the elections reinforced the likelihood of this second post-electoral scenario. Accelerated privatization of state enterprises was
projected to bring in revenues of about $50 billion in the 1998-2001 period.\(^5\) Moreover, assuming that U.S. interest rates remained low, the Asian financial crisis was not rekindled, and the August 1998 meltdown of the Russian economy did not provoke a total collapse of Latin American markets, the Central Bank might eventually be able to reduce interest rates further. Lower borrowing costs would enable the economy to grow faster, thus bringing in more tax revenues and trimming the fiscal deficit. The risks of a speculative attack on the currency could thus diminish appreciably. These circumstances could conceivably permit Cardoso both to eschew unpopular emergency measures and to advance his reform agenda. This agenda would likely consist of more fiscal reform, the second stage of social security reform, tighter administrative controls, party and electoral reforms, and judicial reform. The announcement in late August 1998 of several moves to redouble efforts to reduce the fiscal deficit (for example, reduction of tax rates while broadening the scope of those subject to income taxes; greater discipline over spending by state and municipal governments; and combating corruption, improving efficiency, and firing excess civil servants) foreshadowed such an agenda (Jornal do Brasil 1998m; Estado de São Paulo 1998f).

As seen on the eve of the elections, what were the prospects for the success of Cardoso’s reform agenda during his second term? According to our analysis, it faced major obstacles. The president’s allies in the PFL, PMDB, and PPB were likely to compete aggressively with the PSDB for control over the Chamber of Deputies and the Senate and to insist on naming their luminaries to key cabinet posts. In response, Cardoso would have to employ, once again, the tried-and-true methods of elite conciliation and patronage politics. Moreover, FHC’s strategy of neutrality and failure to support fully some longtime, loyal allies in their contests against the candidates of other parties in his reelection coalition threatened to distance Cardoso from the leaders and rank and file of his own party. Indeed, in several important states, Cardoso was reluctant to appear on local platforms with candidates from his own party so as not to alienate allies from other parties, as national and state alliances often did not coincide. Consequently, even if elected, these PSDB candidates might remain resentful of the lack of support from the president during the electoral campaign.

The risks of Cardoso’s reelection strategy were that the PSDB might emerge significantly weakened and that the president might not be able to count on the support of many governors from his own party. The governors of several of the larger states might turn out to be only nominally allied with Cardoso, as they would be busy positioning themselves as possible presidential candidates for the year 2002. These governors probably would actively manipulate their parties and their followers in Congress in ways certain to make life difficult for Cardoso. For example, if Maluf were to win the São Paulo state house, the PPB’s support for FHC might last only as long as Maluf found it profitable. Similarly, in the PMDB, the ambitions of Itamar Franco and José Sarney to return to the Planalto presidential palace were well known. The aggressive César Maia, the PFL contender in the governor’s race in Rio de Janeiro, had similar designs. There was then a real risk of anticipation of the 2002 presidential campaign. This might make Cardoso hostage to the careers of rival politicians and immobilize whatever reform agenda he had for
the country. Instead of debating policies, Brazil would debate politics and the names of Cardoso’s possible successors.

In short, even if the economy were to turn in a reasonable performance, Cardoso might face a more obstreperous Congress. As in his first term, Cardoso might only be able to win approval of a much weakened version of his reform agenda and then only when aspirants to his office agreed to help him. Needless to say, in this second possible scenario, the cost for Cardoso (and for Brazilian democracy) would be an excruciatingly slow process of change, fraught with potential for scandal and future instability.

_Growth and New Style Social Democracy — Finally?_

The third scenario one could envision following the elections was an optimistic one. In the short run, the economic situation probably would resemble the modest performance sketched for the muddling-through trajectory. The factor differentiating the two scenarios would be essentially political, but the potential medium- and long-term consequences for economic growth and efforts to combat poverty and inequality could be highly significant. Still, a major downturn in the world economy would severely undermine any realistic chance for this third, more optimistic scenario.

In the second “muddling through” scenario, the stress was on the possible erosion of FHC’s political coalition and strengthening of powerful veto players. Events might unfold differently, however. The elections could bring Cardoso good tidings. For one thing, the PSDB had grown into _a partido omnibus_, that is, a broad, amorphous, catch-all party. Together with its support for liberal economics, this characterization certainly clashes with the PSDB’s center-left social democratic image, but this type of evolution would not be all bad: with greater numbers of deputies and senators, the president’s party could assume control of one of the legislative chambers and key committees in both parliamentary bodies. Greater control over the legislative agenda by Cardoso’s party might thwart clientelistic appetites and help smooth the way for the passage of necessary constitutional reforms. Similarly, although the president’s PSDB allies faced up-hill battles in crucial states such as São Paulo and Minas Gerais against their PPB and PMDB rivals, they might succeed in retaining their current governorships. Additionally, Cardoso’s much criticized alliance with powerful Bahia politician Antônio Carlos Magalhães might strengthen Cardoso’s hand with the conservative PFL and help in approving reform legislation.

Further, if Cardoso were to emerge from the elections politically stronger, he might be emboldened to attempt to refurbish his credentials as a new-style social democrat. His campaign strategy — emphasizing more growth, employment generation, and investment in infrastructure, education, and other social areas — could conceivably signal a shift in the orientation of his economic project. In fact, there were some indications that efforts in this direction might already be underway. A presidential advisory group, the Grupo de Análise e Pesquisa da Presidência da República (GAP), was reported to be working closely with the National Bank of Economic and Social Development (Banco Nacional de Desenvolvimento Econômico e Social — BNDES) and the Institute for Applied Economic Research.
DEMOCRACY AND REFORM IN CARDOSO'S BRAZIL

(Instituto de Pesquisa Econômica Aplicada — IPEA) in the elaboration of an ambitious economic agenda for Cardoso's second term (Folha de São Paulo 1998e; Jornal do Brasil 1998g).

While reaffirming a commitment to a market-driven model, the idea advocated by the presidential advisory group was to move beyond the sterile debate over stability versus growth to position Brazil to confront the challenges of globalization, particularly the strengthening of the Southern Cone Common Market (MERCOSUL) and the creation of the Free Trade Area of the Americas (FTAA). This two-fold project entailed a concerted effort to rebuild the state's capacity to provide strategic guidance of the economy. The rationale underlying this inchoate plan was to forge strategic partnerships with essential local and transnational economic groups and to encourage technological innovation and increase Brazil's competitiveness in world markets.

Cardoso himself publicly recognized (Folha de São Paulo 1998m) the need for a new "Southern Consensus," reaching beyond Washington orthodoxy in order to tackle second generation reforms that would focus on social issues, microeconomic reforms, and stronger state capacity. Consonant with this view, some members of Cardoso's team argued that the next phase of Brazilian growth should be propelled initially by three official banks: the BNDES, the Banco do Brasil (BB), and the Caixa Econômica Federal (CEF). These institutions, which would be given greater autonomy from the finance ministry and the Central Bank, were to assume a more activist role in financing dynamic sectors that generate employment and have strong multiplier effects, such as paper and cellulose, steel, telecommunications, energy, transportation, low-income housing, and others (Jornal do Brasil 1998e). In short, the state would be called upon to play a strategic role in the economy that would differ from that of the previous authoritarian period and from current neoliberal orthodoxy.

In the months before the October 1998 elections, Cardoso began to impose stronger, more direct, and more personal control over key ministries, with an eye toward removing them from the fray of clientelistic bargaining and competition over spoils among the members of his political coalition. In the event of Cardoso's reelection, analysts anticipated the possibility of a major ministerial reorganization (creating a Ministry for Production and a Foreign Trade Ministry, for example) and appointments in the BNDES and in the finance, planning, education, and health ministries that could indicate how determined Cardoso might be to reorient his economic project.

HYBRID PATHWAYS IN CARDOSO'S SECOND TERM

What course did events actually take following the 1998 elections? Did one or another of the three scenarios we envisioned prevail over the other possibilities? Many factors, some of which are beyond Brazil's control, shape the future course of events. Nevertheless, the evolution of the international order and strong elements of path dependence and continuity deeply rooted in Brazil's political economy, caution against realization of the optimistic scenario. If the possibility of apocalypse — now or tomorrow — can be pretty much discarded, it certainly is
equally true that, regardless of Cardoso's preferences, Brazil is not on the threshold of a bold social democratic project. The scenario that is unfolding looks rather like a hybrid amalgam of a "back to the future" pathway with excruciatingly slow incremental reforms that leave the country's accumulated social inequities largely untouched. To explain this somber prospect, we must begin with a brief discussion of the electoral results themselves and then turn to the first year of Cardoso's second term.

**Electoral Outcomes**

Turnout in the first round of voting on October 4, 1998 was an impressive 57.6 percent of the electorate of 106 eligible million voters. These voters were confronted not only with 12 candidates for the presidency but also with 14,406 persons contesting elections for 26 state governors, the governor of the Brasília federal district, 27 federal senators, 513 federal deputies, and 1,059 state deputies. FHC garnered 53.1 percent of the valid votes, only marginally less than in 1994 (54.3 percent) but significantly less than the president and his allies had expected. Lula finished with 31.7 percent (compared with 27 percent in 1994), while Ciro Gomes scored a strong third-place showing with 11 percent (see Table 2). As the polling data and analysis of the 1989 and 1994 contests predicted, Cardoso fared poorly in the larger cities, losing in Brasília and in 10 of 26 state capitals. He lost to Lula by a significant margin in the state of Rio Grande do Sul (49 percent versus 40 percent) and was defeated in Rio de Janeiro state (42.32 percent versus 42.28 percent) in a narrow cliffhanger, while also losing to Ciro Gomes in the latter's home state of Ceará (34 percent versus 30 percent).

In the simultaneous legislative elections, the president's broad parliamentary coalition remained almost unchanged. In the Chamber of Deputies, the government's bloc shrank somewhat (down from 396 to 381) but this was compensated for by the defeat of 65 "dissident" members of FHC's legislative alliance who had frequently voted against priority government policies. The PFL became the largest party in the lower house, while Cardoso's PSDB became the second party, and the reverses suffered by the PMDB relegated its bloc of deputies to third place. On the right, Paulo Maluf's PPB was the big loser, while the principal leftist parties — Lula's PT and Ciro Gomes's PPS — gained seats. Of course, the resulting alignment was only provisional. Weak party discipline and the ideological incoherence of the party system guaranteed the perpetuation of the traditional "musical chairs" in which deputies migrate from party to party in hopes of extracting personal benefits and improving their chances of reelection. Although some analysts argued that these changes might give the government a more cohesive support base, numerous defections from the PSDB during 1999 left Cardoso's party deeply split, and the president's coalition actually found itself more fractured than ever. Nor were things much different in the Senate. With 27 seats at stake in the upper chamber, the pro-FHC coalition retained a very substantial majority, although the leftist opposition parties (PT, PSB, PC do B, PDT, and PPS) succeeded in electing four new senators, and left-leaning candidates ran second in 13 states.

Recalling that the same constitutional reform that permitted FHC to seek immediate reelection also gave state governors the same right, it is ironic that the
Table 2.
Results of the First Round Presidential Elections: October 4, 1998

<table>
<thead>
<tr>
<th>Candidate</th>
<th>Party</th>
<th>Number of Votes</th>
<th>% of Electorate</th>
<th>% of Votes</th>
<th>% of Valid Votes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cardoso</td>
<td>PSDB</td>
<td>35,936,918</td>
<td>33.87</td>
<td>43.14</td>
<td>53.06</td>
</tr>
<tr>
<td>Lula</td>
<td>PT</td>
<td>21,475,348</td>
<td>20.24</td>
<td>25.78</td>
<td>31.71</td>
</tr>
<tr>
<td>C. Gomes</td>
<td>PPS</td>
<td>7,426,235</td>
<td>7.00</td>
<td>8.91</td>
<td>10.97</td>
</tr>
<tr>
<td>Enéas</td>
<td>PRONA</td>
<td>1,447,076</td>
<td>1.36</td>
<td>1.74</td>
<td>2.14</td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td>1,437,470</td>
<td>1.36</td>
<td>1.73</td>
<td>2.12</td>
</tr>
</tbody>
</table>

| Total Valid Votes | 67,723,047 | — | — | 100.00 |
| Total Votes Cast | 83,296,085 | — | 100.00 | — |
| Abstention       | 22,798,904* | 21.49 | — | — |
| Electorate       | 106,094,989* | 100.00 | — | — |

Note: Cardoso’s coalition: PSDB, PFL, PTB, PPB, and PSD.
Lula’s coalition: PT, PDT, PSB, PCdoB, and PCB.
C. Gomes’ coalition: PPS, PL, and PAN.
Other Candidates: Thereza Ruiz (PTN); Sérgio Bueno (PSC); José Maria de Almeida (PSTU); José Maria Emauel (PSDC); João de Deus Barbosa de Jesus (PTdoB); Vasco de Azevedo Neto (PSN); Alfredo Sirkis (PV); and Brig. Ivan Moacir de Frolla (PMN).
* Includes 6.4 million suspected fantasmas. Thus, abstention could be reduced to 16.4%.


most uncomfortable results for the president came in the 26 races for state governorships. Of the 22 incumbents who chose to seek immediate reelection, 15 were winners. While FHC’s allies were elected in 21 states, a few key states, formerly governed by members of his party or by governors belonging to his coalition partners, went to opposition parties or to unreliable allies. For example, while tucano (or PSDB) ally Mário Covas won in the runoff in the powerhouse state
of São Paulo, the important states of Rio de Janeiro (won by Anthony Garotinho of the PDT) and Rio Grande do Sul (won by Olívio Dutra of the PT) went to the opposition. In addition, the governorship of the pivotal state of Minas Gerais was captured by ex-president Itamar Franco of the PMDB, an erstwhile FHC friend and ally but now a strong critic yearning to play the role of spoiler during the president’s second term. These results produced resentment and mutual recriminations in the Cardoso coalition, with defeated PMDB and PPB candidates bitterly criticizing the president’s television commercials on behalf of his fellow PSDB associates and complaining about the role played by Cardoso’s cabinet ministers.

Currency Devaluation and Financial Crisis

Cardoso took the oath of office for the second time on January 1, 1999 with these partisan passions still running at fever pitch. One question was on everyone’s mind: Would the $41.5 billion rescue package announced in November 1998 with the IMF (as well as with the strong support of the Clinton administration) prove sufficient to stave off a Russia-style financial collapse in which speculative attacks might rapidly exhaust Brazil’s dwindling hard currency reserves? The answer was not long in coming. During the new administration’s first week, newly elected Governor Itamar Franco of Minas Gerais declared a unilateral moratorium on all of his state’s debts to the federal government, foreign creditors, and most suppliers of goods and services. Dramatically demonstrating both the vitality as well as the hazards of Brazil’s federal system, in which forceful governors frequently act on the national stage as major veto players, Itamar’s bold step was aimed at forcing the federal government to restructure state debts, which had already been renegotiated on very favorable terms in 1997-1998 (Isosté 1999a). Although somewhat reassured by Brasilia’s strongly voiced disapproval in response to the challenge from Minas, foreign and domestic investors viewed this rebellion as a major warning signal of Cardoso’s weakness vis-à-vis key state governors and well-organized political and economic interests.

Less than a week later, on January 12, 1999, these fears reached critical mass when capital outflows hit $1.2 billion, causing panic on the São Paulo and Rio de Janeiro stock exchanges. The next day, the most ardent defender of the crawling peg foreign exchange regime, Central Bank president Gustavo Franco, resigned, and his successor, Francisco Lopes, announced a moderate widening of the acceptable “bands” for currency fluctuation. With the government’s credibility shattered, capital outflows jumped to $1.8 billion on January 14, forcing the Central Bank to abandon the main cornerstone of the Plano Real by letting the currency float freely against the dollar.29 This took the exchange rate to record lows, reaching 2.2 reais to the dollar in February, before stabilizing and ending 1999 at the renegotiated target of 1.95 reais to the dollar.30

Despite the trauma it caused, the consensus view among market players was that this devaluation was both necessary and inevitable, although there were questions about its timing. Indeed, a few weeks after the new exchange rate policy was unveiled, the economic team headed by Finance Minister Pedro Malan agreed that payment of the future tranches stipulated in the IMF rescue package would be contingent upon the Cardoso government’s ability to meet newly revised macroeco-
nomic targets requiring even tougher austerity measures that included greater cuts in spending and heftier tax increases. As the previous analysis of Brazil’s fiscal hyperactivity underscored, the problem was that although the devaluation and currency float met the immediate threat, they worsened the burgeoning public debt, since the outstanding stock of domestic debt (most of which is based on bonds that pay variable rates of interest) immediately skyrocketed. Consequently, by virtue of the devaluation, the cost of servicing Brazil’s debt rose dramatically, driving the nominal fiscal deficit (including interest payments on the debt) up from about 8 percent of GDP in late 1998 to around 10 percent of GDP in late 1999.31

Economic Recovery?

Ironically, the financial crisis provided a short-term boost for Cardoso. The government managed to rally its troops to overwhelmingly approve most of the fiscal measures in the IMF package, including the increase in civil service pension contributions for active and retired public employees, a measure that Congress had previously rejected on four occasions. However, any assumption that his large congressional majority meant that FHC would have a free hand in advancing his reform agenda soon proved misleading. Cardoso made several attempts to strengthen the cohesion of his parliamentary bloc by distributing cabinet posts and other top jobs in his second administration to reward loyalty and to punish recalcitrant alliance partners, but his weakened leadership undermined this tactic’s credibility. Similarly, efforts to pass a “party fidelity” law that would have forced members to vote their party’s line failed, as did the attempt to turn Congress into a “limited” Constituent Assembly (thus setting aside requirements for super-majorities and two rounds of voting in each house) in order to make it possible to approve constitutional reforms by a majority vote (Fleischer 1999).

These setbacks highlighted FHC’s political vulnerabilities and made it clear that the institutional problems discussed previously guaranteed that in FHC’s second term the government’s congressional majority would continue the practice of *política fisiológica*. Once the immediate shock of the devaluation crisis was over, therefore, few politicians had much stomach for firing public employees, enacting pension reforms, reducing or eliminating fiscal incentives, or raising tax rates on key electoral constituencies. Moreover, as 1999 advanced, it became apparent that all the major parties and political figures were focusing obsessively on the municipal elections to be held in 2000 and that Cardoso would have to labor mightily to avoid becoming a lame duck well in advance of the 2002 presidential and congressional elections.

Challenges from the judiciary also exemplified another aspect of Cardoso’s political and institutional weakness. The Supremo Tribunal Federal declared unconstitutional the plan (approved by the lame-duck Congress during the January 1999 devaluation crisis) to increase the social security tax from 11 percent to 25 percent for active federal workers and, for the first time, to impose a social security tax on the benefits and pensions of retired employees. Unless reversed by new legislation, this decision blew a major hole in the government’s strategy of fiscal austerity and dealt yet another blow to its ill-fated plans for “reform of the state” (*Istoé* 1999m and 1999n; *Brazil Focus: Weekly Report* 1999c).
If party politicking, clientelism, and judicial setbacks gave him little respite on the domestic front, the discipline demanded by international capital flows did not afford FHC much maneuvering room before the exigencies of globalized market forces. This was made clear when congressional investigations into alleged irregularities surrounding the January currency float forced the resignation of Central Bank president Francisco Lopes. In a move charged with symbolism, Cardoso reached beyond his circle of technocratic and academic supporters to replace Lopes with Arminio Fraga, a top employee of U.S. billionaire speculator, investor, and philanthropist George Soros. Despite nationalist protests and unsubstantiated charges that Fraga might have passed insider information to his previous boss, this appointment bolstered the prestige of the orthodox wing of Cardoso’s economic team. More concretely, Fraga’s evident financial savvy and privileged entrée at the IMF, the World Bank, and the top echelons of Wall Street and European banks soon helped to calm foreign investors and to restore Brazil’s credibility in Washington and in international financial markets.

The orthodox fiscal and monetary policies counseled by the IMF, moreover, succeeded in avoiding a Russian- or Indonesian-style catastrophe. In the wake of the devaluation crisis, most pundits, as well as the IMF and the government itself, predicted a deep recession in which Brazil’s economy would shrink by a calamitous 4.5 percent; moreover, many analysts expressed concern that consumer prices might rise substantially to 15 percent or more. But the Brazilian economy proved much more resilient than expected, and fears of an impending collapse were seen to be greatly exaggerated. At around 9 percent, inflation in 1999 was lower than expected and came in at the upper range set by official targets. On the negative side, the weakness of the real meant that even though Brazil met the 1999 target of a fiscal surplus (before interest payments) of 3.1 percent of GDP, the public debt stood at 49.95 percent of GDP, which meant that the cost of financing the deficit risked “sucking the blood out of the economy,” in the graphic phrase used by the *Financial Times*. Nevertheless, in contrast to its Spanish-speaking neighbors, many of which confronted the sharpest economic contraction since the early 1980s, Brazil actually experienced a very modest recovery and, instead of shrinking the economy, actually managed a 0.8 percent minuscule expansion (see Table 1) in 1999. (*Economist* 1999; *Latin American Monitor: Brazil* 1999; *Brazil Focus: Weekly Report* 1999e; *Latin American Monitor: Brazil* 2000b).

The problem was that a decline of 7.3 percent in manufacturing jobs and a second straight year of sharply negative per capita growth (-5.5 percent) was hardly what FHC promised Brazilians during the 1998 campaign. Moreover, stability and “getting the prices right” were clearly inadequate to resolve the country’s chronic problems of unemployment, poverty, and inequality. On this score, IMF recipes offered little cause for optimism. The devaluation of the real did not produce the hoped-for reversal of Brazil’s trade imbalance as envisioned in the original IMF target of an $11 billion trade surplus. In fact, this target proved quite ludicrous — although improved from $6.6 billion the previous year, Brazil labored mightily to achieve a deficit of around $1.6 billion in 1999. The current account deficit for 1999 was approximately $24 billion (about 4.4 percent of GDP), and international reserves stood at approximately $36 billion, far below the $75 billion registered in mid-1998. In contrast, at close to $30 billion, direct foreign investment exceeded

Why did the expected surge in export-led growth fail to materialize? A number of reasons can be highlighted: Brazil’s imports fell much less than expected because, among other factors, the price of imported petroleum rebounded sharply; the prices of Brazil’s principal commodity exports dropped in world markets; and, finally, exports to Argentina, a key MERCOSUR partner, declined by more than 20 percent due to that country’s deep recession (caused, in part, by the devaluation of the real).33

However, this is just part of the story. Unfortunately, even if Brazil’s exports demonstrate greater dynamism and competitiveness, the macroeconomic and welfare consequences for most Brazilians will be quite modest. The reason is that merchandise exports represent only 6.6 percent of GDP, while consumer spending accounts for about 80 percent of GDP. Aggregate demand by both firms and households is likely to remain weak because of a combination of a lack of substantial domestic private investment (hurt by very high real interest rates, which remain at nearly 20 percent after initially soaring to 45 percent) and a tight fiscal policy that has sharply curtailed public-sector investments. Finally, although direct foreign investment and capital inflows continued at very high levels in 1999, this would be difficult to sustain in the future because of a combination of lingering fears of turbulence in emerging markets and the fact that the number of high-profile privatizations is dwindling (Gazeta Mercantil Latinoamericana/El Nuevo Herald 1999).

The Logic of Opposition

Given this panorama, it is hardly surprising that maintaining macroeconomic equilibrium and satisfying most IMF targets failed to earn many kudos from most Brazilians. Instead, Cardoso and his economic team were criticized for the explosive rise in real interest rates on consumer credit and the precipitous rise in unemployment, which, according to credible surveys conducted by union-affiliated DIEESE researchers, hovered near the 20 percent mark.34 From their own personal experience, most Brazilians also knew a second year in a row of economic stagnation meant falling standards of living for their families. In fact, with per capita income now lower than in 1995 when FHC first assumed office, the Plano Real’s much ballyhooed improvements in social welfare clearly ground to a halt, with little expectation of significant improvements on the horizon.

In this context, declarations by leading politicians and high profile technocrats touting Brazil’s more-rapid-than-expected economic recovery contributed to a misleading perception that o pior já passou — “the worst is over.”35 This unfounded optimism had particularly perverse consequences for Cardoso and his market reform policies by providing an opening for many politicians — especially those considering mayoral races in 2000 or eyeing the 2002 presidential contest — to criticize the government’s economic strategy and to charge the president with a “lack of sensitivity” regarding the social costs of the priority placed on macroeconomic stability. Fair or not, these criticisms undercut the president’s and the economic team’s calls for continued sacrifice and austerity. Obviously the next step
for many politicians of the left, right, and even the center was to call for more rapid
growth and to promise redistributive measures designed to appeal to their electoral
constituencies.  

Ciro Gomes of the PPS, the third-place finisher in 1998, showed considerable
skill in playing this game. His proposals for attacking the burgeoning fiscal deficit
by renegotiating the domestic debt as part of a broader plan to promote long-term
growth favoring the poor attracted considerable attention from various sectors
(including PSDB politicians dissatisfied with the government's preference for
stability over growth) and propelled him into early presidential contender status
(Estado de Sao Paulo 1999b; New York Times 1999). But no one, neither Ciro
Gomes nor even Minas Governor Itamar Franco, who, in February 2000, lost face
when he was obliged to cancel his debt moratorium (Financial Times 2000),
surpassed Antônio Carlos Magalhães, the 71-year-old veteran politician from
Bahia, as a grand master in playing this game.

As president of the Senate, ACM (as Magalhães is commonly known) was
one of Cardoso's main allies in keeping the fractious governmental coalition in line,
but this did not prevent him distancing himself from the president in order to win
a position on the national stage as a potential candidate for the 2002 presidential
elections. Despite his notorious ties to the post-1964 military regime and his status
as one of the leading figures of the Brazilian right, Magalhães abandoned his
previous support for Finance Minister Malan and seized upon Cardoso's sagging
popularity to criticize the government's conservative economic policies as anti-
growth and anti-poor. In fact, he aggressively sought to co-opt the left's platform
by calling for an expensive anti-poverty program to be financed with 6-8 billion
reais in new taxes on business and the wealthy (Istoé 1999d and 1999g).

The attacks of ambitious politicians like Itamar Franco, ACM, and Ciro
Gomes not only sullied Cardoso’s image but also contributed to worsening tensions
between the so-called monetarists and developmentalists in the economic team and
among the president’s closest advisors. Dramatic evidence of these conflicts
became public in early September 1999 when Development Minister Clôvis
Carvalho, a long-time personal friend of the president, made an ill-tempered
television attack on Finance Minister Malan's orthodox policies. He called upon
the government to be more “daring” and to “take more chances,” proclaiming that “an
excess of caution, at this point, is but another name for cowardice.”37 Although
Malan and Central Bank president Armínio Fraga won this particular showdown by
forcing Carvalho's firing and marginalizing the few remaining developmentalists
to posts of secondary importance (Istoé 1999k), thereby successfully reasserting
orthodox hegemony of economic policy, this episode clearly foreshadowed future
fissures and conflicts within the Cardoso coalition.

Avança Brasil?

From Cardoso’s perspective, these challenges to his authority could not have
come at a less propitious moment. A “March of 100,000” took place in Brasília in
late August 1999 with the participation of public servants and thousands of local
residents under the leadership of the PT, other leftist opposition parties, and union
groups such as the CUT. The militantly oppositionist posture of this large demon-
stration (the organizers claimed to have mobilized 130,000 participants while the Folha de São Paulo calculated the crowd at 75,000) set the tone for subsequent, smaller marches and demonstrations by public school teachers and the MST (Istoé 1999i). Moreover, in September and October, other groups such as agricultural producers, with far less radical political and economic agendas, also conducted their own high-profile marches and demonstrations in Brasília.

In the midst of this surge in popular protests, Cardoso announced his budget proposals for the 2000-2003 period. With considerable hoopla that deliberately recalled his 1998 campaign slogan of Avança Brasil ("Advance, Brazil"), the president’s objective was to regain political momentum by highlighting a distinction between the themes of his first term — stabilization, privatization, deregulation, and the market — and the forward-looking goals — primarily decisive action on behalf of growth and development — he hoped the population would see in his second mandate. The heart of this strategy was an optimistic prediction of 4 percent growth (versus the World Bank’s prediction of 2.5 percent) in 2000 and 5 percent in 2001 and the pledge to create 8.5 million new jobs in four years with a $580 billion spending plan on social development and infrastructure (Istoé 1999i; Brazil Focus: Weekly Report 1999a; El Clarín 2000). Regardless of its merits, however, politically, this attempt by the government to re-launch itself risked falling on deaf ears.38

Cardoso’s support among the population seemed to be in free fall. According to public opinion surveys, by September 1999, the president’s approval rating had sagged to 8 percent while his rejection rate (the sum of “bad” and “terrible” evaluations) had risen to an unprecedented 65 percent, the lowest rating for any president since the return to civilian rule in 1985.39 Of direct policy relevance, over 40 percent of the population believed that the government’s stabilization efforts were not working as well as expected, and fully 44 percent said the government should abandon the IMF targets.40 The same polls asked respondents to evaluate the proposals of potential opposition candidates for 2002: 40 percent approved the ideas of Ciro Gomes, while 42 percent agreed with those of Lula. Although Lula, the veteran three-time candidate of the PT, remained quite popular, Ciro Gomes’s meteoric rise in the polls was interpreted by analysts to mean that the political vacuum caused by FHC’s fall in popularity had been filled by Gomes, the newcomer to presidential politics.

Although FHC’s popularity subsequently recovered somewhat (for example, in February 2000, only 49 percent rated his performance as “bad” or “terrible”; see Brazil Focus 2000), his reduced public support, combined with an increase in popular mobilization in the streets, created a Catch-22 situation: after the Congress had sat on its hands for most of the year, the government urgently needed approval of politically controversial reforms to stimulate growth. But, by the same token, Cardoso simultaneously needed to show that his program could generate growth in order to encourage the Congress to approve the reforms. Without growth, many of his allies were increasingly nervous that continued support for Cardoso’s strategy might inexorably lead to electoral defeat in the 2000 municipal elections and, beyond that, to dismal prospects for the governing coalition in 2002.41
CONCLUSION

In discussing FHC’s first term in the present study, it was observed that Brazilian politics resembles a huge, multi-level collective action dilemma with numerous actors, each with contradictory interests and agendas. In this context, the success of Cardoso’s governing strategy hinged on a big gamble: by offering patronage up front in exchange for support for constitutional reforms, the president hoped to strengthen state capacity, while advancing a project of economic modernization and political democratization that could limit patronage in the future. This gamble clearly paid off for FHC when constitutional changes were approved, permitting his own reelection. However, most of Cardoso’s ambitious reform proposals were greatly diluted, if not completely gutted, by the actions of veto players, particularly the state governors, most of whom succeeded in avoiding any costs to themselves or their constituencies while taking advantage of fiscal federalism to make a mess of subnational finances. If anything, the record of the first year of Cardoso’s second government only reinforces this pessimistic view.

Why are Brazil’s problems so intractable, even for a gifted president like Cardoso? The crux of the problem, this argument suggests, lies at the intersection of deeply entrenched structural inequalities of truly egregious proportions and a complex ensemble of politico-institutional arrangements: geographic distortions in representation, open-list proportional electoral rules, a weak and fragmented party system, and incomplete federalism with willful governors acting as veto players. Although the causation is obviously circular, if the focus is limited to the span of one or two presidential terms, then politico-institutional arrangements clearly constitute the primary obstacles to meaningful reform. These obstacles are, of course, compounded by the impact of global financial volatility, which tempts many politicians to hang back and watch the government implode while they prepare to step into the vacuum.

These institutional arrangements, reinforced by the aggiornamento, or modernization, of traditional forms of clientelism and patronage, strengthen the tendency of most politicians and well-organized collective actors to apostar no fracasso — in Brazilian political parlance, to “bet on failure.” A sophisticated, if intuitive, political calculus impels the most powerful players to eschew “cooperation” in favor of “defection” as their dominant strategy. Given prevailing rules and arrangements, this strategy is eminently “rational” for self-interested actors (operating within notably crude and constrained parameters) because there are few if any institutional disincentives or sanctions for defection. Consequently, politicians, whose short-term interests revolve around the acquisition and dispensation of patronage, usually can ignore party ideology and discipline and change parties with near total impunity, and they may even abandon a sinking presidential ship, all without paying virtually any cost.

Since the 1985 return of civilian rule, all governments have suffered from this syndrome, with the partial exception of that of Itamar Franco, who came to office in a unique moment of unity caused by his predecessor’s impeachment and who left office on an upswing caused by the early successes of the Plano Real. Conversely, from the perspective of these perverse rules-of-the game, those politicians who cooperate, for instance, by supporting measures to reduce patronage, increase
transparency and accountability, or who favor the general welfare over narrow personal or sectoral interests, are, in effect, acting "irrationally" and are generally rewarded with the "sucker’s payoff" and marginalized from the centers of power.

A further complication stems from the frequently perverse interaction between the institutional rules and arrangements and the performance of the economy. While elected leaders and major collective actors in other democracies frequently cohere during crises and downturns, Brazil has few institutional mechanisms to encourage such behavior. In good times, this problem is less apparent. When the economy is growing, patronage resources are abundant, and electoral coattails are available, extreme political bandwagoning tends to be the rule, as occurred under José Sarney in 1986, when the Cruzado Plan temporarily vanquished inflation, or when the euphoria of the Plano Real caused politicians to ally themselves with Cardoso. In periods of relative bonanza, therefore, winning electoral coalitions can be forged relatively easily, and governing coalitions in parliament are more likely to be sustained, despite the fragmenting pull of weak parties, representational bias, and incomplete federalism.

But in economic hard times, politicians’ time horizons shorten and distributive conflicts sharpen and spill over into the political arena. Consequently, in downturns, particularly of the more recent sort associated with international financial volatility, the problematic institutional arrangements discussed here are particularly crucial because weak institutions allow transgressors and political speculators to go unpunished, thus proving that defection is almost always a winning strategy. Of course, opportunistic bandwagoning and speculative behavior by pragmatic politicians are normal in all democratic polities, but, in Brazil, they assume particularly exaggerated forms and have especially perverse consequences. This exaggeration helps explain the fragility of Cardoso’s governing coalition and why, despite his overwhelming majorities in Congress, his reform proposals have stalled so badly, particularly when the Plano Real began to go sour and growth ground to a halt. The exaggeration also provides a useful perspective on the reasons why Cardoso’s PSDB-PFL-PMDB alliance risked implosion in the president’s second term.42

As this chapter’s subtitle suggests, Cardoso is “caught between clientelism and global markets.” But Cardoso’s travails are not unique and prompt us to revisit a question raised at the outset of this chapter: Is FHC a neoliberal or a new-style “third way” social democratic reformer? A clear pattern stands out in post-1985 Brazil: center-left parties cannot govern and remain cohesive at the same time.43 Under Sarney, new adherents from the right, many of whom had supported the previous military dictatorship, first swelled the ranks of the PMDB. Subsequently, the PMDB lost its left wing when the PSDB, led by Cardoso, was founded as a new progressive party. The PSDB came to power with Cardoso’s election and the pattern repeated itself: opportunistic politicians with centrist and center-right credentials flocked to the party and, following the 1998 elections, the progressive wing of the PSDB, its reformist ambitions blocked, began to exit in droves.

In short, there seems to be a clear tradeoff between maintaining identity or governing, which requires pragmatic compromises with powerful conservative forces. FHC has chosen the ugly task of governing Brazil, but, increasingly, the
"authentic" tucanos of the PSDB are tempted to choose the former. This logic highlights an important aspect of the emergence of Ciro Gomes and his PPS as significant political actors, but it also points to the risks that make the PPS a future candidate for, and victim of, the same phenomenon. Only the PT runs alone and would govern alone, although accepting the support of other forces. However, after three consecutive defeats, the PT will have great difficulty winning at the national level. Apparently, Brazilian "social democrats" can neither win nor govern alone. Governing in coalition with the right, first under Sarney and now FHC, has proved demoralizing and disintegrating to the historic center-left.

In light of this pattern, was Cardoso correct to gamble the promise of real social, economic, and political reform for the chance for four more years in the presidency? FHC the sociologist no doubt is fully aware of the ironies implicit in this question. If it is true that the past frequently serves as a prologue to the future, then the verities of Brazilian politics point to the costs both to democracy and the economy of FHC’s gamble and of his reliance on clientelistic modes of governance. But if a social democratic Cardoso legacy is now almost unthinkable, the president can at least strive to leave Brazil better prepared — meaning, with fundamental political, institutional, and fiscal reforms approved — to meet future challenges. If he fails in this task, he will only be remembered as the “man of the Plano Real,” as yet another failed reformer. Ultimately, the decisive test of Cardoso’s leadership during his remaining time in the presidency will be his ability to cajole Brazil’s fractious political class toward credible modernization and democratization of the country’s institutions. Failing this, the denial of full citizenship to millions of Brazilians will continue, as will their exclusion from participating in the benefits of the market and globalization in a more just society.
Notes

1. For analyses of Cardoso from two critics to his left, see Cammock (1997) and Dos Santos (1998). Also see Goertz (1999) for a recent intellectual biography of Cardoso by a U.S. sociologist.

2. See Amaral (1995) for a useful collection of essays on the political, social, and economic circumstances surrounding the 1994 elections.

3. For an early analysis of the Plano Real by one of its leading advocates and the subsequent president of the Central Bank, see Franco (1995). See Kugelmas and Sola (1997) for an analysis of the "Machiavellian moment" facilitating the launching of the Plano Real.

4. U.S. investment in Brazil doubled from 1994 to 1997, rising from $17.9 to $35.7 billion, with most recent investments (64 percent) concentrated in the manufacturing sector. Germany, which currently ranks second in foreign investment (at $13.5 billion), has been challenged recently by Spanish investors (at approximately $12 billion), who have made major commitments in the telecommunications and banking sectors. See O Estado de São Paulo (1998).

5. The reduction in poverty reflected in official statistics appears somewhat optimistic. For example, Londoño and Székely (1997) found that "extreme poverty" had declined from 26.2 percent of the population in 1990 to 18 percent in 1994 and that "moderate poverty" had declined from 53.3 percent to 45.1 percent in the same period. Despite the data, however, press coverage may have led many Brazilians to believe that poverty has increased, not declined. See, for example, the convoluted explanation of IBGE data in Folha de São Paulo (1997a).

6. According to IBGE data, manufacturing jobs declined by 11.2 percent in 1996 and by an additional 5.7 percent in 1997 (Folha de São Paulo 1998).

7. A latifúndio is a large-landed estate.

8. Vice President Marco Maciel made the even more optimistic claim that 280,000 families were settled between 1995 and 1998 (El País 1999). According to Fernández Franco (1997, 72n), the José Sarney government (1985-1989) promised to settle 1.4 million families but gave land to only 140,000; the Collor de Mello government (1990-1992) announced plans to settle 500,000 families but did not settle any; and the Itamar Franco government (1992-1994) promised to give land to 100,000 families but managed to settle only 20,000.

9. For a sophisticated analysis of how international capital flows shape domestic political and macroeconomic policies, see Mahon (1996).

11. Because the economically active population grows by 1 to 1.5 million persons each year, growth rates below about 6 percent imply rising unemployment. See Jornal do Brasil (1998k).

12. Tediuous references to journalistic sources are dispensed with here. The Latin American Monitor: Brazil is a good English-language source for following the path of these reforms through Congress. For a broad defense of the importance of state reform, see Bresser Pereira (1997); see Díaz Pérez (1997) for a more critical historical perspective on state reform in Brazil.

13. See Hagopian (1996) for an insightful analysis of the survival of regional oligarchies into the postauthoritarian period. Power (2000b) provides an in-depth discussion of the right wing sectors of Brazil’s political class and their ability to use traditional methods to adapt to the exigencies of competitive politics.

14. In 1991, FHC strongly criticized Fernando Collor’s use of medidas provisórias; faced with governing, however, FHC has signed 108 new MPs, an average of 2.84 per month, slightly higher than Collor’s average of 2.75. In his first 38 months in office, FHC also reissued the same MPs 1,839 times, 24 times Collor’s rate. See Folha de São Paulo (1998k).

15. The scandal centered on the recently deceased Sérgio Motta. Allegations charged that Motta, then the minister of communications and one of FHC’s closest friends and advisers, had orchestrated the securing of the votes of several obscure PFL deputies in exchange for money ($187,000 each). The threat united the government alliance, and the opposition’s efforts to hold congressional hearings were unsuccessful. Of course, this display of solidarity within the government coalition was costly, both in material and political terms.

A succinct summary of this episode may be found in Latin American Monitor: Brazil (1998b). Literally dozens of press reports during the first half of 1997 detailed constant exchanges between the executive branch and congressmen of funds and favors for votes for the constitutional change permitting FHC’s reelection. See, for example, Folha de São Paulo (1998b, 1998c) for typical accounts of this wheeling and dealing.

16. Thanks to Tim Power for his insight on the issues discussed in this paragraph.

17. See Samuels 2000 for a useful discussion of Brazil’s campaign finance legislation and the role of money in Brazil’s democracy.

18. In fact, in mid-1998, more than half of better-educated voters said they would not vote for Cardoso (Jornal do Brasil 1997b, 1997c).

19. Strictly speaking, the president’s penchant for publicly analyzing Brazil’s many social problems was nothing new. As president, FHC continued to speak frequently as the sociologist about social, economic, and political consequences of Brazil’s encounter with the forces of globalization. See, for example, Cardoso (1996b, 1996c).

20. We omit the fourth scenario — a possible, but unlikely, victory by Lula and his left coalition — which was included in the original, North-South Center Agenda Paper version of this chapter. The following discussion of these scenarios is mostly unchanged from the original text, except for minor editing.

21. However, as Finance Minister Pedro Malan and other members of the economic team insisted, Brazil was in a stronger position than in October 1997 to face a major crash in international markets. In late 1997, Brazil’s hard currency reserves were 1.8 times the current account deficit; in August 1998, in contrast, this ratio was 2.25 times, with international reserves of approximately $73 billion and a $32 billion current account deficit (Jornal do Brasil 1998m).
22. According to forecasting models developed by Standard and Poor's DRI group, an "Asian Armageddon" scenario would "clobber" the Brazilian economy, sharply increasing inflation and cutting exports. See Washington Post (1998).

23. However, save Petrobrás, whose sale was unlikely for reasons of nationalist symbolism, after the $19 billion sale of Telebrás in late July 1998, there were no more large, highly visible privatizations available for the government to demonstrate its commitment to continued market reform and to buttress foreign investors' confidence.

24. See Power (1997) and Power, Fleischer, and Marques (2000) for pertinent reflections on the identity crisis afflicting the tecanos, or party affiliates, of the PSDB.

25. Such a project may have serious short- and medium-term difficulties. For a sobering critique of some of the implications of the pattern of investments, see the analysis of well-known economist Antônio Barros de Castro in the Folha de São Paulo (1998).


27. By the end of September 1999, 81 deputies had changed their party label, thus threatening the record set in 1995, when 83 switches occurred. See Melo (1999).

28. Indeed, to a great extent, FHC received legislative support for the reelection amendment precisely because he offered the governors the same right to run again. However, this created incentives for opposition governors to remain in office. The success of the incumbents in achieving reelection in 1998 suggested that the turnover in the ranks of state governments that might have helped FHC solicit new supporters for his agenda might be low. That could mean that the opposition governors that get in, stay in, producing more sustained subnational opposition to reform.

29. On these events, see Istó 1999b. Also see Istó (1999c) for an interview with Cardoso in which he admits that errors were made in the handling of the devaluation and denies that the IMF was imposing policies on Brazil.

30. In September 1999, the real already reached the $2 mark before recovering somewhat. However, the October 1999 elections in Argentina, the looming constitutional crisis in Venezuela, Ecuador's default on its foreign debt, the ongoing Colombian civil war, plus the U.S. Federal Reserve's tighter money policy all made it difficult to prevent the currency's erosion.

31. See the monthly data published in Latin American Monitor: Brazil (1999, various issues). Here again, it must be stressed that it is domestic, not foreign, debt that is the problem. In the last two years, domestic debt has almost doubled and currently stands at nearly R$200 billion, or about $205 billion dollars. By contrast, the foreign debt has only increased 13 percent in the same period. See The New York Times (1999) and the detailed analysis in Sáinz and Calcagno (1999).

32. The Lopes resignation followed several earlier scandals associated with the privatization of the Telebrás communications conglomerate that forced the ouster of several top Cardoso associates, including, most prominently, André Lara Resende, president of the BNDES, and Communications Minister Luiz Carlos Mendonça de Barros. See Simonens da Silva (1999) for a detailed critical study sponsored by the Catholic Church's Peace and Justice Commission, of scandals in the financial sector.

33. Rising tensions with Argentina over the future of MERCOSUL not only threaten Brazil's policy of integration with regional trading partners but also undermine its bargaining
position on the future Free Trade Area of the Americas with the United States. Thirty percent of Argentina’s exports go to Brazil, and, in recent years, a considerable part of Argentina’s trade surplus has come from its trade with Brazil. Consequently, the devaluation of the real not only struck a blow against Argentina exports but also fed an (exaggerated) impression that its markets were being “invaded” by cheap Brazilian products. The Brazilian devaluation also put pressure on Argentina’s currency board, which locks the peso tightly to the U.S. dollar. President Cardoso’s support of fiscal incentives to encourage the location of a major installation by automaker Ford in the northeastern state of Bahia provoked Argentine protests against its neighbor’s “unfair practices.” The ensuing tit-for-tat imposition of sanctions and restrictions on each other’s exports plunged MERCOSUL into deep crisis. Although tensions subsequently subsided, bilateral trade between both countries was down some 20 percent, and prospects for a deepening of regional integration were in doubt. Of particular concern were the two countries’ contrasting exchange-rate regimes, which make macroeconomic coordination and micro-level planning by firms problematic.

34. For detailed survey data, see the data bank (http://www.dieese.org.br) maintained by the Inter Trade Union Department of Statistics and Socio-Economic Studies (Departamento Intersindical de Estatística e Estudos Socio-Econômicos — DIEESE). It should be stressed that DIEESE surveys are limited to the 10 largest urban centers, so they disproportionately reflect trends in the industrial sectors, particularly the older, import-substituting sectors. According to data released by the Federation of Industries of the State of São Paulo (FIESP), the level of industrial activity for the first 8 months of 1999 was 7.6 percent below that of the same period the previous year (Brazil Focus: Weekly Report 1999c).

35. See Istoc (1999e) for examples of claims that the “worst is over.” For a scathing critique in which the role of the IMF is belittled as the “Queen of England,” see the interview by outspoken economist Maria da Conceição Tavares in Istoc (1999h).

36. Similarly, well-organized lobbies and their parliamentary appendages (such as the infamous bancada rural, comprised of politicians of all parties tied to agricultural interests) championed expensive projects in Congress, thereby forcing the government to brandish its veto powers and to expend its dwindling political capital to defend its commitment to the IMF austerity package. See Acula and Smith (1994) for a more formal explanation of why rational actors — both principals and agents — will step up their demands for redistributive policies well before a sustainable economic recovery is actually at hand.

37. Interestingly, this showdown occurred at a special meeting of the PSDB called to debate the topic “Development with Stability” and to hammer out a coherent political and economic strategy in order to overcome party divisions. For details see Brazil Focus: Weekly Report (1999b).

38. The government preferred not to highlight other figures in its 2000 budget proposals. For example, the budget bill projected that 43.7 percent of federal expenditures would go to servicing the public debt (up from 18.1 percent in 1997, 31.2 percent in 1998, and 34 percent in 1999). In contrast, health expenditures (11 percent in 1997, 8.1 percent in 1998, and 7.7 percent in 1999) were slated to decline to 6 percent in 2000, with education’s share (5.5 percent in 1997, 4.5 percent in 1998, and 4.2 percent in 1999) of public spending to shrink to 3.8 percent in 2000 (Schmidt 1999).

39. According to polls conducted by Vox Populi and commissioned by the National Confederation of Industry, the previous record was the 60-percent rejection for Sarney in March 1990 as he left office with inflation raging at a monthly rate of 80 percent; even Fernando Collor, on the eve of his impeachment in mid-1992, had a 57-percent rejection rate (Estado de São Paulo 1999a; Brazil Focus: Weekly Report 1999c and 1999d).
40. Brazilians were not rejecting the need for austerity per se. In February 1999, following the devaluation, when asked if they "were willing to make further sacrifices" to avoid the return of inflation, 51 percent answered "No" and only 37 percent responded "Yes"; eight months later, those objecting to further sacrifice declined to 35 percent while those who answered "Yes" had risen to 57 percent. For details and analysis of polling trends, see *O Estado de São Paulo* 1999a; *Brazil Focus: Weekly Report* 1999c and 1999d.

41. These problematic prospects were foreshadowed by difficulties in approving the budget in timely fashion, thereby forcing FHC to call for a special legislative session for January and February 2000. Focused on the October 2000 municipal elections, many members of Cardoso's coalition frequently treated his priorities as a mere "wish list," while simultaneously exhibiting a more independent demeanor by strengthening Congress's oversight power by threatening to limit the presidential powers to use *medidas provisórias* to implement urgent measures. See *New York Times* (2000) and *Latin American Monitor: Brazil* (2000a) for an idea of the concern this provoked among foreign observers.

42. Strong parties and coherent state institutions matter, as the comparison with Chile suggests. In Chile, the Concertación government confronted its third consecutive election intact, even as the economy experiences what is (by Chilean standards) a mild recession. For an interesting analysis of the strength and "encompassing" nature of institutions in Chile, see Weyland (1997).

43. The following analysis owes much to conversations of the senior author with Tim Power, who wonders whether Brazilian social democracy has fallen victim to an "impossible game" described by O'Donnell (1978) for Argentina between 1955 and 1996. See Korzeniewicz and Smith (2000) for a more general discussion of the possibilities of "third way" alternatives in Latin America.

44. It should be noted that the PT has been willing to forge alliances behind candidates of other parties at the local and state levels, as its support for the PDT in Rio de Janeiro indicates. Although PT support for another party's presidential candidate (for example, in support of Ciro Gomes and the PPS) remains highly unlikely, a contest pitting a divided centrist alliance against a divided center-right alliance might conceivably lead to a PT victory. In this scenario, in which the center-left supported Ciro Gomes, then the PT perhaps could defeat a PFL-led coalition in first round balloting. Unless runoff elections are eliminated, however, it would be extremely difficult for the PT to win in a second round.

45. For an uncommonly blunt "no" response along these lines, see the interview with Thomas Skidmore, a prestigious U.S. *brasilianista*, in *Istoé* (1999).
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