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Cardoso and the Struggle for Reform in Brazil

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Latin America's Imperiled Progress

On 4 October 1998, Fernando Henrique Cardoso, widely hailed as Brazil's best president in 100 years of republican rule, was reelected president with a 53.4 percent majority in the first round of balloting. Yet soon after he began his second term on 1 January 1999, his approval ratings had sunk to record lows, his credibility abroad was in tatters, and he faced the prospect of a crippled presidency. The reason for his plunge in popularity was clear: Cardoso's political fortunes have been tied to his success in taming inflation through the introduction in mid-1994 (planned while he was serving as finance minister from 1993 to 1994) of a new currency, the real. But on 15 January 1999, after Brazil had lost billions of dollars in an effort to defend the value of the real, Cardoso announced that the government would allow the currency to float on exchange markets. Disillusioned Brazilians feared that the resulting slide of the real might revive the nightmarish inflation that had plagued the country in the past.

Yet more than the danger of renewed inflation is at stake. During his first term Cardoso's administration had made striking progress on a number of fronts. Massive popular support for his currency stabilization program (dubbed the "Real Plan") had dramatically increased his capacity both to push reforms through Congress and to address contentious issues of federalism, such as holding state governors to account for deficit spending. Although the momentum of reform slowed after 1996, Cardoso's early victories had lasting effects, as market-oriented **[End Page 49]** reforms reversed protectionist practices and began to promote a more competitive economy.

Yet much remained to be done, and Cardoso's ability to make further progress in his second term has now been cast into serious doubt. Millions of voters saw the devaluation of the currency as a breach of faith. This has not only created enormous uncertainty about Brazil's economic future, but has shattered political and financial confidence in the president. His sharply diminished popularity threatens his ability to impress a measure of cohesion on an excessively fragmented party and legislative structure, underscoring concerns about the capacity of Brazil's political institutions to govern effectively. Thus the country's economic and political prospects are both tied, to an unusual degree, to the question of whether Cardoso can restore his political standing.

The Cruzado Plan and the 1988 Constitution

Brazil's 1985 transition to democracy took place under extremely adverse economic conditions. Virtually throughout the 1980s, Brazil had triple-digit annual inflation; in the early 1990s, inflation spiraled out of control, reaching at times even four-digit figures. Two major attempts to stabilize the currency, first in 1986 and then in 1990, ended in disaster. In January 1985, the election of Tancredo Neves, a moderate opposition leader from the Party of the Brazilian Democratic Movement (PMDB), completed the transition to civilian rule. Tragically, Neves died before he could take office. He was succeeded by his running mate José Sarney, a former congressional supporter of the military regime and head of the newly-founded Liberal Front Party (PFL), who had originally been added to the ticket to provide a conservative counterweight. In February 1986, Sarney decreed the Cruzado Plan, based on the introduction of a new currency of the same name and a wage-price freeze. The initial plunge in inflation boosted Sarney's popularity ratings sky-high, but the results were short-lived. Like so many subsequent attempts, the Cruzado Plan suppressed inflation without eliminating its underlying cause, deficit spending. By the year's end, inflation had reignited, and President Sarney's popularity ratings took a nose dive. Two new wage-price freezes were tried in 1987 and 1989, but to no avail.

Sarney's abrupt loss of authority seriously weakened his ability to play a leadership role in the drafting of a new constitution. In the absence of strong leadership, institutional reform proceeded in a piece-meal fashion, subject to the ebb and flow of political influence. Rather than crafting new, more efficient institutions, the 1988 Constitution simply enshrined the existing institutional framework, which had created a political system, combining consociational and plebiscitarian **[End Page 50]** elements, that was more oriented toward the representation and protection of minority rights than toward the formation of stable ruling majorities. Its consociational arrangements included proportional representation, a multiparty system, and extremely large electoral districts with open party lists; a bicameral legislature with substantial powers; and a decentralized three-tiered federation, with autonomous state and municipal governments. The minutely detailed new constitution entrenched a whole series of minority rights. At the same time, a plebiscitarian presidency, elected by a broad popular majority, was expected to make the whole system cohesive, counterbalancing the centrifugal forces at work elsewhere in the political system.[1]

In fact, the 1988 Constitution actually exacerbated these institutional imbalances, strengthening the consociational elements of the representative machinery by sanctioning highly permissive electoral and party laws that allowed parties with little electoral weight to gain congressional power. This made it even more difficult to form and maintain stable congressional coalitions. The diverse interests of a large number of legislators have proven to be more difficult to coordinate, delaying action on urgent legislative proposals; at the same time, the legislators' commitment to geographically based constituencies fuels deficit spending.

In addition, by stipulating that a state could have no fewer than eight, and no more than 70 deputies, the new constitution ensured that the smaller states would be overrepresented in the Chamber of Deputies. Consequently, the smaller and more backward states in the north, northeast, and center-west that represent about 40 percent of Brazil's population currently hold about half of the congressional seats. Even greater inequalities exist in the Senate, where each state is granted equal representation. States that represent only 13 percent of the total electorate can block legislation supported by senators representing 87 percent of the population.[2]

The new constitution opted for fiscal decentralization, greatly increasing the political and fiscal autonomy of states and municipalities, while failing to create institutions to ensure fiscal discipline. States were allowed to own commercial banks and to borrow from them, but the expectation remained that the Central Bank would bail them out in the event of default. The overall result of the new constitutional arrangements was to weaken federal control over state and local government spending.

To counteract these centrifugal tendencies, the constitution sought to strengthen the president's plebiscitary authority by adopting two rounds of presidential voting, on the assumption that a president elected by an absolute majority would have greater legitimacy. To prevent gridlock on grave and urgent matters, the president was given the right to issue provisional measures, executive decrees with the force of law. This power was supposed to be held in check by the **[End Page 51]** stipulation that decrees would be canceled automatically if not approved by Congress within 30 days. In practice, however, presidents won the power to reissue a provisional measure unless it had been explicitly rejected by Congress. Legislation by decree thus became a routine feature of Brazilian presidentialism.

Collor, Condominium, and the Rise of Cardoso

The second attempt to stabilize the economy was carried out in March 1990 by newly-elected president Fernando Collor de Mello. With the country teetering on the brink of hyperinflation, Collor froze all short-term financial assets for 18 months in an attempt to reduce the money supply drastically. Inflation fell from a record 85 percent monthly rate in February to about 10 percent in the following months.

Collor used the political capital he earned by bringing down inflation to push for wide-ranging reforms. He sought to balance the budget by eliminating subsidies, streamlining government operations, cutting personnel and government agencies, and privatizing deficit-ridden state-owned companies. Collor also announced a reduction in import tariffs, the elimination of excessive regulations, and a renegotiation of the country's foreign debt.

With his own party holding less than 3 percent of the seats in Congress, however, Collor faced nearly insurmountable difficulties in building the exceptional majorities required to approve constitutional amendments--a 60 percent vote of all members, two times, in each house of Congress. To carry out his ambitious reform program, he issued nearly 100 provisional measures, raising concerns about his inclination to legislate by decree.

Inflation started to rise again by mid-1990, as the government failed to resist pressures to restore liquidity. In early 1991, the government made a last-ditch attempt to stop inflation by decreeing a wage-price freeze. As inflation soared, President Collor's capacity to act was seriously impaired. His fate was sealed when his makeshift legislative majority fell apart amid popular clamor against corruption in the presidential office. He was impeached before completing the first half of his term and was replaced by Vice President Itamar Franco in late 1992.

The Cruzado and Collor fiascos revealed the potential for gridlock created by the unstable mix of presidentialism and a fragmented and undisciplined party system. Institutional conflict and even stalemate are to be expected in any presidential system. In Brazil, however, institutional imbalances exacerbate the inherent rivalry between presidents and legislatures while at the same time weakening the decision making capacity of each. In times of economic crisis, the demand for strong presidential leadership is not easily reconciled with the need to weld a congeries of parties into a broad-based congressional coalition. In such circumstances, the president may be tempted to claim a superior **[End Page 52]** plebisicitarian legitimacy and try to bypass Congress, as President Collor did during his first year in office. Congressional assertiveness can be equally destabilizing for presidents. As presidential popularity falls, legislators may wantonly veto his policy proposals or exact more pork and patronage in exchange for providing a temporary majority, as happened to President Sarney.

Proposals to avoid stalemate by switching to a parliamentary system or at least grafting parliamentary institutions onto presidentialism had been a staple of public debate since the mid-1980s. In 1992, as President Collor's traumatic impeachment process unfolded, Congress and Collor's cabinet negotiated a form of congressional government that came to be known as "informal parliamentarism." To achieve the degree of cohesion needed to unseat the president without over-throwing the regime, Congress embraced a kind of "consensus politics" in support of the cabinet's efforts to govern without a president. By papering over crucial policy differences, consensus politics made it possible to create a supermajority, accommodating the full spectrum of political parties and factions and using near-unanimity as a decision rule.[3] The pretense of parliamentary-style rule was carried a step further when President Itamar Franco displayed a disquieting inability to govern, bowing to congressional opinion on pressing policy matters. Consensus politics, now dubbed "the condominium" to designate a government operating under the joint rule of the executive and legislative branches, dissolved into frantic attempts to restore the political system's declining legitimacy by taking up new issues in place of those issues that could not be resolved. But this self-defeating strategy of overloading the congressional agenda without taking significant action only produced what Bolívar Lamounier labeled "hyperactive paralysis," and thus a further decline in governability.[4]

In May 1993, with chronically high inflation slowly trending upwards, Senator Fernando Henrique Cardoso, a distinguished sociologist, was appointed finance minister. The combination of a weak president and a demoralized Congress gave Cardoso an unusual degree of autonomy in the formulation of economic policy, and he moved swiftly to fill the leadership vacuum. Convinced that unbalanced public accounts were the primary cause of inflation, Cardoso instituted a fiscal adjustment program to prepare for the introduction of a new currency. He moved to change the balance of power between the federal government and the states. State governments were prohibited from borrowing from their own banks, state debts to federal financial institutions were rescheduled over a 20-year period, and federal revenue sharing was cut to produce a fiscal surplus.

Cardoso's Real Plan was a two-pronged strategy. Its first element was the use of the exchange rate as an anchor for stabilizing prices. After the value of the real was pegged to the dollar, a flood of cheap **[End Page 53]** imports dampened inflation, forcing domestic producers to become more competitive. This, however, had the drawback of making Brazilian exports too expensive, creating a current-accounts deficit that had to be financed by abundant inflows of foreign capital. The second element was fiscal reform. Keeping interest rates attractively high for foreign investors required balanced public accounts lest the internal debt explode. Thus the core strategy was to reform public finance through reforming social security, the civil service, and the tax system, through privatizing state-owned companies and eliminating deficit spending at all levels of government. Over the long haul, the stability of the real hinged on the credibility of fiscal policy.[5]

It was also widely acknowledged that economic stability could not be sustained without structural reform. Major changes in economic thinking and in public attitudes laid the groundwork for an ambitious attempt at constitutional change, but its success would require strong presidential leadership. To win the presidency in his own right and to provide the future government with a block of votes in Congress large enough to assure the success of his stabilization plan, Cardoso formed an electoral alliance between his own PSDB (Party of Brazilian Social Democracy) and two other parties: the conservative PFL and the Brazilian Labor Party (PTB). Concurrent presidential and legislative elections, which were to be held for the first time in 1994, augured well for Cardoso's electoral strategy. For the first time in half a century, it seemed possible to avoid the plebiscitarian trap by electing the president and winning a plurality in Congress at the same time.

Up to August 1994, the PT's (Workers' Party) candidate, Luís Inácio ("Lula") da Silva, a veteran of the 1989 presidential race, had been leading the polls by a wide margin. Lula and the PT were confident of victory in the first round and chose to go it alone, eschewing electoral alliances. The resounding success of the real, however, produced a reversal of political fortunes, and it was Cardoso's broad centrist alliance that won the voters. Installed on 1 July 1994, the real brought inflation down from 5,154 percent in early 1994 to about 1.7 percent at the end of 1998. Low inflation ended the erosion of wages and turned millions of poor people into consumers. With confidence in the national currency restored, Cardoso thundered to victory in the October 1994 presidential election, winning a striking 54.3 percent of the vote in the first round, with Lula a distant second with 27 percent.

The parties at the core of President Cardoso's coalition won only about 36 percent of the seats in both houses of Congress, falling far short of the three-fifths majority required to pass constitutional reforms. To increase his support in Congress, Cardoso reached out to the PMDB, and later to the PPB (Brazilian Progressive Party), at the risk of breeding discord within his own coalition. Yet even that was not enough to neutralize the veto power of legislative minorities. **[End Page 54]**

President Cardoso's legislative strategy was to follow a dual track: to work in Congress to muster the extraordinary majorities required for passing constitutional amendments, while legislating urgent matters by decree. (By October 1998, Cardoso had already issued 135 new provisional measures and had reissued 2,179 old ones.) Legislating urgent economic adjustments by decree poses a difficult tradeoff between efficacy and democratic consolidation. Reissuing executive decrees when Congress fails to bring the matter to a vote overrides the separation of powers in an even more damaging way. Some provisional measures have been reissued for over three years, swamping the courts with litigation and bringing chaos to the administration of justice. Instead of asserting its constitutional powers, however, Congress has acquiesced. Not a single provisional measure issued by the Cardoso government has been rejected, and only about a third of the decrees subsequently voted into law have been amended by legislators.

As the executive branch became more active, so did the Congress. A substantial number of laws were enacted, including 28 constitutional amendments, and a favorable attitude generally prevailed toward government bills. As Congress worked through the backlog, however, legislative minorities within the government coalition often used their veto power to defend the status quo. Instead of confronting the president directly, they delayed legislative action, pressed the government for concessions in exchange for their votes, or blocked controversial items. The striking success in early 1995 of constitutional reforms that eliminated the discriminatory treatment of foreign capital and scrapped state or national monopolies in oil, telecommunications, energy, mining, and coastal shipping gave the misleading impression that the momentum for reform could be sustained indefinitely. But in mid-1996, when it came to cutting costly social-security and civil-service entitlements to help reduce the budget deficit, Congress balked. The pace of constitutional reform became unnervingly slow, and the Cardoso administration was forced to spend the best part of its energies avoiding stalemate in Congress, with the president throwing himself into the lobbying task.

Rolling Sisyphus's Stone

In many ways, the Brazilian mix of presidentialism and a fragmented party structure is particularly resistant to budgetary stringency. Coalition governments are prone to failures of coordination that foster fiscal deadlock and delay fiscal adjustments, creating large budget deficits.[6]

Paradoxically, economic stabilization has had a negative impact on fiscal accounts. By eroding the real value of public expenditures, inflation had functioned as a crucial adjustment mechanism. As inflation ebbed and constitutionally embedded entitlements were not **[End Page 55]** retrenched, the persistent gap between spending and revenues created a dangerous imbalance in the government's primary accounts (revenues minus noninterest expenditures). Between 1987 and 1997, social-security benefit spending increased by 126 percent while contributions grew by only 19 percent.[7] Since health expenditures were financed by social-security contributions, the consequences were disastrous for public medical-care programs as well. Strikingly, the deterioration of primary accounts was accompanied by a dramatic rise in tax revenues. In 1997, the overall tax burden peaked at 28.2 percent of GDP. Since the government is unable to reduce constitutionally embedded spending, it has to search continuously for new sources of tax revenue and new ways to cut discretionary spending.

Economic stability was preserved, but at a cost. The failure to slash deficit spending turned the appreciation of the real vis-'a-vis the dollar into the basic government instrument to contain inflation. Despite the Central Bank's skillful use of an implicit band to devalue the currency gradually, the trade balance steadily deteriorated. The current-accounts deficit rose from nearly zero between 1990 and 1994 to 4.5 percent of GDP in 1998. To offset worsening trade and current-accounts deficits, funds had to be attracted from abroad by high interest rates and the new opportunities opened up by privatization. Due to the fixed exchange-rate regime, interest rates had to be set unusually high, crowding out the private sector and dampening domestic investment.[8] High interest rates also caused an enormous expansion of the net public debt, which rose from 27.9 percent of GDP in 1994 to 42.6 percent in 1998, raising widespread concern that the government might eventually fail to honor its commitments.

With social-security and civil-service reform stalled in Congress or gutted by compromise, the Cardoso government was in danger of sinking in political quicksand. The federal government sought to neutralize the influence of political processes on fiscal performance through strict budget management procedures and by insulating the finance minister, the Central Bank governor, and their respective staffs from political pressures.

Inhibited by constitutional constraints from curbing profligate spending by states and municipalities, the federal government sought to control state and local borrowing.[9] Existing state debts were transformed into federal debt in exchange for the sale of state commercial banks and utilities and a commitment to fiscal-adjustment programs. In 1997, state governments were prohibited by the Central Bank from borrowing from their own banks and from issuing new bonds until the end of this decade.

In spite of the government's efforts to rein in spending, however, by the end of 1997 Brazil showed a primary-accounts deficit of 0.9 percent of GDP. Apart from state and local government spending, much of **[End Page 56]** the deficit stemmed from the federal government's earlier decisions to increase social spending before there had been a thorough fiscal adjustment. Between 1994 and 1996, discretionary spending on health, education, and land reform had been increased by nearly 50 percent, the minimum wage by 54.3 percent, and federal salaries by 23 percent.

When the Asian meltdown began in October 1997, an overvalued currency and large fiscal and current-accounts deficits put Brazil in a vulnerable position, raising fears that the government might not be able to impose the fiscal discipline necessary to protect the real. Interest rates were nearly doubled in an effort to stem the outflow of capital and defend the currency from speculative attacks. Yet the crisis also afforded Cardoso a unique opportunity. Many legislators who had previously opposed constitutional reforms now reconsidered, as a sense of alarm gripped the country. An $18 billion deficit-reduction package proposed by President Cardoso was quickly approved by Congress. In November 1997, the civil-service reform bill passed the Chamber of Deputies (though it was enacted only in June 1998, after approval in the Senate.) The bill allowed the dismissal of public employees for poor performance or personnel redundancy, set a ceiling on salaries, and revoked a provision that granted the same employment status to all civil servants.

Letting Up Too Soon

President Cardoso's competent economic stewardship brought him wide acclaim both at home and abroad, and he set out confidently to win a second term in the October 1998 presidential election. Over-confidence, however, led to a relaxation in fiscal discipline. President Cardoso refrained from implementing many of the fiscal-adjustment measures announced in the wake of the Asian crisis, gambling that the favorable international expectations for the performance of Brazil's economy would last. Even so, the pace of privatization was quickened, and companies in key sectors such as telecommunications, electricity, banking, and transportation were auctioned, attracting a record $6 billion in foreign direct investment.

In the eyes of President Cardoso's campaign strategists, his 1998 reelection bid was to be a replay of the 1994 election, as faithful to the original script as possible. The platform's centerpiece was to keep the economy stable at all costs, and the core strategy was to avoid a runoff. President Cardoso successfully maneuvered to keep other credible centrist candidates out of the race in order to have Lula as his main opponent in the first round. The PT entered a broader opposition coalition including the PDT (Democratic Labor Party), PSB (Brazilian Socialist Party), and PCdoB (Communist Party of Brazil), with former governor Leonel Brizola as Lula's running mate. The PPS (the old **[End Page 57]** Brazilian Communist Party, now renamed the Popular Socialist Party) ran its own candidate, former governor and finance minister Ciro Gomes, with Senator Roberto Freire as his running mate.

In August 1998, Russia declared a moratorium on its foreign debt and devalued the ruble, shaking world markets and leading foreign investors to withdraw funds from other "emerging markets," including Brazil. Within two months, the country had lost half of its $73 billion in foreign-currency reserves in an effort to defend the real. To maintain the exchange rate, interest rates were sharply increased, causing the economy to stall and unemployment to skyrocket. Social tension increased in the large cities, as millions of new entrants to the labor force had to compete for jobs with millions of laid-off workers. Rather than devalue the real, Brazil agreed on a fiscal-adjustment program with the IMF in exchange for a $41.5 billion bailout. Its decision to continue to prop up its currency with dwindling reserves was not unrelated to Cardoso's desire to keep prices stable on the eve of a decisive national election.

The sense of urgency that had driven Brazilians to rally behind President Cardoso at the outset of his term heightened as economic prospects worsened. The absence of a credible alternative also helped President Cardoso's bid, as the leftist opposition clung to outmoded ideas about the role of the state and entitlements. In October 1998, President Cardoso was reelected with 53.4 percent of the vote. Lula came in second with 32 percent, followed by Ciro Gomes with 11 percent of the vote.[10]

Yet President Cardoso's reelection did not allay doubts about the ability of the government to deliver needed fiscal adjustments. Fears of a currency devaluation were compounded by the realization that high interest rates might force Brazil to default on its rapidly expanding debt. President Cardoso sought once again to use those fears to overcome congressional unwillingness to cut entitlements and approve austerity measures. In November 1998, a watered-down version of the social security reform bill was finally approved in Congress. Yet a related measure to increase civil-service pension contributions, seen by investors as an acid test of Brazil's ability to bring its budget deficit under control, was soundly defeated in Congress on December 2. As Cardoso hastened to calm panicking investors, Brazil's credibility suffered another blow. On 6 January 1999, former president Itamar Franco, newly elected as governor of Minas Gerais, declared a 90-day moratorium on his state's debt to the federal government. This defiant display of gubernatorial autonomy finally broke the market's tenuous confidence in Brazil. A week later, the currency collapsed.

Looking to the Future

The chain of events that compelled President Cardoso to go ahead with devaluation instead of risking a rigorous fiscal adjustment **[End Page 58]** ultimately originated in institutional arrangements that are corrosive of stable democratic rule. The slide of its currency brought Brazil within an inch of economic disaster, igniting a burst of price increases and raising fears that the gains of four years of economic stability might be wiped out. President

Cardoso took advantage of these fears to push through austerity measures designed to slash $25 billion from the country's budget deficit. Congress also approved the controversial civil-service pension contribution bill it had rejected four times before, as well as a financial-services tax hike sought by the government.

Partly because of the profound transformation that it has undergone in recent years, Brazil's economy has recovered faster from the financial crisis than was anticipated. Three months after devaluation, there are encouraging signs that inflation is going down and that a renewed inflow of foreign funds has helped to stabilize the exchange rate. Yet the fiscal and current-accounts deficits are still menacingly high, and interest payments on the public debt continue to gobble up large portions of the budget. Perhaps most ominous is the expectation of continued recession. After two years of mediocre growth rates in 1996 and 1997, Brazil's economy sputtered toward zero growth in 1998, and real GDP is forecast to shrink by at least one percentage point in 1999. Under these conditions, inflationary pressures are virtually flat and joblessness is now the main public concern.

Although the prospects for containing inflation look increasingly favorable, the political scenario has become alarmingly bleak. Uncertainty over the future of the economy has sent President Cardoso's approval ratings plummeting. With his authority diminished, many fear that the government may be unable to sustain its commitment to a deep fiscal adjustment. The dominant coalition's unity is already under severe stress, and any power struggle that might arise within it could threaten the government's policy initiatives. Some coalition partners are already positioning themselves to influence the political succession to President Cardoso. Even before the new Congress took office, over 10 percent of the federal deputies had switched parties.

Now that the currency has been allowed to float, the exchange-rate anchor must be replaced by strict fiscal discipline. The economic guidelines agreed upon with the IMF provide a coherent blueprint for President Cardoso's second term: to slash the deficit at all levels of government and to produce primary-accounts surpluses in excess of 3 percent of GDP from 1999 to 2001. Cutting the deficit should help produce balanced public accounts and lead to lower interest rates, driving down the public debt. If the IMF targets are met, Brazil should be able to enter a new cycle of economic growth with stability. The issue now is whether the painful crusade to stabilize the economy can be maintained without significant backsliding. **[End Page 59]**

It is not difficult to sketch pessimistic yet plausible scenarios for Cardoso's second term. Good economic news could weaken the government's resolve and dampen the air of urgency that is often needed for Congress to push ahead with needed reforms. In Brazil, as elsewhere in Latin America, public spending tends to expand rather than to contract as the economy improves.[11] The new and more assertive Congress is keen to flex its muscles in other ways. The rush to set up two congressional inquiries to investigate the judicial branch and the Central Bank's decision to bail out private banks in the wake of the devaluation of the real are likely to postpone the vote on reform bills.

State governors are also expected to demand a new round of debt negotiation. Opposition victories in such key states as Minas Gerais, Rio de Janeiro, and Rio Grande do Sul could stiffen state resistance to fiscal discipline. So far, the Cardoso administration has deftly foiled the opposition's strategy by displaying some policy flexibility while withholding revenue-sharing payments as a penalty for noncompliance. But new concessions could reverse this incipient trend toward fiscal austerity within the federation. The fact that almost every election year has been accompanied by growing budget deficits also raises concern about the fiscal impact of the municipal elections to be held in 2000.

The most realistic worst-case scenario revolves around the potential consequences of a mix of political instability and a faltering economy. Executive-legislative rivalries could delay fiscal adjustments, causing the public debt to accumulate more rapidly. A new bout of global financial turmoil could trigger a downward economic spiral, exacerbating social and political tensions. As the economy plunges into recession, first the states and then the federal government could effectively default on part of their debt, undermining investor confidence. Brazil could be forced into a new stop-and-go cycle, with restrictive policies to reduce external imbalances followed by deficit spending, creating still worse imbalances.

These outcomes are all possible, but unlikely. It is true that Brazil is still saddled with huge debts, that the economy is fragile, and that the Congress is unpredictable. Yet the current crisis also offers considerable opportunities for pursuing economic adjustment and political reform. The newly elected Congress has taken the initiative on important institutional reform, though few provisions will emerge unscathed from the legislative maw. Nevertheless, there has been mounting pressure, even from within the public sector, for change.

Proposals for Reform

A cautious redressing of constitutional boundaries and the balance of powers is needed to prevent the inevitable clashes among the executive, legislature, and judiciary from turning into serious and potentially **[End Page 60]** destabilizing institutional crises. The presidential power to legislate by decree is a key issue. Many of the current proposals to limit the powers of the presidency must be regarded with considerable skepticism, since without strong and disciplined parties in Congress legislative minorities can paralyze the executive branch. A reform bill drafted in and approved by the Senate, however, proposes an intriguing tradeoff: to limit the president's power to legislate by decree in exchange for reducing some of the excessive powers granted to Congress by the 1988 Constitution. This would permit administrative and organizational changes in the executive branch (such as decisions to create, reorganize, or eliminate ministries, administrative agencies, and civil-service positions) to be implemented without the prior approval of Congress, as is required today.

Judicial reform should come next, with the goal of making the administration of justice more efficient and developing a system of law and justice that is accessible to all citizens. Controversial measures such as oversight of judicial activities by an independent agency, the limitation of appeals to higher courts, and a cap on spending by the judicial branch should also be included in a reform package.

In the effort to reform the federal system, the biggest battles are likely to come over the regulatory reach of the federal government. To foster fiscal responsibility and budgetary accountability on the part of subnational governments, the federal government recently introduced legislation that will impose automatic spending limits. The spirit of this law dovetails with public opinion, which has increasingly come around to the view that budget deficits are a major cause of inflation. In last year's elections, 13 of the 15 governors who were reelected for a second term had successfully reduced state payroll spending, making more money available for services and investments. In contrast, not one of the seven governors defeated at the polls had managed to do so.[12]

President Cardoso made a bold assertion of policy direction by recently creating the Ministry of Management and Budget. He must now refocus congressional attention on deficit reduction rather than program enhancements. A bill presently before the Chamber seeks to create the appropriate institutions to ensure fiscal discipline. Article 192 of the Constitution could be amended to strengthen the Central Bank's capacity to act more independently by establishing a fixed term for the Central Bank's governor and a "quarantine period" before outgoing staff can join private financial institutions. Transparency could also be enhanced by requiring that information on public finances be publicly disseminated.

The fate of this impressive agenda will depend on President Cardoso's ability to steer the legislation through Congress. In the past, he has had to rely on "horsetrading" to rally support for his policy **[End Page 61]** initiatives. His coalition has succeeded in legislating some significant policy changes, but it would be folly to conclude that the coalition partners are disciplined or united enough to commit themselves to a course of action and to enforce compliance on the part of individual legislators. The coalition partners' unstable behavior underscores the acute need for political reform. The PFL recently introduced a minimalist reform package calling for four basic changes, none of which requires a constitutional amendment to become law: The first would restrict the frequency with which legislators can switch parties. The second would ban party alliances in legislative elections. The third would introduce a mixed electoral system, in which half of the seats would be filled through first-past-the-post elections and the other half would continue to be filled through proportional representation. The fourth would require require parties to obtain at least 5 percent of the vote nationwide to gain representation in Congress.

This will be a decisive year for President Cardoso. A succession of weakened presidents had led many to believe that strong executive leadership was no longer possible, but in many ways Cardoso's administration has rejuvenated presidentialism in Brazil. Unfortunately, however, his desire to preserve his considerable political capital has often made him unwilling to risk worthy but uncertain political battles. He has often waited for a crisis to hit before making a decisive move toward reform. Although this strategy has often proven successful, the thought that such brinksmanship may continue for another four years is unnerving.

More than ever, a strong presidency is necessary to narrow the scope of government, to restore faith in the capacity of democratic governance to manage the economy, and to stay the course of reform over the long run. Failure to achieve these goals could force Brazil onto a deadend road, with disastrous consequences in terms of economic turmoil and declining governability.

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Notes

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1. The evolution of this institutional structure is discussed by Bolívar Lamounier, "Brazil at an Impasse," *Journal of Democracy* 5 (July 1994): 72-87.

2. See Alfred Stepan, "Toward a New Comparative Analysis of Democracy and Federalism: Demos Constraining and Demos Enabling Federations" (paper presented at the XVII World Congress of the International Political Science Association, Seoul, Korea, 17-22 August 1997).

3. See Amaury de Souza, "Collor's Impeachment and Institutional Reform in Brazil," in Keith S. Rosenn and Richard Downes, eds., *Corruption and Political Reform in Brazil: The Impact of Collor's Impeachment* (Coral Gables, Fla.: North-South Center Press, 1998), 87-118.

4. See Bolívar Lamounier, "Brazil at an Impasse."

5. See Albert Fishlow, "Is the Real Plan for Real?" in Susan Kaufman Purcell and Riordan Roett, eds., *Brazil Under Cardoso* (Boulder, Colo.: Lynne Rienner, 1997), 43-61.

6. See Inter-American Development Bank, *Latin America After a Decade of Reforms* (Washington, D.C.: Inter-American Development Bank, 1997), 124-52.

7. See Raul Velloso, "A Situaç~ao das Contas Públicas Após o Real," in Jo~ao Paulo dos Reis Velloso, ed., *O Brasil e o Mundo no Limiar do Novo Século* (Rio de Janeiro: José Olympio Editora, 1998), 101-35.

8. To become more attractive to foreign investors than the average real interest rate of 6 percent offered abroad, the benchmark interest rate had to remain above 21 percent per annum because of Brazil's added burden of a 5 percent tax on financial gains, a 7 percent expected currency devaluation, and an additional 3 percent country risk hedge.

9. See Gustavo Franco, "O Plano Real em Perspectiva de Médio Prazo," in Jo~ao Paulo dos Reis Velloso, ed., *O Brasil e o Mundo no Limiar do Novo Século,* 77.

10. See David Fleischer, "As Eleiç~oes Gerais Brasileiras de 1998: Resultados Finais e Perspectivas para 1999," in *Eleiç~oes 98 no Brasil e na Alemanha* (S~ao Paulo: Konrad Adenauer Stiftung, 1998), 3.

11. In Latin America, it has been estimated that a one percentage point increase in real GDP is associated with an increase in real capital expenditure of 1.58 percentage points and in nonwage government consumption of nearly 3 percentage points. See Inter-American Development Bank, 117.

12. Michael Reid, "The Disorders of Progress," *The Economist,* 27 March 1999, 9.