Brazil: The harder they Fall

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During the 2000s, Brazil's economy took off, with growth driven primarily by strong Chinese demand for commodities. Within a decade, the Brazilian middle class increased from 30% to 50% of the population. Political leaders experienced exceptional popularity ratings. In 2013, the tide turned. The growth rate has slowed and the political class is mired in corruption scandals. Yet, a rebound is possible in Brazil.

politique étrangère

Brazil is experiencing one of the worst political and economic crises in its recent history – and certainly the worst since the return of democracy in the mid-1980s. Darling of the new global economic order for much of the last decade, Brazil has fallen off the pedestal of punditry in the past few years. Broadly speaking, this bout of pessimism is partly due the recurrent habit among international relations pundits and market commentators of viewing the world in terms of inexorable – and even faster – power transition among major powers (or major markets). Until yesterday the BRICS were construed as the building block of a new global order and a good place where to put your money. Now, following the ebb and flow of the financial markets, it appears it is time for other acronyms to have their fifteen minutes in the spotlight.

On the economic side, Brazil is facing the deepest recession in many decades (the country's GDP has decreased nearly 10% in the last four years), a sky-rocketing unemployment rate and a significant fiscal deficit, among other macroeconomic imbalances. From a political perspective, the country is dealing with a presidential impeachment process, a massive corruption scandal reaching the entire political class, and recently faced an unexpected wave of protests on the streets of Brazil's largest cities, with millions of citizens decrying the unresponsive – and occasionally irresponsible – political class.

Those events have led the political system to a state of near-paralysis, and emphasizes the political class' incapacity to respond effectively to the many challenges that the country currently faces.

Paradoxically, and therefore making this scenario even more challenging, just a few years ago Brazil was experiencing one of its most "dynamic" periods of its history – a "Chinese" rate of GDP growth (7.5% in 2007); massive social development with millions of citizens rising from poverty and joining the consumer market; and the most popular president in the country's history (former President Luis Inacio "Lula" da Silva reached a 73% approval rating in 2010).

So, what happened to Brazil? What did go wrong and how and why has the country's political and economic situation deteriorated so quickly? Where is Brazil heading? Beneath the ever-changing and tenuous layers of tea leafs used to foretell geostrategic scenarios or suggest promising investment opportunities lies a much more complex story of a country that has had its share of boom-and-bust cycles. Whether Brazil is undergoing yet another one this time around begs a more insightful examination of recent political and economic events. To uncover some of the factors behind these events may allow us to have a clearer view of the trajectory that the country is heading. To try answering these questions, we will contextualize what is happening in Brazil within a broader scenario, in what we call the *rise and fall of latin america´s political supercycle*.

The end of the commodities boom

Some of Brazil's recent woes – and slightly less recent successes – are not unique to the country. Such issues stem from a broader economic and political process that affected many natural-resource-rich nations in the so-called emerging world, particularly in Latin America, in the last decade or so.

The rise

Directly linked to the unprecedented rise of China – and its appetite for food and raw materials, Latin America went through an historical cycle of economic growth since early this century. Spurred by the high commodity prices, the region enjoyed a prolonged period of economic bonanza. The so-called "commodity boom" or "commodity supercycle", translated into years of above-average expansion of economic activity. This process allowed many countries in the region to tackle numerous bottlenecks to growth and to improve persistently frail macroeconomic indicators. High GDP growth rates, lower debt levels, low unemployment numbers, and inflation relatively under control became more common features in the region during the boom period.

This economic environment also allowed different governments in the region to install both a very aggressive income distribution program and a generous subsided credit structure that boosted a significant percentage of the citizens into the consumer market – the so-called "emerging markets middle class". The arrival of this middle class helped to developed Latin America countries domestic markets, resulting in a very attractive environment for international investments – during an era in which traditional centers of the capitalist system were suffering the effects of the subprime crisis. A booming domestic economy, with international liquidity seeking dynamic markets, resulted in an important inflow of capital into these economies. Many economists defined this period as the "golden era of Latina America", the moment which this region was – after decades of almost constant economic and political crisis – catching up with the world economy.

This favorable tide also had a political dimension to it. Years of more sustainable growth helped bolster many of the regions political leaders. Incumbents from the left or from the right, enjoyed very high approval ratings that helped them remain in power for a longer period of time. Evidences of this trend were seen in Venezuela with Chavismo (Chavez and Maduro), in Argentina with Kirchnerismo (the Kirchner power couple), in Bolivia with Morales, in Colombia with Uribismo (Uribe and Santos), and also in Brazil with the Lulo-Petismo (Lula and Rousseff). In most of these countries, the political opposition to these forces became highly ineffective from an electoral point of view.

This "political super cycle" had an impact on policymaking as well. Supported by the high approval ratings and abundant liquidity, strong and confident leaders had more room to experiment paying little or no political or economic price. The favorable economic environment provided ample resources for the development and extension of redistributive social policies like conditional cash transfer programs and targeted subsidies. In the economy, more expansionary fiscal policies ensued, providing more credit for consumption while raising the incentives for more state intervention in the economy through stricter regulations, protectionist measures or even outright expropriation of assets. Complacency with respect to structural reforms also followed. In many cases, labor, social security, and tax legislation remained outdated, yet its disadvantages went unperceived in times of abundance. To a large extent, this trend, that was exacerbated and become more evident after the 2008-2009 global financial meltdown, contributed to the spread of the idea, among investors and pundits alike, that developing nations were "catching up" with the developed world, as captured by catchy phrases such as the "rise of the rest".

Brazil was – definitely – at the center of this process. After gaining the trust of the electorate and investors alike during the 2002 presidential election, the Workers' Party led by Luiz Inacio Lula da Silva dominated Brazil's political landscape for over a decade, defeating the main opposition party (the Social Democrats, or PSDB) by wide margins in four straight elections (2002, 2006, 2010, 2014) with a discourse that initially combined relatively responsible macroeconomic management with the expansion of a social safety network. From 2003 onward, above-average growth and a cluster of successful social policies boosted presidential approval ratings to unprecedented levels for a prolonged period of time. Lula, as he is known, was capable not only to survive a grave political crisis during his first term (the *mensalao* vote-buying scandal) and guarantee a second term in office, but he also was able to easily secure the election of his relatively unknown anointed successor, Dilma Rousseff, in 2010 (who would be re-elected 4 years later). And without mentioning the choice of Brazil to be hosting of 2014 World Cup and the Rio de Janeiro 2016 Olympics, a personal victory to the (then) Brazilian president. Lula was the epitome of the king – or queen – maker.

And the fall

But as the winds of the global economy started to shift – China's economy started to slowdown, the commodities prices got lower – the story began to change. As economic expansion began to slow down, leaders in the region started to feel the political and economic costs of the policy "experiments" that they had been implementing with great degree of confidence – or even hubris. Despite dwindling resources, in many cases expansionary fiscal policies gave way to outright populism as an attempt to bolster popular support. In the economy, the heavy hand of the state led to significant distortions, which helped to sour investors' expectations. With the means needed to keep up the pace of growth drying up, public disenchantment began to rise across the region. After nearly a decade, incumbents were losing steam – and quickly.

The "new middle class"

The winding down of the supercycle in the last few years helped reshape Latin American –and Brazil's – politics in two ways. First, despite the apparent boom and bust cycle in the economy, a more permanent by-product was left behind: a more robust rising middle class. Years of growth and poverty alleviation policies, such as the Bolsa Familia cash-transfer program, helped raise standard of living. From 2007 to 2010, Brazil's economy grew at an average of 4.6% while Brazil's Human Development Index reached 0.755 in 2015 (from below 0.7 in 2000), a process that yielded something close to a demographic revolution. From 2000 to 2013, the share of Brazil's population in the middle class went from roughly 60 million to 100 million, or from 30% to close to 50% – a trend that was replicated in nearly every major emerging economy in the same period. For one of the most unequal countries in the world, this was – and it is – a big deal.

Across the emerging markets world, Brazil included, the demands of expanding middle classes began to clash with the prerogatives of established elites in ways that fundamentally redefined politics. Leaders who were broadly bolstered by a decade of unprecedented economic growth began to face new demands from rapidly changing societies with fewer economic resources to respond. This was not only an economic phenomenon, but a political one as well. After all, as people rise into the middle class, their expectations change. While the poor focus on basic subsistence, shelter, and employment, people in the middle class begin to seek improved health care, better services and security, and additional educational opportunities for their children. This process poses a challenge of governance to leaders: how to deliver more (and better public services) with less (resources) in a period of slowing down economy?

The relative inability of leaders to deliver on these new demands that became known as the "quality of life agenda" generated growing discontent. In 2013, this trend became more evident in Brazil, after millions of people took to the streets of the country's largest urban center to voice their discontent with the political class. These protests were driven by diffuse grievances about the political class as a whole, not solely against president Dilma Rousseff. Not coincidentally, incumbents at different levels of government (local, state, and federal) saw their approval ratings drop dramatically in a matter of weeks. At the presidential level, Rousseff's new numbers contrasted sharply with those of her predecessor's. A similar process played out in neighboring countries.

Much like the events in Tahrir Square in Egypt and Taksim Square in Turkey in 2013, millions of people have been taking to the streets of Brazil's major cities in recent years to voice their discontent with the country's leaders. There are many similarities between the urban movements in the Middle East and those in Brazil, but an important contrast needs to be clarified. While what generally became known as the Arab Spring consisted mainly of movements against government oppression, recent protests in Brazil were chiefly against corruption and what is perceived as government incompetence. The former usually targets the head of state and the ruling party while the latter is more diffuse, targeting all levels of government and blaming every major political party for many years of disregard with the quality of public services.

After decades of strong leaders, weaker incumbents became the new normal in the region. In case of Brazil, however, this weakening process did not happen fast enough to force a quick turnover in the 2014 presidential election. Despite the growing headwinds, Rousseff was able to muster enough power to secure her reelection. Her main campaign message was to signal policy continuity and to focus on the narrative of the supercycle to convey the idea that, despite the recent economic slowdown, the majority of the population was still better off than a decade earlier. While risky, the strategy (barely) worked. But it came at a steep cost.

The paradox of the situation was that the political capital needed to respond to rising popular grievances was itself being dilapidated by the growing discontent. After a narrow victory, Rousseff's second term began in 2015 under the shadow of unfulfilled promises. Much like many of her counterparts in the region, she wasn't able to ignore the more unfavorable economic environment. The question now was how to respond to these growing challenges. In the region, the response from leaders varied from doubling down on the same set of unorthodox policies that led to the distortions in the first place, like Venezuela of Maduro and Argentina of Kirchner, to a more market-friendly path of adjustment, likely Pena Nieto's Mexico. Despite the misleading rhetoric, Brazil's policy response after Rousseff's reelection was closer to the latter. With the economy entering a recessionary mode and yearly inflation close to double-digits (way over the 4.5% target), the president attempted to rein spending as a means to boost Brazil's credibility, a necessary step to attract more investments.

But the attempt to correct the course came too little too late. While unwilling to double down on the same set of expansionary policies that aggravated many problems, deep ideological constraints and diminishing political capital limited Rousseff's willingness or capacity to implement meaningful measures to adjust the economy. For instance, after her reelection, she appointed former treasury secretary Joaquim Levy, an orthodox economist, as finance minister, but curtailed the scope of his power to do what needed to be done to restore investor confidence. To a large extent, the mismanagement of the economy continued, now as the result of a haphazard course correction driven mainly by necessity, not by conviction.

From a political perspective, this gave Rousseff the worst of both worlds: a combination of very unpopular austerity measures with no glimpse of economic recovery to show for. Popular discontent continued to mount, driving Rousseff's approval ratings to historically low single-digit levels (below 10% through much of 2015).

Corruption

Another main trend that emerged with the end of the supercycle and helped shape Latin American – and Brazilian – politics was corruption. To be sure, corruption scandals are nothing new in emerging markets, but over the last few years they have grown in scope and become increasingly intertwined with national political struggles. After all, throughout much of the boom years, political systems in the region, particularly the natural-resource rich countries, were flooded with liquidity. In addition to incentivizing policy experimentation, the commodity supercycle also provided leaders with plenty of resources to buy political allegiances for a prolonged period of time. Higher incentives for corruption were a by-product of the era of abundance.

When the favorable tide started to recede, many corruption schemes started to be revealed. Distributive conflicts among political and economic agents started to pick up as resources dwindled. Corruptions scandals involving political leaders or their groups started to pop up in Mexico, Chile, Peru, Argentina, Brazil and other emerging nations outside of Latin America, as China, Russia and Turkey. While many of these cases are driven by country-specific factors, the uptick in frequency and scale is no coincidence. The positive economic cycle greatly increased the opportunities for public corruption, whether directly via the expansion of state-owned enterprises and national champions, or indirectly via the ability of the state to regulate, tax, and confer business opportunities on a fast-growing private sector.

Brazil's case is emblematic of this whole process. In 2014, a massive corruption scandal involving state-controlled oil behemoth Petrobras was unveiled. According to prosecutors, billions of dollars were siphoned from the company through kickbacks or murky contracts with some of the country's largest construction conglomerates to fund a broad array of politicians and political parties. In addition to encompassing the core of Brazil's predominantly state-oriented economic model – Petrobras, large construction companies, and public banks – the scandal also dragged most of the political system into an unprecedented crisis of legitimacy. Ultimately, one could argue that no government anywhere in the democratic world would survive a combination of a deep multiyear recession and a multi-billion dollar corruption scandal. And it was what happened in Brazil. With the largest recession in Brazil´s history, the corruption scandal striking the main leaders of the workers party and the protests coming from the streets, President Rousseff suffered an impeachment process already voted by the lower house and waiting to be confirmed by the senate in the following weeks. If confirmed, she will be the second president ousted from power through institutional means since the return to democracy in the mid-1980s (the first was Fernando Collor de Mello, in 1992).

Anti-political sentiment

Economic meltdown, political crisis and a major corruption scandal. There are very little doubts that Brazilian middle class is increasingly disgruntled with its political class. If it is true that the huge protests in recent years – millions have taken to the streets since 2013 – played an important role in president Rousseff´s likely impeachment process, it is highly unlikely that the discontentment will dissipate with her departure. It was and it is an anti-political sentiment at its core, and as such this discontent presents a challenge to Brazil's mainstream political parties, which seem inept to fully correspond to changing popular expectations. It is for no other reason that interim President Michel Temer from the centrist party PMDB (and former Rousseff´s vice president), while counting on the support of Congress, Brazilian elite and the private sector, only counts on support from less than 33% of the public according to the latest polls.[1] Tellingly, 55% believe that there is no real difference between both.

While it could be tempting to interpret these developments as part of a somewhat frequent boom-and-bust cycles, like many Brazil has seen in the last century – or the confirmation of Brazil´s destiny to be forever involved in crises and scandals and never reaching the developed world, this approach would be misleading as it would take little notice of the nuances and the important – and more structural – changes that have happened in the country in the last several years – if not decades.

Even though Brazil continues to live with deeply-rooted problems, some of the elements of the current crisis are in part the result of a positive development: the strengthening of the country's political and legal institutions, or at least part of them. The deep political and economic crisis of recent years may highlight some dysfunctional features of Brazil's public sector that are in desperate need of reforming. But at least with regards

1. CNT poll conducted in June 2016.

to corruption, the country's legal institutions have come a long way to increase transparency and unveil intricate schemes. In the same direction, Brazil's political and economic elites, from different political convictions, seems to converge to at least some basics understandings of the urgency of implementing some structural reforms. Those conditions are not being seen in other emerging markets countries and Institutions are working more that Brazil´s developing countries peers, for instance Turkey, Russia, South Africa, just to mention few examples.

That said, the anti-political anger is very accentuated in Brazil, despite the fact that it is not exclusive to the country. Looking at Emerging Markets outside of Brazil, signs of anti-political movements also abound. Not only have middle classes taken to the streets in large numbers since 2013 in Turkey, Colombia, Argentina, and Malaysia, but this year Philippines voters chose the virulent and brazenly anti-political mayor Rodrigo "Rody" Roa Duterte to be their president. Guatemalan voters elected the comedian Jimmy Morales to the presidency in October of 2015 following the corruption scandals of the previous administration.

Looking ahead to the next round of elections in 2018, where Brazil, Mexico, Colombia and Venezuela will all be headed to the polls, it is not unlikely that the profile of competitive candidates will be increasingly more anti-political or anti-establishment. These "new faces" are more likely to arise from the extremes of the political spectrum, both left or right. Of course, in Brazil much will depend on the success of Temer's government, and how much the economy will recover. But even if the economy comes back to grow almost pace of 1%-2% a year, the room for an anti-establishment candidate to be competitive in 2018 will remain very high. The caveat worth highlighting here is that Brazil's political system is prone to moderation. A high number of parties and costly campaigns force would-be candidates to forge broad coalitions to be elected and to govern. More allies mean more resources to campaign and more votes in congress. This process tends to filter radicalisms and does reduce the odds of a complete outsider winning the election.

While a few years of economic slowdown may reduce the size of Brazil's (and Latin America's) middle class somewhat, there won't be a complete reversal. Despite the deterioration of some economic and social indicators, the gains of the last decade will still be felt. But along with this structural demographic change will also come a political challenge: a higher bar to attend to voters' more demanding expectations. In a way, the phenomena of angry middle classes – even if this comes from different perspectives- is much more global than meets the eye, and will be no privilege of countries like the United States, France or Great Britain, as the recent Brexit from the European Union demonstrates. Politics Latin America and Brazil may be increasingly shaped by these phenomena in the coming years.

Submerging Brazil?

These economic, social, and political transformations of recent years spur broader questions on Brazil's status and future role in global affairs. Much of the current pessimism is driven by the recurrent habit among many international relations pundits and market participants of viewing the world in terms of inexorable power transitions among major powers and markets. Who are the rising powers or the next best market to bet on? The problem has less to do with the idea of power transition itself, but with the excessive expectations that followed the global financial meltdown of 2008-2009. While the US and other developed economies were in a downward spiral, emerging countries such as the BRICS kept growing and shouldering the weight of the global economy with them. To many, this process was a harbinger of a tectonic shift in geopolitics, or the "rise of the rest".[2]

Brazil was never at the center of this process, at least from a geopolitical perspective, but several years of sustained economic growth gave more international visibility to the "B in BRICS". Despite persistent social inequalities, the overall domestic situation (political, economic and social) in the country has improved considerably and Brazil, like other large emerging powers, became more assertive regionally and globally. As such, the country started to redefine its own national interests in ever-expanding terms. Brazilian multinationals conquered markets, more and more immigrants began flocking to Brazil for a better life, and decision-makers started to assertively flex their muscles on the global stage.

But three or four years of disappointing economic growth and questionable policymaking under Dilma Rousseff have sharply deteriorated expectations, not only towards Brazil but also with respect to other key emerging countries. As a result, broken BRICS or the "demise of the rest" have become the newest fad in pundit-land jargon to the point of being replaced by other opportunistic acronyms.

One of the many problems with these premature assessments is that they tend to view international relations as fundamentally as a kind of a zero-sum game. If one country or market is down, the other has to be up. Not a lot of attention is given to the fact that some (but certainly not all!) economic

2. F. Zakaria, *The Post-American World and the Rise of the Rest*, London, Penguin, 2009.

challenges that emerging markets endured in the past few years were influenced by ongoing difficulties in developed economies. Furthermore, part of the frustration has to do with misperception or excessive expectations. The BRICS never represented a new and emerging world order. What glued these countries together were not shared viewpoints of what the world should look like, but a slight overlapping of individual strategies aimed at better enhancing each country's international standing.

The economic situation in Brazil today is unarguably less favorable than before and is likely to remain so for coming years (at least when compared to the first decade of the 2000s). And for a country with limited military resources situated in a relatively nonstrategic region (from a US perspective), global power projection is predominantly a function of long-term economic activity. As such, Japan of the 1980s and even Brazil of the early 1970s serve as cautionary tales of countries that unsuccessfully seek a path to great power.

But while it is always prudent to talk about rising powers with a grain of salt, there are reasons to believe that the current pessimism towards Brazil is overstated. Despite all the problems, Brazil continues to be a vibrant democracy. The country also has a very promising future when it comes to energy – fossil fuel and renewable – resources. Furthermore, while growth is lackluster for now, the majority of the population is better off than they were a decade ago. Finally, the growth of the middle class is a sign that demographics have structurally shifted, with many and yet-unfelt repercussions to Brazil's political and public policy landscape.

In the coming years, the challenge for Brazil's leaders will be to make the country's political system more efficient and responsive to the changing demands from its society. Implementing structural reforms to remove bottlenecks for investments will be a crucial step to set Brazil on a sustainable path of economic growth. This will require strong leadership and long-term strategic planning. If some of those ingredients become available, then Brazil's long awaited future will be much closer to its present.

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