



First Year of Lula: Overview of the Political Situation in Brazil

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► Key Takeaways

- Brazil's economic performance was satisfactory in 2023, while Lula faces a much less favorable international context than in his first two terms and a right wing Brazilian parliament.
- His social priority, just as in 2003, is to lift some of the 71 million Brazilians out of poverty. Social transfers, ultimately inexpensive, will contribute to this aim. Brazil also needs more sustained growth.
- December's vote on tax reform was an undeniable success for both Lula and his Finance Minister. It also highlighted the difficulties of negotiating with a parliament dominated by special interests.
- Lula's time in office was finally marked by Brazil's return to the world scene, after four years of eclipse. Maintaining good relations with all parties, with a view to a possible role as mediator in certain conflicts, is, however, difficult in a more polarized world.

Introduction

Lula was elected President of the Republic on October 30, 2022, after a closer-than-expected second round, with 50.9% of the votes cast and just 2.1 million votes over the incumbent, Jair Bolsonaro. His vice-president is Geraldo Alckmin, from the centre-right. However, in the legislative elections held simultaneously, the parties supporting Lula (Workers' Party [PT], Socialism and Liberty Party [PSOL], Brazilian Socialist Party [PSB], and in the second round, Democratic Labour Party [PDT] and Solidariedade) obtained only a minority of the votes and only 130 deputies out of 513 and 8 state governors out of 27.

Brazil's economic performance has been decent in 2023. Despite the International Monetary Fund's (IMF) conservative growth forecast of 1% in October 2022, the actual growth now exceeds 3%. However, the outlook for 2024 is uncertain. With December's inflation drop to 4.6% compared to the same period in 2022, interest rates are decreasing, yet the Selic key rate¹ remains high at 11.75%. External accounts are robust, with a current account deficit below 2% of gross domestic product (GDP) easily financed by foreign direct investment (FDI), maintaining foreign currency reserves at USD 340 billion. However, a concern arises from the public finance deficit, as the government initially projected a 1.3% GDP primary deficit for 2023 and recently revised it to approximately 1.7%, leading to an overall deficit exceeding 7%, posing sustainability challenges.

Brazil: some economic indicators

	2023e		2019	2020	2021	2022	2023f	2024f
Population (million)	216	GDP (real growth, %)	1,2	-3,3	5,0	2,9	3,1	1,5
GDP (bn USD)	2127	Inflation (annual average, %)	3,7	3,2	8,3	9,3	4,7	4,5
GDP/cap., ppp (USD)	18961	Current account (% of GDP)	-3,6	-1,9	-2,8	-2,8	-1,9	-1,8
Saving rate (% PIB)	15,9	Public fin.: global balance (% GDP)	-5,0	-11,9	-2,5	-3,1	-7,1	-6,0
HDI (2021)*	87	Public debt (% of GDP)	87,1	96,0	90,1	85,3	88,1	90,3
Governance (2021)**	40	Change: BRL/USD (end of year)	4,03	5,20	5,58	5,29	4,85	5,15

* Human Development Indicator (UNDP): ranking among 191 countries
 ** Average of the World Governance Indicators (World Bank) 3 à 6; ranking from 0 (worst) to 100 (best)
 Source: IMF, World Bank, UNDP

Economic policy: What Lula would want²

The Lula elected in October 2022 is not the Lula elected in 2002. He is 20 years older, but above all, he spent 580 days in prison between April 2018 and November 2019, convicted by Judge Moro of Curitiba for corruption in the so-called "Lava Jato" affair.³ He has always

1. The Selic rate is the interest rate of monetary policy, serving as the key tool of the Central Bank of Brazil (BCB) in implementing monetary policy.

2. On September 30, 2022, *The Economist* published a long interview with Lula, which sheds light on his intentions if elected: "How Luiz Inácio Lula da Silva Would Govern Brazil?", September 30, 2022, available at: www.economist.com.

3. The initial sentence of 9 and a half years was confirmed and increased (to 12 years and one month) by a Federal Regional Court. An application for *Habeas Corpus* was rejected by the Supreme Federal Court (Supremo Tribunal Federal – STF). Lula was again sentenced in 2019 to 12 years and 11 months in prison for having "benefited from undue advantages,"

rejected the charges, believing them to be a political maneuver by the Brazilian right to prevent his candidacy in the 2018 presidential election, following the ousting, in his view just as questionable, of Dilma Rousseff in 2016. Lula still wants to see himself as a unifier. Still, he is aware that he now faces a much more determined opposition, representing a portion of the population for whom hatred of the PT and himself is the primary political conviction. As the events of January 8th showed, some are willing to do anything to return to power.

While his goals have seen minimal change, they continue to lean towards social rather than political aims. His foremost priority remains lifting a portion of the 71 million Brazilians (33% of the population) grappling with poverty. In 2023, direct and conditional transfers, encompassing income criteria and obligations like school enrollment and vaccination, were predominantly directed toward enhancing the *Bolsa Família* program. This initiative benefited nearly 21 million families, totaling 55 million people, with a substantial allocation of BRL 175 billion, equivalent to 1.6% of GDP. These programs were not eliminated but instead rebranded by the Bolsonaro government, with *Auxílio Brasil* taking the place of *Bolsa Família*, and *Casa Verde e Amarela* replacing *Minha Casa, Minha Vida*. They were deemed crucial for supporting a population segment and were significantly expanded in 2022, especially in the lead-up to the general elections in October.⁴

Lula still wants
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While there is a more or less enthusiastic consensus on the social transfer programs, the growth strategy is the subject of much livelier debate. Throughout his initial two terms in office, Lula enjoyed the advantages of a predominantly robust global economy (except in 2009), marked by ascending commodity prices. Brazil's average growth from 2002-2010 stood at 4.1%.

The current international landscape is considerably less favorable, and the IMF, possibly adopting a pessimistic outlook, projects Brazil's growth at only 2% annually until 2028. This modest growth rate may offer limited contributions to poverty reduction. Therefore, Lula may be tempted to pursue an economic policy focused on expediting growth, adopting a form of "developmentalism." It is crucial to acknowledge this potential risk, along with the accusations of "statism" or even "communism" leveled by some factions of the Brazilian right (and beyond, as seen with Javier Milei). However, these allegations lack substance; there is no semblance of "communism" in the policies of Lula's initial two terms unless one contends that social transfers, a characteristic feature, align with such a classification (a characteristic also observed under Bolsonaro's administration). While the characterization of "statism" was arguably applicable to Dilma Rousseff (2011-2016), its relevance to Lula is more questionable. Merely opting not to

a sentence confirmed by the STF before it changed its mind in November 2019, ruling that the prison was unconstitutional until all appeals had been exhausted, and then in 2021, annulling all the sentences for "incompetence of the Curitiba court" and "partiality of Judge Moro," who had meanwhile become Bolsonaro's Minister of Justice.

4. In 2022, 16.9% of Brazilian families will have benefited from *Auxílio Brasil*, compared with 8.6% in 2021.

privatize Petrobras, announced shortly after Lula took office, might not be sufficient grounds to brand him as a “statist.”⁵

Lula is essentially pragmatic, supporting policies conducive to accelerating economic growth and job creation. Lula’s commitment to “egalitarianism” primarily extends to rectifying highly unjust circumstances, exemplified by initiatives like those aimed at domestic workers under Dilma Rousseff in 2012. However, if public-private partnerships can enhance Brazil’s economy, particularly in bolstering infrastructure, he is likely to endorse them. Lula doesn’t appear to subscribe to a distinct “social democratic vision” for Brazilian society, a perspective that some PT members, including his Finance Minister Fernando Haddad, might hold. He seems to have never considered the prospect of reforming corrupt and nepotistic political structures, even when opportunities arose during his second term, and he appeared confident that his negotiating skills would suffice to navigate and address their shortcomings. The tax reform negotiated with Congress by his Minister of Finance is, for him, much more a tool for “balancing the books” than for achieving a little more social justice.

Lula is keenly aware of the constraints affecting public finances. When he became President on January 1st, 2003, the public debt reached 76% of GDP, and in 2003, interest on this debt represented 9% of GDP, an exorbitant levy and, in his eyes, an unacceptable transfer to foreign creditors and the richest fringe of the Brazilian population. Benefiting

The current public debt stands at 88% of GDP

from a favorable global economic environment and robust growth, Lula strategically orchestrated budgets that consistently generated a substantial primary surplus (averaging 3% of GDP over his two terms). This approach successfully lowered the public debt to 62% of GDP by the end of 2010. However, the current public debt stands at 88% of GDP, influenced by the more lenient fiscal policies of Dilma Rousseff and Michel Temer, compounded by the impact of the Covid-19 crisis. The interest rate policies the central bank sets are expected to result in interest payments reaching almost 6% of GDP in 2023. Therefore, Lula and his Finance Minister have pledged to return to a zero primary balance in 2024 and a primary surplus of 1% of GDP in 2026. Despite doubts from both the market and Lula himself regarding the 2024 target, a return to orthodox fiscal policies seems highly probable, even in the face of potential obstruction from Congress.

5. This does not prevent Lula, perhaps because of his background as a metalworker, from having some economically questionable hobbies, such as his passion for building the oil rigs Petrobras needs in Brazil. This passion does not seem to be shared by the company: in May 2023, its director of engineering told Reuters that he was skeptical about the value of building the platform hulls in Brazil.

Political constraints: What Lula can do

The Brazilian Congress, comprised of a Senate and a Chamber of Deputies, is a severe obstacle to implementing any economic policy. In addition to the specific difficulties encountered by the Lula government in dealing with the predominantly conservative assemblies elected in October 2022, every government comes up against a practice whereby a large number of parliamentarians from the *centrão* (literally: the “big center”), a group of parties representing particular interests, whether sectoral or geographical, only give their support in exchange for funding that enables them to strengthen their electoral base, which is sometimes geographically quite narrow. The practice goes back a long way: the first Lula government introduced the *mensalão* (“large monthly payments”) mechanism, under which certain members of parliament received regular personal payments in exchange for their support. It was extended and amplified (including during the Rousseff and Temer governments)⁶ by the *petrolão*, with funding provided by Petrobras, which also benefited political parties (including, but not limited to, the PT). Some beneficiaries of *mensalão* and *petrolão* have been convicted by the courts. Since 2020, parliamentary support has been obtained by granting certain members of parliament “secret budgets” (*orçamentos secretos*) for free and non-public use: the congressman obtains a transfer from the executive to a town hall controlled by an ally,⁷ and determines its use without any examination of the value of the expenditure; in addition, the goods and services purchased in this way are generally overpriced. Between 2020 and 2022, BRL 54 billion (EUR 10 billion) was diverted from the budget. All in all, *orçamento secreto* and its derivatives may be less illegal than the “simple” corruption of *mensalão* and *petrolão*. Still, their cost is ultimately higher, and their economic impact is more damaging. Despite condemnation by the STF in December 2022, this practice persisted during the first year of the Lula government, taking the form of “ministerial transfers.”

6. Dilma Rousseff and Michel Temer were both accused of personal corruption. Dilma Rousseff was cleared. Michel Temer was formally charged by the courts and imprisoned for a few days in 2019, then released by the STF, and his case seems to have stalled.

7. During the period 2020-2021, only 4% of the *orçamentos secretos* were granted to the opposition – Estadão, “Orçamento secreto: Leia as reportagens do ‘Estadão’ que revelaram o esquema”, Estadão, February 2, 2022, available at: www.estadao.com.br.

Lula negotiates with the *centrão*



Translation: *Centrão* restaurant. Menu: Chef's Support.

© Drawing by Laerte, for *A Folha de São Paulo*, October 28, 2023.

This became particularly apparent during the assessment of the tax reform. In July 2023, the Ministry of Health allocated BRL 17.9 million to a hospital in Maceió (Alagoas). Notably, the financial director of this hospital is the cousin of Artur Lira, the Member of Parliament for Alagoas, President of the Chamber, and the central orchestrator and beneficiary of the *orçamento secreto* system.⁸ To agree to this reform, parliamentarians also demanded tax exemptions, sometimes with surprising justifications, for sectors such as the hotel industry, football, and independent professionals (lawyers, engineers, accountants, etc.). Arturo Lira's support was even more costly: he asked for and obtained the presidency of Caixa Econômica Federal, a major state-owned bank, for one of his protégés, and this “under closed doors” (*a portas fechadas*), which means that he has complete control over the bank's staff. However, the reform was passed in November 2023 and brought two significant changes to the tax system: increased revenue and simplification. The reform is expected to generate additional revenue equivalent to 1.5% of GDP. This will be achieved by scaling back tax privileges for specific investment funds, tightening taxation on dividends, and eliminating deductions commonly referred to as “interest on equity.” The simplification, which has been well received by businesses, consists of replacing five consumption taxes (three federal – PIS, Cofins, and IPI – and two levied by states and municipalities – ICMS and ISS) with a two-tier VAT system, one federal (CBS), the other local (IBS), albeit at a very high average rate (27.5%).

The difficulties of “managing” parliamentarians illustrate the mediocrity of governance in Brazil. According to the World Bank's World Governance Indicators,⁹ Brazil's “Rule of Law” indicator is slightly better than that of Colombia, Argentina, Peru,

8. In the first seven months of 2023, 29% of these transfers from the Ministry of Health went to the state of Alagoas, whose population represents 1.5% of Brazil's total population.

9. The World Bank, “Worldwide Governance Indicators”, Overview, available at: www.worldbank.org.

and Mexico (in descending order) but is a long way behind Uruguay and Chile. Regarding the “Control of Corruption” indicator, Brazil even lags behind Colombia and Argentina.

Jair Bolsonaro’s term in office has given a new political role to the Brazilian judiciary, which could become uncomfortable. It has not escaped unscathed from the abuses of the Curitiba prosecutors and judges in the prosecution of Lula and from the procrastination of the STF itself in handling the case. It has also dithered in its condemnation of the practice of *orçamento secreto*: it has done so rather weakly, condemning the practice but refraining from calling into question those responsible for carrying it out. Perhaps it is reluctant to take on this new political role of monitoring and sanctioning abuses by Congress. However, the STF and the Supreme Electoral Tribunal (TSE) have been firmer in their condemnation (eight years’ ineligibility) of Jair Bolsonaro’s ex-ante challenge to the integrity of the Brazilian electoral process and in the heavy prison sentences handed down to some of those who took part in the invasion and ransacking of the capital’s institutions on January 8, 2023, without so far calling into question those responsible for this attempted *coup d’état*.

Jair Bolsonaro’s term in office has given a new political role to the Brazilian judiciary

Will Lula stand for a fourth term in 2026? It will depend on his desire (his age – he will be 81 by then – and his state of health) but also on the economy and the polls. If the latter two, which are linked because the left’s most likely alternative candidate is Fernando Haddad, the Finance Minister, are favorable, then he could choose to step down and support his minister. But if the polls are unfavorable and his state allows him to do so, he could once again run against the right-wing candidate, who could be Tarcísio de Freitas, the current governor of the state of São Paulo, or Romeu Zema, governor of Minas Gerais. The governor of São Paulo takes great care to court the Bolsonarist right. He shows his respect for the former president at every opportunity. Still, his eventual access to the presidency would be more a return of the traditional conservative right than an avatar of Bolsonarism and its excesses.

Brazil and the world

Lula disappointed the United States and Europe by initially adopting an ambiguous stance on the war in Ukraine, delaying his condemnation of the Russian invasion. He eventually did, but the consequences were already apparent: the new image of Lula would be associated with being a “friend of dictators,” as demonstrated by his perceived “closeness” to Nicolás Maduro and Daniel Ortega. The reality, however, is more intricate. Firstly, it’s important to note that the Brazilian public, regardless of its political stance, is largely indifferent to events in Ukraine, much like the average European might be to a hypothetical invasion of Paraguay by Brazil – Ukraine, being geographically distant, may not hold much significance for many. It is also possible to attribute some of Brazil’s reluctance to the old anti-Americanism of all Latin American leftists, perhaps aggravated,

in Lula's case, by his prison experience, in which he suspects that the United States played a role. But above all, Lula believes he can be a universal mediator by maintaining cordial relations with all the parties. We remember the Turkish-Brazilian attempt at mediation on the Iranian nuclear issue in 2010, which came close to succeeding. Lula imagines that a Brazil that is "equidistant from the parties in the conflict" could now facilitate negotiations between Russia and Ukraine or even between Israel and Hamas. This deliberate "non-alignment" is obviously frowned upon in a more polarised world than it was twenty years ago. Brazil also believes it should be a permanent member of the UN Security Council (along with India, Japan, Germany, and a representative of Africa). Still, none of the Council's current permanent members is in favor of this.

On the other hand, Brazil did not want the BRICS to be enlarged to include Saudi Arabia, Argentina, Egypt, the United Arab Emirates, Ethiopia, and Iran. However, this will take effect from January 1st, 2024. Brazil tried to delay this move for as long as possible, considering it would reduce its influence in a group where China was already the dominant partner. Initially, Brazil was supported by India. But as India eventually lost interest in the enlargement, it became impossible for Brazil alone to oppose the wishes of its primary customer, with whom it has an average annual trade surplus of more than USD 30 billion between 2018 and 2022.

Brazil considers that past financial commitments are no longer sufficient for climate change

On December 1, 2023, Brazil will also take over the presidency of the G20 for a year. Its 21 members will meet in November 2024 in Rio de Janeiro. Brazil intends to focus the efforts of the G20, which it feels has become dispersed on minor issues, on three themes: hunger and poverty, climate change, and global governance. On the first point, the aim would be to replicate, in cooperation with the World Bank and the Food and Agriculture Organization (FAO), programs that have proved effective in certain countries (including *Bolsa Família*). Brazil considers that past financial commitments are no longer sufficient for climate change. It also notes that a growing proportion of public resources is in danger of being taken up by defense spending. In Brasilia's view, it is therefore necessary to find ways of attracting new private resources to the fight against climate change by developing innovative products.¹⁰ Finally, Brazil's interest in global governance is related to its desire to join the Security Council.

The free trade agreement between Mercosur and the European Union (EU) has been under negotiation since 2000. An agreement in principle was reached on June 28, 2019, with a compromise on beef and ethanol, but the texts have not been finalized, voted on, or ratified. In August 2019, French President Emmanuel Macron declared that he believed Brazilian President Jair Bolsonaro "had not honored his commitments to the

10. Brazil has just announced that it has issued its first sustainable dollar bond on the international market: a 7-year bond maturing in 2031 for USD 2 billion, with a yield to investors of 6.50% per annum. This corresponds to a spread of 182 basis points over the US Treasury bond, the lowest for new Brazilian issues for almost ten years.

environment,” referencing the escalating deforestation in the Amazon. In 2020, German Chancellor Angela Merkel was reluctant to sign the agreement due to its environmental impact. In October 2020, the European Parliament voted against “ratification as it stands.” In March 2023, the EU sent Mercosur an additional protocol to the original text, including new environmental protection requirements. This “side letter” was poorly received in Brasilia, which saw this “attempt to reopen negotiations” as interference, which was also unfair given that deforestation had fallen sharply in the Amazon by 2023. Despite the resumption of negotiations, the agreement’s ratification remains uncertain, with France, Belgium, the Netherlands, and Austria showing reluctance. Each party’s economic benefits appear modest compared to the efforts invested. The election of Javier Milei in Argentina could potentially be the decisive factor, simultaneously complicating relations among Mercosur members.¹¹ It is also conceivable that both parties may ultimately agree to a diluted agreement to end a debate impeding their relations.

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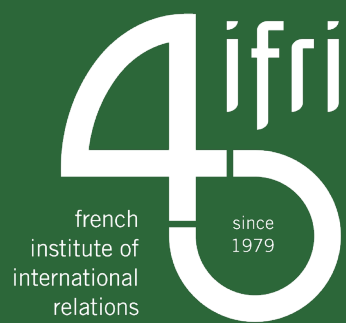
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11. A few months ago, Uruguay expressed its desire to sign a bilateral trade agreement with China, which would be contrary to Mercosur rules. Javier Milei, for his part, has loudly expressed his detestation of any regional agreement.



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