3-5-2004

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LADB Staff

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Brazil's Markets Shaken by Scandal

by LADB Staff

Category/Department: Brazil

Published: 2004-03-05

If there was one characteristic of Brazil's ruling Partido dos Trabalhadores (PT) that most appealed to voters in the national elections that brought its champion, Luis Inacio Lula da Silva, to the presidency, it was its reputation for being free from corruption.

Now this president faces the first scandal of his term, as that reputation has been tarnished by allegations that a high-ranking official had solicited illegal campaign contributions from a Rio de Janeiro gambling kingpin. Waldomiro Diniz was a presidential aide and protege of Chief of Staff Jose Dirceu, often called the second-most-powerful man in Brazil. Diniz was the administration's congressional liaison.

In mid-February, the magazine Epoca wrote that Diniz had solicited contributions from Carlos Ramos, better known on the streets of Rio as Carlinhos Cachoeira (Charlie Waterfall). The magazine's allegations were backed up by a videotape showing Ramos and Diniz in a conversation in which the latter asks for cash contributions to two PT state governorship campaigns.

Diniz also asks a 1% commission and assures Ramos that the transactions will not be reported to election authorities. Failure to report violates election laws. The tape was shown on national television. Lula swiftly fired Diniz.

Dirceu quickly tried to put the situation in perspective, telling the press, "These events took place before the present administration took office, and no irregularity occurred during the present government. Swift action was taken in firing the employee and turning the case over to competent police authorities." But the case took on an undeniable importance as the opposition Partido da Social Democracia Brasiliara (PSDB) began circulating petitions in both houses of the Congress for the creation of a select committee to investigate.

The Ibovespa, Brazil's stock exchange index, took a serious tumble, falling about 3% in the week following the breaking of the story.

Enjoying the prospect of payback for the decades of corruption investigations that built the PT's reputation, including bringing to light corruption during the two terms of the PSDB's Fernando Henrique Cardoso, PSDB Deputy Zulaie Cobra said, "Now they are in power, they want to sweep these latest allegations under the rug." She is leading the petition drive in the legislature.

Political risk analyst Walder de Goes said, "It could easily become a runaway committee. Campaign finance is the black plague of Brazilian politics. There is plenty of scope for fresh revelations."

Scandal could affect

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Congress Between the opposition trying to make the most of the issue and the PT trying to make the least, the problem for Lula is, according to political scientist Amaury de Souza, that "the government is going to try to muzzle the congressional inquiry. They have a good chance of succeeding, but they are going to pay a high price in political patronage and pork barrel legislation."

Lula has a weak congressional coalition stitched together from seven different parties in the 513-member Chamber of Deputies and the 81-member Senate (see NotiSur, 2003-02-21). In January, the coalition was strengthened by the addition of the Partido do Movimento Democratico Brasiliero (PMDB), with 77 deputies and 22 senators.

De Souza said these PMDB legislators "will vote against a congressional investigation, but they are going to want more government jobs and budget allocations for their trouble. This will set a very bad precedent, with the administration buying its way out of every scandal from now on."

Former finance minister Mailson da Nobrega added to the assessment, saying, "In Brazil, a congressional investigation is not aimed at investigating, but it is a political instrument to harm the government as much as possible and that can reduce governability and could paralyze important projects to preserve confidence (see NotiSur, 2000-08-11)."

One way that reduction of governability could come about is if the investigation produces enough negative voter sentiment to sink official hopes of gaining more legislators in elections set for later this year. The sagacity of da Nobrega's observation was not lost on the government.

On Feb. 18, in a pre-emptive move, the government announced it would form a commission of its own to investigate, while simultaneously insisting that Waldomiro Diniz, no matter how guilty he may have been in the past, had done no wrong during his time in the government, beginning in January 2003. Strategists deemed the latter statement crucial to protect Dirceu. If Diniz were shown to have committed any irregularity while under the authority of the chief of staff, Dirceu would have to go, too.

For the moment, however, "There is no contemplation of Jose Dirceu leaving the government," presidential spokesman Andre Singer told the media. The opposition had already begun to beat that drum, demanding Dirceu step down simply for having given Diniz a job. Not naive, and not to be outdone, the opposition opened a new front, putting together enough support to launch a parallel probe into the gaming parlors or, bingos, source of Ramos' wealth.

With other allegations surfacing involving Diniz and the awarding of a contract for state lottery machines worth US$130, and another involving Lula's urban affairs minister in an illegal campaign contribution scandal in 2002, Lula had to counterpunch.

In a speech in a bus-manufacturing plant, he told workers, "There won't be any allegations of corruption in this administration that won't be fully investigated." As for the bingo investigation, it would soon be moot, because he intended to sign a decree banning them.
Market reacts to scandal

Markets reacted favorably to the prompt attention to these issues, and the Ibovespa closed up 2% following the speech, although it was still down 7% since the story broke. The real also gained against the dollar. These indicators are as important to Lula's economic plans for the country as voter sentiment is to his legislative power. He won the crucial approval of international capital last year with policies that stabilized the economy at the risk of angering his political base. But capital always wants more and became jittery at the prospect of a weakened president who would not be able to add electoral, judicial, labor, and bankruptcy reforms to last year's impressive pension reforms.

Lula caught a break when Carnaval kept markets closed the following Feb. 22 and 23 but took on additional grief as several states won injunctions against the bingo decree he had signed the previous Friday. Lula got hit again in the markets, but this time from an unexpected quarter.

Just as he was seeing indications that financiers were shaking off the scandal, the Central Bank issued a statement from its monetary-policy meeting saying, "There is a concrete chance inflation will veer off course, and that means extra caution is needed in monetary-policy management." The statement was accompanied by a decision to leave the prime rate at 16.5%, dashing reduction expectations and the hope of increased consumer and commercial spending.

The market headed for frigid Antarctic waters. The Sao Paolo exchange lost 1.5% in afternoon trading. Worse, the following week, on March 2, a Datafolha poll was released showing that no fewer than 67% of Brazilians want Dirceu fired and 81%, unmoved by the government's move to investigate itself, want a parliamentary investigation (Comissao Parlamentar Inquerito, CPI) to look into the scandals.

The poll held some better news. While the people were ready to see Dirceu, a co-founder with Lula of the PT in 1980, go, their enthusiasm for the president remained unchanged. He had 60% approval ratings last October, and he has 60% approval now. His government fared slightly worse. Government performance got a 42% approval rating from Brazilians in October and 38% now. The survey sampled 2306 voters in 132 places throughout the country.

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