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## Brazil's handover





# The handover

Lula gave Brazil continuity and stability. Now he needs to give his successor independence



**T**HINK back eight years, when the prospect of Luiz Inácio Lula da Silva, leader of the left-wing Workers' Party becoming president of Brazil, the world's fourth most populous democracy, caused panic in financial markets. With Lula now

preparing to step down after two terms, Brazilians seem poised to elect his chosen successor, Dilma Rousseff. She is at least as left-wing as he is. But the markets' mood could hardly be more different. By way of a pre-election boost, Lula even travelled to São Paulo's stock exchange to hail a \$67 billion share issue by Petrobras, the national oil company, to raise funds to develop Brazil's vast new deep-sea fields.

Brazil's circumstances and its standing in the world have been transformed during Lula's presidency and mostly for the better (see our briefing, pages 29-31). Poverty has fallen and economic growth has quickened. Brazil is enjoying a virtuous circle: soaring Asian demand for exports from its farms and mines is balanced by a booming domestic market, as—partly thanks to better social policies—some 20m new consumers have emerged from poverty. No wonder foreign businesses are piling in, while a swelling group of Brazilian multinationals is expanding abroad.

Thanks to his tactile charm and impoverished origins, Lula has been an extraordinary salesman for this transformation. He embodies the fairer, more inclusive democracy he has helped to create. His popularity rating stands close to 80%. Barack Obama called him "the most popular politician on earth". Yet his biggest achievement is not to make his countrymen love him, but to give them continuity. The platform for Brazil's take-off was laid by the liberalising reforms and inflation-busting policies of his predecessor, Fernando Henrique Cardoso. Lula kept these in place when many in his party wanted to scrap them, consolidating economic and political stability.

## Hand in hand at the hustings

It is heartening, then, that the election campaign has confirmed a broad consensus on economic and social policy. But there are still big risks ahead, for Lula has left some troubling problems unsolved, and it is not clear whether Ms Rousseff has the strength or desire to tackle them.

As Lula's chief of staff, Ms Rousseff showed herself to be a capable and forceful administrator. She is a tough and courageous woman: as a young leftist militant, she survived torture at the hands of a military regime, and she came through a battle with lymphatic cancer last year. But she has never before held elected office. If she is victorious, it will be thanks not to her personality or achievements, but to Lula's astounding popularity and tireless presence at her side during the campaign (often in violation of electoral law).

Against this, her rivals have struggled. José Serra, until recently the governor of São Paulo, is an experienced and competent politician from Mr Cardoso's party. But his campaign has been woeful. Marina Silva, a former environment minis-

ter, espouses many good and thoughtful policies, but her Green Party is new and small. Until a fortnight or so ago, Ms Rousseff seemed assured of outright victory on October 3rd. Then allegations surfaced that her successor as Lula's chief of staff was involved in influence-peddling. Though unproven, this scandal may do enough damage to push Ms Rousseff into a run-off election in a month's time, though it is hard to imagine that she will not, in the end, win.

## Let her go

That Ms Rousseff is so dependent on Lula's patronage is a shame, for Brazil needs a strong and independent leader. Success has bred an atmosphere of hubris in Brasília. With the outlook for the world economy so uncertain, that is potentially dangerous. Despite the country's achievements, there are three difficult sets of issues that—assuming she wins—Ms Rousseff will have to deal with.

The first is corruption. The opposition claims that Brazil's new-found oil wealth will foster the elected authoritarianism that grew up in Mexico under the Institutional Revolutionary Party. That looks, for the moment, like an exaggeration; but it is true that the Workers' Party has come to see public office as a perquisite and has a troubling tendency to bloat the federal bureaucracy with political appointees. Fortunately Brazil has a fiercely independent judiciary and media. But Ms Rousseff needs to make a clear commitment to clean government.

The second concerns the role of the state in the economy. This has expanded in Lula's second term, and not only because of the world recession. The government has ill-advisedly given Petrobras a monopoly over developing the new oil fields, and used the share issue to raise its controlling stake in the company. It has lavished cheap loans on firms that it sees as national champions, partly to counteract the strength of the real. But these policies are driving up public debt even as the economy grows. They also crowd out much-needed spending on infrastructure, sanitation, education and innovation. And they do nothing to bring down high interest rates. The next government should aim speedily to eliminate the budget deficit. Better still would be an effort to reform the tax system and relax labour laws that still hold back the economy.

The third test for Ms Rousseff will be in foreign policy. Lula's activism brought benefits to Brazil. But his penchant for autocrats—such as the Castros in Cuba, Venezuela's Hugo Chávez and Iran's Mahmoud Ahmadinejad—damaged the country's reputation as a force for good. The next government will face a particular test in South America, where Brazil has at last become the main engine for regional growth. Mr Chávez's star is waning (see page 41), but it is far from clear that he will relinquish power voluntarily if defeated in two years' time. Brazil should use its clout to ensure that he does.

That most of these problems are perfectly manageable shows how far Brazil has come. Whether, and at what pace, the country solves them will depend on Ms Rousseff's political skills. For her to acquire the authority to do the job properly, she needs to emerge from Lula's shadow. As his final gift to his country, he should let her do that. ■





## Lula's legacy

BRASÍLIA

Life is better for Brazilians than it was eight years ago. But Lula is leaving unsolved problems for his chosen successor, who lacks his personal magnetism

THE "best president ever" is how Sandro, a flower-seller in São Paulo, describes Luiz Inácio Lula da Silva. Who will he vote for in the presidential election on October 3rd? "Dilma, for sure." Why? A shrug and a laugh: "Continuity. And because Lula chose her." His reasoning is echoed across Brazil, especially among the rural poor and migrants to the big cities. The economy is growing strongly. Jobs are being created, and incomes are rising. The man who presided over this is barred by the constitution from running for a third term. Who better to succeed him, voters ask, than the woman he endorses?

A year ago pundits agreed that Lula's vast popularity was strictly personal, and could not be passed on at will. He had tried without success to get allies elected as state governors or mayors of big cities. That may be why José Serra of the opposition Party of Brazilian Social Democracy, a seasoned

politician who long led the opinion polls, barely started campaigning until it was too late. He seemed to think that Lula's choice, Dilma Rousseff, a colourless technocrat who was Lula's chief of staff but has never held elected office, would be easy to beat.

He was wrong. Lula's popularity, it turned out, could be transferred—but only on his going and only to his chosen successor. If the polls are right (see chart on next page), Ms Rousseff will be Brazil's next president. That is despite several brewing scandals. The most serious concerns Erenice Guerra, a longtime associate of Ms Rousseff who took over from her as chief of staff when she stepped down to start campaigning. Last month allegations surfaced that people linked to Ms Guerra, including her sons, had extracted bribes in the form of retainers and success fees from businesses hoping to win government contracts. Ms Guerra was quickly defen-

trated. No evidence implicating either the president or his candidate has come out.

The opposition has tried to get voters to worry about this (Ms Rousseff is either incompetent or complicit, Mr Serra claimed). But few seem to be listening. The affair has knocked only a few points off Ms Rousseff's commanding lead.

Instead, Brazilians are revelling in a golden moment. A country that used to fall over whenever the world economy wobbled was one of the last to go into recession in 2008 and one of the first out in 2009. Median earnings are rising and, despite a minimum wage at its highest in real terms since 1979, so is employment.

Since 2003 some 20m Brazilians have emerged from poverty and joined the market economy. These new consumers buy everything from cars to cookers and fridges to flights. To this burgeoning domestic market, add China's appetite for Brazilian iron ore, meat, soya and more, and in economic terms this is probably "the best moment in the entire history of Brazil," says Marcelo Neri of the Fundação Getúlio Vargas, a university.

### Brazil according to Lula

Lula's remarkable life story—the child of dirt-poor migrants who became a metal-worker and trade-union leader—and personal magnetism have helped him to sell "brand Brazil" around the world: a coming power, a profitable place to invest and a tolerant democracy where a man like him could become president. These qualities also mean that most Brazilians give him most of the credit for the improvement in their lot. Are they right?

In a recent interview with *The Economist* at the presidential palace in Brasília, Lula set out some ways in which Brazil has become a better place during his terms in office. "We are starting to lay steps so that the poorest begin to rise up to the lower-middle class and then to the middle-middle class," he says. With national self-esteem rising and inequality falling, Brazil is poised under the next president to fulfil his dream of becoming "a country in which the great majority are middle-class" with high purchasing power and access to better education and health. Lula understands from personal experience what matters in helping poorer Brazilians get ahead. He is proud that, although he is the first president of Brazil without a university degree, he is the one who created the most universities and technical schools.

"Wherever you go in Brazil you will see work financed by the federal government," he says, highlighting railways, power stations and basic sanitation. After 25 years in which the country failed to maintain its infrastructure, let alone build any more, it is "reacquiring the capacity to carry out the grand infrastructure works that Brazil needs." »



For many of the poor and working-class Brazilians who are his most ardent supporters, Lula's crowning achievements have been big rises in the minimum wage and pensions, and the Bolsa Família programme, which gives 12m families small but life-changing amounts of cash in return for having their children vaccinated and keeping them in school. By boosting domestic demand, these policies have also contributed to economic growth.

Many better-off city dwellers agree that Lula deserves praise for bringing into the Brazilian mainstream the once-novel idea that reducing poverty is a proper aim of government (though others sneer snobbishly). But when asked what Lula has done for his country, such people also point to the policies he inherited from his predecessor, Fernando Henrique Cardoso.

As finance minister under Itamar Franco in 1993-94, Mr Cardoso tamed Brazil's persistent hyperinflation with the Real Plan. As president between 1995 and 2002, he put in place policies that have given the country stability and growth. "Lula inherited sensible macroeconomic policies and was clever enough to realise it," says André Villela of the Fundação Getúlio Vargas. That involved ignoring the socialist economic ideas of his Workers' Party (PT). Early in Lula's presidency, his finance minister, Antônio Palocci, saw off fears of default by tightening fiscal policy and repaying foreign-currency debt. Henrique Meirelles, a former international banker who has run the Central Bank for all of Lula's presidency, has guaranteed monetary orthodoxy. Because of Lula, says Luiz Felipe Lampreia, who was Mr Cardoso's foreign minister, "there is now a national consensus against macroeconomic foolishness."

### A mightier state

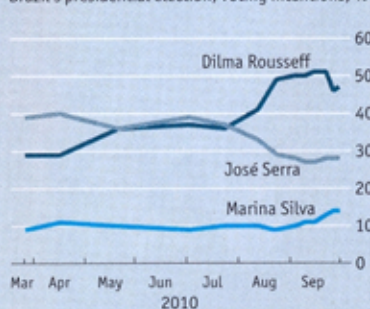
But the consensus breaks down on two issues. His critics argue that, given his popularity, Lula could have done more to fix some of Brazil's deep-rooted problems. They also say that in his second term he allowed the state to become over-mighty.

The last time *The Economist* talked to Lula, in early 2006, he was emerging from a scandal that engulfed his first administration and almost ended his political career. In a scheme known as the *mensalão* (roughly, "big monthly stipend") the PT had bought votes of congressmen from allied parties. Lula said then that in a second term his priority would be tax, political, labour and pension reforms. These are sorely needed: the tax system is multilayered and burdensome, politics prone to corruption and gridlock, labour laws rigid and anachronistic and pensions for public employees absurdly generous. Yet none of these reforms happened, despite (or perhaps because of) Lula's soaring popularity.

Not for want of trying, is Lula's response. He talks up his efforts to reach con-

### Rousseff's race

Brazil's presidential election, voting intentions, %



Source: Datafolha

sensus on most of these issues, and blames "hidden enemies" in Congress who refused to match verbal support with votes. Indeed, when asked what he has learned about his country during eight years as president, Lula speaks of the difficulties of getting things done, especially public-investment projects. A president can find that by the time he has cut through red tape and persuaded state and local governments to co-operate, his four-year term is over. A big infrastructure project—and Brazil needs many, from roads, ports and airports to sewage works and power plants—could easily take "five years to solve all the problems, and two years to get the job done". In Brazil, he concludes, "the president cannot always do what he wants, he does what he can".

Not good enough, retort critics, who see Lula as having surfed the commodity boom on Mr Cardoso's unpopular, but necessary, liberalising reforms. They accuse Lula of using the recession as an excuse to expand the state's grip on the economy, either directly (with oil) or indirectly (through loans by state banks). They worry that he has strayed from the path of fiscal rectitude. The government has lost control over day-to-day spending on pay and pensions, says Marcelo de Paiva Abreu, an economist at the Catholic University in

Rio de Janeiro, losing its chance to boost investment in infrastructure.

The increase in public spending in 2008 shortened the recession, but much of it has not been reversed even as the economy roared back to life. Some of it involves printing money, disguised by accounting tricks: while the government's net debt is falling its gross debt is rising, and its deficit helps to keep Brazil's interest rates high (though they are lower than a decade ago). "Such pro-cyclical spending makes no sense," says Mauro Leos of Moody's, a ratings agency. "When times are bad—and bad times always come—Brazil will be sorry it hasn't been putting money aside."

Lula agrees that the expanded role of the state should be temporary. "I don't want the proprietorial state," he insists, adding that "I respect the workings of the market." But the lesson of the financial crisis is that the state should regulate better and be prepared to intervene when the market fails, as well as "inducing" private investment and acting "for the sake of the people who need it the most".

Rather than reforms, opponents say that Lula has given priority to cementing his party's grip on government. The past eight years have seen an "unprecedented" increase in the award of government jobs to political clients, according to Maria Celina D'Araújo, a political scientist at Rio's Catholic University. Almost a quarter of senior managers in the federal administration are PT members, her research shows, and 45% are trade unionists. Under Mr Cardoso 40% of managers of state pension funds were trade unionists; under Lula, more than half are.

Although Brazil is far from one-party hegemony, there are other signs that Lula and the PT increasingly conflate what is good for the country with what is good for them. One party leader responded to revelations of corruption by warning of the perils of "too much" press freedom, while Lula complained that some publications "act as if they were a political party".

Asked about fears that Brazil's democracy could be threatened by an extension of these trends, Lula says this is "unthinkable". But if such fears are among the most commonly mentioned reservations about his legacy, that is because they are amplified by the huge deep-sea oil reserves (known as *pré-sal*, since they lie beneath a volatile layer of salt) discovered a few years ago. If these can be brought to the surface and to shore they will turn Brazil into an oil power. But oil has a nasty habit of bringing corruption with it. The fund Lula wants to set up with oil revenues could, as he says, help Brazil to overcome poverty, low standards in education and limited investment in science and technology. Or it could provide a lucrative way to reward loyalty to party and president.

Lula makes light of the risks in lifting ▶

### A better Brazil

	1993-95 average	2002	2009
Poverty, % of population with income under 144 reais per month (\$2.50 a day at PPP*)	31.8	26.7	15.3
Income inequality, gini coefficient†	0.6	0.59	0.54
Average real monthly income per person, reais	457.3	507.7	630.3
Average years of schooling	5.4	6.6	7.6
Households with washing machine, % of total	24.3	32.9	44.4
Population with sewage connection, % of total	36.5	43.8	51.0

Source: Centre for Social Policies, Fundação Getúlio Vargas

\* Purchasing-power parity  
† 0=perfect equality,  
1=perfect inequality



the oil. The recent spill in the Gulf of Mexico was caused by the "irresponsibility" of a private company which tried to extract oil in the "cheapest and quickest way possible". Standards in Brazil, he insists, are higher. He dismisses the idea that the state is counting its barrels before they are pumped. His government decided to grant sole operating rights in unallocated fields to Petrobras, the national oil company, rather than grant concessions, as before, because "you offer risk-sharing contracts when there is risk. In the case of the *pré-sal* oil, we are sure." It is a strange way to talk of the most technically demanding oil-extraction project on the planet.

The government has used a huge (\$67 billion) new share issue by Petrobras, launched on September 23rd, to raise its stake in the company from 40% to 48%. It is paying for this partly by selling oil deposits to the firm and partly by more accounting sleight of hand involving the National Development Bank (BNDES). In all, state bodies bought 60% of the offered shares.

But it must also raise finance, either private or public, for its grand infrastructure plans, made more urgent by hosting the World Cup in 2014 and the Olympics in 2016. Since Brazil's savings rate remains low, foreigners will have to pay for most of the projects. At the moment they seem keen to. The current-account deficit has reached 2.4% of GDP so far this year. But capital inflows help to make the real stronger, which is hard on exporters.

#### What next?

"Dilma is going to surprise the world," says Lula. That is a near certainty, given how little is known about her. In the 1960s she was a Marxist revolutionary; in the 1970s she was jailed and tortured by Brazil's military regime. More recently, as Lula's energy minister and then chief of staff, she has been a competent manager, though with a notoriously short fuse. She was not an obvious successor to Lula. He chose her partly for lack of alternatives: the PT's more prominent leaders were caught up in the *mensalão* or other scandals.

Asked whether he will remain the power behind the throne, Lula starts with flat denial. "You can be sure of one thing: I'm leaving," he says, adding that he has no plans to run for election in 2014. "If I get Dilma elected and she is good, she'll have to be a candidate for re-election." But then ambivalence creeps in. "I'm a politician, and I'll continue to be politically active," he says, musing that when he steps down he may find it easier to talk about tricky political matters. "I will start by convincing my own party to accept political reform as a priority." In practice, Ms Rousseff may have to govern in Lula's long shadow.

Since she has spent much of her political life behind the scenes, little can be said about her ability to cope with the limelight. She lacks Lula's faith, rooted in his trade-union background, in his ability to negotiate a deal, whatever the circumstances. At home that helped him to dominate his party and coalition. Abroad, it led him to assert Brazil's right to join the best talking shops, such as the United Nations Security Council. He believes passionately in the power of personal diplomacy. "If I could give one piece of advice to the world's presidents, it would be: 'don't outsource politics'." But many would say he overestimates its possibilities. His most serious misstep came in Iran, when his attempt (with Turkey) to persuade Mahmoud Ahmadinejad to play by the world's nuclear rules was spurned by the UN.

Ms Rousseff may feel the lack of such dealmaking abilities, as she tries to run a party and government no longer dwarfed by their leader, and perhaps in less favourable economic circumstances. She is likely to do less of Lula's globetrotting while she feels her way at home.

What kind of government would she run? Plans for tightening fiscal policy have appeared in the press, attributed to sources close to her. So have predictions that Mr Pallocci, who ran such a tight ship in Lula's first term, might become her chief of staff. But also in that fight are people like José Dirceu, the architect of the *mensalão*, who plays an important role in her campaign. In September he told a group of PT members that the party would be more powerful under Ms Rousseff, since she represented the party project, whereas Lula was "twice as big as the party". Luciano Coutinho, president of the BNDES and archi-

tect of the government's industrial policy, might get the job of finance minister.

Then there is the PT's main electoral ally, the Party of the Brazilian Democratic Movement (PMDB), a coalition of regional bigwigs with a voracious appetite for patronage. In August the PMDB's leader, Michel Temer, who will be vice-president if Ms Rousseff is elected, told party members to campaign hard for her, saying that in return they would partake in what he described as the "sharing out of the bread".

Where Ms Rousseff herself stands nobody bar her closest associates knows. Her early appointments and announcements will be scrutinised with unusual eagerness. Will she surround herself with austere economists, or party hacks, or believers in the state's power to boost growth? Or a mix of all three? Does she plan to trim the budget deficit—or does she, like many on the left of her party, believe that growth makes such tedious rectitude unnecessary? Will she take some steps that Lula shirked, because of a desire to smooth her path to the throne, such as inviting private companies to run Brazil's overstretched state-owned airports?

Ms Rousseff may have cause to wish that her predecessor had been bolder. But she is inheriting a better Brazil than he did, and that is in good part because of him. If one of Lula's finest moments came right at the start of his presidency, another will come at the end, when he stands down after two terms, rather than changing the constitution to allow himself a third. "A popular left-winger but not a populist," concludes Carlos Melo of Insper, a São Paulo business school. "This is something completely new and an example to the rest of Latin America." ■



Still a lot left for Dilma to do