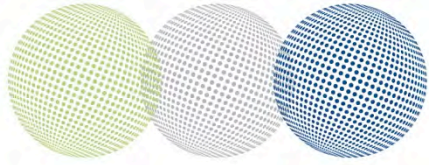


Expert Report: Brazil



INCRA

AN INTERNATIONAL NON-PROFIT
CREDIT RATING AGENCY

by Peter Birle



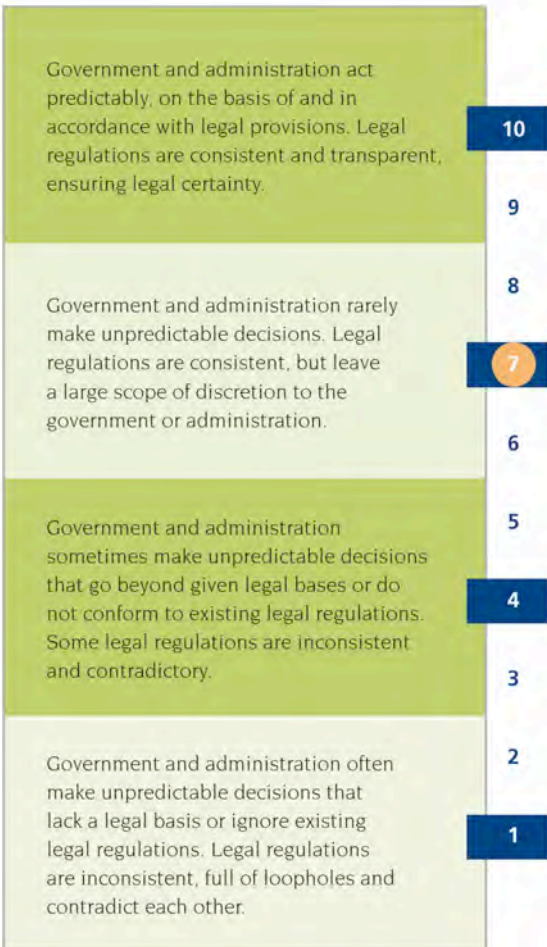
This rating radar illustrates the average scores of all experts who evaluated Brazil in the INCRA rating process. The following report is an assessment of Brazil by Peter Birle with his evaluation of the indicators as they relate to Brazil's willingness and ability to repay its debt, based on INCRA's Forward Looking Indicators.

I. Political, Economic and Social Stability

I. Rule of Law

To what extent do government and administration act on the basis of and in accordance with legal provisions or culturally accepted norms to provide legal or practical certainty?

This question assesses the extent to which executive actions are predictable (i.e., can be expected to be guided by law).



According to the 1988 Brazilian Constitution, government and administration must act on the basis of and in accordance with legal provisions. Decrees and regulations issued by the executive are only valid if they are in conformity with the law. In case of emergency, the president can enact provisional measures that have to be approved by Congress within a period of sixty days to become law, otherwise they lose their efficacy. While the government takes care to assure a friendly and predictable investment environment, its actions can be expected to be guided by law. Legal regulations are largely consistent, while not entirely transparent. Contracts are respected. The government generally makes no distinction between foreign and national capital; its actions apply without discrimination to both foreign and domestic firms. In spite of these general tendencies, it must be said that some critics point out that major political players in Brazil do not serve to help establish the ideal of the rule of law. The legal system suffers from a lack of congruency between the laws and the actual behavior of individuals and state officials. Notably, the still existing extreme levels of social and economic inequality within Brazilian society often cause discrimination against poor people and the legal immunity of the privileged.

To what extent do independent courts control whether government and administration act in conformity with the law?

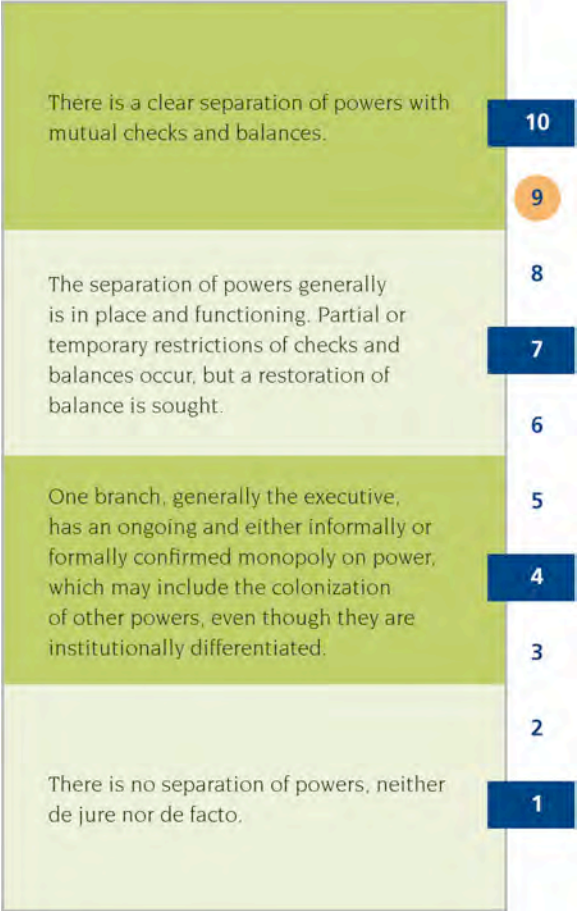
This question examines how well the courts can review actions taken and norms adopted by the executive branch. To provide effective control, courts need to pursue their own reasoning free from the influence of incumbent governments, powerful groups, or individuals. This requires a differentiated organization of the legal system, including legal education, jurisprudence, regulated appointment of the judiciary, rational proceedings, professionalism, channels of appeal, and court administration.



Independent courts usually manage to control whether government and administration act in conformity with the law. There is ample authority granted to judges to evaluate the constitutionality of the government's acts. The judiciary is institutionally well differentiated and free from unconstitutional intervention by other institutions. However, it is heavily overburdened. There are vast disparities in citizens' access to legal counsel and the administration of justice, due to extreme inequalities in resources available to citizens. In following with its Roman law tradition, Brazilian law is heavily procedural. Despite repeated attempts at reform, Brazil's legal system still operates inefficiently. Judges have used their autonomy to impede court reform and often use highly formalistic legal decisions to overturn government efforts at modernization. In 2009, the judiciary launched a new electronic proceeding system aimed at reducing the time spent on bureaucratic aspects of ongoing judicial proceedings and devoting greater energy toward deciding cases. Due to the new system, citizens are now able to gather information on judicial proceedings, decisions and precedents handed down by the courts on the official Web sites of each judicial court.

To what extent is there a working separation of powers (checks and balances)?

This question refers to the basic configuration and operation of the separation of powers (institutional differentiation, division of labor according to functions and, most significantly, checks and balances).



The principle of separation of powers is explicitly approved in the 1988 Constitution. The powers of the federal government are divided horizontally among the executive, the legislative and the judicial power. There are almost no restraints on the basic functions involved in the separation of powers, and mutual checks and balances are in place. The Constitution makes the president accountable to Congress. The legislature can require any executive minister to appear personally to testify or answer written interrogatories. Congress has the power to legislate, but that power is not exclusive. Considerable legislative power is granted to the executive. The president has the right to issue delegated laws and provisional measures that have the force of law for a limited period. He may also veto legislation, and only an absolute majority vote of both houses of Congress can override this decision. Besides, Congress is not allowed to authorize programs that are not included in the annual budgetary law. This grants the executive extraordinary power to prevent the passage of legislation to which it is opposed. The judiciary checks both the legislature and the executive through the power of judicial review. On numerous occasions, the Supreme Court has abolished laws because of perceived constitutional violations. Brazil has a federal system of government in which governmental powers are divided among the federal government, the states and the local authorities.

To what extent do government authorities ensure well-defined property rights and regulate the acquisition, benefits, use, and sale of property?



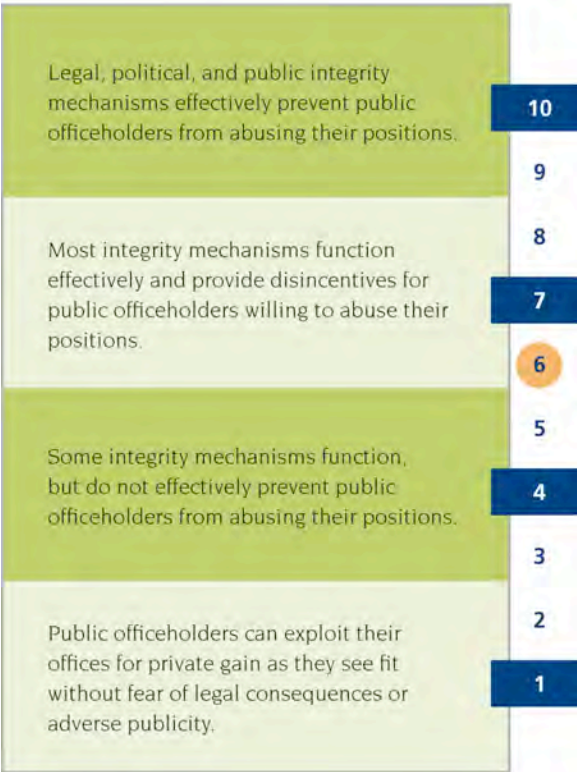
Property rights are secure in Brazil. Private property rights are well defined and property acquisition is adequately regulated. Real estate registration is well-developed and safe. Foreigners can purchase land and property. There are few restrictions on converting or transferring funds associated with a foreign investment. Foreign investors are allowed to remit dividends, capital and gains. Contracts are considered secure. While once criticized for lax intellectual property (IP) rights protection, Brazil has been stepping up

implementation and enforcement of international IP rules in recent years. The country is a signatory to the General Agreement on Tariffs and Trade (GATT) Uruguay Round Accords, including the Trade-Related Aspects of Intellectual Property Agreement. Brazil is also a signatory of the Berne Convention for the Protection of Literary and Artistic Works, the Patent Cooperation Treaty, the International Convention for the Protection of New Varieties of Plants (UPOV) and the Paris Convention for the Protection of Industrial Property. In 2004, the Lula administration established a National Council to Combat Piracy and Crimes against Intellectual Property, an equal partnership between government representatives and private-sector representatives. In most respects, Brazil's Industrial Property Law meets the international standards regarding patent and trademark protection. However, the law permits the grant of a compulsory license if a patent owner has failed to locally manufacture the patented invention in Brazil within three years of patent issuance. One compulsory license was issued on an HIV/AIDS medication in 2007. The decision allowed Brazil to import or manufacture generic versions of the drug. Patent processing is still very slow.: The average time a patent spends awaiting approval is eight years.

2. Transparency / Accountability

Corruption prevention: To what extent are public officials prevented from abusing their position for private interests?

This question addresses how the state and society prevent public servants and politicians from accepting bribes by applying mechanisms to guarantee the integrity of officeholders: auditing of state spending; regulation of party financing; citizen and media access to information; accountability of officeholders (asset declarations, conflict of interest rules, codes of conduct); transparent public procurement systems; effective prosecution of corruption.



Brazil has a strong legal anti-corruption framework, but implementation and effective enforcement remain a problem, especially at the state level. Most integrity mechanisms are in place and are actively supported by the government. The government also advocates for the contractual rights of investors. However, despite a formally well-functioning business environment, corruption and bribery are still obstacles to doing business in Brazil. In 2011 Brazil ranked 73rd out of 183 countries in Transparency International's corruption perceptions index. Corruption scandals are frequent. Time and again, authorities have to conduct corruption investigations involving politicians from both opposition and government coalition parties. The Fiscal Responsibility Law subjects all levels of public administration to scrutiny based on how well the criteria of transparency and discipline are fulfilled. The act makes each level responsible for its own fiscal performance and helps to check corrupt behavior. Regulations govern private contributions to political parties. Individuals can donate up to 10 percent of their declared income to candidates, while firms can donate up to 2 percent of their annual revenue to candidates. Donations to parties are not limited. All contributions are made public after the elections. Beginning in 2006, candidates were required to disclose donations received, but without identifying the donors. There are no limits on total political party expenditures. Candidates must declare how much they will spend in an election, but this amount may be adjusted. The media is able to report on corruption and has increased its coverage of corruption in recent years. Brazilian voters are increasingly aware of and educated about corruption. No journalists investigating corruption have been imprisoned or physically harmed.

Citizens have a right of access to government information and basic government records. Whether access to information is effective depends on the institution. Federal organizations either respond quickly or state that the information does not exist. In states and municipalities, most organizations do not respond. Civil society organizations focused on anti-corruption issues are highly active in political councils at the legislative and executive levels. The judiciary can review the actions of the executive and the legislative branches. The heads of state and government, ministerial-level officials and members of the national legislature are required to file a regular asset disclosure form. Disclosure forms are published in the Official Gazette. Citizens can access this information. There are regulations governing gifts and hospitality offered to members of the executive branch. There are no anti-corruption policy restrictions preventing heads of state and government or ministers from entering the private sector after leaving the government. There are regulations addressing conflicts of interest for public procurement officials. All public procurements are widely advertised. The government is required to publicly announce the results of procurement decisions. The Office of the Comptroller General (CGU), created in 2003, is a central body of internal control in the federal executive branch. To promote transparency and prevent corruption, it undertakes inspections and audits of municipalities and states and carries out awareness-raising campaigns aimed at the private sector. Brazil is a founding member of the Open Government Partnership, a new multilateral initiative launched in September 2011 that aims to secure concrete commitments from governments to promote transparency, empower citizens, fight corruption and

harness new technologies to strengthen governance.

To what extent are the media independent from government?

This question asks to what extent the media are subject to government influence and the influence of actors associated with the government. The question focuses both on media regulation and government intervention. The rules and practice of supervision should guarantee sufficient independence for publicly owned media. Privately owned media should be subject to licensing and regulatory regimes that ensure independence from government.



The freedoms of opinion and the press are unrestricted and generally respected. The national media are free from federal government pressures, but the economic pressure of government advertising and the use of regulatory power are important. The media express a wide variety of views and journalists are generally free to report on corruption involving public authorities. In fact, the media time and again have played a central role in uncovering corruption scandals. In contrast to alarming developments in some other Latin American countries in recent years, Brazilian governments have not tried to limit the freedom of the media by pressures applied through lawsuits, arbitrary arrests, verbal attacks, restrictive laws or the manipulation of official advertising. In spite of serious differences with the media, Brazilian President Dilma Rousseff prevented her party from seeking to implement a project for social control of the media. The broadcasting environment in Brazil is characterized by a strong commercial sector, alongside weak public and community broadcasting. The media provide vigorous reporting on controversial issues and government performance, but media ownership is highly concentrated and information is often biased in favor of private power interests. While Brazil's national media enjoy unrestricted freedom, the media in some provinces are frequently subject to violent attacks and abuses of power by local officials. In many states, there is only one local media conglomerate, often controlled by political groups.

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3. Social Cohesion

To what extent is exclusion and decoupling from society effectively prevented?

Reducing the various risks of social exclusion is a fundamental precondition for social cohesion and stability. The country assessment should focus on the following key questions: 1) To what extent is poverty effectively prevented? 2) To what extent are there enabling conditions for equal opportunity in society? In addition to poverty, please also take into account additional dimensions of exclusion like the experience of marginalization and the desire to be appreciated when evaluating socioeconomic disparities.

Reference Indicators: Poverty rates | Gini Coefficient



In recent years Brazil has achieved very rapid social progress. Thanks to low inflation and consistent economic growth, targeted transfer programs, and improvements in labor productivity due to improved schooling, income distribution indicators have dramatically improved and millions of Brazilians have moved out of poverty. Poverty has fallen markedly, from 20 percent in 2004 to 7 percent in 2009, while extreme poverty dropped from 10 percent to 4 percent. Between 2001 and 2009, the income growth rate of the poorest 10 percent of the population was 7 percent per year, while that of the richest 10 percent was 1.7 percent. This helped decrease income inequality. In spite of many reforms and remarkable social improvements, Brazil’s inequality levels remain among the highest in the world. Millions of people still live in poverty, while social exclusion is quantitatively and qualitatively pronounced and structurally ingrained. With a Gini coefficient of 0.54 in 2011, Brazil still shows one of the world’s most unequal distributions of income. But while the Gini coefficient is still extremely high, the reduction of inequality during the 2000s (in 1999 the Gini was 0.59) demonstrates that the benefits of economic growth are being more fully shared. The redistribution is principally due to the doubling of the minimum wage during the 2000s, but also to the conditional cash transfer programs and other social assistance programs. Brazil exhibits a medium level of development according to key indicators, but national mean values mask the great disparities between the relatively developed southern and southeastern regions, where conditions to some extent resemble those in industrialized countries, and the socioeconomically disadvantaged northern

and northeastern regions. Existing developmental imbalances between these regions have somewhat lessened in recent years. The gender gap in terms of economic opportunity seems to be narrowing, but women remain at a substantial disadvantage. Although female students consistently show better results and higher rates of school attendance than do their male counterparts, this does not translate into better salaries or higher-skilled jobs, or into lower levels of unemployment. The share of women employed in metropolitan areas increased from 43 percent to 45.1 percent of the workforce in recent years. However, salary inequalities still persist: Brazilian women on average earn only 70 percent of the salaries of men. Social life in Brazil is characterized by the largely peaceful manner in which a multiplicity of ethnic groups live together. However, several studies have demonstrated that racial inequality is still a serious problem. Brazil is an extremely unequal country, and racism is an important element in understanding the dynamic of this framework of inequality. The high-income population is essentially white, while most Brazilians who live in poverty are black.

How strong is the citizens' approval of political institutions and procedures?

Please base your assessment on public opinion survey data, addressing the following factors:

- approval of the political system
- approval of performance (measured by how the political institutions function in practice or the satisfaction with the working of the institutions)
- approval of political institutions (often measured by the level of trust in institutions such as government, the legal system and police, state bureaucracy, political parties, and the military)



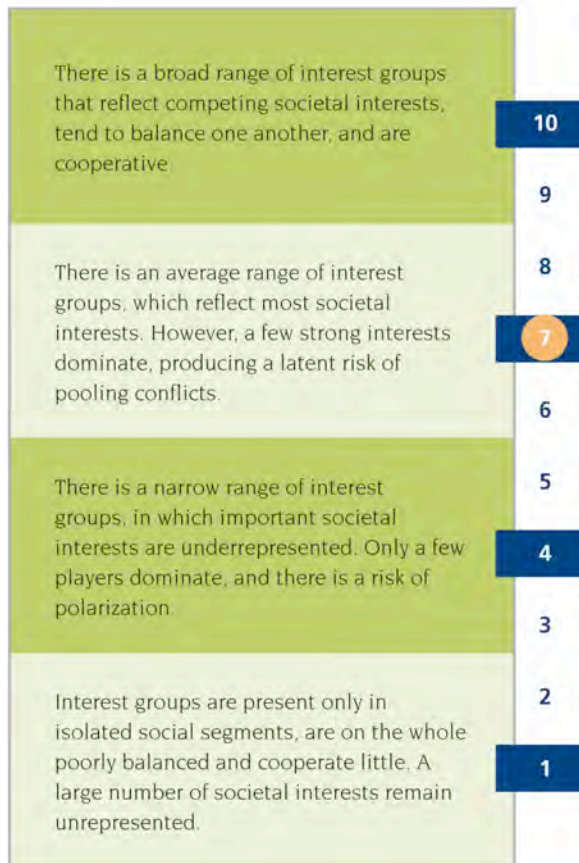
Consent to democracy has been increasing moderately during the last decade. In 2010, 54 percent of respondents (as compared to 47 percent in 2008) agreed that democracy was preferable to any other form of government. The same year, 57 percent said democracy is indispensable to being a developed country. The degree of satisfaction with democracy increased from 38 percent in 2009 to 49 percent in 2010. By the end of President Luiz Inácio Lula da Silva's mandate, 83 percent approved of his administration, and 55 percent expressed confidence in the country's government. In 2011, support for democracy declined nine points, reflecting both political and economic factors. A drop of 3.5 percentage points in Brazil's economic growth in 2011 coincided with the end of the most successful presidency of recent decades. But at 67 percent, approval of the government of Dilma Rousseff was still far from low. The index of consumer confidence, at 61 points, continued to be one of the highest in the region. The percentage anticipating a better future dropped to 64 percent, down from 70 percent in 2010, but was still the highest in the region. Approval of political institutions is fairly high.

Corresponding to the *Latinobarómetro* 2010 Report, trust in institutions was higher in Brazil than in the Latin American average. These are the levels of trust in Brazil (in brackets the Latin American average): church 82.0 (67), armed forces 65.9 (45), radio 63.5 (58), television 61.7 (56), newspapers 61.7 (51), government 56.2 (45), judiciary 52.9 (32), state 52.8 (41), trade unions 51.2 (30), public administration 48.1 (35), National Congress 45.5 (34), police 40.7 (35) and political parties 24.7 (23).

To what extent is there a network of cooperative associations to mediate between society and the political system?

This question addresses the representation of societal interests in the political system. In evaluating the systemic nature and the quality of representative patterns, please consider:

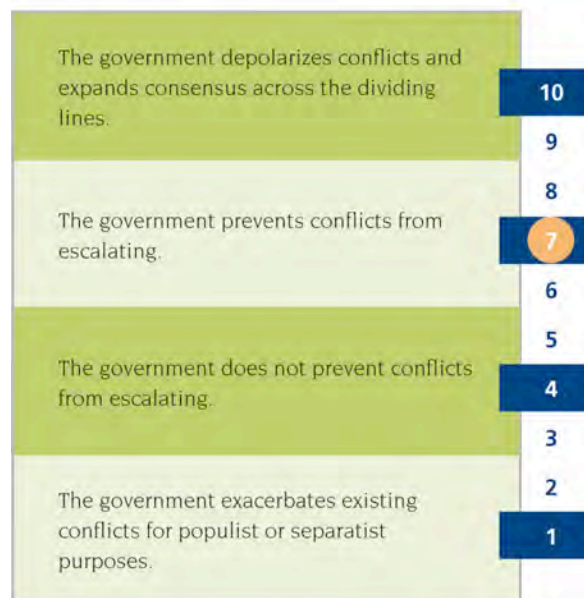
- the spectrum of interest groups, ranging from social movements and community organizations to unions and professional associations
- the capacity to incorporate all (competing) societal interests and to avoid the dominance of a few strong interests
- the degree of cooperation between different interest groups



Brazil’s network of interest groups is relatively close-knit, but dominated by a few strong interests. Labor and capital associations are paramount. Despite divergences among competing umbrella organizations, trade unions are strong political actors. Following democratization, there was a gradual estrangement from traditional corporatist state models. Mobilization capabilities diminished during the 1990s and the level of trade union organization is on the decline, but trade unions are still important to many sectors of workers. Former President Lula co-opted many trade union leaders by awarding them government positions, and by issuing a decree that grants labor federations 10 percent of the compulsory labor union tax. Entrepreneurs have a national umbrella organization, with the National Confederation of Industry in São Paulo wielding the greatest influence. One of the most important and controversial societal organizations is the Landless Workers Movement (Movimento dos Trabalhadores Rurais Sem Terra, MST), the largest social movement in Latin America with an estimated 1.5 million members. The MST aims for land reform and land distribution. There is a robust network of autonomous, self-organized groups and civic organizations in Brazil. However, the level of interpersonal trust among the population is rather low. This apparent contradiction must be explained. While mistrust in public life is widespread, there seems to be trust in associational life and horizontal social formations. Institutions are mistrusted, but Brazilians tend to trust people with whom they engage in the context of everyday life. Brazilian culture differentiates “general others” from “close others.”

To what extent is the government able to moderate domestic economic, political, and social conflicts?

Please assess the extent to which the government is able to depolarize structural conflicts, to prevent society from falling apart, and establish as broad a consensus as possible across the dividing lines.



In spite of many progressive reforms in recent years, Brazil continues to be the most unequal country in Latin America. The government has been able to reach a wide social consensus in view of the basic direction of its economic and social policies. There are no irreconcilable ethnic, religious or social clashes, but there are still extreme social and regional disparities. Conflicts arise frequently between landowners and peasants or between indigenous peoples and settlers. In 2010, 1,186 land conflicts were registered and 34 people were murdered in land conflicts. While in the Brazilian northeast the conflicts increased in 2010, they decreased in the other regions. The government has put into effect initiatives to reduce crime and violence and enhance service delivery and socio-economic inclusion with a focus on favela dwellers. It is also emphasizing protection and promotion of indigenous peoples and lands and targeting other vulnerable populations like the rural landless, Afro-Brazilians and the quilombola. But the administration's social investment initiatives seem to have had only a limited effect on the country's historically marginalized communities of African or indigenous descent. Afro-Brazilians continue to represent a large percentage of the country's poor, and only a small percentage of the professional and managerial middle and upper classes. Only 15 percent of white women work as domestic workers, compared to 40 percent of Afro-Brazilian women. A sizeable education gap continues to be a major constraint to any rapid change. The government has initiated several affirmative action measures to correct these inequalities. While with such initiatives it has been able to prevent conflicts from escalating and society from falling apart, it has not been able to depolarize social conflicts.

4. Future Resources

To what extent does education policy deliver high-quality, efficient, and equitable education and training?

This question assesses the extent to which a government's education policy facilitates high-quality learning that contributes to personal development, sustainable economic growth, and social cohesion. Your response should focus on the following, irrespective of the education system's organization: the contribution of education policy towards providing a skilled labor force, the graduate output of upper secondary and tertiary education, and (equitable) access to education. While the latter pertains to issues of fairness and distributive justice, it also has implications for a country's international competitiveness as unequal education implies a waste of human potential.

Reference Indicators: PISA results | education spending | attainment levels



A few years ago, Brazil still had a fairly cost-ineffective education system, plagued by poor achievement and inequitable outcomes. During the last decade, the country has considerably increased its investment in education, from 4 percent of gross domestic product (GDP) in 2000 to 5.5 percent of GDP in 2009. Public spending on education increased from 10.5 percent of total public expenditure in 2000, to 14.5 percent in 2005, and to 16.8 percent in 2009. Spending has also become more equitable, through measures such as the provision of additional federal funds to poorer states. In 2004, the Lula administration merged the Bolsa Escola program and a number of conditional cash transfers for health and nutrition into the Bolsa Família program, increasing the total amount of funding available. The number of families participating in the program has grown to more than 12 million. Bolsa Família added stipends for children aged between 15 and 17, encouraging higher enrollment rates and attendance levels in secondary schools. One of the key problems in Brazilian education is the quality of its 1.5 million teachers. In many areas of the country, teachers have no more than a secondary school education. However, increases in teacher salaries since the introduction of the fund for primary education administration in the 1990s have made teaching more attractive. In 2006, the program was renewed by the National Congress, expanding its focus to early childhood education and out-of-school youth and adult education. In 2006, 11 years of schooling became mandatory. In May 2007, the government launched an ambitious education development plan (PED), which aims to redress Brazil's long-standing education deficit within 15 years. The plan establishes a results-based education system for the first time in Brazil's history. Schools

have to achieve targets set by the government in order to receive more resources. In support of this program, the government introduced a basic education development index to measure the quality of education in state schools. The PED is also aimed at high schools and continuing education. In recent years, Brazil has seen impressive gains catching up from very low levels of performance. Enrollment rates in early childhood and primary education rose from 21 percent in 2005 to 32 percent in 2010, while those rates among four-year-olds increased from 37 percent to 55 percent. Enrollment rates among five-year-olds have increased from 63 percent in 2005 to 78 percent in 2010. Secondary education attainment rates have also risen. In 2009, 25 percent of the 55-64 year-olds and as much as 53 percent of the 25-34 year-olds had graduated from upper secondary education. Tertiary attainment rates have risen, too, but much slower. In 2009 only 11 percent of the adult population had a tertiary education level. Average PISA scores for Brazil have improved in all subjects measured over the last decade; reading scores improved from 396 in 2000 to 412 in 2009; mathematics scores improved from 356 in 2003 to 386 in 2009; and science scores improved from 390 in 2006 to 405 in 2009. While these scores are still below the Organisation for Economic Co-operation and Development (OECD) average, the gains suggest that Brazil has put in place federal policies based on a coherent vision that appear to be generating consistent improvements. But much remains to be done. Not all the money is invested in a sustainable manner. For instance, a tenth of all the spending goes to students repeating grades; teachers are poorly educated, ill-equipped and often absent. The Brazilian first-grade repetition rate is one of the world's highest:

28 percent, according to the World Bank. Job offers are available all over Brazil, but there is a shortage of qualified personnel to fill the vacancies.

To what extent does research and innovation policy support technological innovations that foster the creation and introduction of new products and services?

This question comprises subsidies and incentives for research institutions conducting basic and applied research, as well as subsidies and incentives for establishing start-up companies that transfer scientific output into products and enhanced productivity. Bureaucratic impediments to research and innovation should also be taken into account.

Reference Indicators: R&D spending | Science and Technology Degrees | Patents | R&D Personnel



Brazil is an emerging economy with a continuing upward growth trajectory. The country has some leading firms and is excellent in some high-technology fields. A few universities undertake high-quality research. This performance, however, does not spill over to the entire economy. Research outputs are still low compared to OECD countries in terms both of articles published in leading international scientific journals and of patents and trademarks. In 2008, Brazil's gross expenditure on research and development was 1.08 percent of GDP, above other major Latin American economies, but below the OECD average. In 2011, the government adopted the so-called Greater Brazil Plan (*Plano Brasil Maior*) 2011-14, that gives innovation a central role and includes proposals for significant changes in legal frameworks. The most important objectives are to close the technological gap with developed economies, to support Brazil's leadership in the nature-related knowledge economy and to strengthen the internationalization of the national research system. The program Science without Frontiers (*Ciência sem Fronteiras*) supports the mobility of national students and seeks to attract young and internationally recognized researchers by providing funding to engage in research projects abroad and to attract foreign researchers.

How successful is a government in reducing unemployment and in increasing employment?

This question addresses a government's strategies to reconcile the following objectives: unemployment reduction and job security, and balancing supply and demand on the labor market by providing sufficient mobility of the labor force according to the needs of potential employers in order to increase the level of employment. To assess labor market and employment policy comprehensively, special emphasis should be placed on the positive or detrimental effects resulting from labor market regulation (e.g., dismissal protection, minimum wages, collective agreements) and from the modus operandi of unemployment insurance).



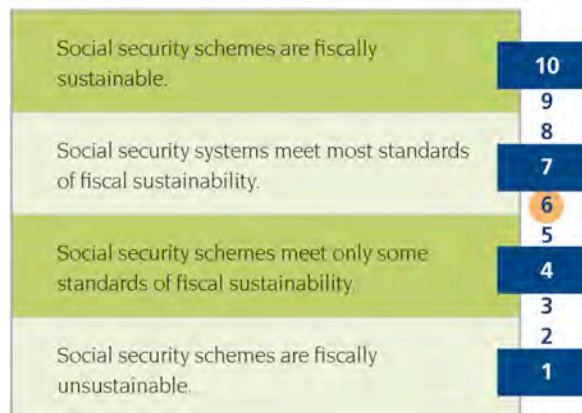
Supporting growth and employment has been one of the fundamental objectives of the Lula government and continues to be a central target of the government of Dilma Rousseff. The Lula administration's social initiatives included a program aimed to create youth employment (*Primeiro Emprego*). In recent years, labor market conditions have tightened, with record levels of job creation and historically low unemployment (5.8 percent in May 2012). The employed population numbered 22.0 million in 2010, 3.5 percent larger than that of 2009 (21.3 million), as a result of the creation of 743,000 jobs. This was the largest annual increase since the 3.4 percent growth registered between 2007 and 2008. In 2011, the total

occupied population was 22.7 million, of which 11.1 million were formally employed in the private sector. Industry provided just 11 percent of the 1.9 million new formal jobs created in 2011. The services sector, civil construction and the commerce sector created 82.3 percent of the total. Monthly wages averaged R\$1,719.50 (US\$847). During the 2000s, Brazil made important progress in improving working conditions, reversing the 1990s trend of increased informality.

Government policies have been instrumental in achieving this goal. Today, formal workers in Brazil enjoy important benefits and protections (pension, sickness, disability and death benefits, paid annual leave, parental leave, restrictions on working hours and a guaranteed minimum wage) that informal workers are not guaranteed. The experience of Brazil in the 1990s and 2000s highlights the important role of government policy in ensuring that workers benefit from the gains of economic growth. The strong growth in formal jobs in the 2000s at the same time that the minimum wage nearly doubled in real terms, demonstrates that labor laws are not an impediment and that some policies, such as the minimum wage, can be important for stimulating growth and job creation.

To what extent are social security schemes based on principles of fiscal sustainability?

This question seeks to assess the extent to which social security schemes (e.g. pension systems, health care insurance, unemployment insurance etc.) are fiscally sustainable. This question is essential for assessing a government's room to maneuver in paying its current financial obligations without shifting the cost to future generations.

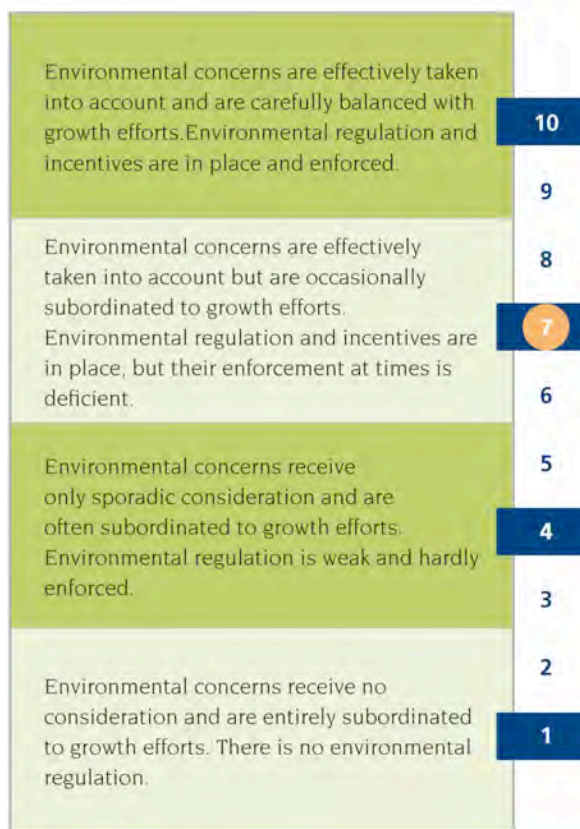


Over the last decade, the government of Brazil has successfully restored aggregate fiscal discipline with low inflation, through the use of fiscal rules, enhanced expenditure controls, and a high degree of fiscal transparency. The country possesses a well-established legal framework for the formulation, execution and monitoring of the budget, which includes a focus on the medium term. This ensures that fiscal and policy measures are affordable, sustainable and can adjust more smoothly to manage fiscal shocks. Around two-thirds of primary spending is dedicated to the social sectors, including social security. While overall spending increased significantly after 2003, as a share of GDP there has been a significant increase in welfare and social security, health and transport. This is partly explained by the expansion of the pension and unemployment schemes, the Bolsa Familia program and an effort to increase public investment that has had a large focus on the transport sector. Containing social security spending -- particularly pensions, which topped 7 percent of GDP in 2008 -- has become a major challenge. The budget is very inflexible with a high level of earmarked tax revenue, social contributions and entitlements.

To what extent are environmental concerns effectively taken into account in both macro- and microeconomic terms?

This question seeks to assess the extent to which externalization of costs or inadequate time horizons are avoided or restrained by environmental regulation. In macroeconomic terms, please determine whether tax and energy policies take ecological goals and measures into account (e.g. promotion of renewable energies, CO² reduction goals). In microeconomic terms, please establish whether the government sets incentives for environmentally sound consumption and investments to households and companies. Please take into account that a deeply engrained awareness of the environment or nature in society may serve as a functional equivalent.

Reference Indicators: CO² emissions | Environmental Performance Index



Brazil has the world's largest reserves of tropical forest, the widest biodiversity and the most substantial flows of fresh water. It also has the largest underground reservoir of fresh water. The country has shown mixed success in dealing with deforestation and other major environmental challenges. Ecologically sustainable development is an issue in some sectors of the economy, but often tends to be subordinated to economic growth targets. One of the greatest challenges is the achievement of sustainable development of the Amazon Basin. The boom in the Brazilian agribusiness industry is pushing agricultural frontiers toward the Amazon region, with a significant environmental impact. Huge tracts of land are being cleared of their original forest to make way for soya farms. Other factors contributing to deforestation include mining, oil and gas projects in the Amazon Basin. In recent years, Brazil has developed many of the legal and institutional instruments necessary for reconciling development and environmental protection, including water management, forest protection and biodiversity regulations. The country ranks third worldwide in terms of annual greenhouse gas emissions, which represent 8 percent of the world's total. In 2009, Brazil committed itself to reduce these emissions by 39 percent by 2020. Brazilians have fought deforestation on several fronts, including the adoption of strict laws on maintaining forest cover and the implementation of better enforcement measures. They have enlisted the help of international scientists to track forest cover by satellite and detect illegal cutting deep in the jungle. They have also pioneered programs through which landowners can be paid to keep their trees standing in order to diminish the financial incentive for much of the illegal logging. The

2012 Environmental Performance Index states that Brazil is one of twelve countries examined in the report where reductions in forest clearing have occurred.

Brazil is the second largest producer of ethanol, and is the largest ethanol exporter in the world. However, environmental and social impacts associated with ethanol production are important challenges to biofuel production in Brazil. Among the most important issues are atmospheric pollution from the burning of sugarcane for harvesting, degradation of soils and aquatic systems, and the exploitation of cane cutters. The expansion of sugarcane crops to the areas presently cultivated for soybeans also represents an environmental threat, because it may increase deforestation pressure associated with soybean crops in the Amazon region.

Hydroelectric power plants, which produce about 90 percent of the country's electrical energy, also have environmental impacts. The construction of new hydroelectric power plants requires the construction of dams and the flooding of large areas, thus altering the ecosystem. The proposed construction of the Belo Monte dam in the state of Pará, for instance, would create one of the world's largest hydroelectric dam complexes. While the government argues that construction of the plant is important for development and will create jobs, environmental activists and indigenous groups say the construction of dams in the Amazon tropical forest areas will displace tens of thousands of people. With a score of 60.9, Brazil ranks 30th in the 2012 Environmental Performance Index. CO₂ emissions per capita are 87.6 (rank 49), per GDP are 60.6 (rank 32) and per KWH are 42.7 (rank 11). Renewable electricity counts for 89 percent of total electricity consumption.

II. Steering Capability and Reform Capacities

5. Strategic Capacity

Prioritization: To what extent does the government set and maintain strategic priorities?

This question seeks to assess:

- the political capability to take on a longer-term perspective going beyond immediate concerns of electoral competition, to maintain strategic priorities over periods of crisis and stalemate
- the strategic capacity of the government to prioritize and organize its policy measures (gaining and organizing expertise, evidence-based policy-making, regulatory impact assessment, strategic planning units)

Make sure to identify reform drivers and defenders of the status quo, as political determination and institutional capacity may vary among different departments and ministries. Please also comment on how setting and maintaining strategic priorities might be constrained by government composition and by actors outside the government (e. g. powerful economic interests, lobbies, foreign governments, foreign donors).



The Workers Party (PT) administrations (President Lula 2003-2010; President Rousseff since 2011) have been committed to the goals of constitutional democracy and a socially responsible market economy. Its policies gave these goals priority over short-term expediency. The role of external influence was modest. Brazil does not depend on foreign aid; net official development assistance (ODA) receipts in 2009 2010 (US\$338 1038 million) were very small in relation to the country's gross national income (GNI). The government's strategic priorities included fighting poverty and improving educational levels. President Lula was elected to his first term of office in October 2002 on a platform that emphasized increased social equity and faster growth. The government committed itself to tight fiscal policy, inflation targeting and the honoring of debt contracts. At the same time, it promised far-reaching improvements to the general public welfare, which were then carried out in the form of several high-priority social initiatives, including efforts to eradicate hunger, create youth employment and unify conditional cash transfer programs in order to enhance effectiveness in reducing poverty. Indeed, Brazil has experienced noticeable improvements in well-being since 2003. In October 2006, President Lula was elected to a second four-year term. He promised faster economic growth, more efforts to enhance the educational system and strong action against the widespread incidents of violence plaguing the country. The government's efforts to accelerate growth and to enhance the educational system were implemented in effective reform programs. The macro foundations of the Brazilian economy improved further and inequality decreased. The Lula government showed an impressive strategic capacity to prioritize and

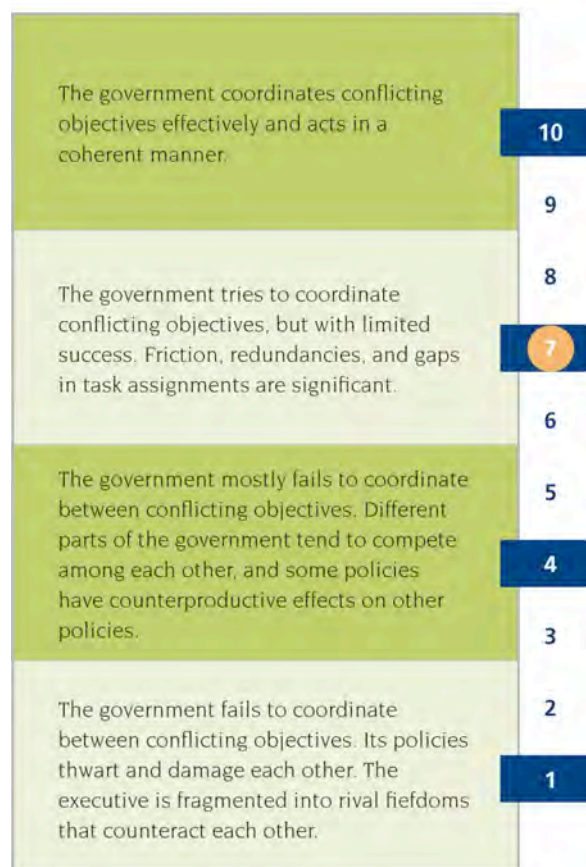
organize its policy measures. Since 2008, Brazil also has been addressing the effects of the global economic crisis successfully. While the country's GDP contracted slightly in 2009, the economy recommenced growth in 2010, with an annual growth rate of 7.5 percent, the highest in more than 20 years. The activities of regulatory agencies in key sectors and a greater reliance on competition have helped Brazil's economic performance in recent years. Regulatory agencies have played an important role in improving standards of service, notably in the private health insurance sector.

Policy coordination: To what extent can the government coordinate conflicting objectives into a coherent policy?

As many policies have conflicting objectives, reflect competing political interests and affect other policies, the government has to ensure that its overall policy is coherent. Successful coordination should:

- assure that trade-offs between policy goals are well balanced
- introduce horizontal forms of coordination to mediate between different departments of the state administration
- ascribe responsibilities in a transparent manner to avoid the negligence of tasks, redundancies, or friction between different government branches.

Various coordination styles (hierarchical-bureaucratic, informal-network, personalist, centralized, decentralized etc.) are possible and may be functionally equivalent. What matters is their impact on policy coherence.



From the outset, the PT governments have tried to coordinate conflicting objectives and interests into a coherent policy, but intra-governmental frictions have proven significant all the time. After being re-elected to his second term in 2006, President Lula formed a broad 11-party government coalition in order to guarantee the passage of government-proposed legislation through Congress. Lula received support for his strategy from his own party, and subsequently won the alliance of the catch-all Brazilian Democratic Movement Party (*Partido do Movimento Democrático Brasileiro*, PMDB) and other minor parties. President Rousseff currently is running a 14-party government coalition. The PMDB is the largest party in the lower chamber of Congress, as well as in the Senate. It does not have a unified ideology; its members are mostly positioned on the right of the political spectrum, and therefore hold positions conflicting with those of the left-wing PT. The price for the successful formation of a broad but very heterogeneous ruling alliance was and continues to be high, as coalition members have to be compensated with posts inside the government and the public administration. As an opposition party, the PT had repeatedly criticized the traditional spoils system of Brazilian politics, but once in power it acted in the same manner as its predecessors. With the goal of attaining a congressional majority, it established a clientelist policy grounded in the mutual exchange of favors.

Stakeholder Involvement: To what extent does the government consult with major economic and social interest groups to support its policy?

This question assesses how successfully the government consults with economic and social actors in preparing its policy. Successful consultation is conceived here as an exchange of views and information that increases the quality of government policies and induces economic and social actors to support them.



This question addresses two different stakeholder groups. Amongst the economic interest groups are business corporations, umbrella federations (such as the Federation of Industries of the State of São Paulo, FIESP) and financial institutions, whereas social interest groups consist of trade and students' unions, non-governmental organizations, social movements, the media and the Catholic Church. The development strategy of the Lula government, though liberal in orientation, placed great emphasis on the positive contribution that an active and strategically oriented state can give in the search for national development. New institutions for state-business dialogue and broader state-society dialogue were created. In doing so, the government sought to engage the business sector and the wider society through institutionalized channels with the aim of ensuring sustainable and more widely shared economic growth as well as legitimacy in the population. Thus it can be said that the Brazilian government is able to gather support from both economic and social actors, but the impact of each actor is distinct. Stakeholders with high power and influence (particularly business corporations, financial institutions, the Catholic Church and the media) are more likely to be consulted and their influence over government decisions is sometimes even deemed excessive, particularly during the election period. Still, less powerful actors are also incorporated to the public policy. Ultimately, there is a dependency relationship between the government and its stakeholders, as no public policy can be successful without the support of such interest groups.

Political Communication: To what extent does the government actively and coherently communicate and justify the rationale for and goals of its policies to the public?

A coherent communication policy is an important aspect of strategic governance, and ultimately in winning public acceptance for governmental policies. This question assesses governments' public communication efforts, and the extent to which policy-makers are able to coherently describe and justify goals and programs to the public.



The government effectively coordinates its communication efforts and it coherently communicates and justifies the goals of its policies to the public. Throughout its eight years, the Lula administration spent R\$10 billion in institutional advertising. Official communication efforts particularly target the ever-growing (lower) middle class. It is necessary to communicate with these segments in an accessible way, by sponsoring cultural and sporting events or holding radio and TV broadcasts, designing newspaper advertisements, brochures, flyers and billboards. Every Monday morning, for instance, President Dilma Rousseff appears on the radio program “Café com a Presidenta” (breakfast with the president) to explain government projects in the “language of the people”. Magazine titles like “Power Woman Dilma Rousseff: Brazil’s Entrepreneur-In-Chief” (*Forbes*, 8-22-2012) are a clear sign that the government also successfully communicates the goals of its policies to the national and international business community. Not only the Brazilian public supports her; a June 2012 poll put her approval rating at 77 percent, even ahead of her predecessor and mentor, former President Lula da Silva, at a similar point in his term). So does Brazil’s entrepreneurial community. Eike Batista, Brazil’s top entrepreneur and one of the world’s richest men recently told the press, “Our government has made substantive reforms in recent years.”

6. Implementation and Efficiency

To what extent can the government achieve its own policy objectives?

This question seeks to evaluate a government's implementation performance against the performance benchmarks set by the government for its own work. The assessment should therefore focus on the major policy priorities identified by a government and examine whether declared objectives could be realized.



The PT governments since 2003 have been committed to democracy, economic stability and social justice. Strategic priorities were to reduce poverty and economic inequality, accelerate growth and enhance the country's role as a global political and economic player. This strategy, though liberal in orientation, placed great emphasis on the positive contribution that an active and strategically oriented state can make in the search for national development. Not all intended reforms could be implemented. The government's problems with effective implementation of its reform policy were in part due to conflicting interests and policy goals inside the ruling coalition, and in part a consequence of formidable institutional barriers to reform, as well as a fragmented political party system. But even so, the government's declared objectives were realized to a high degree. Eight years after having been elected amid serious doubts as to his ability to keep Brazil on a path toward sustainable development, Lula left office having anchored the country solidly in the club of emerging powers. Millions of Brazilians have been pulled out of poverty during Lula's two terms, and Brazil now plays an important role on the world stage. Other major achievements include Brazil's nomination as organizer of the soccer World Cup 2014 and Rio's selection to host the Olympic Games in 2016. In addition, Lula managed to ensure the nomination and election of his protégé, Dilma Rousseff, as his successor.

To what extent does the government make efficient use of available human, financial, and organizational resources?

In assessing the government's resource efficiency, please focus on the executive, including the administration and the cabinet.

Reference Indicators: Personnel expenses relative to the services offered by the state | low number of politically motivated dismissals and new appointments of public servants | competitive recruiting procedures protected against political influence | transparent budget planning and implementation | low deviation of actual budget expenditures from the associated planned expenditures | effective and independent auditing | public administration that enables effective management under criteria of professional rationality | procedures and institutions to reform and modernize public administration.



The administration uses most available resources efficiently. Disciplined fiscal and monetary management enable economic progress. Debt and external vulnerabilities have been substantially reduced. Much progress has been made in strengthening the institutional framework for public debt management. The Fiscal Responsibility Law (FRL) approved in 2000 imposed order and accountability on spending by the states through a general framework of budgetary planning, execution and reporting that is applicable to all levels of government. With respect to revenues, the law mandates the withholding of discretionary federal transfers to states and municipalities that do not collect their own taxes effectively. The FRL requires that governments match any permanent spending decisions with a corresponding increase in permanent revenues or a reduction in other permanent spending items. The FRL also weakens the power of governors to influence national policies, since it gives states more responsibility for their own fiscal problems, reducing their ability to hold the federal government hostage on fiscal grounds.

It is difficult to make general statements about the quality of administration in the country's 5,560 municipalities, given the sometimes very significant differences between them. Some municipalities have introduced a participatory budgeting procedure that allows civic organizations substantial opportunity for input in budget preparation and oversight. Other municipalities seem to prefer less process-oriented and more results-oriented measures of administrative modernization. However, clientelist patterns between administration and citizens have prevailed in a considerable proportion of the municipalities. Regulations require the civil service to be impartial,

independent and fairly managed. Most appointees are hired through public examinations. In some areas, civil servants must be hired according to criteria of professional evaluation. In other areas, civil service positions are not regulated. Positions of responsibility are often filled by political appointees. In the federal sphere alone there are more than 23,000 such positions. The appointment of those is largely driven by political considerations, such as the imperative of holding together the legislative coalition. International observers often criticize the high level of taxation and low quality of public spending in Brazil. They emphasize that the high tax burden provides strong disincentives to private investment, formal sector employment and economic growth. The quality of government spending also suffers from suboptimal public sector management, weaknesses in planning and budgeting and rigid institutional arrangements (including inflexible labor legislation and complicated procedures for registering businesses). Brazil's public expenditures total more than 40 percent of GDP, while the composition of public spending has shifted toward government consumption and social security, and away from public investment.

7. Adaptability

Policy Learning: How innovative and flexible is the government?

Innovation in policy-making often comes from learning. This learning goes beyond changes in policy outputs to include changes in the basic beliefs in guiding policy formulation. Learning opportunities are provided by:

- learning from past experience (effective internal monitoring and evaluation)
- observation and knowledge exchange (good practices, international cooperation)
- consultancy (academic experts and practitioners)

Flexibility refers to a government's ability to adapt to and take advantage of development opportunities inherent to a given political situation. Flexibility and learning allow governments to replace failed policies with innovative ones. If possible, provide empirical evidence on whether policy learning happens coincidentally or if there are institutionalized mechanisms that facilitate innovation and flexibility in policy-making.



The government demonstrates a general ability for policy learning, but its flexibility is limited. Since 2003, leading executive officials have demonstrated learning processes with regard to the functioning of the international economic system. The PT-led administrations have adopted macroeconomic policies that largely continued those of President Fernando Henrique Cardoso's government. At the same time, Presidents Lula and Rousseff successfully pursued their goals of reducing poverty and inequality while preserving stability. However, further modernization in some of Brazil's core infrastructure, including energy, communication and transportation, would help to increase investment and improve service quality for citizens. A 2008 OECD report recommended that Brazil broaden efforts to adopt a "whole-of-government" approach to regulatory quality at the highest political level; improve coordination between ministries, agencies, regulatory institutions and the various levels of government; put in place a system to assess the economic and social impact of new laws; consolidate regulatory authorities' autonomy and statutory environment in order to strengthen their powers and resources; and reinforce the strategic framework for planning and decision-making in regulated sectors. The PT governments can be compared and contrasted strongly with other recent left-wing experiences in the region, particularly with the left-populist government of President Hugo Chávez in Venezuela.

Learning processes have also occurred with respect to building and maintaining a multi-party coalition. Certainly the substantial political and ideological differences within the ruling coalition and the institutional barriers to reform have impeded rapid

implementation of several long-discussed reform projects. But if flexibility refers to political actors' ability to accurately appraise their own political leeway, and to recognize and utilize the developmental opportunities inherent within a given political situation, then it must be said that the PT governments chose their tools and strategies carefully and successfully.

Institutional Learning: To what extent does the government improve its strategic capacity by changing the institutional arrangements of governing?

Strategic capacity is the capacity to take and implement political decisions that take into account the externalities and interdependencies of policies, are based on scientific knowledge, promote the common goods and represent a long-term orientation. Institutional arrangements include the rules of procedure and the work formats defined there, in particular the cabinet, the office of the head of government, the center of government, the portfolio of ministries, the advisory staffs of ministers, and the head of government as well as the management of relations with parliament, governing parties, ministerial administration, and public communication.



The government has been able to change some parts of its institutional arrangements and thus improve its strategic capacity, while at the same time the long overdue political reform has not yet taken place. Beginning with Cardoso's government, Brazil has put in place various policies to foster proactive transparency and enhance citizen engagement. New regulatory agencies were created after 1996, inspired by international experience. The Administrative Council for Economic Defense was transformed into an independent governmental body, with clear powers for competition policy enforcement. While a lot has been done, Brazil still has to improve its capacities for regulatory quality and increase transparency and accountability for public governance. But the country seems well positioned to address current challenges. A consensus tends to emerge among political actors, the different parts of government, and businesses and academia, that changes are required to further improve regulatory quality. The push for budget transparency given through the 2000 Fiscal Responsibility Law has since been expanded to cover administrative processes and decision making. Brazil's participation in the new Open Government Partnership, started in 2011, reflects the country's commitment to strengthen the transparency of government action, to prevent and combat corruption and foster democratic ideals based on citizen participation in decision making. Through the Action Plan for Open Government, the country is adopting measures that will allow it to continue making headway in public transparency, strengthening the existing practices to prevent and combat corruption, ensuring access to information, managing public funds, promoting integrity in the public and private sectors, fostering citizen participation and delivering public services.

While these experiences are quite positive, there have been a lot of discussions about the need for political reforms during the last 25 years, but only minor reforms have been introduced. In 2007, Congress rejected President Lula's proposal for political reform, which was designed to give parties more power to control their own officeholders, as well as to clarify campaign financing rules. In 2008, the government proposed a new package of long-discussed initiatives, including reforms to campaign finance rules, a proposal for closed electoral lists, measures to strengthen party loyalty and the introduction of proportional representation. In May 2009, Congress rejected the government's efforts to introduce a political reform project into the lower house. Thus, the government once again failed in the attempt to introduce political reform that would help consolidate the democratic system. Numerous efforts have run up against a recalcitrant Congress, with political parties unwilling to alter a status quo that has let small, local parties be overrepresented in parliament.

III. Track record of past crisis management (if applicable)

Is there evidence from historical events that the country and its society have already mastered economic and political shocks in the past?

Yes, particularly throughout the last 30 years. During the 1980s and early 1990s, Brazil was able fairly successfully to overcome political turmoil, democratic transition, debt default, hyperinflation and the impeachment of its first democratically elected president. Furthermore, the 2008 international financial crisis did comparatively little damage to the Brazilian economy, proving that the country's financial and political stability is difficult to damage. The Brazilian economy was severely hit by the 2008 crisis. But although deep, the impact of the crisis did not last for a long time. GDP growth experienced a quick recovery, showing that the health of the Brazilian economy was good. The banking system performed very well during the crisis, showing a great deal of resilience. A solid supervision regulation significantly helped the system to avoid the systemic crisis that was a possibility in the Brazilian banking system at the end of 2008.

Does the political system facilitate crisis remediation in a timely manner?

The institutions established by the 1988 Constitution were indeed capable of remediating the crises that occurred until today in a timely manner. However, the Brazilian political system in itself is difficult to change, as the Constitution can only be amended with a three-fifth's majority in both chambers of the legislature, with two rounds of voting in each. For this reason, it is difficult to remediate the very chronic inconsistencies that could be responsible for political crises in Brazil, such as corruption and impunity.

Is the signaling process between decision makers (government, central bank, employers, employee representatives) so well established that confusion about (and resistance to) the expected outcome of decisions by one decision maker on the others can be avoided or at least minimized?

Yes. Following the election of President Lula in 2002, there was general uncertainty about whether the left-wing PT administration would continue fiscal and economic policies pursued by former President Fernando Henrique Cardoso, from the centrist PSDB (Brazilian Social Democracy Party). At that time, the Brazilian currency suffered a historical devaluation, the debt crisis escalated and foreign investors observed the Brazilian economy with caution. Stabilization and confidence building with the financial markets were thus high on the political agenda of the Lula government from the start. Lula was able to minimize the confusion about the expected outcome of his decisions by adopting a conservative fiscal policy (in accordance with his antecessor's) and assuring investors that Brazil's responsibilities towards IMF and foreign investors would be met. Judging by this example, Brazilian decision makers are able to coordinate their activities and minimize confusion by following consistent policies and obtaining international credibility.

Are there constitutionally anchored and politically accepted procedures for sequencing and timing countermeasures in a crisis?

Though there are no constitutionally anchored procedures to counteract a crisis, recent Brazilian governments became known for their austerity and pragmatism when dealing with economic instabilities. For instance, the Brazilian Development Bank (BNDES) lends money on accessible conditions to farmers and small entrepreneurs. The government also promotes tax cuts, lower interest rates (though Brazilian interest rates remain some of the world's highest) and long-term financing of houses and consumer goods in order to stimulate consumption.

Are precautionary measures (e.g., deposit insurances, foreclosure procedures) in place that can protect the most vulnerable groups against the full effect of a crisis?

There are indeed precautionary measures in place. Though mortgages and subsequent foreclosure procedures are less frequent, the Brazilian Credit Guarantee Fund (FGC) offers deposit insurance up to R\$ 70,000. Social programs (such as “Minha Casa, Minha Vida” or “Bolsa Família”) build housing and provide cash transfers for low-income families, minimizing the effects of an eventual crisis.

Are automatic stabilizers in fiscal policies sufficiently strong to contain surges of massive unemployment?

The improvement of fiscal discipline and credibility in fiscal management has made possible the gradual adoption of countercyclical fiscal stances in recent years. Debt management to reduce the pro-cyclicality of fiscal policy has also been an important strategy for reducing exposure to volatile capital flows. The commitment to fiscal discipline, formalized in the Fiscal Responsibility Law enacted in 2000, set constraints on the financing of the public sector, including state-controlled financial institutions, and provides for budgetary planning and disclosure rules. Fiscal targets were met every year up to 2009. The Brazilian government's response to the 2009 international crisis involved protection of financial markets and support to credit, full operation of automatic stabilizers and fiscal stimulus. Fiscal measures pursued by the Brazilian government consistently led to lower unemployment rates (under 6 percent in May 2012) as well as lower taxes and a controlled inflation, in spite of increased government spending.