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Rousseff's Corruption Crackdown Risks Brazil Inflation Fight

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By Alexander Ragir

July 27 (Bloomberg) -- Brazilian President Dilma Rousseff's crackdown on corruption will likely appeal to middle-class voters who are growing in political importance. It also risks undercutting the fiscal discipline needed to cool inflation by disrupting her coalition.

Rousseff has forced out more than a dozen officials from their posts at the Transportation Ministry this month, including Minister Alfredo Nascimento, over allegations of overbilling and kickbacks. Nascimento is a member of the Party of the Republic, which is allied with Rousseff.

The president's move to clean house in a ministry whose budget rivals the size of Paraguay's \$18 billion economy, and is central to preparations for the 2014 World Cup and the 2016 Summer Olympics, has roiled members of her coalition.

"Every day the press reports that another corrupt official was forced out, without having a right to defense," said Lincoln Portela, leader of Nascimento's party in the lower house, in a telephone interview.

The tensions could complicate the task of passing Rousseff-supported legislation and blocking moves to boost spending, said political analyst Rafael Cortez, of Sao Paulo-based Tendencias Consultoria.

"Dilma's motives seem to be making management of the state more efficient, but it's going to have political implications," said Cortez. "The big question is what happens when corruption charges hit the big, core parties of the coalition."

Rousseff's Workers' Party, or PT, lacks a majority in Congress, so the president relies on support from 15 other parties to approve legislation.

Coalition 'Stress'

Portela said Rousseff's handling of the crisis in the Transport Ministry "adds stress" to the government coalition in Congress, though his party won't abandon its support for the president. Fellow member Luciano Castro, co-leader of the coalition in the lower house, said last week that the party would meet in August to decide whether to continue voting with the government bloc.

Atop Rousseff's legislative agenda is getting Congress to fall in line with an anti-inflation austerity drive by approving the 2012 budget, which will be presented for debate next month. The government also wants to defeat bills raising salaries for police and a constitutional amendment earmarking a fixed portion of the budget for health care.

"The big problem for Dilma is inflation, and if government spending keeps going up, they won't meet their target," said Carlos Melo, a political analyst and professor at Insper, a Sao Paulo-based business school.

Inflation Surge

Policy makers increased the benchmark interest rate by a quarter point to 12.50 percent on July 20, the fifth straight increase this year, in a bid to contain inflation that accelerated to 6.75 percent this month. The policy makers' inflation target is 4.5 percent.

Rousseff, 63, took office on Jan. 1 with the broadest governing coalition in the nation's history. Nascimento's party has 40 deputies in the 513-member lower house and six senators in the 81-seat upper chamber. The biggest partner, the Democratic Movement Party, or PMDB, has 79 deputies and 20 senators, while the PT itself has 86 and 13, respectively.

The president must tread more carefully than predecessors such as Janio Quadros, who rose to power in 1961 brandishing a broom and vowing to sweep away inflation-causing corruption from the previous government. Rousseff is trying to tackle the abuses of a coalition inherited from her mentor, former President Luiz Inacio Lula da Silva, whom she served as energy minister and cabinet chief.

Lula's Legacy

In keeping with Brazilian tradition of divvying up high-level positions in proportion to parties' electoral strength, Rousseff retained 12 Lula officials in her cabinet, including Nascimento. Lula battled calls for impeachment in 2005 after top aides were accused of paying bribes to congressmen.

Rousseff was attacked by rivals during the campaign for turning a blind eye to malfeasance when she served as cabinet chief. Support for her candidacy fell after her handpicked successor, Erenice Guerra, resigned amid media reports of influence-peddling. Her own cabinet chief, Antonio Palocci, stepped down in June after weeks of defending himself against corruption charges.

Brazil, the eighth-largest economy in the world, ranks 69th, tied with Cuba, in Berlin-based Transparency International's 2010 Corruption Perception Index of 178 countries.

While Rousseff could withstand the defection of smaller parties, a breach with the PMDB or a major fraction of her own party would put her in a difficult position, Cortez said.

Coalition Defections

Relations between Rousseff and her coalition soured in the run-up to Palocci's resignation, as allies demanded a bigger say in her government in exchange for resisting opposition calls for a congressional probe. Tensions came to a head when some of her lawmakers in the lower house sided with agricultural groups and approved environmental legislation that gives amnesty to ranchers who illegally clear the Amazon rainforest.

Rousseff has tried to reassure allies even as she commits to cleaning up government.

"We're not acting politically against any single party," she told Rio de Janeiro-based O Globo newspaper in an interview July 22, in response to a question about how far her purge would go. "We're acting against people who acted wrongly."

The president's office declined to comment when asked about whether the anti-corruption drive would damage her coalition.

Middle Class Votes

The crackdown will appeal to newly middle-class taxpayers, who are more concerned about corruption than are the poor, said David Fleischer, a political science professor at the University of Brasilia.

"By taking a stand, she has pre-empted the opposition," he said in a telephone interview. "This resonates with the new middle class, so she'll be able to go into 2012 with a high approval rating."

During Lula's eight years in power, 25 million people escaped poverty, and 36 million moved into the lowest rung of the middle class, earning \$1,100 to \$3,900 a month, according to researchers at the Rio de Janeiro-based Getulio Vargas Foundation. By 2009, more than 50 percent of Brazilians fit into this group.

By shaking up the Transport Ministry, Rousseff may speed up the badly needed renovation of Brazil's infrastructure, including airports and roads critical to the World Cup and the Olympics, said Alexandre Barros, head of Early Warning, a Brasilia-based political risk company.

Public Works

The ministry, which has a 27.4 billion reais (\$18 billion) budget this year and is responsible for the biggest number of public works under the government's \$886 billion infrastructure investment plan, is notorious for delays and cost overruns, Barros said in a telephone interview. The projects will likely be better run once Rousseff has appointed a new team, helping to slow inflation in the long run, he said.

"The house-cleaning is important because there are huge projects in the ministry that are very difficult to keep track of," he said.

Rousseff's anti-corruption drive "could be a turning point for the whole model of how you govern Brazil," Fleischer said. "It's a gamble, and we'll see if she can pull it off."

--With assistance from Mario Sergio Lima, Andre Soliani, Carla Simoes and Arnaldo Galvao in Brasilia. Editors: Harry Maurer, Joshua Goodman

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