Brazil's president

The year of changing unexpectedly
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Having secured financial stability, can Lula move on to economic growth and effective social reform?

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"MUDANÇA" means change in Portuguese. It is what Luiz Inácio Lula da Silva promised a year ago when he became Brazil's first elected left-wing president. He would end the economy's habit of crashing like a virus-infested computer, lift millions of Brazilians out of squalor and give his country international heft to match its vast population and territory. A former trade-union leader born in poverty, Lula's arrival in the presidency itself embodied change.

Yet, a year on, both his successes and his failures have defied expectations. On the one hand, his government headed off yet another financial crisis by slashing public spending and raising interest rates, which smothered growth, squeezed wages and killed jobs. A law to trim public-sector pensions, approved last month, angered many traditional supporters of Lula's Workers' Party (PT), who had expected him to expand the state, not reform it.

On the other hand, the PT did not escape the pitfalls of a first experience of national power, albeit in a coalition with centrist parties. Some of its ministers have proved incompetent. Its social policy has been muddled. The party, which boasts of its virtue, has stooped to trading favours for congressional support just as its predecessors did. Its image may yet suffer further damage from a smouldering scandal surrounding party finance and the murder of a PT mayor before the election.

Yet the magic endures. After a year of recession, Lula is as popular as his predecessor was after his first year
(of boom). Abroad, he is a spokesman for critics of the United States’ way of doing things, from trade to the Middle East. “People have never been as supportive of a government as they are of this one,” says Raquel Teixeira, a congresswoman from the opposition Brazilian Social Democracy Party.

Opinion polls show that most Brazilians are prepared to give Lula time, but that their patience is not endless. Unless the economic pain proves temporary, disenchantment will surely grow. So can Brazil’s first government of the left now bring about the kind of sustained job-creating growth that has eluded its predecessors for the past two decades?

The omens from Lula’s first year in office are encouraging. He gave stout backing to the finance minister, Antônio Palocci, who administered a “credibility shock” upon taking office by voluntarily raising the target for a primary fiscal surplus (ie, before interest payments) from 3.3% of GDP to 4.4%. This, plus the pension reform, convinced investors that Brazil was serious about containing its huge public debt. The central bank, meanwhile, raised interest rates. The austerity hurt, but inflation retreated (see chart). With interest rates now falling fast, the economy may grow by as much as 4% in 2004, having stalled in 2003.

Lula has also been a deft manager of Congress, pushing through contentious measures such as the pension reform by striking broad alliances and gaining support from the opposition when necessary. “We did not lose one important vote in 2003,” boasts Luiz Dulci, a senior aide to the president.

All this adds up to the equivalent of mastering level one of a video game. The familiar target of macroeconomic stability does not disappear from level two but new targets pop up. The most important aims are more long-term investment, without which the economic recovery will quickly peter out, and cutting poverty, through welfare programmes and better education and health services. Here, the line between effective government action and unproductive meddling can be a fine one. Mistakes are not immediately detected and punished by the financial markets, as they are in macroeconomic policy.

In both microeconomics and social policy, Lula has started unsteadily. He came to office criticising Brazil’s regulatory agencies, which are supposed to shield contracts from political whim. His telecoms minister invited consumers to go to court to overturn a tariff increase blessed by the regulator. The government “didn’t create conditions for a revival of infrastructure investment,” says Adriano Pires of the Brazilian Centre for Infrastructure, a consultancy in Rio de Janeiro. The government also stumbled on welfare, betting on a big programme called Zero Hunger, which was roundly mocked as old-fashioned and ineffective.

Lula’s team has been supple enough to bend on both issues. The government is now promising a new investor-friendly regulatory policy, as well as rules to encourage partnerships between the cash-strapped public sector and private enterprise. The idea is to “favour productive investment, especially in infrastructure, so it can sustain a new cycle of growth,” says Mr Dulci. But tension will persist between Brazil’s market economy and a party accustomed to seeing markets as the enemy of social equality. The evidence so far is that the outcome will sometimes be an awkward synthesis, arrived at after drawn-out debate.

A long-awaited “new energy model”, unveiled in December, may set the pattern. This is the government’s scheme for avoiding a repetition of the 2001 blackout, which hobbled the economy. It grants the authority to award concessions for building power stations to the energy ministry. It leaves the ministry much room to rewrite the rules, and private investors have damned the model as “statist”. Moreover, the government has no intention of privatising electricity generation, 80% of which is in the hands of state companies.

Yet if the government sets clear and stable rules, the model may achieve its goal: new investment in energy at prices that reflect its true economic cost. Long-term contracts, which will pay generators a fixed charge for building and maintaining plants, will shield them from the vagaries of Brazil’s volatile market. The ministry has discarded a populist plan to hold down the price of electricity by buying it cheaply from old hydro
generators whose investment has already been written off.

This pattern of ad hoc improvisation applies to social policy, too. Zero Hunger continues, but its importance is likely to be eclipsed by the Family Fund, which unifies a clutch of income-transfer programmes for the poor that had been scattered among various ministries.

Education has been hurt by the PT’s ideological instincts. The new minister, Cristovam Buarque, when governor of Brasília pioneered the bright idea of giving cash to poor families if they would send their children to school. But his ministry has disappointed enthusiasts for university reform. It created a commission which proposed scrapping the provão, an exam which evaluates universities. Though disliked by students’ unions, this is one of the few tools with which to improve the (poor) quality of teaching. Mr Buarque seems to have recognised this: he now says he will modify, but not scrap, the provão.

He also unveiled a noble-sounding drive to make every Brazilian literate within three years. This might give many people, including the elderly, a smattering of literacy. But the same money could be used to teach Brazilians aged 15-30 how to read and write proficiently, a more important goal, says Ms Teixeira, a former state education secretary from Goiás. Like many other specialists, she pronounces the education policy “worrying”.

Some Brazilians are also concerned by Lula’s foreign policy. This seems to give greater emphasis to standing up to the United States than to a clear-headed pursuit of Brazil’s interests. The president’s frequent foreign jaunts have featured places such as Cuba, Libya and Syria; in global and regional trade talks, Brazil has led a charge against rich-country trade barriers but has seemed equally reluctant to liberalise itself. This pugnacity abroad at least provides some political cover for macroeconomic moderation at home.

In sum, what drives the government is Lula’s own fusion of fervour and pragmatism. Unlike many other members of his party, he cares more about the overall goal than the methods used to achieve it. He insists that he is a negotiator, not an ideologue. His personal history bestows legitimacy on that pragmatism, making it look less like compromise. When Lula says that it does not matter whether services for the poor come from the public companies or private ones, it is hard to argue.

The coming year may bring more realism and competence to his administration as a whole. It is likely to open with a shuffling of ministerial posts, intended partly to bring into government the centrist Democracy Movement Party, the second-largest in Congress, which helped Lula pass pension and tax reforms. This may also weed out the weakest ministers and perhaps reduce their number from an unwieldy 33.

Lula’s bluff reassurances do not still all doubts. Despite Brazil’s best efforts, its giant debt means it remains vulnerable to outside events. A rise in international interest rates, for example, could suck capital away, forcing up domestic rates and halting recovery. Lula might then be tempted to ditch austerity and dash for growth in time for the 2006 presidential election. Another worry is that the president may never tackle many of the big reforms that Brazil needs if it is to achieve faster growth, including the modernising of a state that consumes 40% of GDP, shackles business with hefty taxes and makes employment needlessly expensive. Even Lula’s appetite for change has limits.